

**HEATHROW
REIMAGINED**
A Better Hub For Britain



REDACTED VERSION FOR PUBLICATION

Fundamental reform of Heathrow

Discussion about examples of potential reform options

5 JUNE 2025

Agenda

01.

Background

02.

**Issues
fundamental
reform must
address**

03.

**Potential key
features for a
new model**

04.

**Overview of
examples of
potential
reform**

05.

**Illustrative
worked
examples**

Important background

- This pack:
 - provides a **recap of the problems** with the current regime; and
 - outlines **examples of potential reforms** to address those problems
- The purpose of this pack is **not to set out a preferred approach** or set of options, but rather to **illustrate that there is a broad range of alternative models that could be applied to Heathrow** to better serve users' interests
- Examples are **not intended to be exhaustive** and should not be viewed as fully developed – they are not a replacement for the work that a review needs to undertake

Changes to the economic regulatory model must address current failings

HAL faces harmful incentives...

Incentives to spend capital inefficiently to grow the RAB

No incentive to ensure commercial activities are NPV positive

Weak incentives to drive operational efficiencies

Weak incentives to be innovative, responsive to user needs

...and the regulatory model is ineffective at preventing HAL acting on those incentives

Stakeholders face strong information asymmetries, making cost assessment impossible

Complexity and uniqueness of the infrastructure and business

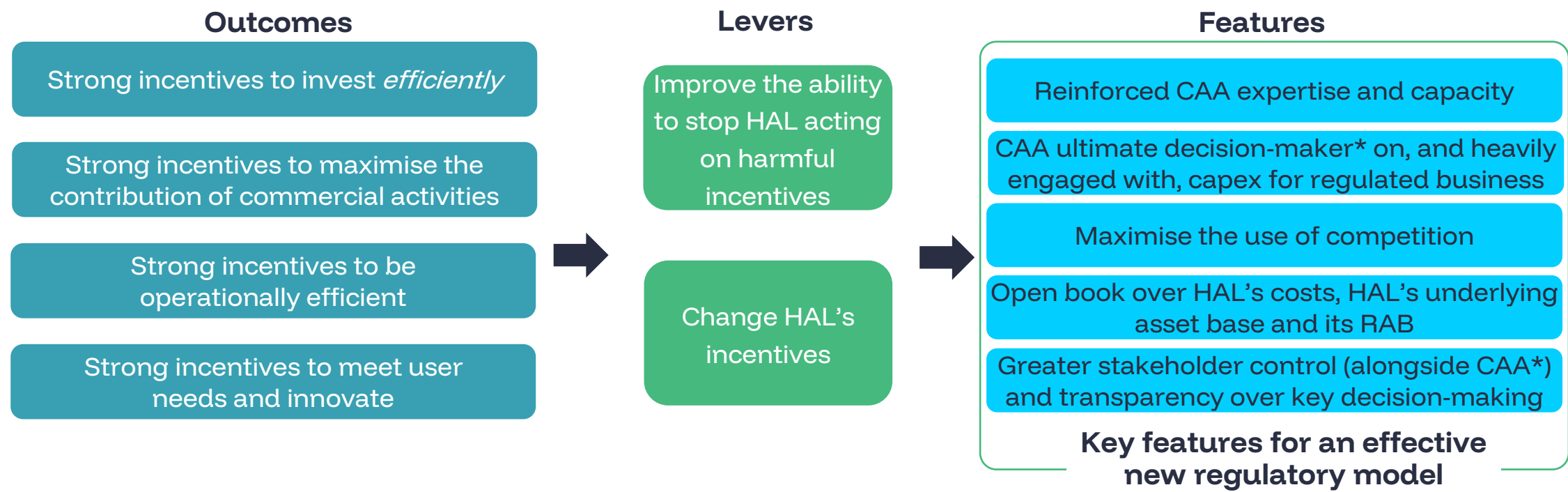
HAL's control of the capex process

Ineffective service quality regime

Overarching objectives of a new, effective regulatory model at Heathrow

- To secure an **efficient airport** delivering **improved value for money** for UK consumers, businesses, and other users, while effectively **supporting Britain's growth ambitions**
- To ensure Heathrow remains an **attractive destination for much-needed investment** and provides **appropriate protection to current investors**

Key features of a new, effective regulatory model at Heathrow



* Noting that, under structural reforms, the CAA would not ultimately be the decision-maker, but would, even with these options, require strengthening compared to today.

The content of this presentation is provided by Heathrow Reimagined without prejudice. Examples provided illustrate that there is a broad range of alternative models that could apply to Heathrow to better serve users' interests. These do not set out a preferred approach and are not intended to be exhaustive, nor a replacement for a fundamental review of regulation.

Example reform options

Effective regulatory reform at Heathrow can draw on experiences and insights from other settings, but it is **unlikely that a single model used elsewhere will provide a complete solution for Heathrow**. In practice, a combination of aspects of the examples outlined may provide a more effective solution to address different features of a more effective regime.

Such reforms would be in addition to the changes set out (see later slide) **to bolster the CAA and provide greater transparency to stakeholders**; even with fundamental reform, there will still – at the very least – be a need for a highly-skilled, strong regulator to play an active role.

Example 1

A capital investment committee, actively led/supervised by CAA

1a: Cross-industry committee (no new legal entity)

1b: Separate legal entity wholly-owned by HAL

1c: Separate legal entity jointly owned by airlines and HAL

- **Active CAA role in defining capex envelopes, monitoring project prioritisation, and ensuring capex efficiency throughout the process**
- **Increase control and transparency** over major capex decisions to **limit HAL's ability to act on harmful incentives** and drive efficient capex
- Airline community not just 'consultees' to major capex but are actively-engaged decision-makers from the earliest stage of the process

Example 2

Exposing terminal operations to greater competitive forces

2a: Independent management of terminals

2b: Long-term leases for terminal operations

2c: Structural separation of airfield and individual terminals

- Uses **competition** to **mitigate HAL's harmful incentives** to operate inefficiently and meet the needs of users
- Use of third parties to invest in and operate terminals **improves efficiency of capex for terminals and improve consumer experience**
- **HAL retains airfield ownership and operation**

A reformed regulatory model could involve combinations of options

- A **comprehensive package of reforms** is likely required to address harmful incentives under the current regime.
- **Individual options alone** are unlikely to resolve all issues; a combination of approaches is necessary.
- Different reform options can **target specific incentive problems** across the airport value chain.
- The package should draw on **domestic and global experiences and insights** from other sectors and countries.
- Reforms could be **sequenced over time** to ensure a smooth transition.
 - For example, **independent ownership for new terminals, independent management contracts for existing HAL terminals, and a capital committee overseeing non-airfield / shared infrastructure.**

Example of how options could be packaged together*

New cross-industry body to develop and manage major capex

Greater airline (and other stakeholder) control and oversight of major capex decisions would result in **greater capital expenditure efficiency, including in relation to commercial activities**, particularly outside of those terminals that benefit from greater competition

+

Long-term leases for terminal operations

Greater use of competition in relation to terminal operations would improve incentives for **responsiveness to user needs and innovation, terminal-specific capex efficiency, and operational efficiency**

Example 1: Capital investment committee



Example 1: A capital investment committee, actively led/supervised by the CAA

Description

- New structure for developing and managing new major capex schemes replacing the current processes
- **Separate body with casting vote for the CAA** where other committee members include HAL and airline tenants/community
- **CAA is actively engaged; e.g. defining the capex envelope, monitoring project prioritisation, ensuring capex efficiency**
- Committee would develop new capex specification, then tender the design, build and the financing required until the scheme is completed , and would monitor delivery of scheme over lifetime
- **HAL acquires infrastructure on completion** (but scope for some infrastructure to continue to be owned and operated by others)
- Open to all shareholders to propose potential capex schemes
- **Body could develop airport master plans for agreement and potential sign-off by the CAA and DfT**
- Operating costs recovered through the charge control

Key features

Strong incentives to invest efficiently

Reinforced CAA expertise/capacity

Strong incentives to maximise the contribution of commercial activities

CAA ultimate decision-maker

Strong incentives to be operationally efficient

Use of competition

Strong incentives to meet user needs and innovate

Open book over HAL's costs and assets

Greater stakeholder control and transparency

Identification, specification and tendering of major capex schemes

Detailed design, construction and financing (during development and construction)

Ownership of completed infrastructure

Operation of completed infrastructure

New body

Winning bidder

HAL*

HAL*

* Or a third party in cases when approved by the airlines and CAA

Ensuring the CAA has the resources it needs is critical as part of a package of wider fundamental reforms

More resources for the CAA

Greater CAA resources and access to in-house expertise in relation to airport operations and development to allow it to play a more active role in Heathrow's capex plans

Effective use of benchmarking

More effective use of benchmarking, including in relation to the individual building blocks (bottom-up benchmarking) as well as the holistic outcome (top line benchmarking)

Requires building own in-house knowledge base, **drawing on a broader set of relevant benchmarks** (incl. other UK airport capex projects, other UK transport projects, other European and global airport capex projects)

Open-book policy allowing a detailed review of the RAB

Full open-book transparency of HAL's financial and operational data, including much more granular information on the RAB and the detailed underpinning analysis of capex programmes

This would allow for a **detailed review of what is in the RAB and how components are treated on an ongoing basis (e.g. land)**

Would need to balance maintaining investment incentives

Example 1: Different implementation options

Example 1a: 'Committee' but no separate legal entity

- New **industry-wide 'committee'**, without legal separation
- HAL staff involved in capex development and management remain within HAL
- Committee would act like the Board for a new entity, with **airlines (or airline representatives) and HAL having equal voting rights** (CAA has the casting vote)
- But without formal corporate governance arrangements (e.g. separate legal entity)
- HAL's capex development teams would be required to provide the committee with all reasonably requested information and analysis to support decision-making

Example 1b: Separate legal entity wholly-owned by HAL

- **New legal entity**, but a wholly-owned subsidiary of HAL
- **Airlines and HAL** have equal voting rights (CAA has the casting vote)
- All relevant employees would remain HAL employees but would sit within the new entity
- **Separate governance arrangements** to **maximise its independence** from HAL management and to embed its focus on promoting efficient capex

Example 1c: Separate legal entity jointly owned by airlines and HAL

- **Separate legal entity** for developing and managing new major capex schemes. Legal entity is **jointly owned by the airlines and HAL**, with equal voting rights (CAA has the casting vote)
- All HAL's employees undertaking capex development and management to **move to the new entity**
- New entity management would **report solely to the entity's Board**
- New entity Board would have sole responsibility for entity recruitment and management remuneration, etc.

Example 2: Terminal operations & competitive forces



Example 2a: Independent management of terminals

Description

- **Major infrastructure operations** (e.g. terminals) are **competitively tendered**; **HAL retains ownership**
- Airlines, HAL and CAA **set minimum specifications** for terminal operators*
- **Fixed-term contracts** (e.g. 5 years) **for operating individual terminals** (and related commercial activities) are awarded based on least cost or best value for money
- Consistent with maintaining single-till
- Additional operator-specific or terminal-specific **T&Cs** (e.g. enhanced service levels) **could be commercially negotiated** bilaterally with terminal operator

* Including, for example, minimum standards for terminal operations, asset maintenance standards, approach to minor capex/enhancement of facilities, etc

Key features

- | | |
|---|--|
| Strong incentives to invest efficiently | Reinforced CAA expertise/capacity |
| Strong incentives to maximise the contribution of commercial activities | CAA ultimate decision-maker |
| Strong incentives to be operationally efficient | Use of competition |
| Strong incentives to meet user needs and innovate | Open book over HAL's costs and assets |
| | Greater stakeholder control and transparency |

	Airfield infrastructure and activities	Terminal A infrastructure and activities	Terminal B infrastructure and activities	Terminal C infrastructure and activities
Owner	HAL	HAL	HAL	HAL
Operator	HAL	Operator A	Operator B	Operator C

Example 2b: Long-term leases for terminal operations

Description

- Similar to Example 2a, but **with longer duration leases awarded** (e.g. 50 years) allowing leaseholder to undertake **broader range of capex, including investment in new terminals, as well as improving opex**
- **HAL retains freehold ownership; competitive process determines leaseholders**, with winners based on least cost or best value for money
- CAA licenses terminal operators as it does HAL and benefits from increased efficiency benchmarking across campus
- Reduces the need to regulate the more complex parts of HAL’s operation; **CAA can focus on airfield**
- **Leaseholder responsible for all operations and terminal-specific capex during lease period**
- Scope for airlines to control terminals means the **terminal experience would be an extension of the intense rivalry between airlines for other parts of the passenger experience**

Key features

Strong incentives to invest efficiently

Reinforced CAA expertise/capacity

Strong incentives to maximise the contribution of commercial activities

CAA ultimate decision-maker

Strong incentives to be operationally efficient

Use of competition

Strong incentives to meet user needs and innovate

Open book over HAL’s costs and assets

Greater stakeholder control and transparency

Airfield infrastructure and activities

Terminal A infrastructure and activities

Terminal B infrastructure and activities

Terminal C infrastructure and activities

Owner

HAL

HAL

HAL

HAL

Operator

HAL

Operator A

Operator B

Operator C

Example 2c: Structural separation of terminals and airfield

Description

- **Airfields and terminals structurally separated** with separate owners and management; HAL required to divest all terminals
- Would support independent terminals **competing** to attract airlines to their terminal
- **Regulation still required for the airfield and potentially for some terminals** (i.e. where SMP still persists)
- Airfield RAB could be used to ensure full cost recovery for all existing assets (including those divested)
- Reduces the need to regulate the more complex parts of HAL's operation; **CAA can focus on airfield and any residual SMP terminals** (where it would **benefit from greater ability to benchmark costs and performance** between terminals)
- Scope for airlines to control terminals means the **terminal experience would be an extension of the intense rivalry between airlines for other parts of the passenger experience**

Key features

Strong incentives to invest efficiently

Reinforced CAA expertise/capacity

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Strong incentives to be operationally efficient

Use of competition

Strong incentives to meet user needs and innovate

Open book over HAL's costs and assets

Greater stakeholder control and transparency

Airfield infrastructure and activities

Terminal A infrastructure and activities

Terminal B infrastructure and activities

Terminal C infrastructure and activities

Owner

HAL owned

Operator A

Operator B

Operator C

Operator

HAL operated

Operator A

Operator B

Operator C

Discussion

Annex

Examples from other countries

Singapore (SIN)

Regulator informs control of Changi's charges by **benchmarking charges** against a range of other international hubs

Changi shows approaches that also consider explicitly the attractiveness of the hub when regulating charges can be consistent with **competitive charges, high service quality and attracting investment in major new infrastructure**

Changi is regularly found to be one of the world's best airports

US (JFK, LGA)

Several US airport examples demonstrate that:

- **Terminals and airfield activities can be separately operated and owned** – there is no operational impediment
- Separation of activities can increase the **opportunity for competitive forces** to determine user outcomes
- Such models can be compatible with attracting **very substantial private sector investment**

Saudi Arabia (JED, RUH)

Following a competitive process in 2022, daa International was awarded a 5-year contract to manage JED. DAA also has managed T5 at RUH since 2016

Demonstrates there is **no impediment on terminals and airfield activities being managed separately** (even if they have common ownership)

Competitive tender processes can be used to introduce competition and drive operational efficiency

US (ATL, LAX)

The Central Passenger Terminal Complex at ATL is operated by an entity jointly owned by airlines. At LAX there are examples of airline-developed and managed terminals

Also demonstrates that it is possible to split runway and terminal operations, but also that **structures can be developed that give airlines greater control over the design, construction and management of the terminals that their passengers use**

Germany (FRA)

FRA has a regulatory framework where aviation charges and capital plans are agreed based on engagement between airlines and the airport

Lufthansa's shareholding in Fraport means: i) it has greater influence over plans; and ii) incentives are better aligned

Demonstrates that stakeholder scrutiny can be **more effective where airlines have more influence and incentives are better aligned**

Examples from other sectors

Telecoms: Greater transparency

Ofcom's approach to BT's regulatory reporting shows there is **scope for considerably improving HAL transparency**

Ofcom has an extensive regulatory reporting regime which provides much more transparency of BT's cost and asset base for SMP services

BT's latest RFS are 112 pages (vs just 30 for HAL) with further detail shared with Ofcom. Also, there are multiple very detailed guidance documents (compared to 26 pages from 2015 for HAL)

Water: Managing major capex

The Thames Tideway model demonstrates that **major capex schemes do not need to be managed in-house by the regulated company**

Construction of the Thames Tideway Tunnel was undertaken by a separate entity to Thames Water (Tideway)

The project was awarded to Tideway following a **competitive process**

The project cost is being paid for by Thames Water customers through their wastewater bills

NATS: Airline and HAL co-ownership

NATS, which provides air traffic control services including at Heathrow, is jointly owned by a consortium of airlines, HAL, NAT's employees, and the UK Government (which has a golden share)

Under the NATS model, **customers have considerably greater control and visibility of key strategic decisions, including investments**, which will affect the (regulated) charges and service they face, than is the case at Heathrow

Water: Use of benchmarking

The separate ownership and management of UK water and wastewater companies means that Ofwat can benchmark the costs of different operators against each other when setting regulated charges

Such benchmarking helps Ofwat establish its assessment of the efficient level of costs

This shows that **even if separate firms do not compete directly, they can still provide valuable information to improve regulation**

Telecoms/Energy: Promoting competition

Reforms of the telecoms and energy sectors in the UK have enabled competition to emerge in those parts of the value chain which can support it, while reserving regulation for those economic bottlenecks where competition is not sustainable

Numerous studies have demonstrated the **consumer benefits associated with promoting competition** – e.g. UK telecoms consumers face extensive choice of providers and services