

The Arora Group's response to CAP1610 Economic regulation of capacity expansion at Heathrow: Policy Update and Consultation

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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 1610 Economic regulation of capacity expansion at Heathrow: Policy update and consultation", published in December 2017 (**CAP 1610**). It builds on our response to the CAA's previous consultation, "CAP 1541 Consultation on the core elements of the regulatory framework to support capacity expansion at Heathrow" (**CAP 1541**).
- 1.2 We fully endorse the CAA's statement that additional runway capacity in the south east of England will benefit air passengers and cargo owners and that it is required to prevent consumers experiencing higher fares, reduced choice and lower service quality. We also continue to support the Government's North West runway scheme and believe we can make a positive contribution.
- 1.3 In our response to CAP 1541, we made the following key points:
- Heathrow Airport Limited (**HAL**)'s substantial market power enables it to charge high airport charges, to the detriment of passengers and airlines;
 - Heathrow expansion is of an unprecedented scale and complexity;
 - HAL should not be assumed as the sole delivery agent for expansion;
 - Heathrow expansion provides a unique opportunity to introduce competition for the long term benefit of users;
 - Competition should not be limited to the delivery of expansion: it should include allowing subsequent airport ownership and operation by a third party (which we refer to throughout this submission as "**terminal competition**");
 - We summarised our design scheme submitted in response to the Government's National Policy Statement (**NPS**) consultation;
 - We showed that our cost estimates were substantially below HAL's estimated costs for its competing proposal;
 - Our proposals are based on extensive engagement with airlines which have provided their general support.
- 1.4 In this submission we provide our key comments in response to CAP 1610, which can be summarised as follows:
- HAL is currently assuming responsibility for Heathrow expansion. Its failings are plainly evident i.e. lacking transparency, inefficient, expensive and resulting in high returns to shareholders. These directly result from its current monopoly position. This is a serious warning sign for the success of expansion and the protection of user interests. This needs to be changed urgently.

- In fact, the CAA's current process is flawed when considered in the context of user interests. It focuses on a single monopoly party, who are recognised as not capable of implementing expansion efficiently. The CAA is judging success on narrow criteria and expects to use cost controls as its primary tool, but late in the process when it will be too late to use this effectively and to introduce alternatives. This is a recipe for failure and needs to be changed fundamentally. The CAA should raise this issue and these concerns with the Secretary of State urgently.
- We strongly recommend that the CAA and the Government consider alternative delivery models at Heathrow to achieve expansion and to introduce much needed competition. **These issues must remain a key focus for the CAA and the Government in taking forward the expansion plans** (see section 2).
- Whilst the CAA has introduced the concept of alternative delivery mechanisms, we call on the CAA to set out the basis on which such alternative delivery mechanisms can be achieved and what the CAA requires to facilitate this. The CAA's approach in CAP 1610 does not demonstrate that it is able or committed to enabling Heathrow expansion in an efficient, economical or competitive manner. **The CAA's current position puts at risk the significant benefits for users that expansion can bring about.** (see section 3)
- The Arora Group has already presented a credible alternative proposal to HAL's scheme in response to the Government's NPS consultation and galvanised support from a number of airlines. Since then, **the Arora Group has made considerable progress on the design of this alternative plan**, in coordination with established specialist advisers including the Bechtel Group (master planning, engineering and construction), Corgan (architecture) and Doig and Smith (cost management). The detailed design provides for expanded capacity on the Western Campus and the potential for substantial operational efficiencies in the implementation and management of that capacity (see section 4 with further details in **Appendix 1**). Our cost estimate remains at £12.4bn, which is substantially below HAL's cost "indications" and makes our approach in line with the Government and airlines' affordability criteria.
- The CAA cannot ignore the existence of credible alternative delivery proposals, such as that of the Arora Group, particularly in light of the CAA's wide ranging statutory duties. **The CAA has a primary duty to further the interests of users of air transport services, and to do so in a manner which it believes will promote competition.** These are broad duties which require it to consider a range of factors, including the range, availability, continuity, cost and quality of airport operation services and the need to promote the economy and efficiency of a licensee such as HAL. We note the CAA's concerns around any delay in the delivery of expansion, as evidenced by Andrew Haines' comments before the

Transport Select Committee on 20 February 2018. However, in our view the CAA does not appear to have fully considered the breadth and implications of its statutory duties in the context of the development of a regulatory framework for Heathrow expansion, which would not for instance permit delay to become the single overriding consideration at the expense of future generations of users. In fact, the current focus on avoiding delay is a false economy and places undue risk on the overall efficiency and success of expansion and related user interests. It also increases the risk of delay through challenge and/or HAL's shareholders not accepting the CAA's cost determination (see **section 5**).

- We note that the CAA considers it does not have the powers to mandate a competitive process to select the party to take forward Heathrow expansion. This being the case, we call on the CAA to address this with the Secretary of State for Transport and for the CAA to set out what it needs and what it is doing to obtain all the necessary powers to facilitate Heathrow expansion to be undertaken in a competitive and cost-efficient manner securing the long-term interests of users. In the absence of mandating a competitive process and considering a broad range of criteria, the Government is at risk of allowing a very significant national infrastructure project to be developed without due consideration of all options and without due regard to the long-term economic efficiency of Heathrow, endangering the benefits expansion is designed to bring about.
- However, in our view, the **CAA does have statutory powers under the Civil Aviation Act 2012 (CAA 2012) to support the development of alternative delivery mechanisms** in the delivery of capacity expansion and terminal competition. In fact, in our view the CAA appears to have taken a narrow view of the extent of its powers. In light of its duties, it is incumbent on the CAA to seek to develop the most competitive delivery model for Heathrow in order to fulfil its statutory duties and there are a number of options open to the CAA. It is critical for the CAA to understand that these options do not necessarily require substantive regulatory change and/or delay in delivering expansion, particularly given the existence of credible alternative delivery proposals such as Arora's. *First*, the CAA could impose a condition on HAL to consider the most competitive solution for delivery of capacity expansion (including a long lease or concession to a third party), or alternatively the CAA could issue a licence to a new entrant who would design, construct, own and operate the new terminal (as well as imposing licence conditions on HAL to accommodate a separate terminal owner), to address any potential concerns the CAA may have regarding a new arrangement. *Second*, the CAA could take measures to incentivise HAL to consider alternative commercial and/or competitive solutions, including through licence conditions and price controls. *Third*, the CAA can impose measures to facilitate engagement regarding alternative delivery mechanisms (see **section 6**).

- **Heathrow expansion is a unique and critical generational project** which it is important to get right, in the interest of both users of air transport services and the UK as a whole. Heathrow is the most expensive commercial airport in the world and it has a unique position as the only hub airport in the UK. There is also considerable stakeholder concern regarding HAL's capacity to deliver timely and cost efficient expansion in light of its past performance. Heathrow expansion provides the ideal opportunity to introduce competition, which is the most powerful and effective tool to ensure the intended benefits of capacity expansion are delivered. This is consistent with the findings of the Competition Commission (CC) in its Market Investigation Report in 2009¹, the objectives of the CAA 2012 and the CAA's duties under it. The level of stakeholder concern and evidence of HAL's poor performance warrants immediate Government and CAA intervention and the CAA and Secretary of State must urgently address the legislative and regulatory framework that is required to ensure that users' interests are met and protected (see **section 7**).

1.5 In **section 8**, we set out our recommendations for the CAA to take forward Heathrow expansion plans.

1.6 Finally, in **section 9** we provide some comments on certain other aspects of CAP 1610.

¹ CC, *BAA airports market investigation – A report on the supply of airport services by BAA in the UK*, 19 March 2009 (referred to as the **Market Investigation Report** in this submission).

2. ALTERNATIVE DELIVERY AND OWNERSHIP MODELS TO ACHIEVE COMPETITION MUST REMAIN A KEY FOCUS IN TAKING FORWARD EXPANSION AT HEATHROW

- 2.1 In CAP 1541, we argued strongly that the CAA’s statutory obligation to facilitate competition at Heathrow should extend to both alternative delivery mechanisms and alternative ownership and operating models for expansion. Both are within the scope of Section 1 of the CAA 2012 and are key issues for users of air transport services.
- 2.2 The former will support the CAA’s desire to ensure an efficient and affordable scheme and the latter will serve the interests of users on completion and operation. We further encouraged the CAA to consider how these should be combined in an overall process and strategic plan for expansion. We strongly urge the CAA and UK Government to continue to place these issues at the forefront of their considerations in taking forward Heathrow expansion.
- 2.3 We set out our planned approach to the delivery element in CAP 1541 in response to the CAA’s questioning around alternative delivery mechanisms. We have not sought to repeat our approach here, but request the CAA to focus on the benefits which our team’s approach can bring and the part we can play in ensuring an efficient, affordable and financeable scheme. We believe these strengths are further evidenced by the design progression explained below and at Appendix 1.
- 2.4 For the alternative ownership and operating models, we suggested that there are various ways of providing this, but that it can be best achieved by the introduction of competition in the supply of terminal capacity. Whilst it is possible for airfield ownership to be separated, we can see the case for the airfield to be operated in a common manner². However, separation of terminal capacity would enable different owners to compete for airline and passenger business, placing competitive pressure on charges and the delivery of facilities and associated services, resulting in material benefits for air transport users and encouraging greater partnership between airlines and owners.
- 2.5 A key factor in introducing competition is for spare terminal capacity to be available, or at least the opportunity for spare capacity to be provided. Here, the CAA should see that our Western Campus approach provides the potential for additional capacity in excess of current Airports Commission forecasts. A competing owner would also have the ability to do so in the Eastern Campus.

² We note that this issue was covered in questioning to the Secretary of State for Transport at the Transport Select Committee on 7th February. It appeared that the issues relating to the airfield and terminals had become confused. We have subsequently written to the Secretary of State to clarify that our view on separation relates to new terminal capacity and not to operation of the airfield.

- 2.6 We believe that our Western Campus design provides the ideal platform to enable terminal separation and the introduction of competition at Heathrow. The Western Campus can be developed and funded by a third party and can be subsequently owned and operated separately, using a commonly operated airfield.
- 2.7 We believe this model would enable the CAA to achieve the introduction of competition at Heathrow, but without any prejudice to the integrity of efficient airport operations. Competition principles are of course a better solution than regulation. It would therefore allow the CAA to review the nature of future economic regulation to reflect the new commercial structure. We would request the CAA include this objective in its aspirations for expansion.
- 2.8 It is important to emphasise that competition within airports is not a new and untried concept. We have included some examples in Appendix 3. Perhaps the closest analogy is JFK in New York. There are six terminals, all with varying degrees of ownership and control with airlines and related consortia. The airlines are required to comply with prescribed standards within the terminals, but otherwise have devolved control over their operations and activities. All airline operations are from a common airfield, which is operated by the Port Authority and the airlines are charged for use. This structure works well and has been successful. Munich is a European example, where Lufthansa has operational responsibility in Terminal 2 but does not own the airport.

3. THE CAA'S APPROACH IN CAP 1610

- 3.1 In CAP 1541, we argued strongly that Heathrow expansion is a generational opportunity to introduce competition into Heathrow for the benefit of air transport users.
- 3.2 We were encouraged that the CAA had voluntarily introduced the concept of alternative delivery mechanisms. This was an important start, but we argued that this should be broadened to lead naturally into considering the introduction of alternative ownership and operational responsibility at the airport. This would provide potential for the true benefits of competition at Heathrow to be achieved for consumers. This is a view we believe is shared generally by Heathrow airlines.
- 3.3 We are therefore disappointed that the CAA has taken a passive position on the means of achieving competition in CAP 1610, and that the CAA has provided no articulation of its assessment of options for alternative ownership and operating models for the airport.
- 3.4 We note that the CAA considers it does not currently have powers to mandate a competitive process to select the party who will deliver Heathrow expansion. However, the CAA has broad statutory obligations and we would expect a rigorous examination of these powers³. We set out in this response why we believe the CAA is at risk of not fulfilling its statutory obligations under section 1 of the CAA 2012, and specifically we call on the CAA to respond clearly on why it considers that it cannot regulate to enable a third party to develop and operate a separate terminal.
- 3.5 We are pleased that the CAA at least indicates that it is open for alternative parties to come forward and considers CAA12 to be sufficiently flexible to accommodate a range of commercial structures and is prepared to discuss the framework for economic regulation.
- 3.6 This is set out in 1610 s.1.16:

"If a party has a specific proposal under development and wants to discuss the operation of the framework for economic regulation, or the provision of information that might better facilitate finalising its proposal, we continue to be open to discussions on these matters. Nonetheless, we would expect that any proposal would be sufficiently developed to:

- *allow for meaningful discussions of key issues (including consumer benefits);*
- *include a description of the means by which their plans can come to fruition through commercial negotiation and discussion, and the planning and other consenting processes; and*

³ Please see section 5

- *allow us to come to a clear understanding of any additional information that might reasonably be required to progress the proposal further.”*

- 3.7 The Arora Group has come forward and developed detailed and costed plans, both for expansion and for a new Heathrow western campus which meets the Airport Commission’s target of 70 mppa in the West with potential to expand beyond.
- 3.8 However, there is no clear process, timetable or means to pursue our proposals and the CAA does not set out the basis on which alternative delivery mechanisms can be achieved, and what the CAA would need to achieve this. In contrast, the overall tone of CAP 1610 focuses almost exclusively on HAL and the existing regulatory structure. We call on the CAA to address this clearly in its response to this consultation
- 3.9 It is difficult not to conclude from this that the CAA has an assumption (or feels constrained) that HAL will undertake the development of expansion and will own and operate all facilities on completion. This is the case despite no formal selection of HAL as expansion provider having taken place, HAL not being sole landowner and HAL not receiving the general support of airlines. In fact, we cannot understand how something as important as Heathrow expansion can be implemented without a competitive process.
- 3.10 We also believe that the CAA’s current approach and timetable is exposing expansion and user interests to significant risk. The CAA is taking a narrow view in trusting that it will be able to control HAL’s costs further down the line ahead of a Go/No-Go decision. However, this just won’t work; it will be too late and the likelihood is that the CAA will be squeezed by HAL’s shareholders. The CAA is falling into an obvious trap. If so, it is users who will suffer. The issue of contestability therefore needs to be addressed immediately.
- 3.11 In fact, we are aware that HAL has been working on the Heathrow expansion plans for over four years. As things stand, there are no signs of a settled scheme, no cost transparency, no evidence that affordability criteria will be met and there is little, if any, airline support for HAL’s scheme and credibility. We also consider it inconceivable that HAL does not have detailed cost information at this stage. It is difficult not to conclude that this is HAL playing it long and thereby strengthening its own position.
- 3.12 We cannot see how this position is compatible with the CAA forming a view on overall scheme affordability and financeability by April for reporting to the Secretary of State (including on HAL’s engagement with airlines as requested in the CAA’s letter of 26 October 2016 to HAL). It is entirely foreseeable that airlines will not support HAL’s role and that by pursuing such a route will ultimately leave its decision open to challenge.
- 3.13 If this approach continues, we believe the CAA will have failed in its statutory duties, and failed to establish that users’ interests will be fully met.

- 3.14 In fact, it is not guaranteed that HAL's shareholders will invest. The interests of users and HAL's shareholders are not necessarily aligned and shareholders (or a single shareholder) withholding consent could delay the expansion of Heathrow until a subsequent change in legislation. The natural risk is that if the CAA and the Government runs with a narrow process, it will find itself leveraged by HAL in due course on the required terms to secure the necessary funding commitments. We consider this to be an unacceptable risk and not a position the CAA would wish to find itself in. This can only be overcome by an open process now, with the correct safeguards in place before developer selection is narrowed down on merit.
- 3.15 This principle should extend to the CAA's planned final report to the Secretary of State in April this year, which we believe should set out options, rather than refer solely to the HAL status quo. This approach is in line with the Government's stated position of leaving development responsibility open.
- 3.16 We also believe expansion should be evaluated within a framework of strategic criteria which are wider than the CAA's current focus on affordability and financeability. In particular, we believe efficiency, capability, user support, phasing opportunity and an overall strategic plan for facilitating competition in use should be incorporated.
- 3.17 We set out in the remainder of this response our views on the CAA's statutory obligations and its powers, and what we consider the CAA should and can do in taking forward Heathrow expansion. These are put forward in a constructive manner to support the CAA and we remain willing and committed to engage fully with the CAA on these issues going forwards.

4. THE UPDATED ARORA GROUP DESIGN

- 4.1 In CAP 1541, we provided details of our first stage design for expansion:
- We outlined the expertise and experience in undertaking major airport infrastructure projects of our development team, led by the Bechtel Group.
 - We set out alternative options for the position and length of runway.
 - We showed an improved approach for the Western Campus layout, developed in consultation with airlines to meet their operational requirements.
 - We achieved a 23% reduction in the expansion footprint and land take against the HAL baseline.
 - We provided cost estimates for the various options, undertaken by Doig and Smith. Our cost for the option which directly compares with the Airport's Commission recommendation was £12.4bn.
- 4.2 Since that time, the Government has clarified that it plans to retain the existing NPS expansion red line boundary and for this reason, we have not progressed the alternative runway options (even though they offer potential to save considerable cost and disruption).
- 4.3 However, we have since completed a detailed design for the Western Campus, led by the Bechtel Group, Corgan and Doig and Smith. The detailed design comprises layouts and sizing for the new terminals, stands and related taxiway infrastructure. This work has been undertaken in consultation with airlines to ensure that it meets airline operational requirements.
- 4.4 Our design concentrates new terminal capacity in the Western Campus. This retains the operational advantage of keeping western operations in one location and avoids the need for remote terminals and satellites and the related expense associated with connectivity. Importantly, this approach provides the flexibility to expand terminal capacity on a phased basis, both in T5 and the new T6 satellites. Our new Western Campus design is in line with the Airports Commission's target of 70mppa in the West. Subsequent phases in the Western Campus provide potential to add additional capacity in line with demand.
- 4.5 Our design includes a new T6A central landside facility, serving as a single campus front door to the existing T5A and to new western satellites. This enables substantive efficiency gains: centralised landside passenger processing frees up more airside capacity in T5A and reduces the required size of the new T6 satellites. The landside building will incorporate check-in, a replacement T5 car park, a new integrated passenger transport interchange and all associated landside commercial facilities (hotels etc.).

- 4.6 Our consultation with airlines has identified the operational advantages of separating long and short haul operations. Our proposal therefore concentrates long haul in the existing T5 and short haul in the new T6 satellites. Long haul capacity growth would be available by converting T5A to predominantly airside and with further growth realised by additional T5 stands on the existing airfield. Short haul traffic would be housed in new T6B and T6C satellites, both connected to T6A by high level bridges to preserve the integrity of aircraft stand movements below.
- 4.7 This approach is therefore highly efficient and flexible. Our estimated cost has been updated by Doig and Smith. This reflects the Western Campus design progression, but with no change to the other elements of the expansion footprint, consistent with the estimate we provided in 1541. Our updated cost estimate for Phase 1 remains at £12.4bn.
- 4.8 We have therefore validated our previous cost estimate, with improved assurance on the Western Campus components. Our latest estimated cost of £12.4bn remains substantially below the latest HAL cost indications (which we believe to be “indications of” £14-15bn) and is at a level which is in line with the airline and Government affordability requirement.

5. THE CAA HAS WIDE-RANGING STATUTORY DUTIES TO FURTHER THE INTERESTS OF USERS AND PROMOTE COMPETITION

5.1 In summary:

5.1.1 the CAA has widely defined statutory duties which mean that it must exercise its powers accordingly, particularly in light of the existence of credible alternative proposals, such as that of the Arora Group detailed in section 2 above;

5.1.2 the CAA has not fully considered the breadth and implications of its duties.

The CAA has broad statutory duties to further the interests of air transport users and promote competition

5.2 The CAA's general duties under Section 1 of the CAA 2012 Act are broadly defined:

“(1) The CAA must carry out its functions under this Chapter in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services.

(2) The CAA must do so, where appropriate, by carrying out the functions in a manner which it considers will promote competition in the provision of airport operation services.”

5.3 The CAA 2012 thus places the promotion of competition at the heart of the CAA's regulatory activities and statutory duties, consistent with the CC's recommendation in its Market Investigation Report⁴ and the reforms the act intended to introduce.

5.4 In performing its duties, the CAA must have regard to a range of factors, which include the need to promote economy and efficiency of a licensee in relation to its role. The Explanatory Notes to the CAA 2012 make it clear that the requirement to have regard to this (and other) factor(s) reflects the fact that the ultimate aim of economic regulation is to replicate as much as possible in regulation the outcomes of a competitive market.

5.5 In light of these duties, it is incumbent on the CAA, as regulator of HAL's activities, to apply a regulatory framework which will facilitate the development of arrangements capable of satisfying its duty to further the interests of users with regard to improving the quality of services and in so doing, promoting economy and efficiency. This is all the more important given the existence of credible alternative proposals to HAL's which are capable of meeting these requirements, such as that of the Arora Group set out in section 4 above. As is shown in section 6, the application of such a

⁴ CC, Market Investigation Report, paragraph 35.

regulatory framework does not necessarily require the CAA to introduce substantive regulatory change.

The CAA does not appear to have fully considered the breadth and implications of these wide duties

- 5.6 In our response to CAP 1541, we agreed with the CAA’s key priorities in the development of a regulatory framework for Heathrow expansion, and in particular that it is delivered consistently with customer requirements, in a cost effective, affordable and financeable manner. However, we noted that the wider strategic objective should include consideration of competition, as a means of furthering the interests of air transport service users.
- 5.7 In our view, it is critical that the CAA has proper regard to its wide statutory duties in assessing and applying the key priorities for the regulatory framework for Heathrow expansion. At the very least, in developing the regulatory framework the CAA must consider the full range of factors which section 1 of the CAA 2012 requires it to take into account, including the need to promote competition, economy and efficiency in the delivery of expansion and subsequent ownership and operation.
- 5.8 In our view, the CAA has given insufficient consideration to these statutory factors in its consultation on the development of the regulatory framework, and in assessing responses and proposals put forward by respondents:
- 5.8.1 The CAA appears to assume that allowing HAL to deliver Heathrow expansion is the best default option which avoids detriment to consumers in terms of less choice, poorer service levels and higher airfares which it considers results from “uncertainty” (paragraph 1.12 CAP 1610);
- 5.8.2 The CAA helpfully states that it is open to a range of commercial structures at Heathrow and in favour of such arrangements where they can be shown to benefit consumers (paragraph 1.11 CAP 1610). However, this is only one of a number of statutory factors which the CAA is required to have regard to and it is concerning that the CAA appears to focus heavily on only one;
- 5.8.3 It is surprising that given the scale, complexity and importance of Heathrow expansion, the regulatory framework which the CAA is currently developing gives such little, if any, importance to the range of factors included in its statutory duties, not least the duty to promote competition. A failure to even consider competition in the context of capacity expansion risks not only an unfettered extension of HAL’s existing market power but also, for the CAA, a failure to comply with its statutory duties;
- 5.8.4 The CAA places much emphasis on the need for “timely and effective steps” and suggests that the introduction of a new condition in HAL’s licence or modification of existing licence conditions might not meet these requirements of timeliness and effectiveness (paragraph 1.20 CAP 1610). We find the CAA’s comments surprising given its proposal, dating back as early as September 2015, to consider including an additional obligation on

HAL requiring it to operate, maintain and develop Heathrow in an economical, efficient and timely manner;

- 5.8.5 The CAA is readily dismissive of proposals provided by respondents (paragraphs 1.12 CAP 1610), which is puzzling considering the evidence of strong support for alternative delivery mechanism from respondents to the CAA's various consultations. The CAA risks ignoring the overwhelming stakeholder feedback which is in favour of introducing competition both in the governance arrangements for capacity expansion and in price control review. Ignoring these would not further the interests of users. Rather, the interests of users are at risk of being overtaken by the guarantee of returns to HAL shareholders.
- 5.8.6 It is not clear why the CAA dismisses the possibility of exercising powers under the Enterprise Act 2002 as "relevant or justifiable" at this stage (paragraph 1.12 CAP 1610), in a manner which risks prejudging the outcome of any proper consideration of the Enterprise Act 2002.

6. THE CAA'S STATUTORY POWERS ALLOW IT TO APPLY A REGULATORY FRAMEWORK TO SUPPORT ALTERNATIVE DELIVERY MECHANISMS

6.1 In summary:

6.1.1 We consider that the CAA has taken an overly narrow view of its powers;

6.1.2 The CAA's wide statutory duties must frame and drive the CAA's exercise of its statutory powers under the CAA 2012. These permit the CAA to develop a regulatory framework which supports alternative delivery mechanisms, without introducing substantive regulatory change (and delay); and

6.1.3 There are a number of measures which the CAA can take to encourage engagement with alternative delivery mechanisms.

The CAA appears to have taken a narrow view of the extent of its powers

6.2 We note that the CAA considers it does not have powers to mandate a competitive process to select the party who will deliver Heathrow expansion. As noted above, we urge the CAA to address this with the Secretary of State. The absence of such a process in a situation where third parties have come forward with credible competing proposals to that of the incumbent is at odds with the existence of a regulatory framework designed to protect users, consumers and promote competition.

6.3 We also note that the CAA considers that it does not have the power to require HAL to enter into particular commercial solutions or to issue a licence to a new market participant (paragraph 1.11 CAP 1610).

6.4 In our view, the CAA has more extensive powers under CAA 2012, and greater flexibility to support alternative delivery mechanisms, than it considers to be the case.

6.5 *First*, section 21 of the CAA 2012 gives the CAA considerable flexibility as to the content of licence conditions it can impose on HAL, including requiring HAL to enter into a contract or other arrangement for a defined purpose and/or on defined terms.

6.6 *Second*, the CAA 2012 appears not to require a person to be subject to a market power determination in order to be licensed. While there is a focus on operators with market power, the wording of the CAA 2012 does not preclude a new market participant from applying for a licence under the Act, particularly if this were helpful in addressing any of the CAA's concerns regarding the regulation of an alternative commercial solution at Heathrow. Section 16 (relating to the grounds for refusing to grant a licence) is permissive. The CAA's position could potentially risk fettering its

discretion to refuse to grant a licence under section 16.⁵ The CAA's existing powers can support alternative delivery mechanisms

- 6.7 We welcome the CAA's statement that the CAA 2012 provides the requisite flexibility for a range of commercial solutions (paragraph 1.11 CAP 1610) and the CAA's willingness to consider proposals for the development of new capacity at Heathrow (paragraph 1.16 CAP 1610). However, we consider that there is scope for much greater CAA involvement.
- 6.8 As set out at section 3 above, the CAA has wide statutory duties which must frame and drive the exercise of its powers under the CAA 2012. To fulfil its statutory duty, the CAA must ensure its approach to regulating HAL seeks to promote the most competitive model at Heathrow. The CAA has a unique opportunity to introduce and encourage competition at Heathrow which is a compelling case for it to do so. The exercise of these powers does not imply the introduction of substantive regulatory change (and delay).
- 6.9 In practice, there are two key means for the CAA to achieve this:
- 6.9.1 The CAA could modify HAL's licence to require it to consider the most competitive solution for the delivery of Heathrow expansion, including granting a long lease or form of "concession" to a third party for the design, building and operation of the new terminal; or
- 6.9.2 The CAA could consider issuing a licence to a third party carrying out the design, building, ownership and operation of the Terminal, with a modification being made to HAL's licence to require interface co-operation in relation to the Terminal, particularly if the CAA were concerned about regulating a new operator of an airport area at Heathrow.
- 6.10 In addition to these options, the CAA also has powers to incentivise HAL to facilitate competition in the delivery of Heathrow expansion and/or to engage with third parties on alternative delivery mechanisms:
- 6.11 *First*, the CAA has the power to enforce existing licence conditions. HAL is under an existing obligation to secure procurement of capital projects in an efficient and economical manner taking account of value for money. There is evidence that HAL is performing poorly (e.g. April 2017 by Cambridge Economic Policy Associates and airline community feedback). The CAA has the opportunity to require HAL to show how it proposes to comply with this condition in respect of capacity expansion (and take enforcement action in relation to existing compliance if necessary). The CAA should similarly require HAL to demonstrate intended compliance with financial and operational resilience requirements during capacity expansion.

⁵ Under section 16 of the CAA 2012, the CAA has *discretion* to refuse to grant a licence on certain grounds, including where the area operated by the applicant is not dominant or not located at a dominant airport. Section 14 also supports this view since section 14(3) contains a deeming provision which applies to a dominant operator. This suggests the applicant may not be a dominant operator.

6.12 *Second*, as the CAA itself recognises (paragraph 1.20 CAP 1610), the CAA could include additional conditions in HAL's licence to incentivise HAL to explore competitive opportunities and we welcome the CAA's comments in this regard (i.e. a lesser version of the condition suggested at paragraph 6.9 above). The CAA has previously recognised that reliance on HAL assurances and procurement obligations might not be enough for a project the scope of Heathrow expansion and there is a compelling case for (at the very least) additional licence conditions to address these issues. In our view, the options set out at paragraph 6.9 are the only meaningful way of ensuring the CAA fulfils its statutory duties to further the interests of users and do so in a way which promotes competition.

6.13 *Third*, the CAA could incentivise HAL to introduce competitive opportunities in the context of the price control review. We welcome the CAA's comments on guarding against inefficient cost recovery (paragraph 1.19 CAP 1610) and using a cost of equity based on a competitive process for equity investment (paragraph 2.14 CAP 1610). The CAA could in addition set cost recovery based on (a) the existence of alternative delivery mechanisms, such as e.g. Arora's proposed plan, including assuming a form of joint venture between a third party operator and HAL to deliver Heathrow expansion; and (b) the benchmark of airports operating in competitive markets.

The CAA can take a number of measures to encourage engagement

6.14 We welcome the CAA's willingness to hold HAL to account at the time of its IBP and FBP for a failure to engage with third parties (paragraphs 1.18-1.19 CAP 1610). However, our own experience of attempting to engage with HAL has proved fruitless.

6.15 In our view, there are a number of measures the CAA can take to apply a framework to facilitate and encourage discussions between HAL and third parties.

6.16 *First*, the CAA should publicly make clear that no decision has yet been made on the party to deliver capacity expansion at Heathrow. There is equally nothing preventing the CAA from reporting on wider possible options, in its final report to the Secretary of State in April 2018, in line with the Government's stated position of leaving development responsibility open.

6.17 *Second*, the CAA should publish a possible framework for engagement between HAL and potential third party developers, including: objectives, approach and target timetable for progression of the engagement, requirements to report to the CAA and other stakeholders, and the CAA's role in monitoring progress. In this context, it would be for the CAA to assess how any ensuing proposals met its statutory duties to further user interests and promote competition.

6.18 *Third*, the CAA should urgently release the data displayed as charts in its top-down benchmarking study, carried out by PA Consulting (June 2017). We intend to benchmark our plans against a core group of directly comparable airports. We

intend to use these airports not only as financial benchmarks, but also to illustrate key operational and commercial aspects of our Western Campus development plan.

- 6.19 *Fourth*, consistent with its willingness to bring transparency to costs of capacity expansion (paragraph 1.17 CAP 1610), the CAA should carry out an audit of HAL's current RAB and make the information available to users where appropriate in order to allow alternative proposals to be able to benchmark their proposals, measure benefits to consumers and potential efficiencies.
- 6.20 In summary, we consider that the CAA does have broad powers to take a range of approaches to facilitate competition at Heathrow. However, we are informed that the CAA does not believe it has the powers to implement our proposed approach to competition for the provision of airport operation services. As part of the consultation process we would welcome engagement with the CAA's legal department to confirm why the CAA does not believe it can accommodate our proposals, we ask that the CAA sets out the basis on why it considers it does not have sufficient powers and we call on the CAA to engage with the Secretary of State on this matter.

7. HEATHROW EXPANSION IS A UNIQUE AND CRITICAL OPPORTUNITY FOR THE CAA TO ACT

7.1 In summary:

- 7.1.1 Capacity expansion at Heathrow is a once-in-a-generation project and the ideal opportunity to introduce competition, consistent with the Competition Commission's findings a decade ago, the objectives of the CAA 2012 and Heathrow's unique status as the only hub airport in the UK;
- 7.1.2 Competition is the natural and most effective means for the CAA to deliver its key priorities in respect of Heathrow and to fulfil its statutory duties, with long term benefits for users including consumers;
- 7.1.3 The CAA has the support of a broad range of stakeholders whose feedback should not be ignored. There is evidence of significant concerns regarding HAL's track record which warrants CAA intervention.

Heathrow expansion is the ideal opportunity to introduce competition

- 7.2 As the CAA has repeatedly stated (and we concur), capacity expansion in the south east of England is necessary to benefit users and to prevent degradation of service quality and offering as well as higher airfares. This is because additional capacity is necessary to ensure competition between airport operators. Capacity constraints were identified as a feature of the market with an adverse effect on competition between airports in the CC's in its Final Report on the BAA Airports Market Investigation. The Competition and Market Authority (CMA) recently confirmed that additional capacity would strengthen competition between airports and would have magnified the benefits of the CC's remedies.⁶
- 7.3 The CMA's recent assessment of the remedies imposed by the CC demonstrates the benefits which the introduction of competition can deliver. The CMA found that competition in airport ownership had delivered substantial benefits to airlines and users, [including innovations, cost reduction, increased efficiencies and substantial improvements in user experience.] This is in spite of the arguments put forward at the time of the CC's market investigation that divestment remedies would impair efficiencies and reduce the benefits of single ownership.
- 7.4 Heathrow expansion has long been considered as essential to bolster competition between airports. It is a generational project which it is critical to get right. In this context, it is inconceivable that the CAA (and indeed the UK Government itself) should not seek to develop as competitive a model at Heathrow as possible. Introduction of competition in both the delivery of expansion and in subsequent terminal ownership and operation is a natural extension of competition in airport

⁶ CMA, *BAA airports: Evaluation of the CC's 2009 market investigation remedies*, 16 May 2016.

ownership, which would support and bolster competition between airports and the benefits of the CC's remedies.

7.5 The case for introducing competition is even more compelling when considering the following:

7.5.1 The CC explicitly recommended competition in capacity expansion, stating (to quote but one example) that: *“we believe it important to ensure that the next tranche of airport capacity in the South-East of England best meets the requirements of airlines and passengers, which is more likely to be achieved if the design, cost, timing and allocation of this investment are determined under conditions of rivalry following divestment”*;⁷

7.5.2 In enacting the CAA 2012, the Parliament allowed for multiple airport operators and explicitly cites examples of terminal competition in the Explanatory Notes (see e.g. paragraphs 43, 45, 61 and 66). The CAA 2012 also introduced a statutory duty for the CAA to promote competition where appropriate (as detailed in section 3 above);

7.5.3 Heathrow airport has substantial market power as a result of its position as the only hub airport in the UK. The CC considered that *“where airports have substantial market power, competition between terminals may be the only effective way that competition can be introduced”*;⁸ and

7.5.4 Heathrow is already the most expensive commercial airport in the world. Allowing Heathrow to deliver capacity expansion without introducing competition, risks failing to deliver cost effective solutions and the very benefits expansion is designed to achieve.

Competition is the most effective means to deliver substantial benefits for users

7.6 The CAA refers to the need to ensure alternative delivery mechanisms deliver consumer benefits (e.g. paragraph 1.16 CAP 1610). It has also set key priorities for the delivery of capacity expansion which include timeliness, affordability and financeability.

7.7 Competition between rivals to deliver capacity expansion and own and operate the expanded airport is the best way to achieve those objectives and deliver long term benefits for consumers, since it is a strong incentive for:

7.7.1 cost efficient proposals and realistic cost estimates for the delivery of expansion (as illustrated by HAL's downward revision of cost estimates following publication of competing proposals);

7.7.2 plans driven by customer needs and demands;

⁷ CC, Market investigation Report, 19 March 2009, paragraph 32.

⁸ *Ibid.* Appendix 10.11, paragraph 20.

7.7.3 innovative solutions (e.g. Gatwick's innovative approaches to capacity management noted by the CMA in its recent report⁹);

7.7.4 in terms of terminal competition, downward pressure on charges, high quality of service and innovative solutions (see for instance examples in Appendix 3). This is particularly where there is spare capacity to enable effective competition between airports and between terminals.

There is evidence of substantial stakeholder concern regarding HAL's performance which warrants CAA intervention

7.8 We welcome the CAA's recognition that a failure by HAL to follow up on commercial and/or competitive arrangements may provide evidence of inefficiency which should be taken into account in price controls (paragraph 1.19 CAP 1610).

7.9 We also strongly support the CAA's proposal to require HAL to demonstrate why – where it has not followed up on a specific opportunity with a third party – its preferred alternative delivers better services for consumers and value for money (paragraph 1.18 CAP 1610). However, we are concerned that this proposal permits CAA intervention late in the process – at the stage of the Interim and Final Business Plan put forward by HAL (currently scheduled for end 2018 and mid 2019).

7.10 The case for CAA intervention in either of the forms suggested in section 4 above, and at the very least by increasing scrutiny of HAL, is compelling in light of the evidence of significant stakeholder concerns regarding HAL's poor record of compliance with existing obligations and of past performance for delivery of expansion.

7.11 *First*, there is strong support from the airline community for CAA intervention. Stakeholders are almost universal in their view, based on previous experience, that HAL is not capable of delivering expansion in a timely and efficient manner. They have also requested greater safeguards and the bolstering of competition in the supply chain (in light of concerns that HAL's largest supplier is also one of its most significant shareholders) (paragraph 1.17 CAP 1541).

7.12 *Second*, there is considerable concern regarding HAL's lack of transparency on cost estimates for delivering Heathrow expansion, despite the four years it has been preparing plans for it. The current estimates provided by HAL for the first part of the expansion are in the region of £14-15 billion; however, we understand that significant additional capital expenditure will have to be spent to deliver full capacity (i.e. 130 mppa) from expansion. This is in spite of your call, in your letter to John Holland-Kaye of 26th October 2016 (launching your assessment of airport-airline engagement), for a fully-costed, benchmarked plan for R3 expansion as soon as possible. This is essential in order for third parties, including those with alternative proposals for elements of the expansion, to be able to engage meaningfully with HAL. Fully-costed, benchmarked plans have not been forthcoming from HAL to date.

⁹ See footnote 4.

- 7.13 *Third*, there is strong evidence of underperformance in the benchmarking reports you carried out as part of preparation of HAL's business plans ("CAP 1540 Guidance for HAL on preparing its business plans for the H7 price control" (**CAP 1540**)). These reports show that HAL materially underperforms its peers on almost every cost metric, and has done so consistently for many years. In all areas of HAL underperformance, your technical experts called for a more detailed study to be carried out before any regulatory decisions can be made. Even in the only area of apparent HAL outperformance - commercial revenue - your experts believed that further detailed investigation is necessary, in order to understand why there has been no material improvement in performance over the last decade, in spite of heavy investment in new terminals.
- 7.14 *Fourth*, there is evidence of a significant lack of transparency and concerns regarding HAL's regulatory accounts and Regulated Asset Base (**RAB**), which are key components not only to be able to assess how realistic HAL's cost estimates and expansion plans are but also a necessary preliminary step to the introduction of any alternative competitive solutions. In light of this, we respectfully disagree with the CAA's position that an audit of HAL's RAB would not be a useful exercise. By way of example, in the context of CAP 1540, your technical experts commented on a lack of granularity of information available to them and which affected their investigations in almost all areas. Available granular information which might help the public better understand HAL's performance was in many cases redacted – such as the amount of retail space available in each terminal, which it is difficult to see could be justified as being commercially sensitive other than to protect HAL's reputation and to restrict competition.
- 7.15 Most worryingly, Cambridge Economics Policy Associates, in their thorough report on HAL's long term cost performance¹⁰, highlighted areas where they feel HAL's accounts may have been materially misstated, for example by capitalising operating expenditure, with the result that airlines and users may be being charged multiple times for costs: once eventually in the form of depreciation, and many times in the meantime in the form of a cost of capital on the undepreciated element in the RAB. They advised that "...we have been unable to fully understand the capitalisation of OPEX which occurs on a relatively material scale. We suggest that the CAA considers whether the regulatory regime is currently adequate for managing and monitoring such movements because HAL has the opportunity to make OPEX savings by increasing CAPEX..." (paragraph 8.2). Cambridge Economics also advises that the CAA ensure "OPEX savings are genuine efficiencies, rather than reclassified as capital without any proper scrutiny" (paragraph 8.2).
- 7.16 *Fifth*, HAL is under a licence obligation to engage with stakeholders and consult on proposals for future investment.¹¹ The Secretary of State's commissioning of CAA

¹⁰ Cambridge Economic Policy Associated Ltd, *Review of Operating Expenditure of Heathrow Airport*, 22 March 2017.

¹¹ Condition F1.1 of HAL Licence, as at 1 February 2017.

advice under section 16 Civil Aviation Act 1982 is testament to HAL's poor compliance history and to the substantial disconnect between HAL and stakeholders.

- 7.17 We are pleased that the CAA appears to recognise these risks in stating that a failure by HAL to follow up on commercial and/or competitive arrangements may provide evidence of inefficiency and that this should be taken into account in price controls. We strongly support the CAA's proposal to require HAL to demonstrate why, where it has not followed up on a specific opportunity with a third party, its preferred alternative delivers better services for consumers and value for money, before allowing HAL to recover costs.

8. HOW WE RECOMMEND THE CAA SHOULD RESPOND

- 8.1 The CAA should ask the Secretary of State for the necessary power to enable competition at Heathrow.
- 8.2 We realise that the CAA is concerned to ensure that expansion plans are not endangered.
- 8.3 We also note the CAA's concerns about any delay to the delivery of capacity expansion, as voiced by Andrew Haines at his appearance before the Transport Select Committee on 20 February 2018. That said, delay cannot be the single overriding consideration and a reason for dismissing out of hand credible alternative proposals which are capable of satisfying the wider range of requirements under the CAA's duties, such as competition, economy and efficiency.
- 8.4 We strongly contend that a failure to consider the full range of statutory duties (including promotion of competition) risks detriment to the interests of future generations of airlines and users, which it would be unacceptable for the CAA, and the Government, to allow. An expansion scheme which is inefficient and costly and does not embrace the principles of competition would be too high a price to pay and would expose the proposal to undue risk. The solution is a more open and competitive process with the CAA playing a full part in this.
- 8.5 In the first instance, we urge the Government to consider introducing a fully open and transparent competitive process to take forward Heathrow expansion through which our proposal can be fully evaluated.
- 8.6 In the absence of a fully competitive process to appoint the developer to take forward Heathrow expansion, then we are committed to working with HAL.
- 8.7 We announced our alternative plans for expansion in July 2017. In CAP 1541 we asked the CAA to encourage HAL to engage with us as we feel the expansion programme could be best served by us working together. We are pleased that the CAA refers to this (1610, para 10), but we have not had any engagement from HAL, even though we have provided our own invitation to do so.
- 8.8 The CAA's expectation that HAL should engage in good faith with airlines and third parties coming forward is therefore welcome, but it is not taking place. We suspect that HAL's reticence is a combination of it believing it has a right to be the sole proponent, developer and operator and a strategy to reinforce its position by playing it long.
- 8.9 Although the principle of competition should be overriding, we do not believe the CAA should necessarily regard the outcome as binary and exclusive for a single party. We believe that a successful scheme could be best served by both parties working together. Each party potentially has strengths to bring and there would be a variety of options for HAL and Arora to joint venture their activities.

- 8.10 We consider that the CAA has an active role and responsibility to play in facilitating and achieving this.
- 8.11 We therefore recommend that the CAA follows the immediate approach set out below:
- The CAA should affirm its objectives for expansion.
 - The CAA's stated objectives should be wider than affordability and financeability and should specifically include the criteria referred to in 3.16 above and particularly facilitation of competition in the provision of terminal capacity as a desired outcome of the expansion programme.
 - That our proposals in sections 6.16 – 6.19 above should be adopted, namely:
 - The CAA should publicly reinforce that no decision has yet been made on the party to undertake the expansion programme.
 - The CAA's forthcoming reporting to the Secretary of State should reinforce the principle of HAL not having exclusive rights and their obligation to engage with Arora and/or other third parties.
 - That the CAA should urgently release the data displayed as charts in its top-down benchmarking study, carried out by PA Consulting (June 2017). We intend to benchmark our plans against a core group of directly comparable airports. We intend to use these airports not only as financial benchmarks, but also to illustrate key operational and commercial aspects of our LHR western campus development plan.
 - The CAA should publish a framework for engagement between HAL and potential third party developers, including objectives, approach and target timetable for progression of the engagement, requirements to report to the CAA and other stakeholders, and the CAA's role in monitoring progress. In this context, it would be for the CAA to assess how any ensuing proposals met its statutory duties to further user interests and promote competition.
 - The CAA should carry out an audit of the current RAB and make the information available to users where appropriate in order to clarify how our alternative proposals will benefit consumers by showing how our facilities can be built more efficiently than those built over the last decade by HAL.

9. OTHER ISSUES IN CAP 1610

9.1 Our comments in response to CAP 1610 primarily relate to the issues covered in Chapter 1 (and are set out above). We provide in the following sections only brief comments on specific areas where we consider this necessary.

Early Construction Costs

9.2 Given our position as a potential third party developer for Heathrow expansion, as the CAA will appreciate, the issue of underwriting HAL's early costs places us and other potential competitors at a disadvantage: all of our expenditure is speculative and at risk. This is the normal approach for developers and ensures that expenditure is efficient and wisely spent.

9.3 We would comment only that we believe the approach to recovery of such costs should reflect an element of risk sharing between HAL and airlines, and that there should be zero tolerance of inefficient spend or expenditure undertaken without clear justification of the business benefit. Further, the longer it takes for HAL to engage with third parties and/or with stakeholders, the higher the risk associated with duplication of design expenditure.

RAB

9.4 We have already briefly comments in section [5] on the CAA's surprising suggestion that an audit of HAL's RAB would not be a useful exercise (paragraph 1.14 CAP 1610).

9.5 The RAB forms the basis of airport charges for airlines (and indirectly users) which are amongst the highest in the world. We would reiterate that full transparency regarding HAL's RAB is an essential and necessary step to be able to (a) assess how realistic and cost efficient HAL's expansion plans are, and how strong a contender for delivering those plans HAL is; and (b) introduce any potential competition in the delivery of capacity expansion and/or terminal competition.

9.6 We therefore would ask the CAA to reconsider and carry out an audit of RAB.

APPENDIX 1 SUMMARY OF ARORA WESTERN CAMPUS DESIGN

EXHIBIT 1



EXHIBIT 2

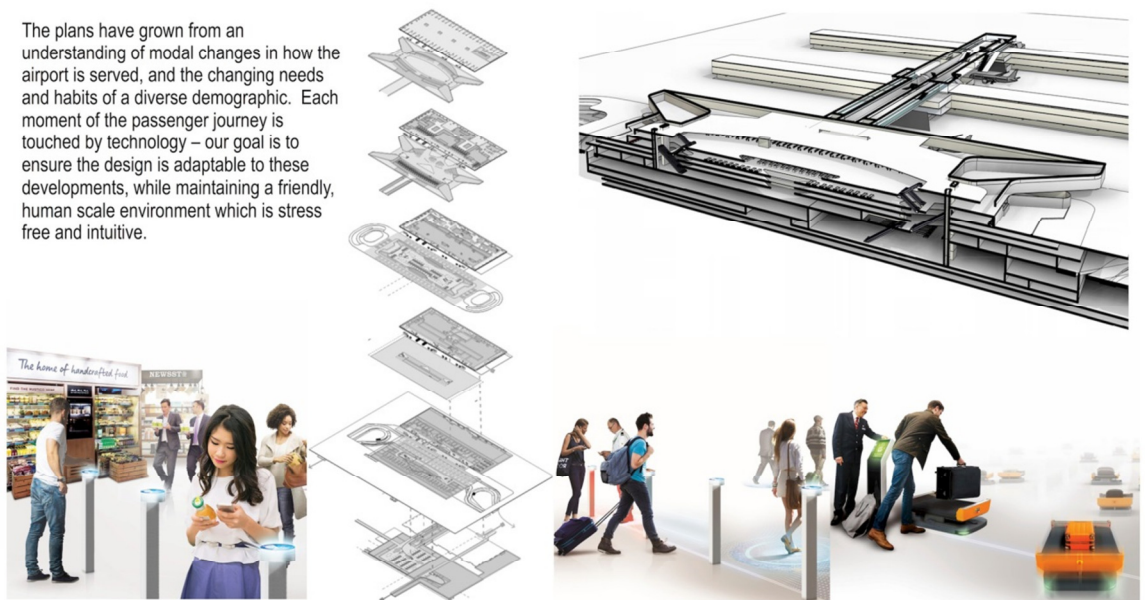


EXHIBIT 3



EXHIBIT 4

The plans have grown from an understanding of modal changes in how the airport is served, and the changing needs and habits of a diverse demographic. Each moment of the passenger journey is touched by technology – our goal is to ensure the design is adaptable to these developments, while maintaining a friendly, human scale environment which is stress free and intuitive.



APPENDIX 2

TRANSCRIPT, WILLIE WALSH, CEO, IAG

(Published in the Financial Times on 5th February 2018.)

Let third parties build and run new facilities, says IAG's Willie Walsh

The owner of British Airways, Heathrow's biggest single customer, has stepped up its stinging attack on the high cost of expansion at the airport, calling for the break-up of Heathrow's monopoly as a way to cut costs. Willie Walsh, chief executive of International Airlines Group, which owns BA, said the government should consider allowing third parties to design, build and run commercial facilities at Heathrow.

Such a move, which could see airlines run terminals at the airport, would create competition and lower costs for customers, he argued. "Heathrow's had it too good for too long and the government must confirm the CAA's [Civil Aviation Authority] powers to introduce this type of competition," said Mr Walsh. "This would cut costs, diversify funding and ensure developments are completed on time, leading to a win-win for customers."

He said competition would provide better facilities more economically and ensure customer charges did not rise to pay for new infrastructure. IAG has long been critical of the cost of Heathrow's £14bn plan to build a third runway north-west of the airport and its likely knock-on effect on passengers and airlines. It has particularly criticised the idea that landing charges could increase well before the new capacity became available sometime in the next decade. Last month, Mr Walsh hit out at Britain's aviation regulator, the CAA, accusing it of failing passengers by not demanding greater transparency and efficiency from Heathrow on investments. IAG's latest attack comes just weeks after Heathrow started a 10-week public consultation with its detailed plans for a new runway and terminal. MPs are due to vote on expansion by the summer.

Heathrow's expansion is a politically charged subject given its environmental impact and strong opposition in Conservative-held constituencies near the airport. However, pressure for new airport capacity is mounting with all of the UK's five major airports expected to be at full capacity by the mid-2030s and British business arguing that congestion is holding back international trade.

A Heathrow spokesperson said expansion would give consumers more choice by promoting competition among carriers: "Expansion will open up opportunities for IAG, Easy Jet, Flybe, Virgin and dozens of international airlines with whom we are working closely to deliver expansion at close to current charges, while meeting all our commitments to local communities."

IAG has supported expansion at Heathrow, but favoured alternative, cheaper, plans. In July, it threw its support behind a new plan from the wealthy founder of the Arora hotel group who

claims he can cut the price of the project to £12.4bn. Mr Walsh pointed out that Heathrow had already reassessed its expansion plans, cutting the cost by £2.5bn after discussions with airlines and other stakeholders. “Our proposal will ensure it continues to focus on cost control, something it has been reluctant to do in the past,” he said. He added that his suggestion was “not rocket science”, noting that most main US airports have terminals owned or leased by airlines. BA leases Terminal 7 at JFK Airport from the New York Port Authority and runs the operation there.

The practice is less common in Europe, according to ACI Europe, the airports’ association. However, Munich Airport has a deal with Lufthansa in which they have worked together to build one of the terminals. Mr Walsh said the government should state explicitly in its Airports National Policy Statement that the cost of Heathrow expansion to customers should be capped at today’s prices.

“With more passengers and the introduction of internal competition, the airport’s charges should go down. If they remain at current levels we, along with other airlines, support a price cap to ensure they cannot rise”, he said.

APPENDIX 3

INDUSTRY EXAMPLES

In introducing terminal competition, we consider that the point of separation should be carefully identified. We recognise that elements of the airport benefit from single operational control (albeit this does not necessarily mean single ownership). This would include the runways, airfield and common surface access facilities.

There are varying degrees of devolved terminal ownership/operation across the world. Most existing precedents involve separation to airlines.

The most mature example is John F Kennedy International Airport in New York. For many years, the Port Authority has operated a devolved model of airport terminal ownership and operations. This has been facilitated for a variety of reasons, but two of the strongest factors are the use of private finance and to reinforce the primary relationship between airlines and passengers. The operators are:

- Terminal 1 – a consortium of Air France, Japan Airlines, Korean Air and Lufthansa.
- Terminal 3 – Delta Airlines
- Terminal 4 – JFK International Air Terminal, a subsidiary of Schiphol Group.
- Terminal 5 – Jet Blue
- Terminal 7 - British Airways
- Terminal 8 – American Airlines.

Common airport infrastructure, including the four runways, is owned and managed by the Port Authority. Importantly, the devolved operational responsibility still enables other airlines to operate from the terminals.

Also in the US, at Hartsfield-Jackson Airport, Atlanta, the domestic terminal is operated by a corporation of airlines, the Atlanta Airlines Terminal Corporation. Management, operation and maintenance of the international terminal are also contracted out.

At Newark Airport, Terminal B is operated by the Port Authority, but Terminals A and C are operated by United Airlines.

At Sydney Airport, the Sydney Airport Corporation Limited operates the runways and Terminals 1 and 2. Until 2015, Terminal 3 was owned and operated by Qantas Airlines Ltd. This leasing arrangement dates from 1989.

In Europe, Munich Airport has a two terminal operation, with Terminal 2 having a major redevelopment and extension in 2016. This was enabled by a 60:40 JV between the airport and Lufthansa. Non-Star Alliance airlines are primarily handled in Terminal 1. Terminal 2 was redeveloped despite Terminal 1 having spare capacity.

The Irish Aviation Authority is giving consideration to the development of a new Terminal 3 at Dublin Airport, alongside the planned second runway. It is giving consideration to the terminal being privately financed and operated.