

House of Commons
Transport, Local Government and
the Regions Committee

**AIR TRANSPORT
INDUSTRY**

Eleventh Report of Session 2001–02

Volume I

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Footnotes

In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated by the page number as in 'Ev 12'.

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ELEVENTH REPORT

The Transport, Local Government and the Regions Committee has agreed to the following Report:

AIR TRANSPORT INDUSTRY

I. Introduction

1. Global demand for air travel collapsed immediately after the catastrophic events of 11 September 2001. In the month after the terrorist attacks, air traffic on routes between the United States and Europe fell by 35 per cent, and within Europe by 10 per cent.¹ In the United Kingdom, British Airways traffic in October fell by 24.7 per cent overall on the previous year, with a 36.2 per cent fall in premium traffic, and load factors fell by 8.1 percentage points to 63.1 per cent.² Premium traffic was hardest hit, partly as a result of the decline in economic confidence and partly due to companies imposing travel bans, with trans-Atlantic and Japanese routes worst affected.³ In response, many airlines withdrew routes, cut back services and shed staff. For example, shortly after 11 September, British Airways announced an additional 5,200 job losses, and bmi British Midland announced 600 job losses.⁴ Several airlines with pre-existing financial difficulties were forced into part or full closure.⁵ In December 2001 and January 2002, we held two evidence sessions into the responses of the air transport industry and of governments to the attacks in the United States and the longer-term prospects for aviation in this country. We received more than thirty written memoranda. We are grateful to all those who submitted written and oral evidence and to our specialist advisor, Mr Laurie Price.

2. Since concluding evidence for this Inquiry, we have undertaken a separate short inquiry into the finances of National Air Traffic Services. We shall consider some of the wider issues relating to air transport in our forthcoming inquiry into the Government's Aviation White Paper, which the Minister, Mr David Jamieson confirmed to us in evidence in January would be published in the autumn.⁶ **We expect to see firm proposals for the future of aviation in the forthcoming Aviation White Paper, which is due to be published in the autumn of 2002. We are concerned that the timetable for the White Paper has already slipped.**

The United Kingdom air transport industry before 11 September

3. In 1998, the United Kingdom's air transport industry contributed, in 1998, an estimated £10.2 billion to gross domestic product, and directly supported 180,000 jobs.⁷ In addition to its direct economic effects, the air transport industry is vital to many businesses, providing cargo services, supporting tourism and attracting international foreign investment through the quality and quantity of international air connections.⁸ The United Kingdom supports a large number of airlines that operate scheduled, charter, no-

¹ AEA data for the period 10 September to 28 October; Ev. pp 54, 120. The CAA cite forecasts for full-year 2001 on 2000 from IATA of -7% to -13% for US domestic passenger traffic, up to -13% for trans-Atlantic traffic under its optimistic scenario, -1% to -5% for intra-European passenger traffic, and up to -6% for total international passenger traffic.

² Ev. p 139.

³ QQ 56, 57.

⁴ Ev. pp 136-137; Q 285.

⁵ Ev. pp 121, 147-148.

⁶ QQ 373-374. In a written answer on 8 May 2002, Mr Jamieson stated that the Government hoped to publish the Aviation White Paper "before the end of the year", HC Deb, 8 May 2002, col 219W.

⁷ *The Future of Aviation, The Government's consultation document on air transport policy*, Department of Environment, Transport and the Regions, December 2000, pp 32-33 (hereinafter *The Future of Aviation*).

⁸ Ev. pp 47, 96, 163; *The Future of Aviation*, pp 32-33; see also *Economic benefits of aviation*, Issue Brief, BAA, September 2001, and *Airport Statistics*, Issue Brief, BAA, September 2001.

frills and cargo services.⁹ The industry also provides vital social and economic links for the United Kingdom's remoter regions.¹⁰

4. Despite the size and scale of the industry, airlines have traditionally survived on slim profit margins. Moreover, the industry displays cycles of growth and contraction. Capacity follows demand, which creates periods of overcapacity when demand falls.¹¹ Industry analysts had forecasted another cyclical downturn was due at the start of 2001.¹² The Civil Aviation Authority (CAA) described the industry as having been "on the cusp of recession" before the attacks on 11 September. The attacks in the United States accentuated and accelerated the industry's difficulties of overcapacity, high costs, a changing demand structure and intense competition.¹³

5. The industry's financial resilience depended on an "appropriate cost base for the traffic stream".¹⁴ Before 11 September, there was pressure on both costs and traffic levels. Labour and aviation fuel costs had increased, and excess capacity had built up over a period of time.¹⁵ Mr Chris Tarry, an aviation investment analyst, considered the overcapacity in the industry before the terrorist attacks to be as much as 30 per cent, which led to severe financial pressures for airlines that had failed to adjust to the "incompatibility of the pricing strategy with the cost of operations".¹⁶

6. Scheduled airlines have had to respond to changes in traveller behaviour and the dramatic increase in competition from no-frills airlines on short-haul routes. Increasing numbers of business travellers have moved from business to economy class, or switched to low-cost carriers in order to achieve best value for money, adding to the pressure on those airlines that make the majority of their profit from premium class passengers.¹⁷ The CAA noted that new entrants to the market, which are mainly in the no-frills sector, put considerable pressure on airlines with poor products or high cost structures.¹⁸ The industry had responded to the less favourable operating environment by seeking opportunities to consolidate and reducing costs and the number of unprofitable routes.¹⁹

7. In addition to pressures within the industry, aviation has been susceptible to the general global economic slowdown.²⁰ The onset, or at least the perception, of an economic slowdown was evident in underlying demand, particularly in the business traveller and trans-Atlantic leisure sectors.²¹ Before the attacks on 11 September, the International Air Transport Association forecast a \$2 billion to \$3 billion loss on international services due to the drop in demand for business traffic and excess capacity. In the United Kingdom, the foot and mouth outbreak and the relative strength of sterling also had an impact on the number of air travellers.

⁹ Ev. p 157; The main scheduled carriers (British Airways, bmi British Midland and Virgin) carry 59 per cent of passengers, the charter and leisure carriers 31 per cent, and the low-cost or no-frills airlines 10 per cent (this figure excludes Ryanair which is a major participant in the low-cost segment but is registered in the Republic of Ireland).

¹⁰ *The Future of Aviation*, p 34; see HC (1997-98) 589-I.

¹¹ QQ 252-253; Ev. pp 48, 156-159; see also *Managing the cycle*, Airline Business, December 2000.

¹² *Managing the cycle*, Airline Business, December 2000; *The unpalatable truth*, The Economist, 24 November, 2001.

¹³ Ev. pp 142-144, 164. For example British Airways traffic in early 2001 on North Atlantic routes was down 17 per cent for passengers and 21 per cent for freight.

¹⁴ Q 254.

¹⁵ QQ 229-230.

¹⁶ Ev. pp 158-159; QQ 237-239, 241, 253.

¹⁷ QQ 229-230, 240; Ev. pp 156-157.

¹⁸ Ev. p 54.

¹⁹ Ev. pp 136-142; QQ 3, 9, 283, 285.

²⁰ Ev. p 54.

²¹ Ev. pp 96-97; QQ 9, 229.

8. The air transport industry is cyclical and susceptible to downturns in the economy. Since 2000, there have been signs of a general slowdown in the global economy that led to fewer passengers and less money for investment in the industry. Many sectors of the United Kingdom's air transport industry were, therefore, already experiencing a significant reduction in business even before the terrorist attacks in the United States. There has been a marked contrast in reaction by the various industry sectors in responding to that reduction in business. The low-cost sector appears to have been the most successful in generating traffic and improving profitability by exploiting new markets and, in some cases, use of secondary airports while restraining costs.

II. Operational and financial consequences of 11 September

9. Immediately after the 11 September attacks, the United Kingdom's air transport industry faced reduced revenues as a result of airspace closures and restrictions and longer-term declines in traffic.²² Economic optimism declined following the attacks, exacerbating the pre-existing decline in the lucrative premium and the trans-Atlantic market.²³ The industry also faced increased costs for insurance and security, which we consider below. Sir Roy McNulty, Chairman of the Civil Aviation Authority described the situation as the "transition from a cold to having pneumonia".²⁴

Security

10. Following the attacks, security increased in the air and on the ground.²⁵ In the United Kingdom, security was already higher than elsewhere in the world, and the industry was already compliant with the European Union's new Regulations and Common Rules on Aviation Safety.²⁶ Nevertheless, the industry has had to bear the substantial cost of additional security. The airlines themselves could not be precise about the cost of extra security. The Charter Group estimated a figure in the order of £5 per passenger.²⁷ The British Air Transport Association (BATA) estimated the cost of higher security could be £100 million a year for United Kingdom airlines.²⁸ Airports, which may incur additional capital and policing costs, expected to incur additional costs of 5 to 10 per cent for security, which, when passed on to airlines, would equate to ten pence per departing passenger.²⁹ Service providers such as catering companies and ground handling organisations have also incurred additional security costs.³⁰

11. The Government does not intend to provide financial assistance for the additional security costs to airlines.³¹ The British Air Transport Association asserted that the United Kingdom industry was at a disadvantage because in other European states security was subsidised by Governments.³² The Airport Operators Association added that the "recent additional costs that we have experienced in the United Kingdom's airport system are obviously adding to those inequities".³³ The industry therefore favours the Government taking a greater role in providing and financing security.³⁴ **We do not support long-term public assistance for the additional security costs incurred by the air transport industry as a result of 11 September.**

Insurance

12. Within days of the attacks on the United States, airlines and airports were informed by their insurers that war, terrorism and third party cover would be withdrawn. That would invalidate leasing agreements and other obligations, which would result in the cessation of air travel in the United Kingdom.³⁵ The insurance industry did not consult the Government or the industry prior to the withdrawal of insurance.³⁶ The Government rapidly set in place

²² Ev. pp 138–139; QQ 2, 9, 229.

²³ Ev. pp 97–98, 164.

²⁴ Q 229.

²⁵ See HC Deb, 11 April 2002, col 508W and HC Deb, 15 April 2002, cols 738W–739W.

²⁶ QQ 314, 51.

²⁷ QQ 53, 49.

²⁸ Q 52; Ev. p 120; see also Q 137.

²⁹ QQ 158, 138, 148.

³⁰ Q 161.

³¹ QQ 162–163.

³² Q 52; Ev. pp 121, 166–167; see also Q 137.

³³ Q 137.

³⁴ QQ 135, 137, 288, 303; Ev. pp 86–87, 166–167.

³⁵ QQ 43, 324.

³⁶ QQ 322, 42–44.

measures to provide the necessary insurance cover, initially for thirty days, and subsequently extended that cover.³⁷ The Government's intervention in the insurance market has been welcomed, although the Charter Group pointed out that the insurance scheme is calculated on a per passenger basis, which it considered inequitable as charter airlines fly at higher load factors than scheduled airlines.³⁸

13. The industry has also faced increases in other insurance costs.³⁹ The Government considers the significant increase in the cost of insurance for the air transport industry to be primarily a commercial matter and that the cost of increased premia should be passed on to users in the normal way. Sir Roy McNulty accepted that the insurance industry had left "a big gap ... which has been filled by the Government".⁴⁰ Mr Jamieson was hopeful that there would be a return to the commercial insurance market shortly.⁴¹

14. We condemn the hasty manner in which the insurance industry withdrew cover for aviation following the terrorist attacks and welcome the Government's prompt and appropriate action in implementing short-term measures to ensure continuity of essential insurance cover. The Department should provide a report on progress towards a return to a wholly commercial insurance market, and an indication of its view on long-term solutions to providing war risk and terrorism liability insurance cover for the air transport industry. We recommend that the Treasury publish figures on the amount of money it has received from the industry by way of premia and explain what it intends to do with the money.

Impact on the industry

15. Scheduled airlines responded to the events of 11 September by seeking cost reductions through withdrawing flights and cutting staff numbers.⁴² Many carriers withdrew aircraft from service. More than fifty aircraft have been grounded.⁴³ However, there has been a long-standing requirement for all ICAO signatory states to have their transport aircraft fleets comply with the new noise standards by April 2002. Many of the United Kingdom carriers' aircraft grounded following 11 September would have been required to be retired under the ICAO standards.⁴⁴

³⁷ Treasury minute: HM Treasury Airline Insurance Scheme and Extensions, 28 November 2001; HC Deb, 29 January 2002, col 202W; Q 47. The Government backed *Troika* insurance scheme for UK airlines was extended from 22 January 2002 to 20 March 2002, and then to 31 March 2002. The scheme has been extended to the end of May 2002. The premium payable by the insured airlines for cover above US\$50 million increased on 1 February from US\$ 0.35 to US\$ 0.40 per passenger per flight, Treasury Minute: Amendments to HM Treasury Airline Insurance Scheme, 5 February 2002.

³⁸ QQ 41, 46; Ev. p 137.

³⁹ Q 40; Ev. p 124.

⁴⁰ Q 271.

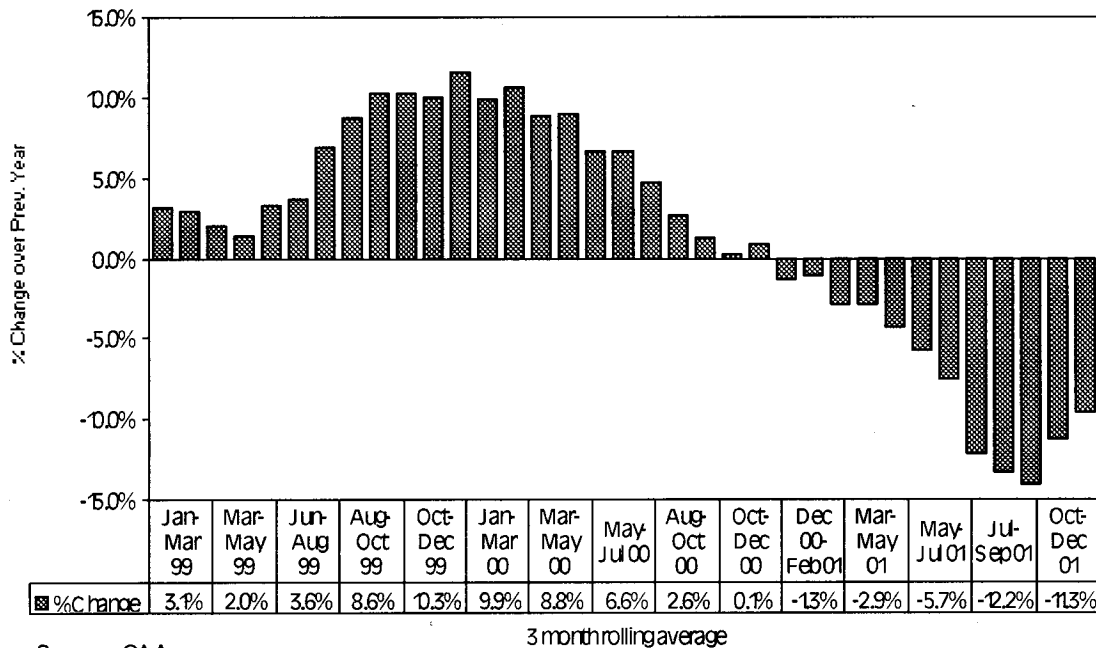
⁴¹ Q 325; see also HC Deb, 29 January 2002, 202W.

⁴² QQ 6, 11.

⁴³ Q 9; Ev. pp 121, 136–137, 139.

⁴⁴ Aircraft were retired or hush kitted in order to meet ICAO Annex 16 Chapter 3 standards which had an April 2002 deadline.

**Figure 1: Freight Tonnes at All UK Airports -
% Change over Previous Year**



Source: CAA

16. Figure 1 indicates how cargo traffic declined following 11 September 2001. The Association of European Airlines freight data shows a total annual reduction of 15.4 per cent for international routes, with North Atlantic traffic showing the greatest decline of 30 per cent.⁴⁵ Figure 1, however, indicates that air freight tonnage to and from the United Kingdom had been in decline as early as December 2000.

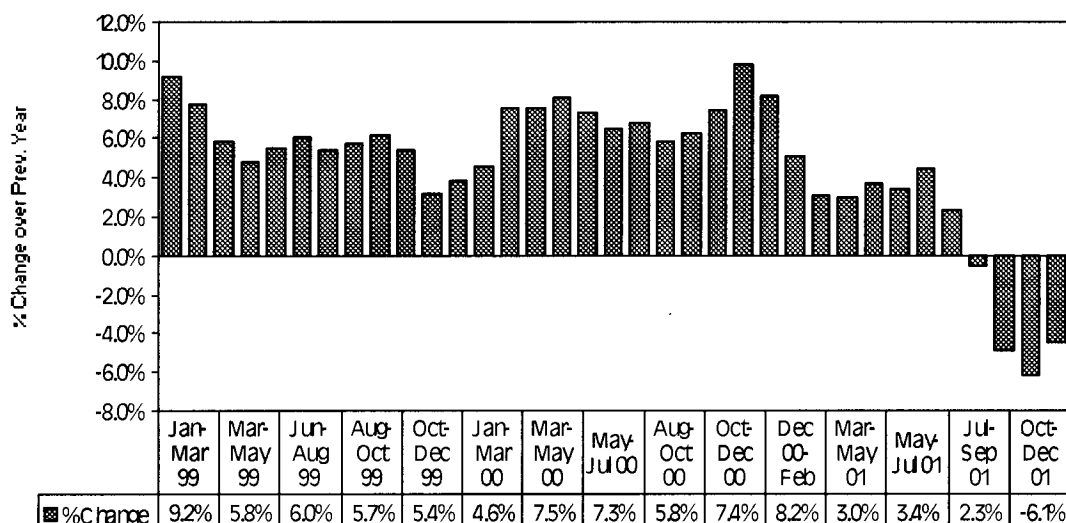
17. Low-cost operators, including charter and no-frills carriers, fared better than scheduled airlines after 11 September. No-frills airlines such as easyJet suffered an immediate decline in traffic, but recovered more quickly.⁴⁶ The impact on charter carriers has been less clear. Although charter carriers did not suffer the immediate catastrophic drop in traffic, forward bookings declined, because holiday-makers book well in advance. Charter carriers remain concerned about bookings for the summer of 2002.⁴⁷

⁴⁵ Ev. p 50; *Thirty per cent fall on North Atlantic routes is main cause for Europe's worst ever monthly air cargo volumes*, 31 October 2001, European Logistics Management, p 7.

⁴⁶ Q 34; Ev. pp 142-143.

⁴⁷ Ev. pp 147, 165; Q 38. In September 2001, bookings for Winter 2001-02 were 32 per cent down and 34 per cent down for Summer 2002, in October bookings declined further to 33 per cent down for Winter 2001-02 and 56 per cent down for Summer 2002.

**Figure 2: Terminal Passengers at All UK Airports -
% Change over Previous Year**



Source: CAA

3 month rolling average

18. Figure 2 illustrates the downturn in traffic at airports.⁴⁸ The impact varied between airports, with those that are largely reliant on low-cost airlines and not exposed to the United States market being relatively insulated from the worst effects.⁴⁹ Outside south east England, the impact on airports has varied, with Manchester airport reporting, in September 2001, a decline of 15.2 per cent in long-haul scheduled passenger numbers, a 10 per cent reduction for the domestic London traffic and a 3.6 per cent reduction for other domestic routes. Manchester Airport Group reported a “significant fall in consumer confidence” for inbound and outbound passengers.⁵⁰ Ground handling companies, which service airports, identified the cost of insurance as their primary concern.⁵¹

19. **The immediate impact on airlines of the 11 September attacks was severe, particularly for those providing premium services to the United States. But there is no compelling evidence to suggest that there will be a medium to long-term reduction in passenger confidence in aircraft safety and security. In the past, passengers have adjusted to the imposition of more stringent security regulations and are unlikely to find difficulty in doing so again. We do not anticipate that the latest security requirements will have an adverse impact on the market for air travel.**

20. **There is no doubt that, even though passenger confidence is recovering, times are tough for the air transport industry. We do not consider it appropriate to increase either the regulatory burden or the costs to any sector of the air transport industry now. We recommend that the CAA seek to postpone the introduction of any proposed increases in charges at regulated airports that may result from its recent review.**

⁴⁸ Q 117.

⁴⁹ QQ126, 129–130; Ev. p 55. For example traffic figures for November were Heathrow 13 per cent down, Gatwick 20 per cent down, Stanstead 7 per cent up, Leeds Bradford International 26 per cent down, Newcastle 17 per cent down, Birmingham 4.7 per cent down, Manchester 11 per cent down. In Scotland and the Republic of Ireland passenger numbers increased in November. At Gatwick airport passenger numbers for November were European scheduled down 8 per cent, European charter down 3 per cent, North Atlantic down 26 per cent, and other long haul down 13 per cent.

⁵⁰ Ev. p 100.

⁵¹ Ev. pp 134–135.

Job losses

21. There have been substantial numbers of job losses, possibly as many as 20,000, throughout the air transport industry, support industries and the industry's supply chain.⁵² Scheduled airlines such as British Airways, Virgin and bmi British Midland all announced job losses and attributed them to the events of 11 September.⁵³ The Transport and General Workers Union referred to a total of about 11,000 jobs lost throughout the air transport industry, and more than 12,500 jobs lost in industries that are partly or wholly reliant on air transport.⁵⁴ The union considered all the job losses in ground handling, catering, refuelling, and support service companies to be a consequence of reduced airline services following 11 September.⁵⁵ In aerospace manufacture, 7,000 redundancies have been announced.⁵⁶ The Minister confirmed that the Government would take action if it perceived large numbers of highly skilled manufacturing jobs being lost. He observed that "sadly ... a lot of the people who have lost their jobs in these circumstances are often people with low skills".⁵⁷ **The events of 11 September had implications throughout the air transport industry, including general aviation and ground service providers. We recommend that the Government bring forward firm proposals to guard against the permanent loss of highly skilled jobs and personnel in the industry.**

Air Traffic Control

22. Air traffic control revenues were drastically affected by the reduced traffic (see Figure 3) and the use of smaller aircraft since 11 September, particularly on trans-Atlantic routes, which generate 44 per cent of National Air Traffic Services' income.⁵⁸ Since concluding this inquiry, the Transport Sub-Committee has taken further evidence on the finances of National Air Traffic Services and the additional funding provided by the Government. We shall report our conclusions in due course.

⁵² QQ 284, 294. The Transport and General Workers Union referred to job losses in catering firms: Lufthansa Skychef 193 jobs, Gate Gourmet 320 jobs, Alpha 65 jobs; ground handling: Aviance 270 jobs, Service Air 414 jobs, Ground Star 20 jobs.

⁵³ Ev. pp 136–137; QQ 193–194, 285.

⁵⁴ Q 284; Ev. p 106. The Transport and General Workers Union referred to 6,373 job losses in engineering, 3,000 in tourism, 1,750 in travel firms, 1,010 in airport support services, and 540 in the hotel industry.

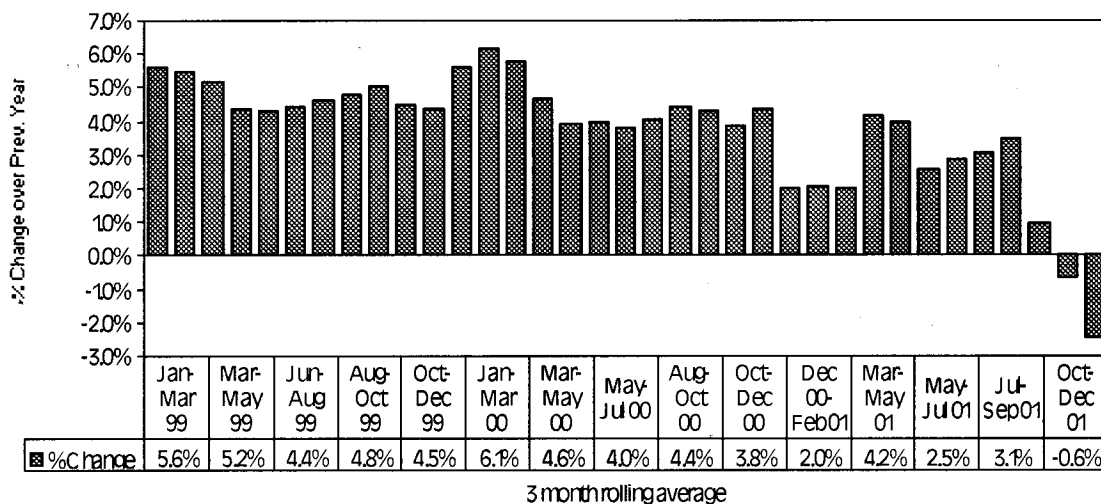
⁵⁵ Q 285.

⁵⁶ Ev. p 48. For example, Airbus, the European aircraft manufacturer plans to cut the equivalent of 6,000 full-time jobs, including 1,200 to 1,500 in the United Kingdom. The company has had 101 orders cancelled since 11 September, 90 per cent of which could be attributed to 11 September, *Airbus to cut 6,000 jobs as orders fall*, The Daily Telegraph, 18 January 2001.

⁵⁷ Q 376.

⁵⁸ QQ 191, 201, 204, 206, 219, 265, 357–358. North Atlantic routes constitute 14–16 per cent of NATS' traffic, but provides 44 per cent of its income, Ev. pp 55, 88, 99.

**Figure 3: Air Transport Movements at All UK Airports -
% Change over Previous Year**



Source: CAA

23. Without prejudice to the findings of our separate inquiry into NATS finances, we find it remarkable that the Department had not prepared a contingency plan for NATS going into administration or receivership.⁵⁹

⁵⁹ HC Deb, 30 January 2002, col 327w.

III. Long-term prospects for the United Kingdom air transport industry

24. The events of 11 September provided the “catalyst” for the air transport industry to rectify some of its fundamental problems.⁶⁰ Mr Jamieson told the Sub-Committee that the Government had a role to play in restoring the industry, including “maintaining the confidence of the travelling public, overseeing the safety and security arrangements and ... making sure with our European colleagues the framework for fair competition for the airlines”. He also stressed that the Government should not “buck the market place”, or “artificially try and boost demand”.⁶¹

Duration of the downturn

25. The duration of the current downturn has been forecast by comparison with previous serious events such as the Falklands and Gulf wars, although many in the industry believe the present situation to be of a different order due to the unequivocal use of aircraft as instruments of terror and the open-ended nature of the ‘conflict’.⁶² The evidence that we received predicted that it would take between one and two years for the industry to recover to previous traffic levels.⁶³ There was greater optimism about an early recovery in domestic and short-haul markets, and there have even been signs of recovery on North Atlantic routes.⁶⁴ **The evidence that we received at the beginning of this inquiry about the duration of the current downturn seems to have been pessimistic. We welcome signs of recovery that suggest that in the absence of another incident traffic levels could recover within the two years forecast by the more pessimistic analysts, although we do recognise that the recovery in traffic may have been achieved with some dilution of revenue.**

Government financial support

26. The United States and United Kingdom Governments and the European Commission have all announced measures to help the industry. The United States introduced the largest and most comprehensive package, which encompassed compensation, insurance, security and loan guarantees. In the United Kingdom, the Government provided insurance cover, and a compensation scheme was announced for losses incurred during the period of closed airspace. The European Commission agreed that compensation and insurance assistance could be provided and agreed to a suspension of the ‘use it or lose it’ rule.

The United States Air Transportation Safety and Stabilization Act

27. The Air Transportation Association of America (ATA) estimated the total loss to the industry in the United States for September directly attributed to the attacks to be \$5 billion.⁶⁵ On 22 September 2001, Congress passed the Air Transportation Safety and Stabilization Act, which provided financial assistance in two main ways.

- \$5 billion in compensation to air carriers for direct and incremental losses incurred as a result of the 11 September attacks.
- up to \$10 billion in loan guarantees to air carriers.⁶⁶

⁶⁰ Q 228.

⁶¹ Q 314.

⁶² Q 101; Ev. p 84.

⁶³ QQ 100, 127.

⁶⁴ Ev. pp 100, 102; HC Deb, 7 February 2002, cols 1104W–1105W; *EasyJet and Go zoom ahead*, The Daily Telegraph, 8 February 2002; see also Q 229.

⁶⁵ Letter of Carol Hallett, President and CEO ATA, Regarding allegations of fare subsidisation. See also Testimony of the Air Transport Association on the Financial Condition of the Airline Industry, www.airlines.org/public/testimony/display2.asp?nid=1332.

⁶⁶ Air Transportation Safety and System Stabilization Act, Public Law 107–42—Sept. 22, 2001, section 101 (a) (2); US Department of State press notice, 25 September 2001; Ev. p 50.

The Act also provides assistance for increases in insurance and security costs.⁶⁷ According to the ATA, “neither cash grants nor the loan guarantees constitute government subsidies”.⁶⁸ In return for the risk assumed by the Federal Government in making the loan guarantees, airlines are required to provide warrants or other equity instruments.⁶⁹

The European response

28. The European Commission has said that member states’ Governments may compensate airlines for losses resulting directly from the four-day closure of American airspace, but may not provide aid in respect of financial difficulties that pre-date the attacks.⁷⁰ The Commission is also recommending a flexible application of the rules on slots and the suspension of the ‘use it or lose it’ rule, which requires airlines to use a slot 80 per cent of the time in order to retain their ‘grandfather rights’ for that slot in the next equivalent scheduling season. The Commission has agreed to suspend the ‘use it or lose it’ rule for the winter 2001–02, summer 2002 and winter 2002–03 seasons.

29. British Airways released slots for winter 2001–02, but sought to retain its grandfather rights to those slots.⁷¹ bmi British Midland was concerned that some of its European competitors enjoyed “a more ‘understanding’ relationship with their own national authorities” and called for a clear and unambiguous suspension of the rules for all airlines.⁷² **Although we accept the rationale for waiving the ‘use it or lose it’ rule, the Government should firmly resist implementing any further European Union directives on slot allocation that are inappropriate to the United Kingdom’s needs and circumstances.**

The United Kingdom’s compensation package

30. The United Kingdom Government announced up to £40 million of financial assistance to compensate airlines for losses due to air space closure arising directly from the 11 September terrorist attacks.⁷³ Those compensation arrangements comply with the measures announced by the European Commission that allow for aid “to make good the damage caused by ... exceptional occurrences”.⁷⁴ The Civil Aviation Authority expressed some reservations about the industry receiving subsidies from central Government, although it did not “disagree strongly” with the compensation package.⁷⁵

Maintaining the United Kingdom’s competitive position

31. The long-term competitive position of the United Kingdom’s air transport industry depends on the outcome of major structural questions now being considered in this country, the European Union and the United States. We consider those issues briefly in this Report and will return to them in our forthcoming inquiry into the Aviation White Paper. It is imperative that the United Kingdom continues to provide “a very competitive and very

⁶⁷ Air Transportation Safety and System Stabilization Act, Public Law 107–42—Sept. 22, 2001, sections 201 (a) (3), 201 (b) (2); section 501; Letter of Carol Hallett, President and CEO ATA, Regarding allegations of fare subsidisation; FAA APO Aviation Insurance Program, www.api.faa.gov/911Policies/InsCover.html.

⁶⁸ Letter of Carol Hallett, President and CEO ATA, Regarding allegations of fare subsidisation.

⁶⁹ Regulations for Air Carrier Guarantee Loan Program; United States Department of the Treasury, press release, PO-666, 5 October 2001, *Regulations issued for air Carrier Loan Guarantee Program*.

⁷⁰ The European Commission approved a one-month bridging loan of euro 125 million to Sabena from the Belgian Government on 17 October 2001. The French Government proposed to grant euro 55 million in emergency aid to French airlines. In Switzerland a complex financial package was put together following the collapse of Swissair, including euro 650 million of direct aid from the Swiss federal and Canton Governments. HC Deb, 12 February 2002, col 223 W.

⁷¹ QQ 266–269.

⁷² Ev. p 137.

⁷³ QQ 365, 327; HC Deb, 13 December 2001, cols 1013–1014 W.

⁷⁴ Ev. pp 176–177.

⁷⁵ Q 242; Ev. p 54.

wide range of air travel products".⁷⁶ The rescue package will mitigate the immediate difficulties, but some in the industry believe that the level of assistance granted to the airlines in the United States may have prejudiced the ability of United Kingdom airlines to compete.⁷⁷ The United Kingdom Government was not consulted before that assistance package was put in place.⁷⁸ Many witnesses considered the discrepancy in the assistance being offered and the scale and scope of the United States Government's assistance to represent state aid that provided the industry in America with an unfair advantage.⁷⁹ Sir Roy McNulty told the Sub-Committee that the Civil Aviation Authority would "watch very carefully", and "monitor" the situation.⁸⁰ **The Committee considers the United States compensation package to have provided an unfair advantage to US carriers. It is imperative that the United Kingdom Government ensure that the competitive balance between US and UK carriers is restored.**

International agreements

32. At present, United Kingdom—United States bilateral negotiations on open skies have stalled, although the Government has said that it remains "committed to achieving the full and genuine liberalisation of the UK/US aviation market".⁸¹ The Department's "nirvana" would be "a full and fair liberalised market between us and the United States ... either/or with both cabotage ... and/or waving their controls over ownership and control of US carriers".⁸² The Government's approach, "pending nirvana" would be to gain access to the United States domestic market through alliances, the conditions attached to which would have to be acceptable to the competition authorities and the carriers involved.⁸³ The *quid pro quo* for such alliances "would be access to Heathrow [where] slots ... are available and can be made available", although not guaranteed access to such slots.⁸⁴ However, there is no evidence to show how the slot situation would be resolved without the loss of other routes into Heathrow and Gatwick, or placing regional routes at particular risk. We received evidence from Airport Coordination Limited which confirmed that the requests for slots at Heathrow and Gatwick, particularly for Summer 2002, still exceeded those available by a substantial margin.

33. The European Commission has a vision of a Trans-Atlantic Common Aviation Area, with the European Commission negotiating directly with the United States. The Government said: "The UK has no policy that air services agreements which it concludes with the US, or indeed with any other country, should be subject to review by the European Court or the European Commission."⁸⁵ However, the Government is a "strong supporter" of the Single European Sky, which it believes will overcome delays and congestion caused by structural problems in Europe's Air Traffic Management system.⁸⁶

34. The Government must ensure that any future international aviation agreements maintain the competitive position of United Kingdom carriers. However, the Government should not make concessions to United States airlines in receipt of US State Aid, merely to hasten the signing of a new US UK bilateral on open skies. The Minister confirmed that there would be no agreement unless the United States made

⁷⁶ QQ 62, 64.

⁷⁷ QQ 68–70.

⁷⁸ QQ 317–321.

⁷⁹ QQ 217, 276, 308, 327; Ev. pp 107, 121, 166.

⁸⁰ QQ 272–274.

⁸¹ HC Deb, 4 February 2002, col 728W; see also HC Deb, 17 January 2002, col 423W and HC Deb, 15 April 2002, col 704W.

⁸² QQ 341–342.

⁸³ QQ 345, 367–368.

⁸⁴ QQ 345, 347–348, 350–351.

⁸⁵ HC Deb, 4 February 2002, col 728W.

⁸⁶ HC Deb, 19 March 2002, col 231W.

concessions that were advantageous to the United Kingdom.⁸⁷ Despite the importance of the issues of open skies, cabotage, wet leasing and foreign ownership, the Department was not negotiating on those issues because they would make it impossible to reach agreement within the desired timetable.⁸⁸ **This Committee believes that the bilateral agreements on open skies must include progress on the critical issues of open skies, cabotage, wet leasing and ownership. As we concluded in our July 2000 Report into *Air Service Agreements between the United Kingdom and the United States*, it is imperative that the Government maintain its efforts to agree beneficial aviation bilateral agreements with the United States.**⁸⁹

Consolidation and Restructuring

35. Airlines have an appetite for consolidation to reduce costs, despite a lack of evidence that size improves performance, removes overcapacity or enables airlines to escape the cyclical nature of the industry.⁹⁰ The experience of United States and United Kingdom low-cost carriers, which have by and large grown organically, suggests that management competence and improved use of resources and capital assets have a greater impact on profitability than consolidation and operating from congested hub airports.

36. The British Air Transport Association considers “international consolidation” to be the way forward. Current rules on ownership for international airlines largely prohibit such consolidation.⁹¹ bmi British Midland supported the abolition of “all restrictions on ownership and control of UK airlines”.⁹² The Civil Aviation Authority and many airlines share that view.⁹³ **We remain to be convinced by arguments in favour of changes to the rules of ownership or that consolidation will bring benefits to the industry or consumers. The Government should be cautious about changes to the rules of ownership that would allow unfettered consolidation within the industry. We recommend that the relevant competition authorities give rigorous scrutiny to any further moves towards consolidation of the United Kingdom airline industry.**

Slot allocation

37. Slot allocation at European airports is governed by European Regulation 95/93. The Government is currently consulting the industry on the Commission’s proposals to amend those regulations, which were issued before 11 September.⁹⁴ The availability of slots, particularly at Heathrow and Gatwick, is crucial to the industry’s future development. We received conflicting evidence about changes in the availability of slots at major airports following the attacks on 11 September.⁹⁵ Despite the reductions in routes, there has been no significant increase in the numbers of free slots at either Heathrow or Gatwick. Evidence from BAA states that since 11 September British Airways have stopped flying twenty routes from Gatwick and plan to stop a further six routes in the summer of 2002.⁹⁶ Slots for peak periods and premium routes remain scarce.⁹⁷ As the industry recovers trading in slots is likely to increase. Demand will continue to outstrip supply, and new

⁸⁷ QQ 343–344.

⁸⁸ Q 367.

⁸⁹ Eighteenth Report of the Environment, Transport and Regional Affairs Committee, *Air Service Agreements Between the United Kingdom and the United States*, HC (1999–2000) 532.

⁹⁰ Q 261.

⁹¹ QQ 4, 16; Ev. pp 50–51.

⁹² Ev. p 138.

⁹³ QQ 259–260.

⁹⁴ HC Deb, 15 April 2002, col 739W.

⁹⁵ QQ 72–76, 235; Ev. pp 55, 129, 151–152.

⁹⁶ Ev. p 172.

⁹⁷ QQ 111, 183; HC Deb, 30 January 2002, col 326W.

entrants will have difficulty in becoming established at major hub airports.⁹⁸ However, BAA was keen to highlight the benefit of attracting low-cost carriers to Gatwick.⁹⁹

Regional air services

38. The Government accepts that regional air services are socially and economically vital for the United Kingdom's remoter regions.¹⁰⁰ Regional slots can be protected, or "ring-fenced", through designation as Public Service Obligations.¹⁰¹ The Minister told us that the Government considered the present availability of slots to be sufficient to preclude the need to intervene to ensure the protection of regional air services.¹⁰² Nevertheless, we were assured that the Government was aware of the importance of regional air services and had, for example, listened "very, very carefully to the argument ... put forward for protecting their slots from Inverness to Gatwick".¹⁰³ The Government has confirmed in a written answer that any changes to the "rules for imposing public service obligations will need to be agreed at the European level".¹⁰⁴

39. The Minister's optimism may be misplaced. British Airways, the largest regional operator in the United Kingdom, withdrew the important Heathrow-Belfast route immediately after the events of 11 September even though it had served the route for fifty years, although the company expressed the intention to continue to serve the regions.¹⁰⁵ It claimed to have done so because it had been losing money on the route for several years.¹⁰⁶ However, Mr Nicol of easyJet told the Sub-Committee that his company's Belfast route was "highly profitable".¹⁰⁷ TBI plc, which owns three United Kingdom airports, including Belfast, criticised the British Airways' decision, saying: "The slots at Heathrow used for this route were not offered to other carriers prepared to operate the route but have been handed over to non-vital holiday routes from Gatwick in order to keep them 'warm' for BA".¹⁰⁸

40. The present situation has strengthened arguments in favour of Public Service Obligations to ensure the continuity of vital regional links with Heathrow and Gatwick. We recommend that the Government ensure that slot allocation at the main London airports be consistent with its aims of ensuring access to the United Kingdom's peripheral regions as regional air services are "socially and economically vital to the regions". Prior to the availability of any additional runways in the south east, we believe the Government must adopt Public Service Obligation protection for the most vital links to the United Kingdom regions. This is a widely established policy within the European Union. We do not see or anticipate any European regulatory impediment to securing such slot protection. We are aware that some airlines and airport operators may be against the use of such designation at congested hub airports but the needs of the United Kingdom regions should have priority.

⁹⁸ QQ 170, 183, 185.

⁹⁹ Ev. p 172.

¹⁰⁰ Q 354; *Air Transport Consultation Document*, Department for Transport, Local Government and the Regions, December 2000, p 34, para 118.

¹⁰¹ QQ 264, 354.

¹⁰² Q 353.

¹⁰³ QQ 354, 353. See also HC Deb, 11 April 2002, col 505W, the Government expects to announce shortly its decision on the Scottish Executive's request for a Public Service Obligation to be imposed on Inverness-Gatwick air services.

¹⁰⁴ HC Deb, 21 March 2002, col 493W.

¹⁰⁵ Q 110.

¹⁰⁶ QQ 28-30.

¹⁰⁷ Q 33.

¹⁰⁸ Ev. p 71.

Infrastructure

41. The industry remains convinced of the importance of developing infrastructure in the medium term in order to provide additional airport capacity, particularly in the south east.¹⁰⁹ Airport owners and operators are responsible for developing and pursuing plans to increase airport capacity. Such plans are subject to the full gamut of planning legislation and consultation. Airport operators are unlikely to pursue the costly exercise of planning to expand capacity or build additional runways without a firm policy for increasing airport capacity from the Government.¹¹⁰ **The Sub-Committee intends to consider aviation infrastructure and capacity requirements when it conducts its inquiry into the Aviation White Paper.**

Air Travel Trust

42. The CAA manages the Air Travel Organisers' Licensing scheme, which protects holiday makers from being stranded or losing money as a result of tour operator failure. The Authority is concerned that the Air Travel Trust Fund, which acts as a back-up to bonds provided by licensed tour operators, is exhausted. The Fund had a deficit of £8.96 million at the end of 2000, which was underwritten by an overdraft of approximately £10 million, which is guaranteed by the Government.¹¹¹ The Air Travel Insolvency Protection Advisory Committee, which was set up by the Secretary of State to advise on financial protection arrangements for air travellers and customers of air travel organisers, is "deeply concerned that the annual interest burden is more than double the amount required to meet the year's passenger claims", and maintains that "allowing the Trust Fund to remain in deficit is detrimental to the protection system for air travellers and the delay in putting in place long term arrangements is wholly unsatisfactory".¹¹² The CAA, supported by the travel industry, is lobbying the Government to allow the levy of an additional charge to replenish the fund.¹¹³ Since 1991, successive Governments have promised to make Parliamentary time available to introduce the necessary legislation. However, no legislation has been proposed yet. The Minister confirmed in evidence that primary legislation would be required, and that a draft Bill was being prepared.¹¹⁴ **The Committee is concerned that the Air Travel Reserve Fund should be maintained at a sufficient level and calls on the Minister to bring forward legislation providing for that at the earliest opportunity.**

¹⁰⁹ QQ 128, 166; Ev. p 167. BAA state that "Terminal 5 would secure Heathrow's status as the world's leading international airport, reinforce its vital role in the UK economy, and help meet people's expectations to fly in the most efficient and environmentally acceptable way". *BAA Issue brief: Terminal 5*, BAA, September 2001.

¹¹⁰ QQ 171–173.

¹¹¹ Q 355.

¹¹² *Report of the Air Travel Insolvency Protection Advisory Committee 31 March 2001*, Civil Aviation Authority, July 2001.

¹¹³ QQ 243–247; Ev. pp 92, 147–148, 150–151.

¹¹⁴ QQ 355–356; HC Deb, 15 January 2002, col 210W.

IV. List of Conclusions and Recommendations

- (a) **We expect to see firm proposals for the future of aviation in the forthcoming Aviation White Paper, which is due to be published in the autumn of 2002. We are concerned that the timetable for the White Paper has already slipped (paragraph 2).**
- (b) **The air transport industry is cyclical and susceptible to downturns in the economy. Since 2000, there have been signs of a general slowdown in the global economy that led to fewer passengers and less money for investment in the industry. Many sectors of the United Kingdom's air transport industry were, therefore, already experiencing a significant reduction in business even before the terrorist attacks in the United States. There has been a marked contrast in reaction by the various industry sectors in responding to that reduction in business. The low-cost sector appears to have been the most successful in generating traffic and improving profitability by exploiting new markets and, in some cases, use of secondary airports while restraining costs (paragraph 8).**
- (c) **We do not support long-term public assistance for the additional security costs incurred by the air transport industry as a result of 11 September (paragraph 11).**
- (d) **We condemn the hasty manner in which the insurance industry withdrew cover for aviation following the terrorist attacks and welcome the Government's prompt and appropriate action in implementing short-term measures to ensure continuity of essential insurance cover. The Department should provide a report on progress towards a return to a wholly commercial insurance market, and an indication of its view on long-term solutions to providing war risk and terrorism liability insurance cover for the air transport industry. We recommend that the Treasury publish figures on the amount of money it has received from the industry by way of premia and explain what it intends to do with the money (paragraph 14).**
- (e) **The immediate impact on airlines of the 11 September attacks was severe, particularly for those providing premium services to the United States. But there is no compelling evidence to suggest that there will be a medium to long-term reduction in passenger confidence in aircraft safety and security. In the past, passengers have adjusted to the imposition of more stringent security regulations and are unlikely to find difficulty in doing so again. We do not anticipate that the latest security requirements will have an adverse impact on the market for air travel (paragraph 19).**
- (f) **There is no doubt that, even though passenger confidence is recovering, times are tough for the air transport industry. We do not consider it appropriate to increase either the regulatory burden or the costs to any sector of the air transport industry now. We recommend that the CAA seek to postpone the introduction of any proposed increases in charges at regulated airports that may result from its recent review (paragraph 20).**
- (g) **The events of 11 September had implications throughout the air transport industry, including general aviation and ground service providers. We recommend that the Government bring forward firm proposals to guard against the permanent loss of highly skilled jobs and personnel in the industry (paragraph 21).**

- (h) Without prejudice to the findings of our separate inquiry into NATS finances, we find it remarkable that the Department had not prepared a contingency plan for NATS going into administration or receivership (paragraph 23).
- (i) The evidence that we received at the beginning of this inquiry about the duration of the current downturn seems to have been pessimistic. We welcome signs of recovery that suggest that in the absence of another incident traffic levels could recover within the two years forecast by the more pessimistic analysts, although we do recognise that the recovery in traffic may have been achieved with some dilution of revenue (paragraph 25).
- (j) Although we accept the rationale for waiving the 'use it or lose it' rule, the Government should firmly resist implementing any further European Union directives on slot allocation that are inappropriate to the United Kingdom's needs and circumstances (paragraph 29).
- (k) The Committee considers the United States compensation package to have provided an unfair advantage to US carriers. It is imperative that the United Kingdom Government ensure that the competitive balance between US and UK carriers is restored (paragraph 31).
- (l) The Government must ensure that any future international aviation agreements maintain the competitive position of United Kingdom carriers. However, the Government should not make concessions to United States airlines in receipt of US State Aid, merely to hasten the signing of a new US UK bilateral on open skies (paragraph 34).
- (m) This Committee believes that the bilateral agreements on open skies must include progress on the critical issues of open skies, cabotage, wet leasing and ownership. As we concluded in our July 2000 Report into *Air Service Agreements between the United Kingdom and the United States*, it is imperative that the Government maintain its efforts to agree beneficial aviation bilateral agreements with the United States (paragraph 34).
- (n) We remain to be convinced by arguments in favour of changes to the rules of ownership or that consolidation will bring benefits to the industry or consumers. The Government should be cautious about changes to the rules of ownership that would allow unfettered consolidation within the industry. We recommend that the relevant competition authorities give rigorous scrutiny to any further moves towards consolidation of the United Kingdom airline industry (paragraph 36).
- (o) The present situation has strengthened arguments in favour of Public Service Obligations to ensure the continuity of vital regional links with Heathrow and Gatwick. We recommend that the Government ensure that slot allocation at the main London airports be consistent with its aims of ensuring access to the United Kingdom's peripheral regions as regional air services are "socially and economically vital to the regions". Prior to the availability of any additional runways in the south east, we believe the Government must adopt Public Service Obligation protection for the most vital links to the United Kingdom regions. This is a widely established policy within the European Union. We do not see or anticipate any European regulatory impediment to securing such slot protection. We are aware that some airlines and airport operators may be against the use of such designation at congested hub airports but the needs of the United Kingdom regions should have priority (paragraph 40).

- (p) **The Sub-Committee intends to consider aviation infrastructure and capacity requirements when it conducts its inquiry into the Aviation White Paper (paragraph 41).**
- (q) **The Committee is concerned that the Air Travel Reserve Fund should be maintained at a sufficient level and calls on the Minister to bring forward legislation providing for that at the earliest opportunity (paragraph 42).**

**PROCEEDINGS OF THE TRANSPORT SUB-COMMITTEE
RELATING TO THE REPORT**

WEDNESDAY 19 JUNE 2002

Members Present:

Mrs Gwyneth Dunwoody, in the Chair

Andrew Bennett
Mr Gregory Campbell
Mr Brian H Donohoe
Mrs Louise Ellman

Chris Grayling
Helen Jackson
Mr Bill O'Brien
Dr John Pugh

The Sub-Committee deliberated.

Draft Report [*Air Transport Industry*] proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 and 42 read and agreed to.

Resolved, That the Report be the Fourth Report of the Sub-Committee to the Committee.—(*The Chairman.*)

Ordered, That the Chairman do make the Report to the Committee.

[Adjourned till Wednesday 26 June at a quarter to Four o'clock

PROCEEDINGS OF THE COMMITTEE RELATING TO THE REPORT

WEDNESDAY 26 JUNE 2002

Members Present:

Mrs Gwyneth Dunwoody, in the Chair

Andrew Bennett
Mr Clive Betts
Mr Gregory Campbell
Mr Brian H Donohoe
Mrs Louise Ellman

Chris Grayling
Miss Anne McIntosh
Mr Bill O'Brien
Mr George Stevenson

The Committee deliberated.

Report from the Transport Sub-Committee [*Air Transport Industry*] brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 and 42 read and agreed to.

Resolved, That the Report be the Eleventh Report of the Committee to the House.—(*The Chairman.*)

Ordered, That the Chairman do make the Report to the House.

Ordered, That the Appendices to the Minutes of Evidence taken before the Transport Sub-Committee be reported to the House.

[Adjourned till Monday 1 July at half past Four o'clock.]

LIST OF WITNESSES

Wednesday 19 December 2001

BRITISH AIR TRANSPORT ASSOCIATION

Mr Roger Wiltshire, Mr Bob Parker-Eaton, Mr Andrew Cahn
and Mr Barry Humphreys

EASYJET

Mr Toby Nicol

AIRPORT OPERATORS ASSOCIATION

Mr Ed Anderson, Mr Mike Toms and Mr Keith Jowett

BRITISH AIR LINE PILOTS ASSOCIATION

Dr John McGurk and Mr Roger Kline

PROSPECT

Mr Ian Findlay and Mr Robin Morris

Wednesday 9 January 2002

CIVIL AVIATION AUTHORITY AND MR CHRIS TARRY

Sir Roy McNulty, Mr Bob Cotterill and Captain Michael A Vivian
Mr Chris Tarry

TRANSPORT AND GENERAL WORKERS UNION

Mr Tim Lyle and Mr Roger Sealey

DEPARTMENT FOR TRANSPORT, LOCAL GOVERNMENT AND THE REGIONS

Mr David Jamieson MP, Mr Ian Devlin and Mr Roy Griffins

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- 02 Neil Shaw Esq
- 03 Society of British Aerospace Companies
- 04 Boeing
- 05 British Cargo Airline Alliance
- 06 Friends of the Earth
- 07 Civil Aviation Authority
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Second Report: London Underground (HC 387)

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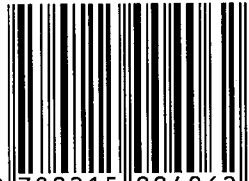
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Ninth Report: Road Traffic Speed (HC 557-I)

Tenth Report: Ordnance Survey (HC 481)

Eleventh Report: Air Transport Industry (HC 484-I)

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