



The Arora Group's response to CAP 1722

Economic regulation of capacity at Heathrow policy update and consultation

January 2019

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**THE ARORA GROUP'S RESPONSE TO CAP 1722
ECONOMIC REGULATION OF CAPACITY AT HEATHROW: POLICY UPDATE AND CONSULTATION**

JANUARY 2019

1. SECTION 1 - INTRODUCTION AND EXECUTIVE SUMMARY

- 1.1 This submission is provided by the Arora Group in response to the Civil Aviation Authority (CAA)'s consultation "*CAP 1722 Economic regulation of capacity expansion at Heathrow: Policy update and consultation*", published in October 2018 (**CAP 1722**). It builds on our responses to the CAA's previous consultations, "*CAP 1541 Consultation on core elements of the regulatory framework to support capacity expansion at Heathrow*" (**CAP 1541**), "*CAP 1610 Regulation of capacity expansion at Heathrow: policy update and consultation*" (**CAP 1610**) and "*CAP 1658: Regulation of capacity expansion at Heathrow: policy update and consultation*" (**CAP 1658**).
- 1.2 We fully endorse the CAA's position that additional runway capacity in the south east of England will benefit air passengers and cargo owners. We also support the Government's Northwest Runway Scheme (**NRS**) and provide evidence that we can make a positive contribution in ensuring it is implemented and operated in an efficient manner to the benefit of consumers. Indeed, we are defending the legal challenges to the designation of the airports national policy statement (**ANPS**) as an interested party to the various legal challenges, given our interest in the delivery of Heathrow expansion.
- 1.3 We have also been progressing our own plans to promote components of the NRS supported by the ANPS.
- 1.4 In summary:
- 1.4.1 The Arora Group has now assembled a full team and is committing significant work and resources to its application for a Development Consent Order (DCO) for its terminal- led development plans. The application will seek powers for the Arora Group to construct, own and operate the Heathrow Western Hub.
- 1.4.2 We welcome the CAA's clear statements in CAP 1722 and the CAA's Technical Information Note (**TIN**) published in August 2018 that another terminal operator can be accommodated within the regulatory framework for Heathrow expansion. We also welcome the CAA's acknowledgement of Arora's plans and the role we can play in Heathrow expansion. On the basis of those statements, we have an expectation that the CAA will (continue to) take our proposals seriously.
- 1.4.3 We would emphasise that the CAA needs to follow through with those statements and the work needed to ensure a regulatory framework is developed in time to show how a third party could be accommodated. As the CAA recognises, this could still involve a material amount of further work. It is critical that the CAA considers the design of this framework as early as possible to assist third parties to determine how they would fit in to expansion and to enable them to shape their DCO applications in that context;
- 1.4.4 We welcome the CAA's proposed licence condition but believe that the CAA should introduce it as early as possible, in early 2019, rather than at the end of 2019, in order to ensure it is effective through the DCO preparation period. Leaving it until the end of 2019 risks introducing it too late;

- 1.4.5 We believe that the licence condition needs to sit alongside alternative delivery mechanisms, in order to ensure that competition is properly promoted, rather than as a replacement to such arrangements (although we recognise this is not currently being proposed);
- 1.4.6 The CAA needs to recognise the importance of ensuring that HAL engages fully and genuinely with third parties – as it has committed to do – and that it provides any essential information required by those parties (which is not commercially sensitive) to ensure that the DCO process is as efficient and level as possible. We believe the CAA has a positive obligation to ensure this happens and that this should be included in the licence condition.
- 1.4.7 HAL is in a unique position as an existing owner and operator of Heathrow Airport, with a significant comparative advantage to third parties. We caution the CAA against an automatic assumption that all information within HAL’s possession and requested by third parties is commercially sensitive, and urge the CAA to ensure there is a level playing field which can give third parties wanting to deliver alternative arrangements a genuine chance;
- 1.4.8 We are engaging fully with Arcadis and are committed to an ongoing evaluation of our proposals by the CAA. We recognise the need to move forward with our proposals at pace and for that reason we are seeking the fullest possible engagement with the CAA and other stakeholders to ensure that we are able to ensure efficiency of our application process.

2. SECTION 2 - UPDATE ON THE ARORA GROUP'S PROPOSALS

- 2.1 In responses to previous CAA consultations, we set out our proposals and approach to Heathrow expansion. In May 2018, we publicised our design and cost proposals for the terminal elements.
- 2.2 The Arora Group has now assembled a full team and is currently committing significant work and resources to its application for a Development Consent Order (DCO) for terminal-led development to support the new third runway being promoted by HAL. The Arora Group's development comprises 'Heathrow Western Hub' and other infrastructure necessary to provide a comprehensive and integrated solution to connect in to the new runway.
- 2.3 Heathrow Western Hub is an alternative to HAL's proposals for the terminal elements of the NRS. It comprises the reconfiguration and expansion to the west of Heathrow Terminal 5. Heathrow Western Hub integrates new passenger facilities with Terminal 5 into a single hub campus.¹
- 2.4 Heathrow Western Hub forms part of the NRS, although it is not our intention that it includes the runway itself or the major M25 alterations necessary to accommodate the runway. Both of these elements are being promoted by HAL, through a separate DCO.
- 2.5 It is the Arora Group's position that Heathrow Western Hub can be delivered in conjunction with components of HAL's proposals for the runway and associated M25 alterations to deliver the complete NRS.
- 2.6 The Arora Group's application for development consent will seek powers for the Arora Group to construct, own and operate Heathrow Western Hub and powers for HAL to deliver and operate the remainder of the development.
- 2.7 We believe that this approach will evidence significant benefits arising from the terminal elements of the NRS being delivered and operated by the Arora Group, including:
- 2.7.1 The introduction of competition in development, ownership and operation.
 - 2.7.2 Delivery of additional terminal capacity efficiently and affordably.
 - 2.7.3 Significantly lower construction costs.
 - 2.7.4 Flexibility to enable a phased increase in terminal capacity in a timely manner and in line with demand.
 - 2.7.5 Reduced costs for consumers and improved passenger experience.
 - 2.7.6 Greater design quality and operational efficiency, brought about by the Arora Group's extensive experience in airport based developments.
 - 2.7.7 Integration of existing and new public transport interchanges in a single location to support key modal shift.
 - 2.7.8 Reduced land take and impacts and positive focus on communities.
 - 2.7.9 A fully sustainable approach to development and operation.
- 2.8 The Arora Group already owns a substantial amount of the land required for the Heathrow Western Hub.

¹ Full details of the western hub can be found at <http://heathrow.thearoragroup.com/>.

- 2.9 We have introduced our planned DCO application and scoping proposals to the Planning Inspectorate (**PINs**).
- 2.10 We have also fully supported and engaged with Arcadis, which has been appointed by the CAA to undertake a review of the Arora Group's proposals.
- 2.11 We are continuing the process of engaging with the wider stakeholders, in addition to the airline community, the CAA and the Department for Transport (**DfT**), with which we have been engaging for some time.

3. SECTION 3 - THE OVERALL TIMETABLE AND THE INTERIM PRICE CONTROL

- 3.1 In our response to CAP 1658, we noted the CAA's plans for an interim pricing review. At the time, the CAA's proposal was for a possible one- or two-year extension period. We encouraged the CAA to keep the respective 'business as usual' and 'expansion' criteria separate to enable clear comparison with alternative proposals for expansion.
- 3.2 It is disappointing to now learn that HAL's DCO timetable has slipped and is at risk of even further delay. The CAA has previously stated that the timely delivery of Heathrow expansion is an important issue and this news therefore reinforces the requirement for alternative parties and proposals to be considered and incorporated on a level and transparent basis. This is essential to provide expansion with the best chance of timely delivery.
- 3.3 We note the CAA's comments about a possible commercial deal between HAL and airlines which could wholly or largely replace the need for an interim price control. While noting that such an arrangement could have obvious benefits in the interim period, we would caution the CAA against considering this as an alternative to introducing long term competition at Heathrow Airport. We have repeatedly emphasised our view that competition is the most effective means of delivering benefits to consumers.

4. SECTION 4 - PROMOTING ECONOMY AND EFFICIENCY

- 4.1 We strongly support and welcome the CAA's proposal to include a new licence condition to promote economy and efficiency. Such a condition should apply to expansion as well as business as usual activities.
- 4.2 However, our view is that this condition should sit alongside alternative delivery arrangements and not be considered as a substitute. It should also be incorporated at an early stage to cover HAL's activities during the DCO process. The combined effect of these two points would be to establish clear obligations on HAL and to ensure that alternatives are available for open comparison, thus allowing the benefits of competition to be assessed in a timely manner and minimising the risk for the expansion timetable.
- 4.3 We are also pleased that the CAA recognises the limitations of the current licence obligations, which in this area relate only to the procurement of capital projects in an economical manner (CAP 1722, para 2.2). We have consistently argued that consumer interests for expansion must incorporate not only the efficient development of expansion, but also the ownership and operational dimensions.
- 4.4 HAL has already in effect sought to limit the scope of competition from alternative delivery arrangements in its Innovation Partners Process by excluding certain categories of proposals which are not consistent with its strategic objective of retaining ownership and operating responsibility for Heathrow as a single hub. It has therefore excluded the benefits which may be achieved from separate terminal ownership and operation.
- 4.5 If the CAA were to consider that introducing this new licence condition alone were a sufficient means of promoting competition in accordance with its statutory duties, and to stop considering wider alternative delivery mechanisms, it would in effect be endorsing the narrow position that HAL has chosen to take as against the express requirements of the CAA in CAP 1658. Whilst we do not think this is the CAA's position, we see merit in clarifying our view.
- 4.6 We support the CAA's proposed approach and ideas on drafting of the condition, including identifying areas of particular importance in the licence condition itself, rather than in separate guidance. As currently drafted, the condition would not in our view risk being vague or disproportionate, as suggested by HAL. We also disagree with HAL's implicit suggestion that there is no evidence to justify the introduction of such a condition. In our view, there is ample evidence in the CAA's Section 16 reporting duties and multiple consultant reports commissioned by the CAA² to support the view that HAL is not running its business as efficiently as possible in the best interests of consumers, or engaging with stakeholders to provide timely and accurate information.
- 4.7 Our view in welcoming the CAA's proposals for such a licence condition is subject to the following comments.

² See for example the benchmarking reports carried out as part of preparation of HAL's business plans (CAP 1540), which show that HAL materially underperforms its peers on almost every cost metric and has consistently done so for many years; see also Cambridge Economic Policy Associated Ltd, *Review of Operating Expenditure of Heathrow Airport*, 22 March 2017, which suggests that HAL's accounts may have been misstated. For further information, see Part 7 of our response to CAP 1610.

- 4.8 *First*, we urge the CAA to clarify that such a condition could be enforced against HAL if it refused to engage with third parties, including Arora, in respect of the development of their alternative proposals (provided the request was made in line with the CAA's expectations).
- 4.9 *Second*, we urge the CAA to introduce this condition early in 2019 to ensure that it is effective through the DCO preparation period. The licence condition will be most effective if it shapes HAL's behaviour during the DCO process, rather than be used as a stick to penalise breach further down the line and when it is potentially too late.
- 4.10 *Third*, it is important that the CAA operates a dual approach of licensing conditions and alternative party inclusion to provide the best opportunity for expansion success.
- 4.11 *Fourth*, we urge the CAA to include clear licence obligations on HAL to collaborate and make non-commercially sensitive information available to alternative parties who are promoting alternative plans for Heathrow expansion. In this context, the CAA should form a clear view on what is meant by "commercially sensitive". It should not be construed narrowly as any information which might be useful to a third party which is offering an alternative to HAL.
- 4.12 This is a point we have urged the CAA to consider previously. The context is that where alternative parties are submitting competing DCO applications, there will be significant benefits for commonality of activity and information. Examples are surveys, land referencing, traffic forecasts, impacts assessments and stakeholder/community engagement. The risk of community confusion and duplication is a point which has been made strongly by the DfT in our recent engagement.
- 4.13 A co-ordinated approach would avoid duplication, reduce cost, promote efficiency and save time. It would enable the DCO process to focus on respective parties' outputs, rather than inputs, and we expect would be welcomed by PINs, the DfT and stakeholders. It should be remembered that the information which HAL has chosen to withhold from third parties and not release through collaboration includes a significant amount of information covered by Category B costs (which the CAA allows HAL to remunerate, paid for by airlines).
- 4.14 When we have raised this issue with the CAA previously, it has advised us to be specific and targeted about the information requested. While we have followed up with specific requests for information, we would respectfully argue that this does not address the underlying issue of HAL's failure to properly engage. The issue is one of HAL's lack of willingness to cooperate and this is what needs to be addressed urgently. Unless this is tackled by clear and decisive direction by the CAA, HAL will continue to slow down and frustrate what should be a clear, sensible and efficient process.

5. SECTION 5 - ALTERNATIVE DELIVERY ARRANGEMENTS

The CAA's Role and Powers

- 5.1 In response to the CAA's previous consultations, the Arora Group has repeatedly emphasised that the CAA has a statutory responsibility to promote competition in airport operation services in the exercise of its functions and to consider competition more widely in the context of designing a regulatory framework for Heathrow expansion. We have consistently stated that the CAA needs to consider the benefit of competition, both for delivery of expansion and beyond that, in subsequent ownership, control and operation of the expanded airport.
- 5.2 Specifically, we highlighted our view that the CAA underestimated the extent of its powers to facilitate competition in delivering Heathrow expansion (short of *mandating* competition) and in so doing, was at risk of losing a generational opportunity to introduce competition at Heathrow Airport and identify the benefits to consumers which could arise.
- 5.3 We expressed our view that, while the CAA was nominally supportive of alternative delivery mechanisms for Heathrow expansion, it was silent on the regulatory position and the detail of its approach to support such arrangements.
- 5.4 We very much welcome the CAA's clear statements, in CAP 1722 and the TIN published in August 2018 to which CAP 1722 refers, that the regulatory framework under the Civil Aviation Act 2012 (**CAA 2012**) can accommodate multiple operators at Heathrow airport. We particularly welcome the CAA's acknowledgement that its powers can extend, where necessary and appropriate, to requiring HAL to enter into contractual arrangements or agreements with a developer or operator of new terminal capacity at Heathrow, including to ensure the integration of new capacity into the operation of the airport as a whole. We consider that such a statement is important to ensure that third parties, such as Arora, can have the confidence to come forward with developed proposals for alternative arrangements.
- 5.5 We are very pleased that the CAA recognises in CAP 1722 the Arora Group's important role in the delivery of alternative arrangements for Heathrow expansion with its separate application for a DCO, by giving such pre-eminence to Arora's plans.

Developing the Regulatory Framework

- 5.6 We agree with the CAA's statement of the importance of developing the regulatory framework in a timely way and welcome the CAA's acknowledgement of the need to adjust the existing regulatory framework to facilitate and support alternative arrangements, with particular reference to the Arora Group's plans.
- 5.7 The principle of assessing the benefits of alternative delivery mechanisms extends not only to the efficient delivery of expansion, but also to subsequent ownership and operation. All of these components fall within airport operation services.
- 5.8 We are anxious that the significant further work which the CAA will have to undertake to adjust the regulatory framework is undertaken quickly, efficiently and without undue constraint. It is critical that the CAA maintains momentum in considering these issues and does not allow delay in

designing the regulatory framework to potentially impact development and implementation of third parties' plans, such as Arora's. We will continue to maintain ongoing discussions with the CAA both on our views on the regulatory framework and as our plans progress. We therefore welcome the high level work programme that the CAA has set out for itself in order to consider the regulatory issues raised by Arora's plans.

- 5.9 We believe that the CAA needs to have a clear view on the regulatory framework which could apply for competition and alternative third party inclusion prior to the DCO applications being submitted. The regulatory framework may need to be adjusted quite significantly to incorporate more than a single operator. In fact, it is difficult to understand how the CAA would be able to respond fully as a statutory consultee on competing DCO applications at least until it has reached a view on the regulatory framework which may apply.
- 5.10 In our view, the CAA must consider and plan this workstream immediately, and it should include consideration of the following issues:
- 5.10.1 How the CAA intends to allow for the integration of the different parts of the airport operated by different parties. We welcome the CAA's clear statement in the TIN that the CAA 2012 can accommodate multiple operators at a particular airport and the CAA's statement that it would have regulatory and licensing powers over such operators. Arora considers that the CAA should be beginning to consider how these powers would be exercised to allow integration of the different parts. For instance, it is likely that, whoever the third party and whichever part of the airport they may be developing and/or operating, they would require access to common facilities operated by HAL.
- 5.10.2 Related to the above point, the CAA will need to consider the division of responsibility between different operators of the parts of the airport. This would include consideration of any necessary obligations on all operators, both in respect of their exclusive areas and common areas.
- 5.10.3 What changes may be required to HAL's licence to accommodate these changes. It may be that HAL's licence is amended to ensure it provides access to third parties over common areas or some of the areas that it exclusively controls, where this is necessary for the operation of the airport as a whole.
- 5.10.4 How the CAA intends to regulate third parties. The CAA did not clarify in the TIN whether it stands by its previous statements that it would only be able to issue a licence to a new operator if it first made a market power determination, or whether it considers that it can do so adequately on the basis of an operator determination alone.
- 5.10.5 The timing implications of all of the above. The CAA will need to factor into its overall timetable for designing the regulatory framework for Heathrow expansion any need to amend HAL's licence and/or make any necessary operator or market power determinations.
- 5.11 We ask the CAA to provide guidance on the process and timetable to undertake this work and the Arora Group is prepared to support this fully.
- 5.12 While we appreciate that the CAA does not want to undertake significant additional work without evidence that credible and feasible proposals are being developed, the CAA is aware that Arora is engaging with Arcadis, and indeed with the CAA itself and other stakeholders, to explain the detail of its developing proposals. Arora requires the confidence and guidance from the CAA's process progressively as it prepares its DCO.

- 5.13 It is important that the CAA facilitates this and does not set the bar too high for third parties such as Arora to come forward with alternative proposals for expansion, and create an uneven playing field which would inevitably benefit HAL and risk deterring third parties. As the CAA is aware, Arora is committing significant resource and investment to the development of its proposals and needs to have confidence that the CAA will adjust the regulatory framework in time to accommodate its proposals, if its DCO application is successful.
- 5.14 In this regard, we concur with the airline community's warning that the CAA's emphasis on timely delivery should not risk prioritising speed of delivery over possible efficiency savings in years to come.

Information provision, collaboration and section 16 reporting

- 5.15 We are particularly concerned to ensure that the CAA does not allow HAL to "time out" Arora's proposals, by virtue of its failure to engage with us to facilitate the preparation of granular and detailed proposals, including interactions between our proposals. As we have repeatedly stated to the CAA, HAL holds key information, which is critical to enable the development of our plans.
- 5.16 HAL's failure to collaborate and provide this information risks unfairly tipping the balance in its favour when it comes to a comparative assessment of our competing proposals. It also risks timing out competing applications for DCOs. The CAA needs to be acutely aware of this issue and take decisive action, and quickly. We have also commented on the need for HAL to engage in good faith with Arora and other stakeholders in Section 4 above.
- 5.17 In our view, the CAA cannot and should not permit HAL to frustrate competition in the interests of its own commercial and strategic ambitions. If the CAA allowed this to happen it would be at risk of not complying with its statutory duties. The greater potential benefits for consumer interests must have priority over HAL's narrow commercial interests.
- 5.18 We have previously and consistently highlighted to the CAA our concerns regarding HAL's failure to engage with us regarding alternative commercial arrangements to the standard expected of the CAA and clearly set out in CAP 1658, and in particular its failure to supply key information which it holds and we have requested to support the development of our plans.
- 5.19 Despite the CAA's expectations that HAL engage with third parties in good faith, we have been faced with a persistent refusal to collaborate and to supply information, which demonstrates an unwillingness to engage. Although we have received a limited amount of traffic data, this is significantly short of our full list of requests and has in itself taken a long time to secure
- 5.20 We note the CAA's comments that, as Arora is a potential rival to HAL in the context of bringing its own DCO application, its expectations of HAL's engagement with and provision of information to Arora would be different. However, we urge the CAA to consider such a position carefully. HAL is at a significant advantage compared to any third party wishing to bring forward alternative delivery mechanisms, given its position as the owner and operator of Heathrow airport for many years. It necessarily holds a significant amount of information which third parties would simply not be able to access, or which it would be difficult and expensive to replicate.
- 5.21 We understand the CAA's concerns regarding competition law. We are very aware of the requirements of competition law, as our leniency application to the UK Competition and Market Authority relating to pricing restrictions in our Terminal 5 Sofitel Hotel Lease demonstrates. However, we would caution the CAA against taking a simplistic view assuming all information is commercially sensitive. This is not the case and this would in effect foreclose any rivals from

bringing a credible proposal in the context of Heathrow expansion as well as create an uneven playing field, by virtue of the high bar set for third parties.

- 5.22 There is inherent merit in both parties taking a joint approach to certain activities in the interests of time and cost efficiency, and without prejudicing the competitive dynamic between them or involving the disclosure of commercially sensitive information. We have made clear our readiness to engage in joint activities with HAL where there is potential for efficiencies and to avoid duplication. As an example and to this end, we have proposed to undertake joint land referencing with HAL.
- 5.23 We request the CAA to recognise the benefits of appropriate collaboration and common approach and information and to seek to enforce this with HAL immediately.

HAL's Innovation Partners Programme

- 5.24 In this context, we therefore welcome the CAA's clear statement that HAL's Innovation Partners programme does not meet the CAA's expectations or the requirements set out in CAP 1658.
- 5.25 HAL committed to engage in good faith with (among others) third parties coming forward with alternative delivery arrangements in its response to CAP 1541 and the CAA has been clear a number of times that it expects HAL to stand by those statements. In CAP 1658, the CAA set out the detail of its requirements, which include an expectation that HAL engages proactively and constructively with third parties, and treat their proposals as genuine alternatives in relation to which it must seek to resolve any weaknesses.
- 5.26 In spite of these requirements, HAL launched its Innovation Partners programme to invite expressions of interest from parties with proposals which align with HAL's strategic objectives, including to continue to own and operate Heathrow as a single hub airport. This is inconsistent with the CAA's express expectations and its responsibility to promote competition, which in our view requires it to carefully assess the benefits of competition without allowing HAL to close the door prematurely, at the very least until the merits of each proposal have been assessed openly and without constraint.
- 5.27 We welcome the CAA's confirmation that the Innovation Partners programme developed by HAL in response to the CAA's requirements does not in fact meet the criteria clearly set out by the CAA in CAP 1658, nor meet its expectations (or those of third parties) that HAL engage with third parties to explore in good faith alternative ways of delivering expansion in a manner which would further consumer interest. HAL's Innovation Partners programme is akin to a procurement process, designed to select potential suppliers. Its explicit rejection of proposals based on separate terminal operation is hasty and unjustified, as the CAA rightly points out, and appears to be a premature position given our stated intentions. It also means the process is not an adequate framework within which we can properly engage with HAL.
- 5.28 Moreover, Heathrow's programme unduly narrows the concept of competition to the procurement of the component of expansion delivery, rather than in the wider aspects of both delivery of expansion and subsequent ownership and operation. The CAA must not allow HAL to narrow competition in this way, and we are pleased that the CAA has expressly confirmed that the programme falls short of its requirements – we fully support it in this position.

Information Provision by Arora

- 5.29 We appreciate the CAA's general point that it cannot set out its position on certain regulatory issues without further details of third party plans or alternative commercial arrangements. That

said, it is important that as these plans progress, as Arora's are now, the CAA continues to give third parties the required clarity on its approach to the regulatory issues and framework.

- 5.30 In CAP 1722, the CAA refers to the requirement to assess the Arora plans to establish whether they have merit. We are fully committed to support the CAA in this process and see the airlines as also playing a major role.
- 5.31 The CAA has appointed Arcadis to undertake an initial review of the Arora proposals. At the time of this response to CAP 1722, this review is nearing completion.
- 5.32 During this review process, Arora has fully supported Arcadis, albeit reflecting the early stage of our design process. We are fully committed to supporting the CAA and Arcadis in the progressive evaluation of our plans as design progresses through the DCO. We see this as an ongoing process.

