



London (Heathrow) Airline Consultative Committee

# The Airline Community's Response to the CAA's Final Decision for the Regulation of Heathrow Airport.

24<sup>th</sup> January 2014

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## 1 Summary

The Heathrow Airline Community (The Airline Community) is encouraged that the CAA's final decision has recognised the broad thrust of the evidence regarding the efficiency of the current operation at Heathrow Airport and the need for substantial improvement across a range of services in order to meet the needs of current and future passengers.

The Airline Community also welcomes the recognition by the CAA that users cannot pay for inefficiencies that risk airlines' investment and route development plans. However the Airline Community is disappointed that issues pertaining to the cost of debt remain inconsistent with the CAA's previous policy. For the avoidance of doubt, the Airline Community stands by the evidence previously submitted to the CAA.

The retention of the current service quality scheme is particularly welcomed and will build on the achievements of the Q5 framework and incentivise Heathrow Airport Limited (HAL) to remain both passenger centric and airline focussed.

The Airline Community supports and welcomes many of the CAA's proposed licence conditions and particularly its indication that the interests of passengers will be protected across a range of functions.

This collective response, on behalf of the 82 airlines operating at Heathrow Airport, is without prejudice to the airlines' individual assessment of the CAA's decision and any further steps that an individual airline may take. In addition, due to the time constraints set by the CAA, this is the Airline Community's initial response. The Airline Community may make further submissions, if appropriate, on matters emerging from the settlement.

## 2 Licence

### 2.1 Fuel

The Airline Community notes the view of the CAA that the 'airport area' for licencing purposes does not include fuel facilities as listed in paragraph 1.6. The Airline Community continues to hold the view that the Civil Aviation Act 2012 indicates that the fuel facilities should be included in the airport area of HAL. The clauses which support The Airline Community's view have been set out already for the CAA in the response to the CAA's Final Proposal. Fuel provision is an important dimension of operational resilience at Heathrow Airport and HAL controls access to the facilities as the infrastructure is on HAL land. In addition, the facilities provided for fuel are an integral part of the infrastructure required for 'servicing of aircraft' as defined in Section 5(4) of the Civil Aviation Act. Furthermore, it is instructive to this debate that HAL has, in its Conditions of Use for 2014, adopted a new geographic definition of the airport area which includes the fuel facilities at Heathrow Airport. It is therefore disappointing that the CAA has not included the fuel facilities in the airport area.

Notwithstanding the CAA's position on the airport area, the Airline Community welcomes the CAA's recognition of the critical role HAL plays in connection with fuel supply and the development of operational resilience. In particular the Airline Community welcomes the indication by the CAA in paragraph 2.8 that:

Under section 21(1) (f) of the Act it may also include conditions containing provisions relating to activities carried on outside the airport area for which the licence is granted. These give the CAA the power to go wider than the relevant market and the airport area when including conditions in the licence.

The Airline Community also welcomes the indication by the CAA that it will continue to use its influence and, where necessary, its powers to ensure that the interests of passengers are protected. The Airline Community is committed to pursuing the interests of passengers through increasing the fuel supply resilience of Heathrow Airport. Therefore, the Airline Community welcomes the inclusion of £130 million in the capital plan for the development of fuel infrastructure and looks forward to working with the CAA and HAL on the development of this infrastructure.

### 2.2 Definition of 'Core Capex Project'

The Airline Community welcomes the recognition by the CAA, on page 34 of the Q6 Decision of the need for the definition of a Core Capex Project to be specific in indicating that such a project is one which has been approved at Gateway 3. This is in contrast to the previous definition, being a project which simply reached Gateway 3.

However, the definition of a Core Capex Project in the Draft Licence, on page 88 of the Q6 Decision, defines a Core Capex Project as one that ‘has passed Gateway 3’. This definition is set out below for ease of reference:

(d) core capex project is any project that **has passed** Gateway 3, being taken forward for implementation in accordance with the governance arrangements; [our emphasis]

The Airline Community considers that ‘has passed Gateway 3’ remains a vague definition and one which does not convey the CAA’s policy to define such a project as one which was approved at Gateway 3. Passing a Gateway does not necessarily indicate that a project was approved or agreed by stakeholders. The Airline Community remains of the view that the definition in the Licence should contain text indicating that a project has to be approved or agreed at Gateway 3 in order for it to transition from development capex to being a core capex project.

### **2.3 Definition of Development Capex Allowance**

The Airline Community notes the definition of development capex allowance ‘is a capex allowance included in the Q6 RAB’. The Airline Community questions if this definition should refer to a capex allowance in the Q6 ‘settlement’ (rather than RAB) based on the sum of development capex project P80 cost estimates as set out in the governance arrangements.

### **2.4 Efficient Procurement of Capital Projects**

The Airline Community welcomes the Licence conditions requiring HAL to secure its procurement of capital projects efficiently and economically and also welcomes the requirement on HAL to publish a Procurement Code of Practice by 01 October 2014 on how it will comply with the Licence condition. However, the Airline Community thinks the definition of a significant project should be one above £10 million rather than one above £15 million. Alternatively, the Licence could require HAL to agree with the Airline Community the occasions when a £15 million project is not subject to the requirements of the Licence condition.

Also recognising the value of the CAA Licence condition requiring a procurement efficiency protocol, the Airline Community would like the CAA to clarify that all capital projects over the determined threshold should be subject to the condition, including any projects which HAL wishes to provide through framework contractors or using resources internal to HAL or the wider Ferrovial Group.

### **2.5 Capital Investment Condition in the Licence.**

The Airline Community welcomes the indication by the CAA of its intention to develop a condition for the Licence to address the propensity of HAL to disengage from capital investment commitments which had been made by it in the process of Constructive

Engagement (CE). The Airline Community particularly welcomes the indication by the CAA that it will explore if such a condition can influence the delivery of the capital programme which emerged from the Q6 CE discussions. The Airline Community welcomes an opportunity to work with the CAA and HAL on the development of such a condition.

## **2.6 S-Factor**

The Airline Community welcomes the amendments made by the CAA to S-Factor. Noting that paragraph C1.4 refers to costs as a result of changes in 'security standards', paragraph C.1.12 (a) expands on this by indicating that the change in security standards is something 'certified by the CAA'. The clarity of the costs allowed in an S-Factor being only as certified by the CAA is helpful and should be included in paragraph C 1.4.

## **2.7 Provision of Information**

The Airline Community notes the intention of the CAA that D 2.15 (a) refers to the inclusion of information from HAL related to its own performance. This should be more explicit in this section as the current reference is simply to 'relevant operational information' rather than a specific indication that this information should contain detail of the performance of HAL's own operation.

## **2.8 Part D - Service Quality**

### **2.8.1 Central and Transfer Search**

The Airline Community is surprised to read, in paragraph J76, a proposed timetable from HAL for the introduction of the harmonised security search standard in the Terminals at Heathrow Airport which appears to have been accepted by the CAA without consultation with the airlines whose passengers are impacted. This is something the Airline Community will need to consider and may wish to address as Q5 transitions into Q6.

Notwithstanding the above, the Airline Community welcomes the commitment of the CAA to work with all stakeholders in the development of a security queue metric and standard which delivers improvements in the level of quality experienced by passengers. Therefore, the Airline Community welcomes the indication by the CAA that it will monitor closely the performance of security queues under the new standards and metrics and does not rule out improving the standard if queues lengthen under the new proposed standards.

The Airline Community is committed to working with all stakeholders to improve the experience of passengers through the security search functions at Heathrow Airport.

## 2.8.2 Control Posts

The Airline Community welcomes the improvement of the Control Post metric through aggregation of the control posts into groups as set out by the CAA. In particular, the Airline Community welcomes the CAA position as set out in paragraph J118 that:

The CAA therefore proposed to apply the Q5 standard of 95% of vehicles waiting less than 15 minutes to control posts groups individually...

This is assumed to indicate that each control post grouping would have to pass the standard for the overall standard to be met and in this way remove the averaging effect of the current airport wide standard that has worked against the interests of passengers. If this is the policy intention of the CAA it should be more explicitly stated in the Licence.

## 2.9 Part F – Consultation Conditions

Condition F1.1 (a) (ii) refers to Condition F1.1.i (1). Should this reference be to F1.1 (a) (i)?

## 3 Forecast

The Airline Community welcomes the upward adjustment made to the CAA's traffic projections over the Q6 period. To take no account of recent outperformance in the base year would have been a clear error of fact. However, it is disappointing that the CAA has not taken full account of this and has therefore inflated the fair price the passengers will pay. Furthermore, the Airline Community continues to disagree with the CAA's inclusion of demand shocks within the forecast.

## 4 WACC

The Airline Community welcomes the CAA's consideration of the Competition Commission's Northern Ireland Electricity investigation and its subsequent downward revision of the Total Market Returns (TMR). However, the Airline Community still believes, as it has highlighted in previous submissions, that the CAA has made a number of errors in its calculation of the WACC which has resulted in the CAA setting a WACC that is higher than it should be.

## 5 Capital Plan

The Airline Community at Heathrow Airport broadly welcomes the CAA's determination that a capital plan of around £3b, adjusted to £2.9b due to a 4 year and 9 month settlement period, is aligned with the results of CE and the Airline Capital Plan which has been regularly maintained throughout the Q6 process. The needs of the 82 airlines, across 5 terminals, have been reflected in this approach and are largely related to asset

renewal, supporting the passenger experience and enhancing resilience including the widening of taxiways to cope with increased operations of Code F aircraft.

Whilst the CAA made a determination based on a top down approach and recognised the usefulness of the Airline Capital Plan, it has stated that HAL's Alternative Business Plan, about which they did not consult with the airlines, will provide the reference for the CAA's determination. Whilst the Airline Community would have preferred a bottom up approach, it recognises that this is a practical solution. The Airline Community particularly acknowledge and welcome the CAA's statement that "all projects will in any case be discussed and agreed through the capex governance process at the airport". Consequently the Airline Community will continue to work collaboratively with HAL within the context of a £3b capital budget. Section 9 provides an indication of the next steps towards a collaborative governance process to achieve this objective.

The CAA has raised several issues regarding various projects and these will be considered as follows:

### **5.1 Fuel Infrastructure**

The Airline Community welcomes the CAA's clear statement that a robust fuel infrastructure is crucial for operational resilience and that the current level of resilience is unacceptably low compared with international norms. The Airline Community will welcome the reopening of commercial discussions between HAL and HAFCO with respect to the resolution of liability issues and rapid progress towards concluding a commercial agreement. The recognition by the CAA that a full capital allowance for £130m implies that the funding allocation will not impose any financial constraints and mitigates the risk of HAL and HAFCO being unable to reach appropriate commercial terms. Continuous involvement by the CAA will be welcomed as a facilitator of progress, together with a recognition that the interim recommendation from the Airport Commission regarding options for a third runway at Heathrow may have a bearing on the optimal location of new storage facilities.

### **5.2 Crossrail**

The Airline Community remains not persuaded regarding the justification for an airline contribution towards Crossrail. The Airline Community position remains unchanged, namely, the business case was negative to the extent that there was no business rationale for any investment. This position is inconsistent as the CAA did not support an allocation for Western Rail Access on the basis that no business case was presented by HAL. Furthermore the rationale proposed by the DfT's counter proposal remains unconvincing and the CAA's statement regarding the impact of a third runway was outside the scope of its regulatory duties. The Airline Community remains extremely

concerned regarding the precedential aspects of this decision in regard to future allocations for surface access costs.

### **5.3 T3IB**

The Airline Community welcomed the CAA's decision to remove £35m from the RAB and that it will undertake a further review of the latest overspend on the T3IB project, together with further adjustments if inefficiencies and an absence of consultation are confirmed, as outlined in the airline evidence on T3 IB to the CAA..

## **6 Capital Efficiency**

The Airline Community supports the CAA's final position on Capex efficiency, having taken on board all of the key principles and mechanisms that the airlines have worked on and agreed with HAL through CE. This marks a significant and positive step-change in the way capital projects are managed from inception to completion. The Airline Community believes that this outcome will support better informed decision making and assurance to deliver value for money and valued benefits for Heathrow Airport users.

It should be noted that the various mechanisms available detailed within the capex efficiency handbook are designed to be used in an integrated way. For instance, project approval and sign-off at Gateway 3 is predicated on the basis that for selected projects there is an agreed detailed capital Trigger definition, a cost plan and a programme which has been scrutinised by the IFS, within the framework of the core and development mechanism.

The Airline Community welcomes the CAA's support for a requirement that HAL will obtain airline sign-off for investment programmes. This will ensure that an equitable and balanced approach is taken in the development and approval of projects. The Airline Community is committed to engaging constructively in the further work that is required to determine the precise Governance structure that will support this requirement.

The Airline Community is also pleased that the CAA has taken a pragmatic approach to setting the level of construction inflation in Q6, based on evidence available in the market.

Progress is being made in the definition of triggers for Q6 with the objective of meeting the CAA's timeline for completion by 31 March 2014. Some alignment of trigger dates from the Q6 capital programme with enabling work by NATS, in the context of the CAA's Future Airspace Strategy, will need to be defined and agreed if operational resilience at Heathrow Airport is to be enhanced in a timely manner as recommended by the Airport Commission.

## **7 Opex and Commercial Revenues**

The Airline Community continues to maintain that the targets set by the CAA are not stretching enough and it continues to support the figures as set out in previous submissions.

## **8 ORCs**

The Airline Community is pleased that the CAA recognised £38m of efficiencies are attainable within ORCs in Q6. However, the Airline Community is concerned with how the CAA will ensure that these targets will have focus from HAL and how these target savings 'included' in the settlement will ultimately see reduced charges for passengers. In an area where there is a protocol that says that all efficient and justified costs follow a pass through mechanism, the airlines have no assurance that these targets, which are now included in the settlement, will be delivered. It can only presume that the CAA intends to fix this target into ORCs throughout the Q6 duration. Confirmation of this would be appreciated together with a reference to the appropriate governance structure.

## **9 Governance Arrangements for Q6**

The Airline Community welcomes the CAA's ruling in the final determination for a provision in the HAL draft licence that requires it to develop a governance protocol in agreement with the airlines and the CAA ahead of the start of Q6. The Airline Community will work collaboratively with HAL to achieve this and develop the detailed structures and responsibilities for the governance mechanisms at Heathrow Airport. The intention as an Airline Community is to build on the governance structures that were in place in Q5 and to develop the most efficient structure to support the governance of Q6. The Airline Community is encouraged by the CAA's decision for a more cooperative and collaborative approach around all aspects of governance from managing disruption, general day to day running of the Heathrow Airport and strategic planning. The Airline Community has been discussing governance with HAL throughout the Q6 process and this work will now include agreeing the protocols as outlined in the draft licence and incorporate an agreed structure for Q6.

The support of the CAA in this process will assist both the Airline Community and HAL in addressing any differences encountered on the final design.

## **10 Market Determination**

The Airline Community accepts the findings of the CAA regarding the results of its Market Power Assessment. The CAA's decision that HAL has Significant Market Power and that this will endure over time is persuasive in its analysis. Consequently the Airline

Community supports the need for a regulatory licencing system together with a governance structure which is fit for purpose in the light of the CAA's findings.