

Stephen Nelson speech to Global Airport Development Conference, Rome.
November 23, 2006.

Good morning.

I am delighted to be here in Rome to take part in this important gathering.

As someone who studied classics at university, I have a real personal fondness for Rome.

And it's difficult to think of a better location for discussing the future of this most political, I might even say gladiatorial, of industries.

I gather from the conference organizers that when they researched the subjects you wanted to see covered at this year's conference, the subject of BAA was pretty much top of the list.

And I've been invited to answer the question: what next?

It's a good question.

Predicting the future is never easy. And it's certainly true that if my predecessor been asked the "What Next?" question a year ago, he would not have predicted BAA's acquisition by a consortium led by Grupo Ferrovial for over £10 billion.

He would, however, have made many of the same points I'll make here today.

Which is another way of saying that whilst the BAA story in the last year clearly involves some big changes, there are also substantial continuities.

At a personal level, one year ago, I had just joined as Retail Director with BAA, coming from the world of supermarkets and customer service. I was working on the plans for the opening of Heathrow Terminal 5, where we intend to take the airport shopping experience to a new level.

That's a good example of something which hasn't changed.

Terminal 5, Europe's largest construction project, is still on time, on budget and due to open on March 30, 2008.

Actually, much else has remained constant. All of the great forces shaping the aviation business today were well established a year ago:

Globalisation and growing affluence, which drive air passenger growth;

Global terrorism, which creates shocks, severe operational challenges and which, together with global growth, puts upward pressure on oil prices;

And

Climate change.

Despite persistent denial from some sections of the aviation industry, surely no-one in this room can now doubt that the political and public response to climate change will re-shape the context in which our industry works.

It will re-shape the fiscal and commercial framework for our business and will alter the way our customers think about flying and shape their expectations of the aviation industry.

In the UK, the report of the distinguished economist Sir Nicholas Stern has recently put some numbers on the cost of taking necessary action.

But the key point is that the cost of action is much less than the cost of inaction.

On climate change, we are past the point of no return. There will be action. It's simply a question of whether or not it will be timely action. And the aviation industry needs to decide whether it wants to play an active part in the solution or wait for solutions to be imposed.

So, when I am asked: After the Ferrovial acquisition, what next at BAA? My answer is that much of what happens next at BAA would have happened whether or not BAA's ownership had changed.

Here are some other things which won't change.

BAA will continue to meet the challenges laid down for us in the 2003 UK Government White Paper on the *Future of Air Transport*. That means adding runway capacity at Stansted Airport and then, if environmental conditions can be met, at Heathrow or, failing that, Gatwick.

We are expecting the Government before the end of this year to publish a progress report on its White Paper and there is much to report.

We have already made excellent progress in preparing our planning application for Stansted Generation 2, which we expect to submit early next year, so I won't say any more about that today.

At Heathrow, we have supported the Government's efforts to understand in more detail the air quality issues which currently impede the case for greater capacity.

In this context, the Government plans to consult shortly on plans to increase throughput by using the runways in mixed rather than segregated mode.

We have also recently submitted our case for planning permission for a new Heathrow East terminal which will, if approved by the planning authority and appropriately remunerated by our regulator, transform service quality in the oldest part of the airport.

We aim to open the first part of this facility in time for the London Olympics in 2012. Together with T5 and other refurbishments, this will represent a genuine transformation of the world's busiest international airport.

London will at last have a hub airport of which it can be proud.

Some may think that these developments will be blown off course by greater environmental anxiety and global terrorism, but I don't share that view.

The economic case for investment in aviation infrastructure remains powerful. Aviation is a vital industry in its own right, and I shall be making that clear alongside Richard Lambert and Willie Walsh on 4th December when we publish the OEF report. Aviation is also a catalyst for a modern, open, trading economy. Good aviation links to the rest of the world attract businesses to the UK. Look at our record of inward investment over the years. Without a dynamic aviation industry, this record would not look nearly so good.

No political party which wishes to be a party of government can afford to ignore this fact.

It is vital, however, that we do not take it for granted that everyone understands these arguments. A major review of UK infrastructure policy by Rod Eddington, well known to you all as the former boss of British Airways is nearing completion.

I'm sure that it will present further strong and influential support for the argument that investment in transport infrastructure is critical to growth in national productivity.

The economic return to the UK as a whole from the infrastructure plans set out in the White Paper is measured in many billions of pounds.

The scale of this contribution to the economy sits challengingly alongside the calculations of the recent Stern report on climate change.

The truth is that we need to invest in controlling climate change, as well as investing in the capacity of aviation.

This is not a self-contradiction. Globally, it is entirely possible to curtail carbon emissions from the biggest culprits, whilst containing the growth of emissions from aviation and other forms of transport through intelligent, market-based trading mechanisms.

That's why BAA has taken such a forthright, leadership role in emissions trading for some years now. BAA has reason to be proud of its record in this respect, and it's a position upon which I intend to build.

These then are some continuities between, if you like, old BAA and new BAA.

We must be committed to delivering the investment the UK, the aviation industry and air travelers want and need.

We must be committed to a high level of customer service, based on modern, fit-for-purpose facilities.

And we are committed to accepting our responsibilities to manage our industry's environmental impacts.

So these are the continuities.

But what about the differences?

How will new BAA differ from old BAA?

Well, the most significant short term change is the change in share ownership.

Instead of having 350,000 shareholders, BAA now has three: Ferrovial, a Canadian pension fund and the Government of Singapore. Of these Ferrovial, a major and highly regarded Spanish construction and infrastructure company, is the largest and most influential.

It is also true that in order to acquire BAA, the consortium borrowed a large amount of money, applying a much higher gearing to BAA's assets.

This, by the way, was something the stock market was already pressing BAA to do regardless of the takeover.

The discipline of servicing that additional debt, along with the interests of the company's shareholders, will require BAA to become more efficient and more effective: to deliver better service with fewer resources.

We are now vigorously working through the implications of this new financial reality on our business plans.

In short, the acquisition will make BAA more efficient, and of course, delivering on my shareholders' financial goals will be a key objective.

I also have no doubt that our shareholders have taken ownership of BAA for the long term, and I have made it clear that we shall not act in a way which prejudices our longer term future.

When you're a new CEO of a business you often get asked "What's the vision?" Well, I think very simply that we're in the business of service. That means clean airports, run for the benefit of passengers, keeping them safe, secure and satisfied. Clean floors, toilets, restaurants and shops. The highest available standards of security. No queues at security, in your car parks, at your shops. Well maintained and plentiful trolleys, clear signs, friendly staff, facilities for the physically disadvantaged, natural light wherever possible, retail products and services that meet passenger needs at competitive prices. That's our journey; it's a long one and has no point of arrival. You've always got to improve, and in some areas, we've got a lot of work to do to raise our standards.

Essentially, therefore, we work for passengers and work with government, airlines, local communities, retailers, contractors. That's the objective.

It sounds simple. And in some ways it is.

But there is also much stifling complexity.

BAA's London airports are a regulated monopoly and that system of regulation has barely altered in the 20 years since privatisation.

Given the structural changes that have occurred in the industry in that time, I think that's a problem.

The UK approach to airports regulation involves not one economic regulator but two: the Civil Aviation Authority and the Competition Commission.

I'm delighted to be sharing this platform today with Dr Harry Bush who leads economic regulation at the CAA and I look forward to his comments.

But I don't think that Harry would deny that the process of regulating BAA has become more onerous.

Conducted across a sequence of five-year cycles, each price review takes a good two years of highly detailed work to determine.

We reckon that roughly speaking, the level of paperwork involved in dealing with this process just for BAA has increased by roughly 50 per cent at each quinquennium. Nice Latin word that one and appropriate for something so archaic.

Its now been 20 years since airports regulation was put into place. Now, the standard regulatory process involves a set piece confrontation between airports and airlines, with the regulator (2 in our case) holding the ring. Remember the Emperor and the Gladiators?

We talk about how much we have invested and want to invest and how service quality is important. Airlines talk about how our prices are too high, and that we don't deliver what they want at that particular time.

The regulator does arcane calculations about the cost of capital, and comes up with ever more complicated formulae in an attempt to incentivise us. It's been a very "us" and "them" world.

I used to think supermarkets generated a lot of paper, but this is something else. Reams of detailed reports are produced culminating in a 5 year formula and it's a game which we have played well.

But despite all that has been achieved, I look at the state of Heathrow airport and reflect on the result of 20 years of regulation. Sure we are transforming it - T5 is on time and on budget - but it will be 2012, six years away, before that transformation is experienced by the vast majority of passengers.

As for Gatwick - certainly we have plans to renovate that airport - but we should be worried more about the fabric of the airport, how it impacts passengers, and less about the fact that it is the cheapest major airport in Europe.

I look at Stansted - and everyone knows the airlines' views on our plans to develop that airport. And I think that surely there must be a better way to go forward than fighting your customers in public, a course which I have not taken - to date.

The central questions are these: is regulation preventing our airports from being as good as they could be now? Will current regulation hinder the delivery of new capacity in the south east and mean that passengers of the future are unable to fly? Is this not the right time for a fundamental overhaul of the regulatory framework?

There have been other factors in play, not least the UK's notorious planning system. But regulation itself is an issue that the industry owns and controls.

To question the regulatory framework is not to question the regulatory authorities. It is simply the case that, as in other regulatory industries, from time to time a root and branch review of regulation is necessary. Harry has started the ball rolling with constructive engagement. Airports and airlines were wary at first, but I think we have all been surprised at the mature debate we have had at Heathrow and Gatwick over the future of those airports.

But we should be able to go further. Are there other areas of the process that the regulator can step out of? Would de-regulation offer incentives to build capacity and improve overall service to passengers and airlines that are more effective, incentives that are better suited to the objective, rather than increasingly complicated regulation?

The answers are not yet clear, but this is why we have urged the OFT - if it is to refer the UK airports sector - to put the regulatory framework on the table as well as the ownership of BAA's airports. I know that the airlines have also asked that the regulatory framework be given a full scale review.

I have said publicly that I do not consider that there is a case for the break up of BAA. That said, if the OFT and the Competition Commission do take the view that some or all of the London airports are competing in a substantial way with each other, then it follows that there is a case for lighter regulation or even deregulation.

Alternative models to the UK's approach are readily available.

Australia runs a form of shadow regulation – incentivising non price regulated airports to behave in reasonable terms commercially under threat of re-regulation.

As for the quinquennial review of aeronautical charges, this is probably neither the right time or place for me to say more.

We await a paper from Dr Bush and the CAA next month, following which the Competition Commission will examine the issues.

As we have reminded the CAA and I put on record now, the success of Terminal 5 rests upon the terms of the last quinquennial review. Any drawing back from the cost of capital assumptions in that review, which were clearly intended to roll forward into the period which starts in 2008, risk jeopardizing the second phase of T5 and undermining confidence in other vital investments at Heathrow and beyond.

No-one should underestimate the difficulties of achieving the right level of investment in the London airports.

And it has not been easy in a period when Government had considerable leverage over BAA, through its ownership of a golden share and other mechanisms.

Under its new ownership, BAA is answerable to the strictures of financial markets. Everyone involved needs to think through the implications of that.

Let me sum up.

New BAA faces some very familiar problems and some new ones.

This is a company which has been at the cutting edge of the interface between market forces and airport development for longer than any other airport operator in the world.

We are in the business of great service to passengers.

We are ready for the challenges of today's marketplace.

We own some of the world's most valuable airports.

And we intend to invest in their growth.

Furthermore, we will do all of these things in a way which takes a far-sighted but realistic view of the environmental issues faced by our industry.

So, I shall now hand over to some of the other individuals who have played such a significant part in BAA's life during the last year, and no doubt I'll return to some of these points in my dialogue with Professor Doganis at the end of this session.

Thank you.

