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Response to Economic Regulation of Heathrow – CAP2524G Draft Guidance on Capital Expenditure Governance (H7 Final Determination)

Thank you for the opportunity to respond to the above consultation, setting out the CAA's initial guidance regarding the proposed engagement and governance arrangements related to Heathrow Airport Limited ("HAL") capital portfolio and expenditure during H7 (the "Consultation").

This submission is made jointly by the London (Heathrow) Airline Consultative Committee ("LACC") and Heathrow Airline Operators Committee ("AOC"), collectively referred to as (the "Airline Community") and sets out agreed principles and outcomes that we believe the CAA's policy should aim to address. It responds to the questions raised in order of the Consultation with answers grouped under related headings where appropriate.

Please note individual airlines, groups and alliances may make their own submissions detailing their specific views on the CAA's proposals.

A. Context

The Airline Community note the CAA is seeking feedback on the specific guidance and questions raised within the Consultation which this response seeks to address. This response does not make comment on the wider capital expenditure policies or portfolio related matters addressed in the CAA's Final Determination for H7 which have remained largely unchanged from the Final Proposals and to which the Airline Community were, and continue to be, broadly supportive of, subject to comments made at the time. Further details of the Airline Community positions, rationale and evidence on such wider matters can be found in our submissions made throughout the H7 consultation process¹.

In addition, over the past six months, airline representatives have been working with HAL on a number of initiatives contained within the Consultation, in particular through the Programme Airline Working Group² ("PAWG"). This includes: the concept, and development of a standard set of questions to address through the capital gateway process (in particular G0 – G3); commissioning the support of independent Subject Matter Experts ("SME") resource; the governance and engagement

¹ Airline Community responses to CAA CAP1951, CAA CAP2265 and CAA CAP2365

² Joint working group consisting of representatives from airlines, HAL and Gardiner & Theobald, the Independent Fund Surveyor, with an open invite to the CAA. The Terms of Reference have been included as Appendix A PAWG Terms of Reference



under HAL's new 'Programmatic Approach' which incorporates and builds on the existing and proven Heathrow Gateway Lifecycle; as well as the introduction of Programme Stakeholder Groups³.

To that end and subject to further comments set out in this response, we are very supportive of the proposals set out by the CAA within the Consultation.

The Airline Community welcome the CAA's observations of the joint airline / HAL work in developing the existing governance arrangements and a willingness to see that continue⁴.

Given the above, our broad recommendation is for the CAA to promptly set guidance where it can and allow for HAL and airlines to develop the application of the proposals set out within the Consultation, within a timeframe set by the CAA.

As well as setting a deadline to conclude or acknowledge a failure to reach agreement, we would also welcome the CAA taking a direct role, as either a participant or observer, in this process.

B. Standard Questions (Questions 1 & 2)

The Airline Community support the principle of having a set of standard questions. As identified within the Consultation, this should help drive consistency and set clear expectations for all parties involved in the governance process.

As set out in Section A (Context) above, this is an area that HAL and the Airline Community have identified as an opportunity for improving governance and engagement through the Gateway lifecycle process and have been independently developing a template to be used by HAL. As well as the questions themselves, this also includes reference to the specific Gateways, and therefore the timing for each question to be addressed.

At this moment in time the above work is not completed but we would welcome the opportunity to submit, or provide a further update on its progression, in due course; the timescale of which to be determined by the CAA. This could also include a comment as to how and where the questions proposed by the CAA in the Consultation, which broadly reflect those already being discussed between HAL and the Airline Community⁵, have been considered.

Should the CAA determine upon this path of allowing the Airline Community and HAL to establish the questions, building on the comments set out in the Context above regarding HAL and airlines continually developing the engagement process, this could be managed through the CAA setting clear guidance and principles for HAL to adhere to which could be replicated in the future H7 Capital Protocol. The questions could be set as an Annex and which are updated from time to time where agreement between HAL and the Airline Community, and with any escalations following the agreed process. This approach would allow a flexibility for those parties directly engaging in the governance process, whilst retaining the benefit of the CAA's oversight and direction.

In addition to the above, the Airline Community would highlight however that it is not just the provision of such information but the *timeliness* of such which is critical to the efficient progression through the relevant capital gateways. By way of example, significant issues arose at [REDACTED]

³ The Airline Community understand the CAA are familiar with the proposed Programme Gateway Lifecycle and recent (interim) changes to the Capital Governance / Engagement structure. Should this not be the case and / or further background be required, further detail can be provided.

⁴ Paragraph 1.6, CAA CAP2524G

⁵ Notwithstanding any further comments, the Airline Community note 'Assumptions' should be explicitly referenced.

[REDACTED], the details of which the CAA are fully appraised on.

Furthermore, it should be clear that the establishment of a set of standard questions does not mean that this excludes other questions being raised nor a requirement for questions to be sufficiently addressed by HAL, noting the CAA's comments that these should still be proportionate and raised in a timely manner⁶.

For the reasons set out above, we welcome the introduction of the concept of standard questions embedded and sufficiently answered within the capital governance process. In terms of next steps, we would propose the CAA:

- Confirm its expectations as set out in the Consultation for the establishment of a standard question framework and the specific matters they should address;
- allow for the specific questions, timings and format of such to be agreed between the Airline Community and HAL, with a date set by the CAA for jointly presenting a position – we would suggest this could be completed by the end of May; and
- in addition to the principle of the questions, enshrine the principles of *transparency*, *timeliness*, and *non-exclusivity* within its future guidance, as well as that of HAL providing information in itself does not mean there may be agreement between parties on the information and / or next steps based on such.

C. Independent Assessments of Designs and Standards (Question 3)

Based on the experiences and evidence of agreement over the years, the Airline Community agree with the assessment set out in the Consultation that, generally, airlines have sufficient experience to assess the investment decisions being presented; however, there are also a number of areas where a greater level of independent assurance, particularly around costs, and / or SME input into requirements and options which would be particularly beneficial⁷.

Not only would allowing for such additional independent support build on the successful Q6 concept of an Independent Fund Surveyor (“IFS”), but it would: help address the asymmetry of certain information as well; enhance the engagement through the governance process; and assist in filling gaps in resource requirements, particularly where solutions will have a material bearing on the consumer experience and airline operations.

Processes

The Airline Community are strongly supportive of the assurance activities proposed under Paragraph 3.14 of the Consultation and agree these could be undertaken independently of the Gateway process.

We would reference the CAA's Q6 capital review⁸ which identified improvements that were subsequently implemented, and the enhancement of the IFS role for the Heathrow Expansion

⁶ Paragraph 3.0, CAA CAP2524G

⁷ Paragraph 3.30, CAA CAP2524G

⁸ The CAA commissioned “Review of Heathrow Airport’s Q6 Capex Governance” undertaken by CEPA



Programme⁹ as examples of evidence of precedence and value in undertaking this type of review activity.

By undertaking this review early in H7 it will allow: (i) all parties to be comfortable with the underlying processes being applied, and therefore help address a number of consistent questions; and (ii) allow any best practice learnings to be considered and incorporated early in H7 when the majority of investment decisions are being made.

We agree with those areas listed under Paragraph 3.14 of the Consultation and would also add: (i) given it accounts for 13% of the overall portfolio value and a full assessment has not been undertaken since Q6, a review of the appropriateness of the Leadership and Logistics allocation for the H7 portfolio (both size and breakdown); (ii) the cost assurance process undertaken by HAL; and (iii) benefit measurement and realisation.

Regarding selecting an assurance provider to undertake this review, the Airline Community agree such an assessment should be met from within the HAL capital budget¹⁰. In terms of the appointment itself, we remain open but note that this could be undertaken by the IFS, the principle of which having already been set out in the Enhanced Engagement Protocol.

This need for an assessment is an area we would strongly encourage the CAA to take forward by setting specific guidance and timings for HAL and the Airline Community to progress, noting where we are already within H7¹¹.

Design Standards, Requirements and Assessment Management Approach

Notwithstanding the requirement for evidencing the *process* of creating and following design standards, requirements and the approach to assessment management (as set out above), we note these areas have a material bearing on the proposed solutions, cost and timings of the investments themselves, particularly in relation to assessment management which accounts for circa 50% of the entire portfolio¹²

In line with our comments in response Questions 4, 6 & 7 under Section D below, the Airline Community believe there would be material benefits in a structured approach to reviewing certain design standards and requirements themselves across projects that are common, repeatable and managed on an ongoing basis and form the core basis for a large proportion of HAL asset replacement requirements.

We would suggest this is something that could be managed between HAL and the Airline Community through the Asset Management and Compliance Stakeholder Programme Group and given the nature of the works, could be assessed on a rolling basis, outside the Gateway process. Subject to the specific topic, this work may require independent, expert support as set out further in Section D below.

⁹ Paragraph 7.3, Enhanced Engagement Protocol

¹⁰ Paragraph 3.26, CAA CAP2524G

¹¹ In the event it was agreed for the IFS to undertake this role, the current IFS Working Group could be a suitable forum for progressing, with reporting and agreement / escalation at the Capital Portfolio Board by a date set by the CAA.

¹² As per HAL's presentation at the April 2023 Future Portfolio Group



D. Specific Projects for Review and Independent Assurance (Questions 4 – 7)

As set out further in Sections A and C of this response, the Airline Community are highly supportive of independent, SME input in the capital process. Furthermore, we agree with the CAA's view that this should be an extension (rather than replacement) of the roles of airlines and the Airline Community in the Governance process¹³.

In the absence of a specific CAA policy, HAL and the Airline Community have begun undertaking a twelve-month trial, funded from the HAL capital budget, and the outline of which has been jointly developed and included as Appendix B "Third Party SME Support Scope"

We are broadly agreeable to much of what has been set out within Annex A and the referenced correspondence within, however we firmly believe that, to ensure full independence, rather than a joint appointment this should be contracted and managed by the Airline Community with appropriate safeguards on supplier selection and governance. Such an approach does not detract from the required engagement with HAL but rather, would retain independent accountability of HAL and act as an extension of the Airline Community capital group. For the avoidance of doubt, we do not see this as replacing or requiring their approval for Gateways, but rather it will strongly inform the Airline Community in its own engagement with HAL. Given this will enhance the overall delivery of the capital plan for the benefit of consumers, we would again see this funded from within the HAL capital budget with the required total still being considered.

Role of the IFS

The Airline Community are very supportive of the role the IFS undertakes in providing a level of assurance, and 'critical friend' role in the investment process. As set out in the existing capital protocol documents, the IFS role is *"...ongoing assessment of the reasonableness of all key decisions...capital is being used efficiently"* with 'efficiency' being assessment being *"focus on the process being followed"*¹⁴

We would note a distinction in terms of this role as defined above, and which is more akin to works proposed under Section C of this response, than that which is being considered under Section F which is directly involved in working with, challenging and bringing specific expert knowledge into the early stage of the business case and design and requirement process, particularly where airlines do not have the resource and / or required skillset.

Notwithstanding the diverse skillsets required in fulfilling the proposed support, we also note that the current arrangement of the IFS is not structurally set up as we would propose (being one of a joint HAL / AOC appointment and report-based output) and furthermore, undertaking such work could run the risk of a conflict of interest in its assessment work it undertakes.

As such, the Airline Community respectfully does not agree with the CAA's initial position that this requirement could or should be fulfilled by the IFS¹⁵, but instead would strongly encourage the CAA to take up the proposals as set out in this Section D.

¹³ Paragraph 3.30, CAA CAP2524G

¹⁴ Section 4 Independent Fund Surveyor, Heathrow Capital Efficiency Handbook; and Section 7.3 Independent Fund Surveyor, Enhanced Engagement Protocol

¹⁵ Paragraph 3.31, CAA CAP2524G



Notwithstanding the above, the Airline Community does welcome the CAA's guidance on a specific review of the IFS role and function in H7, particularly as to how their assessment captures or reflects the considerations set out under Paragraph 3.28 of the Consultation.

Allocation and Annual Reporting

As addressed further under Section F of this response, the Airline Community believe HAL should have the capability to be able to produce a forward lookahead of G3s over the coming 12 months.

Notwithstanding that whilst this lookahead would form an important consideration in determining the potential scope and level of SME resource required, we believe such an assessment on the need and scope of would be better determined at the outset of the project initiation or definition, such as at G1, P2 and / or P2 Tranche.

This is something that, with guidance from the CAA, could be jointly agreed by HAL and the Airline Community, and could form part of the standard questions addressed in Section B of this response.

Initial Projects for Consideration

Currently the Airline Community and HAL have identified specific requirements in relation to the Terminal 2 Baggage Programme, included as Appendix C "Terminal 2 Baggage Programme SME Requirements", which we believe gives a good example as to the types of activities and value being sought from SMEs in support of the airlines' engagement in the capital process.

Our initial focus has been in getting this initiative going with the above example, further projects have already been discussed but as yet to be fully developed, including but not limited to: MSCP4 Car Park; Security Programme; PCA; Capacity.

In terms of asset management, as well as any material projects that may arise through the P2 process, we would reiterate the requirement for SME support on standards as set out in Section C.

The criteria for selecting these specific projects has not been strictly defined, however have jointly arisen with HAL where a material development for the consumer experience and airline operation has been identified and / or value based. Likewise, it is this nature that also needs to allow flexibility in the skillset and organisation(s) that would be undertaking such assessments and work in the future.

In terms of the SME involvement, in order to add value to the engagement and governance process, we see these activities are in the early stages of the project and solution development, involving direct engagement and feedback with HAL and its suppliers.

For the purposes of launching this proposal, we would suggest a proposed list for the next twelve months could be agreed between the Airline Community and HAL post the current P2 Gateways which, in the main, are due to be presented by June. We would reiterate however this should be an ongoing, iterative assessment.

E. Further Guidance in Setting Delivery Obligations (Question 8)

The Airline Community are very supportive of the proposal for Delivery Obligations ("DOs") and see these as a strong component in moving to an ex-ante framework.



We also agree that the information proposed in setting such¹⁶ should in any case be available from HAL and assessed for each project seeking investment, should be SMART (as per the CAA's independent advice set out in its Final Proposals) and therefore do not see these as being unnecessarily or overly burdensome. Furthermore, the CAA's proposals for an equal weighting unless otherwise agreed, should also help ensure a smoother process.

We also agree on the need to avoid 'double jeopardy' of the assessment of a capital solution and the OBR framework which to date we have been successful in doing through the Triggers process. By way of example, we would point to the recent discussions between HAL and the Airline Community on T3 CSA and T5 Track Transit which has sought to avoid these potential issues.

The Airline Community are not seeking any further guidance from the CAA on DOs at this stage other than a clear timetable from the CAA, noting a number of G3s having already been progressed.

In terms of next steps for establishing DOs, HAL and the Airline Community have an existing and appropriate engagement model through which we would propose to start working on their expedient implementation, including consideration of assessing DOs and the closure of projects. We note, subject to this work, further guidance and / or timings may be required of the CAA.

With regards to reconciling and reporting, we would suggest this can be managed on a regular basis through the Stakeholder Programme Groups and Capital Portfolio Board. An annual reconciliation and report would be useful and see this could also form part of the proposal set out further in Section F. This engagement and report should include the additions and subtractions from the RAB throughout the year for transparency.

F. Accessible Information on Projects Performance (Question 9)

The Airline Community fully support the requirement for HAL to be providing accessible information and welcome the CAA setting out its expectations.

Table 2 of the Consultation provides a useful summary of the CAA's requirement on information provision by HAL which have largely been covered under the relevant sections within this response. In addition to these we would also note the following in response to Question 9:

Annual Reporting:

With regards to the CAA's proposal for the annual reporting of G3s¹⁷, we note HAL's 'Programmatic approach' including the creation of Tranches, as well as the current PMO reporting, should allow for such foresight of G3 investment decisions.

HAL are currently required to produce an annual Strategic Capital Business Plan ("SCBP") which the Airline Community find a useful look back and forward summary¹⁸. Recognising Gateway dates might change, in order to meet the CAA's proposal, the SCBP could be used as the annual record to capture the position of those G3 investment decisions due in the next 12 – 18 months, as well as provide a look back as to the extent of which the previous G3s were achieved or moved. We would also suggest this is extended to the Programme (P) Gateways.

¹⁶ Paragraph 3.42, CAA CAP2524G

¹⁷ Paragraph 3.33, CAA CAP2524G

¹⁸ The Airline Community are open to discussing with HAL the contents of this, including aligning / combing with any other annual capital related reports it is required to produce e.g. Procurement activities

The ongoing, live reporting and engagement of investment decisions should then continue through the relevant monthly Stakeholder Programme Groups and Capital Portfolio Board.

Information Location

In terms of the location of information, to date HAL have used an online repository, accessible to airline representatives and the CAA, for all Gateway and engagement materials. Notwithstanding specific administrative improvements, for example common naming conventions or saving Gateway material as a standalone document (as opposed to within a particular month's meeting material), the Airline Community are comfortable to continue with this approach.

G. Role of the CAA re Dispute Resolutions (Question 10)

The Airline Community note the current dispute resolution in place, involving escalation to the Capital Portfolio Board, Joint Steering Board and ultimately to the CAA. To date, escalations have been infrequent and where arisen have been managed within this process. The most recent and challenging of which being [REDACTED] which ultimately was resolved with further lessons learned being reviewed with the CAA.

The dispute resolution process is not an area that has been discussed in detail with HAL although we note it would be an item for the H7 Capital Protocol and therefore require the agreement of HAL and the Airline Community.

The Airline Community do not have any further questions of the CAA at this stage other than to understand whether the CAA has any further guidance as to whether it sees an amendment or build on the current dispute resolution process and if so, any particular areas for improvement, or overhaul.

In any event we would encourage a consistency, where possible, across the broader H7 framework i.e. ORCs, OBR.

We would also highlight the importance for all parties on the timeliness for the CAA (assuming it remains / where it is the arbiter) in addressing any disputes raised.

H. Further Comments

Enhanced Engagement Protocol

The Airline Community note that the current governance arrangements are, in part, covered by Enhanced Engagement Protocol. This was created in the context of the Expansion programme which, whilst covering capital arrangements, was broader in setting out how airlines and HAL would work together. We support the principle of a document that clearly sets out the engagement and Governance structure but note much of the material is now outdated.

Noting this was established by the CAA, we welcome its guidance as to the relevance and future (if at all) within the H7 governance arrangements.

Implementation of current Guidance within the Consultation

As set out in this response we are broadly supportive of the measures being proposed by the CAA within the Consultation and in the interest of time, given we are already sixteen months into H7, are keen to start progressing these further as soon as possible. We welcome the CAA's support in this aim and remain open to working with HAL and the CAA in a manner that will enable that.

Appendix A – PAWG Terms of Reference

Classification: Public

Programme Airlines Working Group Terms of Reference

<p>Frequency: Duration:</p> <p>Purpose:</p> <p>Ground Rules:</p>	<p>As required 2 hours</p> <p>To jointly develop the Programme Governance Framework ("PGF"), which is also consistent with the emerging CAA approach for H7, gaining input from the Airlines on the proposed approach.</p> <ul style="list-style-type: none"> ▪ Agenda and papers to be issued 5 Working days before meeting ▪ Minutes and actions to be issued within 3 working days ▪ Members have an accountability to actively participate at both the meetings and outside of meetings to drive forward agreed plans ▪ Members are expected to make themselves available to attend meetings regularly ▪ Members have an accountability to support agreed decisions and outputs from the group, and actively show this support at CPB 	<p>Chair:</p> <p>Members:</p> <p>HAL:</p> <p>Airlines:</p> <p>CAA Invite</p> <p>Independent Fund Surveyor:</p> <p>Quorum:</p>	<p>Members / Attendees: Ben Jones – Head of PMO, Infrastructure</p> <p>Alistair Maxwell – H of Scope & Regulation Paul Hill - H7 Mobilisation Finbarr Roche-Kelly - IFS Coordinator - HAL Marianne Edwards - PM Seb Tatum - H&M Mobilisation (Secretary)</p> <p>Simon Laver - LACC Walter Weems - AA Sarah Daniels - AOC Matt Webster - VS Tim Parker - IFS Coordinator AOC & Airlines Matt Davies - BA Simon Scoggins - Star Sarah Poynter – BA Alex Dawe - BA</p> <p>CAA Invitee TBC</p> <p>Mark Cowieson - G&T Chris Swinerton - G&T</p> <p>The Chair, HAL and AOC IFS Co-ordinators, one LACC or AOC representative, two further airline representatives from different airline alliances and one IFS representative.</p>
<p>Terms of Reference:</p> <ul style="list-style-type: none"> ▪ Review the PGF proposed by HAL and suggest further amendments for HAL and all Members to discuss with a view to reach agreement ▪ Ensure the PGF's relationship complies with and compliments the Heathrow Gateway Lifecycle (HGL) and is consistent with the emerging CAA approach for H7 ▪ Review plans for further work on the PGF and report back to CPB. At the appropriate time submit the PGF Ver3.0 for endorsement at the CPB ▪ The development of the Governance protocol will be jointly undertaken by HAL and the Airlines and will commence once the PGF/HGL has been established. Engagement in the Governance Protocol will include HAL, the Airlines and IFS. <p>N.B. The Capital Efficiency Handbook: it may be decided to be referred to differently in H7 making the distinction between the ex-post and ex-ante approach.</p>	<p>Inputs:</p> <ul style="list-style-type: none"> ▪ Previous meeting actions and minutes ▪ Latest version of PGF for review with changes tracked, version controlled and referenced as appropriate ▪ Relevant developments from HAL, Airlines and / or the CAA's H7 capital plan and incentive work ▪ IFS to provide updates as to how it proposes to assess preparedness for any Programme Gateway in light of changes to the PGF, using its assessment tool called Programme Management Assessment Criteria ("PMAC") ▪ Updates / issues raised as appropriate <p>Outputs:</p> <ul style="list-style-type: none"> ▪ Agreed minutes & time bound actions. ▪ Preparation of updates to the CPB as appropriate detailing agreed plans and associated progress 	<p>Agenda:</p> <ul style="list-style-type: none"> ▪ Previous minutes and actions ▪ Discuss on latest version of PGF previously distributed ▪ Agree updates to PGF ▪ Plan of work to next meeting ▪ AOB 	



Appendix C – T2 Baggage Programme SME Requirement Brief

Confidential

(File embedded and submitted separately)