



## Case Study

*on Commercialization, Privatization and Economic Oversight of Airports and Air Navigation Services Providers*

# United Kingdom

## Background (until the mid-1980s)

Until the mid-1960s, the Government had owned and operated 22 airports. Rapid technological advance and a huge increase in traffic, however, resulted in the day-to-day business of running airports becoming too complex for the Government. Against this background, the British Airports Authority (BAA) was established in 1965 by the Airports Authority Act 1965 as a Government-owned independent commercial enterprise. In April 1966, BAA assumed ownership and responsibility for four of the 22 Government-owned airports, i.e. three major London airports (Heathrow, Gatwick and Stansted) and Prestwick. Other Government-owned airports were transferred to respective local authorities. BAA acquired Edinburgh in 1971, and Aberdeen and Glasgow in 1975.

In the United Kingdom, all the airports were required to be licensed by the Civil Aviation Authority (CAA, which also had owned and managed aerodromes in the Highlands and Islands of Scotland. CAA reserved statutory powers to regulate the airport charges, and its main focus was placed on costs and rates of return on capital. Airport charges also had to be consistent with the terms of an air services agreement with the United States (the Bermuda 2 agreement of July 1977), under which the Government committed to applying a single till approach. This commitment was reaffirmed in the MoU with the United States in April 1983.

With respect to air navigation services, the National Air Traffic Services (NATS, the National Air Traffic Control Services at that time) was established in December 1962 in the form of a civil-military partnership. After the establishment of CAA in 1972, the operation of NATS became a principal responsibility of CAA jointly with the Minister of Defence.

## Commercialization/privatization: Airports

In the Airports Policy White Paper of 1985, the Government announced its intention to privatize BAA in the context of the privatization and reform of public sectors. In December 1985, BAA plc was incorporated under the Airports Act 1986, which called for dissolution of BAA and the transfer of its property, rights and liabilities to a newly-formed public limited company. Several subsidiaries of BAA plc were also established to operate the airports. In July 1987, 500 million shares in BAA plc were offered for sale and the company was listed on the London Stock Exchange with a capitalisation of £1,225 million.

Following privatisation, BAA plc purchased Southampton Airport in 1990 and sold Prestwick Airport to PIK Facilities in 1992. In 1996, the Government sold its remaining 2.9 per cent stake in BAA plc, but the Secretary of State has retained a golden share until September 2003 primarily to prevent a take-over by foreign investors (the golden share was redeemed because of the judgment of the European Court of Justice).

In 2006, a consortium led by Spanish construction group Ferrovial took over BAA plc with the value of £10.1 billion. As a result, the company was delisted from the London Stock Exchange, and the company name was changed from BAA plc to BAA Ltd. In August 2008, the Competition Commission proposed that BAA Ltd. sell off two of its three London airports and one in Scotland (see Economic oversight: Airports). BAA Limited sold Gatwick Airport to Global Infrastructure Partners (GIP, owner of London City Airport) in 2009. It also sold Edinburgh

Airport to GIP in April 2012. BAA also sold London-Stansted airport to the Manchester Airports Group in January 2013.

Finally, Qatar Holding bought 20 per cent of BAA shares in August 2012 and Chinese Investment Corporation bought 10 per cent of the shares in November 2012, thus reducing Ferrovial stake to just over one third while the Chinese, Qatari and Singaporean governments would control more than 40 per cent of the airport operator shares. It should lastly be noted that BAA changed its name to Heathrow Ltd, and the airports of Heathrow, Glasgow, Aberdeen and Southampton now operated under their stand-alone brands.

Around the same time as the privatisation of BAA, most airports owned by local authorities were corporatized by law. This was because the Airports Act 1986 required municipal airports, with a turnover in excess of £1 million, to become public airport companies. Over 20 corporatized airports have since been privatised to some extent. The privatization trend was spurred by the public sector borrowing requirement strengthened by the Government in 1993. Under this requirement, future development of an airport could only be funded by using private sector finance.

Among privatized airports, East Midlands Airport became the first major regional airports wholly owned by private hands. In August 1993, the airport was purchased by the National Express Group (which sold the airport to the Manchester Airport Group plc in March 2001). In July 1994, Belfast International Airport was privatised by a management buy-out resulting in the creation of the BIA Holdings Ltd (which was bought by TBI Plc. in August 1996 and taken over by a Spanish consortium Airport Concessions and Development (ACDL) in January 2005). In April 1995, Cardiff Airport was sold to Welsh property and TBI Plc. In March 1997, seven West Midlands' district councils sold a 40 per cent stake in Birmingham Airport to the Irish airports' operator (after several changes, seven councils' shareholding has been reduced to 49 per cent while a consortium of Ontario Teachers' Pension Plan and Australia's Victorian Funds Management Corporation owns 48.25 per cent). In December 1997, Bristol City Council sold 51 per cent stake in Bristol Airport to FirstGroup. In January 2001, the airport was taken over by Tidedast Limited (now South West Airports Limited, originally jointly owned by Australian investment company Macquarie and Ferrovial; Macquarie and its group companies assumed 100 per cent in December 2006).

Some other airports also experienced the change of corporate structures and/or moved to private participation. For example, CAA's aerodromes in Scotland were hived down to a subsidiary company, Highlands and Islands Airport Ltd, which was transferred to the Secretary of State for Scotland (now Scottish Ministers) in April 1995. Under a pioneering public-private partnership (PPP) concluded in August 1998, London Luton Airport is operated and developed by a private consortium, London Luton Airport Operations Ltd (in which TBI Plc. became a majority shareholder in March 2001 and was taken over by ACDL in January 2005), for a period of 30 years, while the airport remains publicly owned by Luton Borough Council. A supplemental agreement signed in 2012 extended the concession to 2031. In May 2001, Newcastle Airport's seven local authorities sold 49 per cent stake to Copenhagen Airports to form a PPP (the latter sold its shares to AMP Capital in 2012). In March 2002, Manchester Airport became one of trading subsidiaries of the Manchester Airport Group plc (MAG), which is owned by the Manchester City Council (55 per cent) and the other nine district councils (5 per cent each). MAG operates the airports of Manchester, East Midlands and Bournemouth (it sold its 82.7 per cent stake in Humberside Airport to the Eastern Group, which operates Eastern Airways, in August 2012).

### **Commercialization/privatization: ANSP**

The status of NATS has been under review as far back as the early 1980s, especially in terms of the relationship between CAA and NATS. In 1989, the Transport Select Committee

(TSC) recommended the separation of the provision of air traffic services from the regulatory functions of CAA, as this would improve efficiency and accountability. In 1994, the TSC proposed the privatization of NATS. Over the same period, the sharp reduction of capital funding by the Government and the need to keep a tight rein on public expenditures posed an issue for the delivery of NATS' investment on new air traffic control systems.

In April 1996, NATS became a wholly-owned subsidiary (the National Air Traffic Services Ltd) of CAA. In July 1998, the Government announced its proposal to create a PPP for NATS. The aim of the PPP was to put NATS on a more commercial footing and to provide it with the ability to secure private financing. In November 2000, Parliament passed the Transport Act 2000, which provided, *inter alia*, for the transfer of CAA's 100 per cent shareholding in NATS to the Secretary of State for the preparation of the PPP.

Through the competitive bidding in March 2001, the Government selected the Airline Group, a consortium of seven UK airlines (British Airways, bmi British Midland, Virgin Atlantic, Britannia, Monarch, easyJet and Airtours My Travel), as a strategic partner for NATS. In July 2001, the Airline Group acquired a 46 per cent stake in NATS Holdings Ltd for £800 million, with the Government retaining 49 per cent (and a golden share) and the remaining 5 per cent was for an employees' trust. In March 2003, a financial restructuring called "Composite Solution", necessitated by the downturn in business following the events of 11 September 2001, was completed with an injection of new capital from the Government and BAA plc. As a result, the Airline Group's share was reduced to 42 per cent, while BAA plc acquired 4 per cent. In January 2012, Lufthansa became a partner in NATS after it acquired shares from bmi British Midland (Lufthansa currently holds a 14.5 per cent stake in the Airline Group).

### **Economic oversight: Airports**

CAA has statutory powers under the Airports Act 1986 and the Airports (Northern Ireland) Order 1994 for the economic regulation of airports. CAA applies a two-tier regulatory structure for airports, at which annual turnover has exceeded £1 million in two of the last three financial years. The exceptions are those in the Isle of Man and Channel Islands, those owned or managed by CAA or a CAA subsidiary, and those managed by the Government.

The first tier is a system of "light-handed" regulation. Airports that meet the revenue threshold must apply to CAA for permission to levy charges. A key component of the system is public disclosure of airport charges and accounts. All airports holding CAA permission must provide CAA with their annual statutory accounts, schedules of airport charges and changes, if any, to the information provided in their original application. Airports do not need to seek approval before they revise their charges but must notify CAA of the charges before they take effect.

CAA has discretionary power to place additional restrictions if an airport is considered to have abused market power. In such cases, CAA can impose an accounts condition, i.e. requirement to reveal, *inter alia*, the revenue and costs from airport activities, other airport-related activities and non-airport activities. Besides, CAA can investigate the conduct of such airports, and if it finds that the airport operator is unreasonably discriminating between users, unfairly exploiting its bargaining position or engaging in predatory pricing, it can impose conditions to remedy the situation.

The second tier of regulation is applied only to airports designated by the Minister of State under the Airports Act 1986. The three designated three London Airports (Heathrow, Gatwick and Stansted) and Manchester Airport were designated in 1986 (Manchester was de-designated in 2008). Designated airports must adhere to two mandatory conditions, an account condition and a charges condition, in addition to those applying to airports holding CAA permission. An account condition requires airport accounts to disclose detailed information beyond that required under the Company Act. A charges condition is a price cap in the form of a

retail price index (RPI) minus X formula, which is set on a revenue yield basis and in consistency with the single-till approach. The RPI-X cap limits the maximum allowable revenue yield per passenger that can be levied by way of airport charges, i.e. those associated with the landing, take-off, and parking of aircraft, and with the processing of passengers through the terminals.

The first price caps were introduced for BAA plc's three London Airports in April 1987 and for Manchester Airport in April 1988, and these caps have so far been reset every five years by the CAA in consultation with the Competition Commission (formerly the Monopolies and Mergers Commission). BAA plc also introduced the price cap for Glasgow and Edinburgh airports voluntarily. Until March 2003, CAA had used a system approach in setting caps for BAA plc's three London Airports, but this was changed to a stand-alone approach (i.e. price caps for each airport are set in relation to that airport's own assets and costs).

In addition to the CAA's two-tier regulation, airports are subject to general competition law applied by the Office of Fair Trading (OFT) (as well as the Competition Commission when the case is referred to it) and the European Commission

### **Economic oversight: ANSP**

Under the Transport Act 2000, the Government issued a licence in March 2001 to NATS (En Route) plc (NERL), a wholly-owned subsidiary of NATS Holding Ltd, to provide air navigation services. The Act gives CAA the role of an economic regulator of NERL. CAA exercises this role mainly through monitoring and enforcing the conditions in the licence and through modifications to the licence.

The licence granted to NERL includes conditions relating to charges levied for Eurocontrol services and Oceanic services. The conditions are detailed down to two separate RPI-X price caps (one for Eurocontrol charges and the other for Oceanic charges), which are defined in terms of annual limits on the maximum allowed revenue and consistent with the single-till approach. Although the initial five-year price caps, which took effect in January 2001 for Eurocontrol charges and in April 2001 for Oceanic charges, were set by the then Department for the Environment, Transport and Regions, CAA has responsibility for setting subsequent price caps.

### **Economic oversight: General conclusion**

CAA created in 2011 a new Regulatory Policy Group with the specific task of providing policy advice across the CAA, aiming to help the organisation to put the protection of consumers at the heart of its work. This new transversal group has four functions: (1) the economic regulation of the three designated airports (Heathrow, Gatwick, and Stansted Airports; Manchester Airport was de-designated in 2009) and NATS; (2) the enforcement of consumer legislation; (3) the provision of expert policy and economic advice and analysis; and (4) the collection and analysis of aviation statistics and survey responses.

Last update: 14 February 2013