



Response to the CAA Q6 Policy Consultation

July 2012

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Introduction

The Heathrow Airline Operators Committee (AOC) and the London Airports Consultative Committee (LACC) of the International Air Transport Association (IATA) welcome the opportunity to respond to the CAA consultation on Q6 Regulatory Review policy issues.

The AOC and LACC are industry bodies which represent the operational and strategic interests of airlines operating at Heathrow Airport. Therefore, this response is a joint response and is with reference only to the Q6 regulatory policy issues as related to Heathrow Airport Limited (HAL).

The AOC and LACC welcome the clarity of structure in the CAA consultation and this response is set out as answers to the specific questions highlighted by the CAA.

However, before answering the questions posed by the CAA, we believe it is worth highlighting a number of areas of importance to the AOC and LACC. These are:

- We welcome the focus of the CAA on passenger interests. In the competitive environment in which the airlines operate the success (or not) of their business depends on the extent to which they meet the needs of their customers – the passengers. Therefore, the interests of the airlines and passengers at Heathrow are aligned.
- The main objective for our member airlines for the Q6 Regulatory Review is the achievement of an affordable settlement which provides the services and infrastructure required by the airlines in a manner which represents value for money and is affordable. The annual price cap increases in the Q5 Regulatory period borne by airlines and their passengers are not sustainable.
- We believe it is important to draw a distinction between the calendar years of the Q6 Period (April 2014 – March 2019) and the Q6 Regulatory Review. In our view the Q6 Period represents the period in which stakeholders will be engaging to undertake air transport services at Heathrow Airport. The Q6 Regulatory Review represents the process through which the CAA will establish a price cap designed to remunerate HAL for the services and facilities it is agreed that will be provided by HAL in the Q6 Period.

We welcome the work being undertaken by all parties in the current Constructive Engagement phase of the Q6 Regulatory Review and remain committed to this and the subsequent stages of the process set out by the CAA.

If there are areas of this consultation response which the CAA would wish to discuss further with the AOC or IATA please contact.

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General Secretary
Heathrow AOC

or

Mark Gardiner
Chairman LACC

1.0 Question 1 – How should the CAA Develop a Strategy for Airport Licencing?

We welcome the introduction by the CAA of an airport licence regime for Heathrow Airport. In order to facilitate the optimal development of the Licence we believe it will be important for the CAA to continue its evolutionary approach to the development of the licence. And to do it a manner which provides as much information as possible at an early stage of what will be contained in the licence. Such an approach will facilitate maximum industry input which we believe would be beneficial, in the long-term, for the development of the licence.

We note and welcome the indication by the CAA that the licence cannot be used to bind or control the actions of third parties over which the licensee has no control or influence.

We welcome the indication by the CAA that the development of the licences will be subject to extensive stakeholder discussion and consultation. Also, if modifications to the Licence are suggested in the future, we believe there should be provision for these to be subject to appeal to the Competition Commission (CC) by all stakeholders with an interest in the proposed modifications.

We look forward to engaging with the CAA on the development of the airport licence for HAL as such a consultative process will be key to furthering the interests of both the current and future airport users and passengers.

2.0 Question 2 – How can the CAA ensure that its review of economic regulation is passenger-focused?

We welcome the commitment of the CAA to ensure that passengers benefit from better aviation experiences and journeys. We and our member airlines share this commitment. We are also aware that our members operate in an extremely competitive environment which benefits their customers – the passengers. This is not the case for HAL which possesses substantial market power requiring regulation to ensure that this market power is not exercised to the detriment of the airlines and passengers.

The Q6 Review and the wider passenger experience

The CAA has highlighted that the airport section of a passenger journey is only a part of the overall passenger experience. We recognise this as a point well made. Therefore, we believe it is important to maintain a distinction between two important dimensions of pursuing the interests of passengers. These are:

- Work being undertaken in the Q6 Regulatory Review of HAL, and
- Work associated with improving the overall passenger experience – with specific (but not exclusive) emphasis on the period 2014 – 2019 (the Q6 period)

In more detail, we see the Q6 Review as the work currently being led by the CAA in the Q6 Regulatory Review to determine the services & facilities to be provided by HAL, the quality of those services & facilities and the appropriate level of price cap. This work has a natural immediacy and priority as it must be undertaken within the time constraints of the CAA led Q6 Regulatory Review of HAL.

In our view the overall passenger experience work is a wider exercise involving a comprehensive range of stakeholders which engage with passengers throughout their overall journey. Such a piece of work deserves specific attention to maximise the opportunity it presents for considering the overall interests of passengers.

It is useful to be cognisant of both workstreams concurrently. However, the two workstreams are quite distinct and require specific approaches to address them. The Q6 Review focuses on ensuring the substantial market power of one supplier in the passenger experience is regulated in a way which ensures the interests of passengers are protected and promoted. In contrast, the overall passenger experience work includes the requirement for a multi-stakeholder consideration of how to promote the interests of passengers within a mix of companies operating in a competitive environment, government agencies and regulated industries. Therefore, we believe a significant opportunity to maximise the passenger benefits from both workstreams could be missed if stakeholder resources and attention were to be concurrently split between the two workstreams.

We believe, therefore, that a specific way to ensure the Q6 Review is passenger focussed is for the CAA to concentrate their resources on the objective of the review – the

establishment of a regulatory settlement on HAL to ensure that its substantial market power is not leveraged against the public interest.

Alignment of passenger and airline interests

We welcome the indication by the CAA that its working rebuttable assumption is that the interests of airlines and passengers are often aligned. In our experience this is the case. The CAA has highlighted a number of areas where the interests of passengers and airlines may not align. These include; the needs of future passengers, arriving passengers and disrupted passengers. In our experience the interests of passengers are still to the forefront of airline consideration in these circumstances. This is evidenced firstly, by the significant amounts of time that are devoted by senior airline planners in the development of Heathrow in seeking to ensure that future airport developments are those best suited to meeting future passenger needs. Secondly, the airlines recognise that their contract with a passenger includes reuniting arriving passengers with their baggage – passengers are not disregarded once they disembark an aircraft. Therefore, airlines commit significant resources and time to ensuring this can be done efficiently and consistently. The airlines are especially cognisant of the fact that they rely heavily on the infrastructure provided by HAL to do this and therefore fund substantial investment projects to improve this aspect of their operations and the experience of passengers in this area. Lastly, in times of disruption the airlines recognise and devote significant resources (people and money) into ensuring the interests of passengers are promoted.

Therefore, a way to ensure that the Q6 Review is passenger focused is to specifically canvass the views of the airlines on the needs of their passengers from the services and facilities provided by HAL.

The Service Quality Rebate scheme

The Service Quality Rebate (SQR) scheme developed and implemented by the CAA in Q4 as a remedy to a public interest finding by the Competition Commission has led to improvements in the quality of services and facilities provide by HAL. The SQR scheme was then improved by the CAA for Q5 with a further commensurate improvement in the quality of services provided by HAL. We believe an opportunity exists for the CAA to ensure the Q6 Review is passenger focussed by maintaining and developing the SQR scheme's focus on the services and facilities provided by HAL – the only company in the supply of services to passengers with substantial market power which requires service quality regulation as well as price cap regulation.

Identification of key passenger priorities

We believe the CAA is correct in highlighting that a key factor in ensuring that the Q6 Review is passenger focused is through identification of the key passenger priorities and

requirements from the services and facilities provided by the airport. In our view there are four key ways to identify passenger priorities. These are:

- i) The CAA's own research of passenger priorities
- ii) The extensive passenger needs research undertaken by the airlines
- iii) The passenger research undertaken by HAL, and
- iv) Seeking the input of passenger representative groups.

Work has already been undertaken in all 4 of these areas through the Service Quality Group in Constructive Engagement and we look forward to continuing to understand the priorities of passengers in order to develop proposals in the Q6 Review designed to meet the needs of passengers.

However, in considering the research on passenger priorities we believe it is worth highlighting a number of points:

- We welcome the indication by the CAA that 'soundness of argument is not necessarily determined by detailed research'. We believe the CAA is correct in being mindful of the fact that not all stakeholders have the resources to undertake detailed research. We welcome the indication by the CAA that it will primarily be 'influenced by the soundness of the argument made, which may be substantiated by other material and not just detailed quantitative research'.
- We believe the CAA is also correct in highlighting the need for robust passenger research. We believe this points to a need for a robust base data set of information as well as robustness of the method of analysing this information.
- We also welcome the recognition by the CAA of the limitation of certain types of passenger panel based research which, due to its method of application, is unable to capture the full spectrum of passenger views.
- Airlines are uniquely placed to understand the passenger experience and the components that make this partly because the market drives us and partly because we can assess the components that the Airport delivers that may not be immediately obvious to the passenger.

We recognise that meeting the needs of their passengers is a priority for our members and look forward to working with all stakeholders in the development of proposals for the Q6 regulatory settlement which protect and promote the interests of passengers.

3.0 Question 3 – How can regulatory incentives towards service quality be improved?

Q4 and Q5 Service Quality Public Interest finding

We believe that in considering the Service Quality Rebate (SQR) scheme it is important to be cognisant of the fact that it was established by the CAA as a remedy to a quality based public interest finding by the CC in the Q4 review. In the Q4 Review the CC recognised that airlines paid airport charges to HAL without any mechanism to judge what level of service or quality from airport facilities the airlines could expect for the charges paid. The CC found that the fact that airlines were not able to make the cost /quality judgements which customers are able to make in competitive markets worked against the public interest. In Q5 the CC found that the same circumstances continued to make it appropriate to retain the public interest finding for the Q5 regulatory settlement. The same circumstances continue to apply and we believe it appropriate for a SQR scheme to be in place for Q6 focused exclusively on measuring the quality provided by the airport in exchange for the charges paid by the airlines.

Base level of airport wide service quality

The SQR scheme provides a base level of service across the airport which airlines and their passengers can expect to receive in exchange for the airport charges paid. In addition to this we believe that airlines (or groups of airlines) should be able to ‘contract up’ with the airport for the provision of services or facilities in addition to those contained in the base-level of services & facilities. We believe it is appropriate for these two dimensions of the SQR to be carried forward into Q6 regulatory settlement.

CAA highlighted potential areas for improving the service quality rebate scheme

We welcome the indication by the CAA that it will undertake an analysis of the current SQR to help identify possible improvements and look forward to engaging with the CAA in the work on this important area of the Q6 Review. Some brief comments are set out below on the areas highlighted by the CAA in considering improvement to the current SQR scheme.

1. Priorities and simplification

The elements in the Q5 SQR were established by the CAA as the elements required to cover the range of services provided by the airport which were critical in the provision of services to passengers and airlines. Whilst it would be useful to consider if these services and facilities contained the SQR are still critical we do not think that a reduction in the number of elements should be an objective in itself. Our current assessment of

passenger and airline service requirements indicates that the current suite of SQR elements should be carried forward into the Q6 regulatory settlement.

If the CAA is of the view that the level of rebates paid may not provide a sufficient incentive on the airport we believe it would be more appropriate to increase the amount of airport charges at risk rather than reduce the number of SQR elements over which the at risk amount of airport charges is spread.

2. Greater flexibility

We recognise the benefits of additional flexibility in the SQR scheme in order to be able to target dimensions of quality which may emerge with increased priority in a regulatory period. However, we recognise the challenge of introducing flexibility and the risk of this working against the simplification aspired to the point 1 above; particularly the need to consider operating and capital cost implications within an established price cap.

3. Strength and balance of financial incentives

A core principle in the SQR scheme established by the CAA was the payments of rebates by HAL to the airlines when levels of quality were below the standards set by the CAA. The rebates are a rebate to the airlines of a portion of the airport charges paid by them. They are specifically not intended to have a punitive function on HAL. The rebates simply recognise that airport charges were paid by the airlines for services which were not delivered as expected, therefore a portion of airport charges are returned to the airlines.

In keeping with this we do not believe the SQR should contain bonuses for the airport for delivery of services above a particular standard. Even though the SQR scheme is based on performance standards of, in most cases, 99% the airlines are actually paying for full service delivery. Therefore we do not think it is appropriate for the airport to be able to earn a bonus for achievement of a level of quality the airlines are already paying for.

We specifically do not think the rebates should be referred to as penalties. This is because penalties carry with them a sense of punitive sanction on the airport as compared to a simple recognition that the services expected in return for airport charges were not delivered by the airport.

In our view the SQR scheme should not contain bonuses or penalties, but rather be simply a rebate based scheme. Such an arrangement would best replicate what would be expected to operate in a competitive environment with respect to supply of goods and services below contracted levels. However, if the CAA was minded to consider bonuses (payments to the airport in addition to airport charges) being available to the airport, then for reciprocity there should be penalty payments (payments to the airlines in addition to rebate payments) at risk for the airport on the elements where bonuses are available to the airport.

4. Balance between passenger facing and airline facing targets

We agree that the distinction between passenger facing and airline facing SQR elements may be a spurious one. Some of the airport services and facilities are provided directly to passengers. Others are provided to airlines in order for them to be able to offer quality services and facilities to passengers. The ultimate objective of the SQR scheme is to maintain levels of quality in the areas which impact on the journey experience of passengers. It would be spurious to make a distinction between passenger facing and airline facing elements in a way implied the application of either had a higher priority based on its target grouping.

5. Balance between objective and subjective measures

We agree with the indication by the CAA that objective measures have the benefit of being transparent, comparable and auditable and that objective measures allow for a robust link between the charges paid by airlines and the quality delivered. This is not the case with passenger perception based, subjective, measures.

We believe any extra effort required to gather objective performance data is more than compensated for by the capacity of the data to measure the actual performance of the services and facilities provided by the airport. The perception of passengers regarding the quality experienced by them can be influenced by many factors outwith the actual performance of the airport. The subjectivity of such measures therefore limits their utility in measuring the performance of the airport for regulatory purposes.

We note that four areas of the current SQR scheme are measured using HAL's in house Quality of Service Monitor (QSM) passenger perception survey. Whilst noting the limitations of such a survey to capture the performance of assets we recognise the difficulties in measuring the dimensions of the SQR listed below outside of a passenger perception methodology:

- Cleanliness
- Departure lounge seat availability (ease of finding a seat)
- Wayfinding, and
- Flight information

However, in order for these passenger perception based measures to most accurately measure the performance of these dimensions of quality we believe the attainment of the standards should be based on the monthly results of the passenger perception surveys rather than a moving annual average which averages the result of each month with the preceding 11 months into an overall average. Such an average further dilutes the ability to measure the actual quality experienced by passengers.

6. Operational resilience

We agree with the CAA that there should be strong incentives on the airport to provide a resilient service to passenger and airlines. However, the CAA should ensure that this is provided efficiently; particularly as the airlines have already provided additional funds to increase the resilience of the airport.

7. Continuous improvement

We agree with the desire of the CAA to see continuous improvement. In fact the development of the SQR scheme by the CAA between Q4 and Q5 enabled a step change in airport quality improvement to be achieved through incentivisation. We believe a similar opportunity exists between Q5 and Q6. This can be achieved not just through the setting of the standards for each element but also by considering the method of measurement and the eradication of averaging in the measurement of asset performance.

We recognise the need for a performance culture vis a vis a compliance culture in HAL but believe this needs to be addressed through HAL management commitment to the interests of passengers rather than simply working to the level of failure ‘allowances’ which are available within the Q5 performance standards. Working to the exact service standards rather than the adoption of a performance culture further evidences HAL’s substantial market power and the absence of an approach to quality that would be evident in a competitive environment.

8. Competitive equivalence

The regulatory settlement for the Q6 period should seek to facilitate the provision of comparable levels of quality across Heathrow airport in order for all airlines to be able to expect similar levels of quality for the common levels of airport charges paid. Any attempt to account for lower levels of quality in specific terminals would further push back the likelihood of comparable services and facilities being provided and unnecessarily complicate the establishment of campus wide regulatory settlement.

Encouraging greater sector wide-wide collaboration

As indicated above we believe the CAA led Q6 regulatory review of Heathrow airport should concentrate on establishing a regulatory settlement which addresses the substantial market power of the airport and the risk that this market power will be abused through increased prices or lower levels of quality.

Nevertheless our members remain committed to working with all stakeholders outside of the context of airport economic regulation to improve the experience of passengers. This is something critical to the survival of the airlines operating at Heathrow airport.

Improving airport/airline governance vehicles

We welcome the identification by the CAA of the issues associated with governance between the airlines and HAL. In particular, we welcome the proposal by the CAA to include a licence provision requiring the airport's 'Conditions of Use to be fair, non-discriminatory, transparent and subject to appropriate consultation requirements'. The experience of our members in the recent annual consultations on the airport's Conditions of Use also suggests it would be important for airlines to be able to appeal the CC when they consider that the airport is seeking to impose conditions which are not fair or non-discriminatory.

Empowering passengers through information transparency

We welcome the CAA highlighting the need for passengers to be aware of the parties responsible for service at the airports. The CAA has used the example of possible confusion amongst passengers as to the responsibilities in the delivery of arrivals baggage. However, in our view, there is significantly more confusion in passengers continuing to think that airlines are responsible for the services received in an airport when the airports are actually responsible. For example, terminal services, infrastructure and fabric.

We also welcome the indication by the CAA that they would consult on any future proposals around the publication of information and look forward to engaging in any future work. However, we recognise the importance and immediacy of working on the Q6 Regulatory review of Heathrow airport to ensure the substantial market power of the airport is not abused to the detriment of passengers and airlines.

4.0 Question 4 – What is your view on the rationale for economic regulation at Heathrow Airport?

Does the airport have substantial market power ?

Test A:

It is the LACC/AOC view that Heathrow has substantial market power and we are in agreement with the CAA's position on this subject. We consider the evidence gathered by CAA and the Competition Commission, as well as our own observations of HAL, as supportive of this position. We are also strongly support as an airline community the 'single till' as the appropriate model in a competitive market. As such we advocate that commercial and retail revenues should be included in the market power assessment as these revenues are a key component of the single till.

Test B

Whilst recognising the importance of the economic analysis of the market power of Heathrow Airport we believe it is equally important for consideration to be given to the behaviours of the airport which evidence its market power. Such market power can be manifested in two ways. The first of these are the occasions when the airport undertakes actions which leverage its substantial market power. These are actions which would not characterise suppliers in a competitive market. The second of these is when the airport does not undertake actions because its substantial market power allows it avoid the competitive pressures which would normally ensure that a company seeks to supply what its customers need.

Both of these behaviours are evident at Heathrow Airport and we believe evidences the substantial market power of the airport. We have set out an example of both of these types of behaviours below:

Market power based action

We believe the airport's approach to the setting of its annual Conditions of Use and the nature of some of the clauses evidence a proactive leverage of its substantial market power. We consider that both some of the conditions proposed by the airport (especially regarding the level of its liability) and its position on its ability to unilaterally impose the conditions as evidence that Heathrow Airport has and exercises substantial market power.

Market power based omission

The track record of Heathrow Airport in delivering infrastructure evidences the extent to which it manifests behaviour that would not be expected from an infrastructure supplier operating in a competitive environment. For example, the Terminal 3 Integrated

Baggage system is a project which should have been complete and operational by the end of 2011. It has instead been a project which has suffered from extreme delays and cost overruns. This is a key element of airport infrastructure required in the interests of passengers. If it was being supplied in a competitive environment it would not have suffered from the level of delays and increased cost being proposed by the airport. The delay in this project and proposed increased costs evidence that Heathrow Airport has been able to act in a manner only possible because of the substantial market power it possesses.

The examples above evidence the substantial market power of Heathrow Airport and the ways in which the market power demonstrated by economic analysis can (and is) manifested behaviourally by the Airport.

Test C : Benefits and costs of economic regulation.

LACC / AOC supports the CAA's conclusion that the application of Test C would appear not to support deregulation of LHR before April 2014. We continue to maintain an upgraded version of the current RAB based price control process is the most appropriate regulatory model for Heathrow in Q6. We also agree with the CAA's position that the costs and benefits of regulation warrant continued regulation beyond 2014 if we are to avoid the inevitable price increase passengers would be faced with under a deregulated Heathrow. It is imperative that the trend of the last 10 years in terms of prices is halted and reversed.

The LACC / AOC also agrees with the CAA's assessment that the new Civil Aviation Bill allows for a tailored approach at Heathrow which should ensure that the benefits of regulation outweigh the costs. We would support a bespoke solution for Heathrow in Q6.

5.0 Question 5 - What do you think is the most appropriate form or model for price regulation at each of the airports ?

LACC / AOC favour a RAB based regulation at Heathrow and believes this is in the best interest of our customers. We also want to make sure that there is no change to the components of the single till and that the Q6 settlement is affordable for our customers. We must avoid a situation where HAL promotes and drives forward projects in Q6 that are not in the interests of passengers.

Incentives

The LACC / AOC is fully supportive of efforts to explore incentives to encourage HAL to become a more efficient airport operator in terms of the level of opex deployed and in the construction of infrastructure (Capex). This should encompass a full and healthy dialogue on the construction of the WACC. We are also supportive of the airline view that HAL should be focused on cost control, efficient operations, efficient procurement and high quality project management. This would, in our view, support a sustainable business for HAL that is crucial for the future prosperity of Heathrow.

Asset Remuneration

The problem of predicting capital cost outlay with any accuracy, associated opex and commercial revenue implications as we move through Q6 adds further complexity that needs to be dealt with. Delayed capital investment in a Q only provides a benefit to HAL and this may distort HAL's behaviour. On time and budget delivery of capital projects is the key and we want to see development of incentives that drive this behaviour in HAL in Q6.

OPEX

Central to Q6 is a level of scrutiny of HAL's costs and a plan to progressively reduce these closer to market levels. This must be a primary objective if we are to have an affordable settlement that delivers meaningfully for our passengers and enables HAL to have an efficient and sustainable business. We see the process of cost reduction as central to the Q6 settlement and to ongoing engagement between the airport and airlines after the settlement.

Capex Budget

LACC / AOC supports the development of fixed and development capex in Q6 together with a suitable governance process to ensure that the inherent uncertainty with capital investment further into the Q can be managed taking development through an efficient gateway process before turning project funding from ' development' funding into 'fixed'.

Service Standards

These should be set at a level that provides for a positive customer experience through Heathrow but also at a level that ensures investment has added value and the final delivery is an affordable one for our customers.

Non Regulated Charges

These maintain the mechanism for ensuring that differentiated services can be paid for separately and we also advocate that the CAA should look at protections to ensure that airlines are not over charged for essential services in Q6.

6.0 Question 6 - What are the priorities for improved efficiency incentives within the price control settlements ?

LACC / AOC fully supports the CAA's recognition that incentives are a critical part of the regulatory framework and these should be as simple as possible to administer. We should take the opportunity of the Q6 review to evaluate the best possible incentives to engender the right behaviour within HAL to deliver for the passenger interest. We maintain that there is sufficient evidence gathered through Q5 to suggest that operating expenditure (opex) and capital expenditure (capex) have not been incentivised as effectively as they should have been and we would be keen to address this in Q6. Specifically this should address the following ;

- (i) Addressing the propensity of HAL to front load the plan before the cap is set and then to back-end delivery
- (ii) Cash flow benefits accruing to HAL as a result of delayed delivery within a Q of capital projects
- (iii) Allowing HAL to retain the difference between the allowed return on the higher forecast plan and the lower actual plan
- (iv) Addressing the fact that the RAB is rolled forward under ' actual' capex rather than as ' efficient ' capex thereby removing any incentive for HAL to drive towards efficient delivery.

This leads us to the conclusion that a new approach to capex is required that addresses the above issues and encourages airports to deliver investment that airlines and our customers need and value.

We would request that CAA take into full consideration our submission that detailed our ideas on capital efficiency and how it can be handled more effectively. In summary these are as follows ;

Principle 1 ; BAA's ownership of LHR should not allow it the right to conduct any capex project it wishes. Only capex that is efficient, offers value for money, and is desired by passengers should be considered for delivery ;

Principle 2 : BAA should be fairly rewarded for undertaking capex spend efficiently in the final settlement for Q6 ;

Principle 3 : Incentives on capex should be stronger for the efficient and timely delivery of projects than for delivering a project under budget ;

Principle 4 : Inefficient capex spend in terms of cost or delayed delivery should not be rewarded and should be reflected in a diminishing return for HAL ;

Principle 5 : all capital projects should be supported by a proper governance structure which provides for the right level of transparency, has accountability through experienced leadership and delivers sound financial assurance.

In summary we believe as an airline community that these principles will assist in ensuring that the regulatory regime provides the right type of incentives for HAL to deliver investment for the overall benefit of the passenger.

The LACC / AOC would cite the following five key improvement areas on the present arrangements in order to incentivise greater efficiency in Q6 ;

1. Improved in Q governance that provides greater engagement of the airline community at each project gateway ;
2. The introduction of more fixed price arrangements rather than the current pass through mechanism for major projects ;
3. The use of expert reporters to improve assurance and build further confidence in the process for all stakeholders, including HAL, airlines and the CAA ;
4. Modifications to the trigger regime to ensure HAL is financially neutral to the profiling of the capital plan ;
5. A change to the rules for rolling forward the RAB to discourage inefficient investment

The expansion of these points has been provided in British Airways' response to the consultation. The British Airways paper details the rationale for these improvement areas and also provides the necessary detail for the CAA to consider in their review. The airline community strongly advocates these initiatives to the CAA.

Benchmarking

The LACC / AOC believes that quality external benchmarking of HAL's costing of projects is essential to ensure that Heathrow's passengers receive value for money in Q6. We would see this being developed initially through the use of ' expert reporters ' to review and challenge HAL. In the medium and longer term we would like to develop with CAA support and guidance a far more comprehensive benchmarking process that provides the ongoing level of scrutiny that is required. This may encompass international benchmarking, national inter industry benchmarking and intra-company benchmarking.

OPEX Controls

The airline community view is that the present regulatory arrangements for opex do not provide for sufficient incentive on HAL to reduce their operating costs. HAL's own regulatory accounts show the growth in HAL's operating costs between 2004/5 and 2010/11 . This is an unsustainable position that we are keen to address in the Q6 regulatory review. Our thoughts around the CAA's use of the standard RPI-X framework and concerns have been expanded by British Airways in their response and have airline community endorsement.

Efficient benefit sharing

The LACC / AOC are keen to develop the thinking that there may well be better ways of aligning the interests of HAL and the airline community by strengthening the incentives to drive efficiency improvements. The gain sharing arrangements that we have helped to develop in the non-regulated charges arena could well provide the type of model that can be adopted for wider aspects of the Q6 programme. Further expansion of the thinking in this area can be found in British Airways response to the consultation.

7.0 Question 7 – How should the CAA interpret its new financing duty?

We welcome and support the CAA's interpretation of its new financing duty. In particular, we welcome the emphasis by the CAA of its intention to base financing requirements on those that would be expected from an efficient company with a notional capital structure. We believe the CAA is correct in determining that the actual financing is a matter for the airport and it should bear the risks/benefits of the structure it puts in place. We also welcome the indication by the CAA of its view that 'passengers should not be expected to pay the additional costs of the airport's actual capital structure nor pay the costs of repairing an inappropriate actual capital structure'.

We support the continuation of RAB based regulation and within this context would support a review of the treatment of safeguarded assets. These assets have been classified by HAL in the construction of the terminals as safeguarded assets that may be required for alternative developments. Airlines were not, until recently, informed that assets which were agreed to be classified as safeguarded were added to be RAB but not depreciated. If airlines had understood that classifying but not using safeguarded assets resulted in these assets appreciating in RAB with no associated depreciation until use, then airlines may have proposed that these assets be put into operational use for passengers. We believe this is an area which the CAA should investigate further in determining the size of HAL's RAB and future funding requirements.

We welcome the transparency with which the CAA is approaching the Cost of Capital debate. We recognise that it is in the interests of passengers and all stakeholders for HAL to be financially sustainable but we see a distinction between financial sustainability and a regulatory settlement which has the effect of insulating HAL from market forces or the consequences of its own actions.

The Cost of Capital has been an area of significant contention in previous reviews, particularly in the final stages of the process. We welcome the early thinking on this issue being led by CAA and hope this presents an opportunity for an ongoing collaborative process between stakeholders in determining an appropriate Q6 cost of capital for HAL. We are aware of and support the work being undertaken by British Airways as an input to this debate and look forward to continuing to engage with the CAA and stakeholders on this issue.

If the CAA require any further clarity on the LACC / AOC response please contact us and we would be happy to set up a meeting to discuss at your convenience.