

**Stephen Nelson**

**Speech to Airport Operators' Association, London, November 15, 2006**

Good morning.

I am delighted to be here with you this morning. It is highly appropriate that I am making my first major speech as Chief Executive of BAA to our industry association, backing the AOA at what is a challenging time for UK airport operators.

The structure of our industry is under review by the Office of Fair Trading.

The Stern report on climate change has heightened the pressure on Government to impose additional taxes on aviation.

The economic benefits of aviation, which everyone in this room knows to be substantial, are at risk of neglect.

Meanwhile terrorism and the threat of terrorism continue to impact our business. The losses suffered by BA and BAA alone as a result of the August security crisis look like coming in at something close to the £150 million mark.

Terrorism and related geopolitical disturbances are also among the reasons why oil prices have been so volatile.

And you may also have noticed that BAA, is under new ownership. A consortium led by Grupo Ferrovial of Spain bought our business in July for more than £10 billion, a premium of more than a third on what the market thought we were worth at this time last year.

It has been quite a year.

At a personal level, one year ago, I was just settling into the role of Retail Director with BAA, having joined the company from the world of supermarkets and with a consumer goods background.

I was stimulated by the prospect of building on BAA's reputation as the inventor of modern airport retailing.

And I was working on the retail plans for Terminal 5, where we intend to take the airport shopping experience to a new level.

Happily, some things don't change. Terminal 5, Europe's largest construction project, is still on time, on budget and due to open on March 30, 2008. It is increasingly recognized as a benchmark for big project risk management.

Its retail offer really will be something really special. And so will the overall passenger experience. For the first time in nearly 25 years, Heathrow will have a brand new terminal incorporating the latest in airport design and planning.

But it is the external issues facing our business upon which I would like to focus today.

I want to say something about three areas:

- the environmental debate around aviation;
- the economic issues at stake
- and thirdly, I would like to share with you some thoughts arising from the August security crisis

So let me start with climate change.

Despite a few persistent voices of denial, 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 both the fiscal context and the commercial context.

Will climate change alter the way our customers think about flying and shape their expectations of the aviation industry?

In my view, without a doubt.

Stern has called it the greatest market failure in history. It is a global problem and requires a global solution. The BRIC economies are booming and so is their demand for air travel. The US is not a signatory to Kyoto. Real and deep concern will come slowly to these economies.

But in Europe concern about climate change is more likely to affect customer behaviour in the short term. We know aviation is a relatively small contributor to greenhouse emissions, but it is growing fast.

It's not so much that climate change is making many people reluctant to fly just yet, but it is making people feel less good about flying.

It's rather like the challenge facing the food industry. People still need to eat, but they want re-assurance about the quality and healthiness of the food they buy .

Smart food manufacturers and retailers listen very carefully to what their customers say about how they're feeling.

Airlines and airport operators need to do the same.

For airport operators, this is not easy.

We sit between passengers and the airlines, and the politicians and planners who determine whether or not we can expand our facilities.

We also live alongside our neighbours, who have to live with the direct consequences of airport expansion. That is why BAA continues to place such a heavy emphasis upon managing a close dialogue with all its stakeholders. And why we place such importance on the AOA in its role as industry spokesman and lobbyist. In my view the AOA's role is going to be even more important over time.

In terms of climate change, I'm proud of the fact that BAA alongside the AOA has played a leadership role in winning cross-party political support for emissions trading.

Nicholas Stern gave us hope that it is not too late to act. And he strongly backed the case for carbon trading.

Under carbon trading, companies must either cut their own emissions or help pay for others to cut their emissions instead. That creates a tremendous incentive for innovation.

Because some industries find it easier and cheaper to cut emissions than others, a carbon trading system helps seek out the most cost effective ways to cut emissions.

In short, carbon trading gets the best environmental 'bang for your buck'.

And the more open and the more international the system the more effective it will be.

As I have pointed out, climate change is a global problem requiring international action, so European action makes sense.

But carbon trading is always going to be much more effective than blunt taxation, where the response to the recent doubling of oil prices suggests that an air tax would have to be of sky-high proportions in order to flatten demand.

Of course, carbon trading doesn't come without a cost - which must find its way into the airline ticket. But, by applying a competitive market mechanism, the environmental cost would be driven down rather than inflated.

We therefore continue to urge the European Union to admit aviation into its emissions trading system as soon as possible.

The problem is that the process of getting aviation into the scheme is proving slow and there is a risk that politicians and the public are losing patience.

In the meantime, I hope that our own Government will remain patient and that the Chancellor, in the Budget, will avoid a 'knee jerk reaction'.

Rather, I would urge him and other ministers to work with the aviation industry to explore the scope for transitional mechanisms which will draw aviation into the EU emissions trading scheme at the earliest possible opportunity.

There are a number of ways this could be done. Aviation, for example, could be allowed to acquire advance credits in the emissions trading scheme.

There is also scope for wider use of voluntary carbon offsetting of the kind promoted by British Airways. We – as airports and the AOA - are exploring some ideas for possible airport-based approaches to this. Government could help verify standards and incentivise participation.

But, however we do it, the climate change debate requires the whole aviation industry to engage in debate and to act in concert.

In this respect, the work of the Sustainable Aviation group has been helpful in laying down some basic points of agreement and in establishing a direction of travel.

But it's clear that we're going to have to go much further.

We must do this with determination and without naivety.

I recognize that an industry which involves deep commercial rivalry and which has more than its share of larger than life figures won't find this kind of collaboration easy.

All I can say is that if we don't sort out our own thinking on these matters, governments will do it for us.

And my experience is that the best solutions are those where politicians and business leaders genuinely work together.

What about the economic issues?

There is no doubt that this is our trump card in the debate about aviation's future.

Not only is aviation a vital industry in its own right – think Rolls Royce, British Aerospace, British Airways, Virgin, BMI, EasyJet and many others – it is 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.

London is experiencing its most rapid population growth since World War Two, adding roughly 100,000 people a year.

The capital is booming.

As a financial centre, London is number one in its time zone and by some measures it is running ahead of New York.

For the UK to damage London's global connectivity by failing to sanction growth in airport capacity would be an act of economic self-harm for which future generations would pay a heavy price.

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.

That's why BAA, along with several other players in our industry and beyond have commissioned Oxford Economic Forecasting to update its 1999 study on aviation's contribution to the UK economy.

The resulting report is due out shortly and I'm confident that it will provide important new data on the contribution to the UK's productivity from investment in airports.

Sir Rod Eddington's wider review of transport infrastructure, conducted at the request of the Treasury and the Department for Transport, is imminent and will provide another important contribution to the debate.

But let me repeat my key point: we all need to join in that debate.

If we don't, aviation and the UK economy risk being damaged by hasty political responses to climate change and other important, but in reality wholly manageable, environmental issues.

These arguments about environmental and economic issues will also form the backdrop to the Government's progress report on the 2003 Air Transport White Paper, which Douglas Alexander is due to publish before the end of this year.

I know that Mr Alexander is under pressure from an array of voices among the NGOs and indeed from the main opposition parties in Parliament to turn this progress report into a re-think.

Let's not beat about the bush.

This country cannot afford a U-turn on the White Paper.

This White Paper is not the “predict and provide” monster characterized by those who campaign against all airport growth.

It is a sensible and balanced framework within which planners can respond to a vital set of national transport infrastructure issues.

It makes clear that there are environmental limits, which must be respected.

It sets out the case for emissions trading as the most effective route to deal with aviation’s climate change impacts.

It was a well judged document when Alastair Darling published it in 2003 and it remains so today. We dismiss the White Paper at our peril.

I want to make it quite clear today that under its new owners, BAA will continue to meet the challenges laid down for us in that White Paper, so long as everyone else plays their part.

That means adding runway capacity at Stansted Airport and then, if environmental conditions can be met, at Heathrow or, failing that, Gatwick.

Our commitment to these investments is, of course, conditional upon receiving satisfactory rates of return from our regulator, the CAA, but that is not a new point. We are a private sector company with lenders and shareholders. Without their support, we could not invest at all.

Since privatization, these lenders and shareholders have saved the taxpayer many billions of pounds in capital expenditure which, in most countries, still comes largely from the public purse.

I won't rehearse today in any detail the great progress we have already made in preparing our planning application for Stansted Generation 2, which we expect to submit next year.

But I will say that we have worked hard to make G2 greener and cheaper.

We have driven down the headline cost of this project from the £5bn figure estimated in the White Paper to around £3bn. And we have improved the project's environmental footprint, not least by reducing land take.

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.

The Government plans to consult shortly on plans to increase throughput by using the runways in mixed rather than segregated mode.

I am confident that we will get more capacity at Heathrow and I am in full agreement with Willie Walsh that if we do not, Heathrow will continue to lose competitive ground to Schiphol, Paris and Frankfurt. And that will weaken the heart of the British economy.

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 real transformation of the world's busiest international airport.

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

But there is another question.

Will these developments be undermined by the third of my themes today: the growth of global terrorism and its impact on airport security?

I don't think so.

We have seen since the first Gulf War in 1991 that the recovery in passenger growth trends following geopolitical shocks has tended to become shorter, rather than longer.

The forces driving global growth in aviation, especially in Asia and South America, are formidable and will not be easily arrested.

But clearly we can't be complacent. If we fail to argue our case for the growth of our industry, we will find ourselves having to deal with that growth at overcrowded terminals delivering substandard passenger service.

Which brings me to the events of August this year.

I have to say that I do not think that August 2006 was the UK aviation sector's finest hour.

Airports can only work well for passengers if operators and airlines collaborate closely.

Yet as an industry, we managed to turn an event which reflected great credit on the UK intelligence services and the police in intercepting a deadly assault on a number of transatlantic aircraft into a public relations disaster.

I have reflected long and hard on these events and within BAA we have done a great deal of work to try to ensure that the mistakes we made will not be repeated.

But let's keep a sense of perspective. There can be no higher priority than keeping our passengers and our aircraft safe from terrorist attack.

Let me say something briefly about what happened in the weeks following the imposition by Government of an unprecedented "critical" level of security at 2am on the morning of August 10.

Right in the middle of the August holiday peak.

The change in required procedures was draconian. One hundred per cent hand search for all staff and all passengers. All cabin baggage to be re-processed as hold baggage.

The clearest response to this “critical” level of security would have been to close the airports.

We discussed this very option, but concluded that so long as we judged the operation of the airports to be safe, we should go on operating as best we could.

The Government’s view, correct in my eyes, was that to close the airports would look like giving in to the would-be terrorists.

But disruption was forecast. Not least by Transec, the DfT security authority. And it duly occurred.

I won’t go into a blow by blow account of what happened in the subsequent days. All our airports activated their crisis management teams and put in place established crisis procedures, most of them involving close co-operation with airlines.

There were plenty of difficulties, as a very complex set of security rules changed not once but twice then three and four times as the drama unfolded.

Passengers were at first patient, but then confused and sometimes angry.

Airlines were understandably frustrated at the commercial damage being done to their businesses.

Heathrow came it for the heaviest criticism.

It was the worst affected of all the UK airports, which was hardly surprising given its pre-eminence in transatlantic services and its status as a hub airport.

Heathrow handles passengers interlining from airports all over the world which by August 11 were operating quite different security regimes from those in force at Heathrow.

Let me be clear.

Everyone made mistakes. At security. At check-in. On the baggage systems. Certainly BAA did, but we were no different to many others in this regard.

Our web-site crashed because it could not cope with the volume of inquiry.

Not good enough.

Communication with passengers at the airports was disjointed and confused.

Airports got by using contractors and non-operational staff as volunteers.

Some of these resources were better than others.

As for the airlines, well, I'm happy to let them give their own accounts as they choose. If mud-slinging was a bad idea in August, it's certainly a bad idea in November.

On 10 August, I was three weeks into my new role and this crisis could not have happened at a worse time for BAA.

Significantly, a major change programme at the big airports – Delivering Excellence – was working its way through the system. Its goal is to de-layer management and improve effectiveness.

It's working.

But in mid August, it was causing temporary disturbance to familiar resourcing and management patterns.

That said, the core accusation made against BAA was that we did not have a contingency plan for the situation that arose.

That's both true and untrue.

BAA had and still has detailed and well understood crisis management procedures for a very wide range of contingencies.

But when we had imagined a “critical” level of security – for example a suicide bomb attack on one of our terminals - we had always imagined that it would entail airport closure.

The idea that we would find ourselves keeping going through a situation where the length and complexity of security procedures increased literally overnight by a factor of more than two had never been planned for.

As a result, BAA did not have a reserve army of security personnel on stand-by for such an eventuality.

But be under no illusions, there would have been no support from the industry for maintaining this cost, the airlines would have shouted us down to the regulator, who would not have supported any such course of action.

And we’ll have to see in the coming weeks and months the extent to which there is support for significantly increased resilience.

One specific BAA decision during the crisis stands out because it was the source of much friction.

On August 12, Heathrow decided to mitigate the security threat by declaring “reduced capacity” operations. It was intended as a practical way of achieving the best possible outcomes in very trying circumstances. But we needed a better understanding with airlines in order to make such a decision.

In future, we need to be clear what level of resilience the airlines and the regulator are prepared to see built into our security and other operating systems for activation in the event of a “critical” security requirement.

And we need to work through the procedures for sharing the pain in a “reduced capacity” scenario.

During the crisis, we often spoke to each other about the “new normal” caused by the heightened threat of terrorism.

In these circumstances, we know that security procedures will ratchet up and down in line with the threat assessment.

We are still feeling our way towards that “new normal”. The recent change in regulations on liquids have been onerous and have significantly reduced our capacity at every lane that we operate in our central search.

Am I satisfied with the pace of our response on this? No I am not. Passengers are still experiencing long queues on occasions, notably at the Flight Connection Centre at Heathrow. But the constraints on our business are significant, both in terms of physical infrastructure and recruitment lead times, despite what you may hear from some quarters. Recruiting, training and security screening new guards takes a minimum of six weeks. Contract labour for hand searching is not possible because of our union agreements. And the use of armed forces is emphatically not an option.

However, we have taken a number of very specific actions.

Across our seven airports, we are adding an additional 17 security lanes together with the all the necessary x-ray equipment and archway metal detectors at a cost of nearly £7 million.

To put this in perspective, the additional space required for these lanes, some 1200 square metres, is the equivalent of 16 airside shops and we have already served notice on affected retailers.

We are also working extremely hard to recruit and train more staff. By next month, we will have in place nearly 500 additional, full time security staff compared to August. Men and women who will work on front line security duties speeding up the security search process for passengers.

Our additional investment in these staff amounts to an extra £16 million a year on top of the £200+ million a year that we already spend. This investment will mean that by the holidays we will have increased our search capacity by nearly 20%. Does this mean I can guarantee that by Christmas there will be no long queues at our airports? No I cannot. What I can guarantee is that BAA, supported by its shareholders will invest the money and resources needed to get this right. We are in the business of customer service and we must and will be fully committed to delivering safe and secure airports that provide a positive experience for all.

We are also re-doubling our efforts, working closely with the DfT to take advantage of improvements in security technology, though it would be over optimistic to believe that there are any easy solutions here.

BAA has long been a world leader in airport security technology. We intend to retain that position.

The fact is that the security threat to Britain's airports in recent years has constantly shifted.

From hijacking to suicide missions.

From explosives in hold baggage to explosives in shoes.

To d-i-y explosives made from liquids carried in hand baggage.

It is our job to deal with these changes, working within DfT mandates, in a way that makes life as pleasant as possible for our passengers and as profitable as possible for our airlines.

In short, our assessment of the August crisis tells us that we must:

- go on working as closely as possible with the Government, in order to achieve the maximum clarity about agreed operational responses to various levels of security mandate;

We must:

- update and improve our crisis and business recovery procedures, in collaboration with airlines, to meet a higher level of threat;

And we must

- ensure that our own internal security and communications procedures have a level of resilience agreed and understood by ourselves, the airlines, our regulator and the Government.

One thing we must not do is to blame our staff. Anyone who has spent even a single working shift on constant hand-search duty knows how exhausting it is. It's like doing a very repetitive exercise in the gym without any respite.

During one television interview early in the crisis I used the word "magnificent" to describe the way our staff had responded to the crisis and was duly criticised for being out of touch with my customers.

In one sense, Fair Cop. Our biggest customer was unhappy. And no set of events in which tens of thousands of people going on holiday are delayed and inconvenienced can be anything other than a matter of deep regret. As I said earlier, my emphasis will always be the passenger perspective.

That is why BAA apologised constantly then and why I apologise now for the trouble people had to put up with then and, to a degree, still put up with now.

But I don't apologise for using the word "magnificent" with regard to the thousands of BAA staff who saw us through this crisis.

They were magnificent and I thank them.

Let me sum up.

Airport operators find themselves caught between the three most potent forces currently shaping our world:

- globalisation, which propels growth in demand for air travel;
- climate change, which raises acute concerns about that growth;
- and the spread of terrorism, which sees aviation as a choice target.

The success of the aviation industry depends upon the skill with which we read and manage these trends and BAA, under its new ownership, and under my leadership will continue to play its part. At the same time, I will also ensure that we don't lose sight of the essentials – delivering an experience that airlines and passengers have a right to demand and one that allows us to deliver a full commercial return to our shareholders.

Thank you.