

BAA Heathrow: The Intelligent Client (A)

A month had passed since Steven Morgan had taken the post of Director of Capital Programmes at BAA in February 2009, and the news didn't look good. The UK's Competition Commission were expected to announce that BAA had been abusing its dominant market position and would likely demand that BAA's regulated asset base (RAB) be dismantled through the sale of Gatwick, Stansted, and either Edinburgh or Glasgow International airport. With the loss of several profitable airports, BAA was now increasingly reliant upon its most important asset - Heathrow Airport. Described by one colleague as "an inspirational leader with a strong belief in the value of competition", Steven, a former rear admiral from the US Navy, was deeply committed to overhaul the firm's approach to procuring capital projects. Steven thought of himself as a major systems acquisition expert. As the former commercial director of Sellafield Ltd, UK's largest nuclear complex, he had led the overhaul of £700m/year procurement activities and contract management involving major construction and cleanup projects for which Sellafield was awarded World-Class designation in independent benchmarking studies.

At BAA, Steven, had been appointed to oversee over £9bn in construction projects ranging from building new terminals to new runways. Steven's priority was to turn the page on BAA's traditional approach to capital procurement. Steven felt BAA had over relied on long-term frameworks and cost reimbursable contracts which had placed the risk entirely with the company and had failed to drive value for money. And Steven would not hesitate to remind BAA's executive committee of the botched opening of the £4.3bn Terminal 5 (T5) campus on 27th March 2008. Passengers had been promised a "calmer, smoother, simpler airport experience"¹, and were confronted instead with cancelled flights, baggage delays, and a temporary suspension in check-in labeled by the press as a national embarrassment. While BAA and British Airways (BA), the main occupier of T5, were careful not to publicly blame each other

¹ "Final preparations for Terminal 5", British Airways press release, 18 March 2008

Professor Nuno Gil with doctoral student Colm Lundrigan prepared this case study. The case does not intend to serve as endorsement or illustration of effective or ineffective handling of an administrative situation. We are grateful for the contributions of Caitlin Wyndham and of all those professionals who gave an interview for this independent research project. The authors are solely responsible for any factual inaccuracies.

both organizations suffered a publicity disaster. T5 had been completed on time and to a high technical standard but the opening was marred by failure on the operations side. It took BA over a month before it was able to operate a full schedule. And a month later BAA and BA agreed to delay the move of BA's 120 long-haul services from T4 to T5 until the autumn 2008.

For Steven, the priority was to change BAA's approach to capital procurement. He wanted the company to move away from long-term framework agreements and the overall 'Rethinking Construction' ethos spearheaded by a former BAA chief executive, Sir John Egan. As Steven insisted, BAA needed to be an 'Intelligent Client'! He wanted the BAA executive to endorse his plan to use the company's largest ongoing capital programme at Heathrow - the £2.1bn Heathrow East programme recently renamed to T2 - as a test bed for implementing the change. Steven was mindful that the T2 programme was going through potential major changes in scope particularly with regard to how baggage would be handled. He also understood that T2's main customer, the Star Alliance, was significantly different from British Airways. The Star Alliance represented 25% of Heathrow's passengers, spread across 18 airlines, and whilst this was not as many passengers as British Airways provided it was still significant. T2 would co-locate all of the Star Alliance airlines - a major step to restore parity between the Star Alliance and their rival BA following the building of the Terminal 5. Steven was convinced that to cope in such a changed environment BAA needed to rethink again its capital procurement strategy.

The British Airports Authority

The British Airports Authority (BAA) was created in 1965 as a vehicle to manage a number of state-owned airports within the United Kingdom. Initially, the organisation controlled the airport infrastructure at London Heathrow, Gatwick and Stansted. Over the next two decades the company expanded its operations to include airports in Southampton, Edinburgh, Glasgow and Aberdeen. In the 1980s, the UK suffered a prolonged period of recession which drove the then Conservative government to privatise a number of industries. In 1986, the parliament passed the Airports Act which mandated the privatisation of the British Airports Authority creating BAA plc. which was listed on the London Stock Exchange and became a constituent of

the FTSE 100 index. The initial capitalisation of BAA was £1,225 million. Following the privatisation, the company continued to expand the number of airports in its portfolio by undertaking short-term airport lease contracts in the United States and mainland Europe. By 2005, BAA owned and managed seven UK airports: Heathrow, Gatwick, Stansted, Southampton, Edinburgh, Glasgow International, and Aberdeen, representing 60% of total passenger numbers in the UK, 92% of travellers to and from the London area, and 86% in Scotland.

In June 2006, with a commanding market position, and in the midst of a £4.2bn capital programme to add a state-of-the-art fifth terminal campus (T5) to Heathrow, BAA plc. was subject to a hostile takeover bid by the Airport Development and Investment Ltd (ADI). ADI was a wholly-owned subsidiary of FGP TopCo Ltd, in which Grupo Ferrovial SA (Ferrovial), a Spanish infrastructure consortium, were the majority shareholder (61.06%). Other shareholders included Caisse de dépôt et placement du Québec (28.94%), which managed public pension plans in the Canadian province of Quebec, and GIC Special Investments, a sovereign wealth fund established by the Government of Singapore (10%). The highly leveraged bid - ADI was borrowing nearly £9bn from five banks - valued BAA plc. at £10.11bn, and represented a 49% premium on the company's market value before the takeover approach became public.²

Upon the successful completion of the takeover, BAA was delisted from the London Stock Exchange and formed BAA Ltd. Margaret Ewing, who stepped down as CFO shortly after the takeover, later observed Ferrovial was driving the business "purely from a financial perspective". And another former director would note "It's a different leadership model, and the drivers have changed ... under the former CEO, it was a FTSE 50 company on the public-private boundary. That changed when Ferrovial came on board. Now it's about saving cash."³ But Ferrovial insisted they had a long-term commitment while noting that "BAA is not a public, but a responsible private company ... It must be understood that we will not build runways or

² The initial offer of £8.75bn was turned down after the BAA Board insisted it 'did not begin to reflect the true value of BAA's unique portfolio'

³ Stewart, D. (2008). "BAA the Economy Class Client," *Building*, 4

terminals unless there is a commercial incentive.”⁴ From then onwards, BAA rarely managed to get out of the headlines. And it started facing investigations by the Competition Commission the Civil Aviation Authority, the Department for Transport, and a Parliamentary Committee.

Less than a year had passed following BAA’s acquisition by the Ferrovial-led consortium when the Office of Fair Trading (OFT) referred the BAA airports to the Competition Commission (CC) for investigation on 29 March 2007. CC carried investigations into merges, markets, and the regulated industries. OFT had identified potential adverse effects on competition relating to a combination of features: joint ownership of airports, regulation, development restrictions, and capacity constraints. A day later, the Civil Aviation Authority (CAA), the industry’s regulator for England, also asked CC to inquiry into the maximum level of airport charges at Heathrow and Gatwick for the five years beginning on 1 April 2008, and to investigate if BAA had pursued a code of conduct adverse to the public interest in the past. In a submission to CC in May 2007, *Putting Passengers First*, BAA stated its disagreement with significant elements of the OFT analysis and challenged the conclusions. In CC’s report on the charges to airlines at Heathrow and Gatwick submitted to CAA in September 2007 (the Q5 report), CC concluded that the two airports had failed to manage security queuing and queue times to avoid unacceptable delays to passengers, crew and flights and consequently had not furthered the reasonable interests of the users. CC also expressed concern with significant increases in BAA’s projected capital and operating expenditure during the course of the regulatory review for Q5. (CAA’s final determination on airport charges at Heathrow and service standards was published on 11 March 2008⁵.) And in April 2008, in its interim *Emerging Thinking* report published for consultation, CC stated that BAA had failed to proper consult the Star Alliance regarding the T2 programme during the Constructive Engagement process, an assertion that BAA refuted in its response. CC also judged the lack of competitive pressures faced by BAA had contributed to the

⁴ Nelson, S. (2006). BAA CEO addressing the Heathrow Consultative Committee, December

⁵ This was a controversial process with Financial Times reporting that airlines claimed a rise in fees represented a “reward for failure”, despite an overall reduction in the return on capital investment from 7.75% to 6.2% at Heathrow for BAA owners.

lack of investment in new airport capacity in the South East of England, and were not serving well the interests of either airline or passengers. In August 2008, CC published its provisional findings confirming its findings in the interim report, and BAA put forward an evidenced case that their ownership of the airports had not “distorted, prevented or restricted competition” in September 2008. Still, in the same month, BAA announced the sale of Gatwick. But in December 2008, the CC published its Provisional Remedies for its market investigation of BAA’s UK airports where it proposed the divestment by BAA of two of its three London airports. And the CC also proposed undertakings for Heathrow focused on improving the consultation process between HAL and airlines to make constructive engagement work more effectively.

Concurrently to this process, in October 2007, the House of Commons Transport Committee (Committee) announced an inquiry into the future of BAA, and in March 2008 the Committee published a report *The Future of BAA*. This report delivered a very damaging assessment of the company pointing that its step by step risk averse capital expansion had only been possible because it did not face competitive pressure from other airport operators to introduce more capacity more rapidly. It also pointed that the company’s ownership of all London major airports had exacerbated delays in delivering runway capacity, and that BAA had shown weakness in consultation, lack of responsiveness to the airlines' needs, and lack of genuine 2-way dialogue and exchange of views. In memorandums submitted to the Committee, different airlines argued the lack of strategic investment at Heathrow for decades had led to chronic congestion, delays, poor customer experience, and insufficient capacity to meet demand.

The Department for Transport (DfT), which had been working closely with the CC, was another organisation looking into the same matters. And after announcing an independent review of airport regulation in April 2007, one year later the DfT commissioned two separate but complementary reviews of the framework for the airport regulation in response to widespread criticism of BAA’s management of several airports, particularly Heathrow, calls by the airlines to break the BAA monopoly, and the previous reports by the House of Commons Transport Committee. DfT also commissioned a report on air passenger experience from the Consumer

Protection Group of the CAA. And in November 2007 announced a public consultation (*Adding capacity at Heathrow*) on the construction of a third runway and sixth terminal at Heathrow. Amidst a raft of bad news, and a change of Chief Executives in April 2008, BAA received good news in January 2009 - the Secretary of State for Transport announced conditional support for plans for a third runway and a six terminal at Heathrow, subject to a limit on air transport movements at Heathrow to be reviewed in 2020 to ensure compliance with noise conditions.

But more bad news were in stock. And in March 09, the CC finally published its final report on the investigation on the supply of airport services by BAA in the UK, and ruled that BAA had been abusing its dominant market position and demanded that BAA's asset base be dismantled through the sale of Gatwick, Stansted and either Edinburgh or Glasgow International airport. Whilst BAA had already put Gatwick for sale, the company decided to legally challenge the order to sell Stansted and further break-up the company. The CC also called for HAL to strengthen its consultation process with the airlines, arguing that demand for airport services was a market that derives from the demand for flights, and changes in price/quality of airport services can affect demand by affecting airline or passenger behaviour. In addition, the CC noted Heathrow was the most convenient airport for many passengers particularly business travellers and would continue to have substantial market power and would require price control after divesture. In the same month, DfT announced a consultation until June 2009 on a proposed reform to the economic regulation of airports to put the interests of passengers at the centre of the new regulatory regime.

Airport Regulations

Aviation is a critical part of the UK's economy with UK airports handling hundreds of millions of passengers every year. In order to ensure that airport operators such as BAA continue to invest capital to improve the UK's airport infrastructure, the industry is overseen by a regulatory body – the Civil Aviation Authority (CAA). Airport operators generate a large portion of their revenues from charges levied on airlines that land and take-off from their airports. The CAA caps the maximum amount that an airport operator can charge airlines, and charges are revised every five years (a quinquennium). The price caps reflect the overall value of the regulated

asset base (RAB) in order to ensure that the airport operator can have appropriate reasonable rate of return on capital investment into infrastructure, service and operations. Increases in the price caps from one quinquennium to the next are determined based on the amount of capital that the airport operator commits to invest over the new quinquennium, and the amount of profit the company is allowed to make in order to pay for the capital investment. Thus, the more CAA authorises an airport operator to invest in improving the airport infrastructure the higher the fees that operator may ultimately charge. Airport charges are designed to increase incrementally provided the operator meets trigger conditions. These triggers define the dates at which certain projects must be completed – failure to reach a trigger reduces the maximum amount that the operator can charge. But operators do not have total freedom in choosing how and how much they can invest; the price capping mechanism requires that operators engage the airline community and CAA to negotiate how the capital should best be invested. As all airlines ultimately share the cost of an operator's investment, and they all pay the same fees, each airline competes to have their needs met during the quinquennium. When a large amount of capital is being invested into a new terminal which will only benefit selected airlines, this can generate resentment from other airlines as it was the case of T5. In January 2007 prior to the opening of T5, Mark Johnson, the representative of the Star Alliance at Heathrow, asked:

The T5 campus is about to 'go live' and is being proclaimed as a world-class facility, having received directly and indirectly more than 25% of its funding from Star Alliance members. All of this raises the question: Will competitive equivalence, therefore, be matched at the same time for Star Alliance members?

If an operator fails to deliver the improvements offered to the airlines at the start of that quinquennium, the CAA can impose additional penalties. Operators who exceed the agreed upon budget for a project also cannot increase fees to reclaim the extra costs without first demonstrating to both the airlines and CAA that the additional outlay offered value for money.

Heathrow Airport

Heathrow Airport was the world's third busiest airport⁶ and represented BAA's most strategically important asset. Heathrow was also the closest airport to central London, and some studies estimated it contributed around 0.8-0.9% to the UK's GDP. Heathrow was founded in 1929 and expanded rapidly through the 1950s and 1960s to house three terminal buildings. In 1989 a fourth terminal was added to meet growing demand. However, these first four terminals made use of a sprawling network of taxiways inherited from the original "Star of David" pattern of runways which were liable to congestion creating serious delays to air traffic referred to by the media as "the Heathrow hassle". In the late nineties, the airport was already operating in excess of planning standards on peak periods. In 2000 Heathrow handled about 63 million passengers per annum (mppa) from nearly 460,500 air transport movements (atms), while its planned capacity was around 60 mppa from 440,000 atms.⁷ And demand forecasts for Heathrow projected demand to be in the range of 118-143 mppa in 2016.⁸ The £4.2bn Terminal 5 campus was starting to address the capacity problems at Heathrow. As a greenfield development⁹, T5 had adopted a modern "toast rack" layout that maximised the use of the land by placing the main terminal building (T5A) and its satellites (T5B, T5C) perpendicular to the runways. But T5 left unresolved the congestion problems in the old central terminal area (T1, T2, T3) which was the basis for operations of the airlines that were part of the Star Alliance.

Airline Alliances at Heathrow Airport

In 2008 the airline industry was dominated by three large airline alliances Oneworld, SkyTeam, and Star Alliance. Each alliance sought to encourage its members to coordinate and connect their routes together to provide services over a wider geographical area and maximise

⁶ By passenger number – Airports Council International 2008

⁷ Heathrow was subjected to a planning restriction of 480,000atms, but not on the number of passengers using the airport

⁸ With two thirds of the market for long-haul passengers in the UK, Heathrow competed with other hubs in Continental Europe, eg., Paris, Frankfurt, and in Middle East, e.g., Dubai

⁹ The T5 development was not hindered by the existing terminal buildings

passenger numbers through transfers and code-sharing. To achieve this, the alliances used key airports as 'hubs' to transfer passengers between alliance members, as well as frequent flyer programs, terminal co-location, and joint ground handling wherever possible. Being a member of an airline alliance also allowed the airlines to reduce operational costs by sharing ground staff, joint purchasing of fuel, aeroplane parts, and in-flight service commodities. Alliance members also shared market intelligence in order to maximise each airline's business. But alliance members were expected to have differing requirements in terms of airport facilities. Some airlines tried differentiating their services within an airport by making use of branded VIP lounges, check-in desks, and boarding gates. The heterogeneous nature of the alliances meant that members placed contradictory demands upon airport operators. To resolve these conflicts the alliances employed representatives who collated the requirements of all members into a ostensibly coherent set of specifications for airport operators to work towards.

Heathrow was a critical hub for the Oneworld Alliance who accounted for over 50% of the passengers travelling through the airport. At Heathrow the leading carrier for OneWorld was BA. As both a domestic and international carrier, BA could bring passengers from across the UK to Heathrow where they could connect to international flights. Connecting passengers were a vital part of both BA and BAA's market strategy. Oneworld's dominant position at Heathrow meant that BA and its partners were solely occupying the modern T5 campus **[Exhibit 1]**

The Star Alliance was the second largest customer group at Heathrow representing around 25% of the passengers. Star had been established in established in 1997 by Lufthansa, Scandinavian airlines, Air Canada, Thai Airlines and United Airlines, and was headquartered in Frankfurt, Germany. By 2008 Star was the largest airline alliance with 21 members. Star was host to both large international airlines and smaller domestic airlines. It had a particular focus on business travel and for several years had been awarded the Best Airline Alliance by Business Traveller Magazine and Skytrax. Their vision was: 'to be the leading global airline alliance for the high value international traveller' and their mission was 'to contribute to the long-term profitability of its members beyond their individual capabilities'. Star had a 'Move under One Roof' policy to

improve passenger transfer times and make transfers and code-sharing easier for both airlines and passengers. This policy was formalised with BAA in 2002 when the two organisations signed a first memorandum of understanding (MoU) agreeing to offer collocation at Heathrow by 2010. This agreement was further developed in a second MoU in January 2005 which led to the development of the Heathrow East proposal that offered Star co-location for the 2012 Olympics. The key airline for Star at Heathrow was British Midlands International (BMI). As the only UK member of Star Alliance, BMI provided much needed domestic and regional flights. With the major Star airlines based outside of the UK, in Germany and the US, Star had not used Heathrow as a hub preferring instead to transfer connecting passengers at Frankfurt Airport.

The Heathrow East/Terminal 2 Programme

In June 2005, under pressure from the CAA, and in response to the Government's 2003 Air Transport White Paper and DfT guidance on airport master planning, BAA released a draft long-term strategy for consultation. The central focus of the interim master plan was on adding a controversial third runway and a sixth terminal to Heathrow. Following a period of consultation which ran until October 2005 and the dismay of Star for the way the draft ignored their MoU, BAA changed its priorities and announced in November 2005 the £1-1.5bn Heathrow East Terminal scheme with a statement of support from Virgin and Star **[Exhibit 2]**. The vision offered a modern terminal building (later termed T2A) and a midfield pier (T2B) with the toast-rack layout similar to that used on T5. The first phase of HET pivoted around delivering the first phase of the main building, which should open it in time for the 2012 London Olympics.

In January 2006, BAA appointed Foster and Ove Arup to advance the design of HET, and in July 2006 BAA presented plans for a £1.6bn project to the Heathrow airport consultative committee. HET was to be a key part of a £6.2bn, 10-year investment programme to transform Heathrow. The ambition for the HET's main building was to rival the scale and ambience of Richard Rogers' T5 main building. Work was scheduled to start on site in 2009 and involved demolishing the 1950s T2 and Queen's buildings - the oldest parts of the airport. BAA insisted that the scheme was not going to increase passenger capacity and would produce 40 per cent

less carbon dioxide than the existing terminals. HET would be delivered in 2 phases, and would be fully operational around 2016 offering 180,000sqm of modern facilities with capacity to accommodate 30mppa. After a period of public consultation BAA submitted an outline planning application to Hillingdon Council in October 2006 just for the main building, and the company was granted outline planning permission by the Mayor of London and Hillingdon Council in July 2007 with a projected opening of summer 2012. Another application followed suit to build a midfield pier. BAA hoped that by co-locating Star in a new bespoke terminal it would induce its members to use Heathrow, rather than Frankfurt, as a central hub for connecting passengers. This would make Heathrow one of the world's only airports acting as a hub for two major alliances. But Star Alliance insisted that to restore competitive equivalence with Oneworld, BAA needed to build a new campus rather than new terminals in a piecemeal fashion. And disappointed with BAA plans, Star asked the Council to reject the HET planning application because it did not include all the elements that could make the Heathrow East campus work.¹⁰

During the Constructive engagement period that ran initially until January 27th 2008, and which unfolded concurrently with the public consultation to agree the capital investment programme for Q5, BAA's relationship with Star began to turn sour. There were two main points of contention between Star and BAA. First the opening dates of the first and second phases, and second, the scope of each phase. In terms of opening dates, Star became frustrated after BAA announced in December 2007 that the completion date for the first phase was delayed to December 2012 conditional on a number of assumptions to discuss with the airlines. Somehow it seemed the Summer 2012 deadline had been nothing but a ruse to help BAA gain planning consent for T2A. The delay stoked resentment from the Star Alliance, but BAA justified the delay due to changes in the timings of the move sequences [**Exhibit 3**]. Star's only available recourse was to complain to BAA and the regulator, CAA, which the airline alliance did extensively [**Exhibit 4**]. By January 2007, the tension between the two organisations was so intense that in the response to the CCA consultation paper on Heathrow price control for Q6,

¹⁰ This piecemeal approach enabled, however, BAA to apply for a general permitted development order, avoiding a very protracted full planning permission process

Star suggested “BAA and BA are indirectly conspiring not to allow a competitor equal ability to see the realisation of facilities that match the T5 Campus, albeit some 5 years later.”

The debate around the scope of the T2 programme was equally fierce. Star had developed a long term set of requirements for Heathrow’s eastern campus **[Exhibit 5]**. Insisting on a campus vision, the alliance requested a main terminal building (T2A), with two satellite buildings (Terminals 2B and 2C). These would be serviced by an underground passenger transit system, as well as a multi-storey car park for passengers, an automated baggage handling system, and a utility station. For the first phase, Star demanded that BAA constructed both a 4.5bay wide main terminal and two smaller versions of both satellites whilst providing modern underground connectivity for baggage and passengers. For Star, these requirements were needed to achieve competitive equivalence with the T5 campus within an acceptable time-frame. BAA countered this demand with an offer of a 4.0 bay wide main building, a small midfield pier (T2B), and a bridge connecting T2A and T2B for passenger connectivity. Star would have to use the existing baggage system in T1. Mark Johnson, who had been recruited to represent Star’s interests during the HET programme, was dismayed by what he saw as a lack of foresight from BAA. And conflict flared over the lack of an integrated baggage system with Mark retorting: *‘this is the first time ever in the world a brand-new terminal with 20 million passengers is going to be opened without a new baggage system...and it’s a nightmare because..if you don’t build the baggage system in T2 there is an inherent weakness in everything that is being supplied in the first phase of T2.’*

Star and BAA continued to have a fractured relationship, with Star pushing for BAA to take into account the wider implications of the long-term master plan. Mark Johnson remarked: *“I got called Mr Masterplan because I was the guy with the masterplan ... [I said] ‘you cannot design this from the bottom up it has to be top-down with the master plan. If you don’t have that, you don’t know what you’re asking for”*. Throughout this process and under a fierce fight for the survival of the monopoly, HAL/BAA kept negotiating with the airline community and regulators increases to the capital expenditure plan that needed to submit in January 2008. The amount of investment grew rapidly after BAA realised it had underestimated the cost and scope of the first

phase of Heathrow East. To help produce a concept that BAA, CAA, and the airline community deemed both acceptable and affordable, Ferrovial brought in a famous Spanish architect Luis Vidal to adapt Foster's design bringing the design team to around 40 people.¹¹ Finally, in March 2008, the CAA set the new price caps for Q5 (2008-2013) based on BAA's plans to spend £2.2bn to deliver the first phase of the T2 Programme by November 2013 and overall spend of £4.5bn at Heathrow [**Exhibit 7**]. By now, as part of the tripartite negotiations between BAA, CAA, and the airline community, BAA had settled for including in the first phase of the T2 programme: 1. demolishing the old T2 and associated piers, the Queens administrative building, part of T1, and two multi-storey car parks; and 2. delivering the first phase of the main building (T2A), a midfield pier (T2B), a multi-storey car park, and a power station. In the second phase, after demolishing the remainder of the old T1, BAA would deliver the second phase of T2A, another satellite (T2C), a baggage handling system, and a passenger transit system connecting all the buildings. BMI, a key Star member felt aggrieved with this outcome. And in April 2008, it threatened legal action against BAA if plans for HET were further scaled back.

But the design for the Heathrow East continued to evolve. With T5 people joining the T2 programme after April 2008, Star unexpectedly found some allies for the campus vision it had long been fighting for. The new programme director for HET, a former T5 project leader, rapidly changed the names of the Heathrow East (HET) and midfield pier to T2A and T2B. And he outrightly accepted Star's point that a baggage handling system needed to connect T2A, T2B, and T2C in the long run, and the first phase needed to safeguard at least a baggage handling basement in T2B and tunnels connecting all the buildings to avoid digging up the taxiways in the second phase. Clearly, BAA needed to change the design agreed for Q5. Realising the whole construction programme was going to be delayed given that BA needed an additional year to move out of the old T2 after the fallout from the T5 opening, BAA initiated a major strategic change. It turned to Mott MacDonald, an engineering consultancy, to hastily modify the T2B

¹¹ Whilst Star was the main stakeholders, the team was also engaging with a myriad of internal stakeholders, e.g., BAA maintenance and operations, airport security, customs,

delivery strategy to allow for building in a massive basement¹². BAA also acquiesced to Star demands to provide underground passenger connectivity between T2A and T2B in the first phase, scrapping the original plan for a bridge. And new tunnels were added to the scope of the first phase to safeguard underground inter-terminal baggage and train connectivity from T2A through T2B to T2C in the future [Exhibit 6]. But BAA explained it was physically impossible to provide an underground system for handling departures bags until the second phase due to the proximity of the first phase of T2A with a London underground line. BAA's director for Programme Control and Performance said: *'If we could, we wouldn't be spending nearly £200 million on enhancing a baggage system in T1. We would like to build it in T2, but we can't. If we had more space, we would put the bloody baggage system in T2A.'* BAA also changed the T2A layout in response to feedback from T5, and introduced separate security areas for transfer and direct passengers. As the scope of the first phase for the T2 campus evolved, BAA faced at some point a £600m shortfall relative to the £2.2bn budgeted for Q5. The pressure on costs became enormous, with the BAA executive demanding a 'single version of the truth'. Through value engineering, the shortfall got down to around £250m. Because the Q5 figures had been fixed, BAA jointly with the airline community and CAA engaged in a review of the allocation of the £4.5bn capital investment committed for Heathrow during Q5.

In August 2008, BAA finally submitted a revised outline planning application (followed by a reserved matters design report in September) for T2. The company insisted T2 would not increase capacity but was instead about replacing like for like to provide competitive equivalence with T5 to keep to the terms of the general permitted development order. But the company postponed again the opening of the T2. BAA was committed to prevent any repeat of the T5 experience with T2. The completion date of the construction moved to end of October 2013. And an extra period of operational readiness testing was added to the end of the first phase of the T2 programme. The T2 campus would not be opened for passenger use until summer 2014, and the second phase not until 2018. In January 2009, BAA, airlines, and CAA agreed three triggers for HET: 1. Demolition of T2 should enable start of HET construction by

¹² 60m wide and 240m long and 20 m deep

March 2011; 2. the T2A phase 1 building should be weather-tight by February 2012, and 3. the T2A phase 1 construction should have progressed sufficiently for operational trials to commence in November 2013 [Exhibit 8]

The Intelligent Client Model

It was with a backdrop of a loss-making Heathrow Ltd. [Exhibit 9], an acrimonious relationship with Star, successive delays of the T2 opening, escalation in the T2 programme scope, and regulator threat to claw back money if BAA were capital inefficient or failed to consult, that in February 2009 BAA recruited Steven Morgan as Director of Capital Programmes. This post placed him in charge of overseeing the £5bn capital expenditure over Q5 with over £4.5bn being spent at Heathrow alone, and the need to deal urgently with a £250m-plus shortfall in funding. Steven's arrival also coincided with a period of tumultuous change in Heathrow's operating environment. The T5 opening fiasco, which had generated media frenzy, had subsided but the damage to BAA's reputation was significant. To make matters worse the CC was nearing the completion of an investigation which would likely force BAA to sell some profitable airports. And the UK economy had entered into a recession after the worst financial crisis it had faced since the 1930s. The financial crisis had cast the £4.3bn T5 investment as profligate. BAA had posted a loss in 2008 and did not pay dividends. Phil Wilbraham, who in April 2008 had moved from T5 to become T2 Programme Director noted that *"on T2 there was immense pressure on cost because there were some people who weren't involved [in T5] who generally believed that we had overpaid on T5, although we proved to the regulator that we didn't"*. More than ever, BAA was under pressure to demonstrate it was an intelligent client.

In the face of these commercial pressures, BAA began to reflect on the contracting strategy which had driven the T5 investment - the so called 'T5 agreement'. T5 had been BAA's first terminal investment in 14 years and prior to undertaking the project BAA had been concerned by the propensity for megaproject budgets to spiral out of control. The T5 agreement had set out a bold plan for BAA to be solely responsible for both the project's design and management. As a traditionally operations-based business, BAA had to hire over a thousand professional

designers and project managers to supplement its existing staff. And it selected a novel commercial strategy. The T5 agreement made use of cost reimbursable construction contracts which guaranteed contractors a profit margin regardless of how the scope would change. Suppliers did not have to competitively bid for the work, but rather were selected from a pool of long-term framework agreements based on their competence and reputation. In T5, BAA was concerned that with more traditional fixed price contracts contractors often charge a premium to accommodate change to the design. BAA believed that cost reimbursable contracts, which placed all risk of loss with BAA, would prevent contractors seeking to take advantage of changes to the design. This flexibility was considered particularly critical on Terminal 5 as BA, the T5 main occupier, was repositioning its business model to better compete with low cost carriers, and introducing a great deal of technological uncertainty to the project¹³.

It was Steven Morgan's responsibility now to tell BAA the most appropriate procurement strategy for T2. He was not totally dismissive of the T5 agreement, but said *"That model for T5 may well have been the right model for that era but we are hoping to get something that is equivalent to T5 for £2bn"*. This reflected a perception that had gained traction in the company since 2006 that the T5 agreement had led to an expensive undertaking. And when BAA started to procure the second phase of T5 in 2007, the £300m T5C satellite to be completed in 2010, it used a radically different strategy. BAA felt the supply chain had moved on from the 1990s, and that suppliers had more capabilities to take greater accountability for managing design and construction risk. BAA reduced the number of long-term frameworks to nine CBIs (Complex Build Integrators) and five CBCs (Commodity Build Contractors), who were expected to provide design and delivery management and control on behalf of BAA. And for T5C, BAA awarded all the works (design, construction, project management) to one firm under a Value in Partnership framework for a target price of £230m¹⁴. Subsequently, when awarding the contract for the

¹³ Examples of this uncertainty made it hard to define requirements for onsite self-service check-in procedures, and the number of stands required to park larger A380 aircraft

¹⁴ Two key packages were nonetheless left outside Carillion's package of work including baggage (a fixed price contract with VanderLande), and the airfield (managed by BAA and constructed by Ferrovial Agroman)

midfield pier (the first phase of T2B) in 2008, BAA decided to shift risk even further to the contractors, and awarded the project through a £84m fixed-price contract to Balford Beatty, the largest fixed-price contract BAA had ever let for an airside project. The belief that BAA had struck good bargains for T5C and T2B reinforced the executive's confidence in this new approach. The BAA's Head of Commercial explained: *"We're not talking about indiscriminate transfer of risk to the supply chain. If you take a portfolio of projects, there are some parts where a supplier can manage the risk effectively with little involvement required from BAA."*¹⁵ And by January 2008, as T5 work was petering out, BAA axed 200 staff from its construction project management division in a simplification process.

But both T5C and the first phase of the mid field pier (T2B) were small satellites with standard pier facilities. The track transit and baggage system extensions to T5C were also relatively straightforward. In contrast, T2 was a mega development that whilst smaller in scope than T5, in many aspects was more challenging given that construction would take place in the middle of an operational airport whereas T5 was a greenfield project. Steven knew this: "The challenges are not to be underestimated. We are constructing a significant new building in the middle of one of the world's busiest airports and ensuring the operating airport is not affected is an absolute priority." Notwithstanding this, Steven believed BAA procurement practices needed to be upended. And he was bold: "I don't want to say that 'you lot have had it too easy' but we did have an environment where BAA took most of the risk and the margins that we paid were very good. Now to get that kind of return I expect good performance." Drawing upon his experience in asset acquisition, Steven's solution was to argue for a new model - the 'intelligent client' model. Steven then summarized this model into 'Ten Commandments' **[Exhibit 10]**.

The intelligent client model required that clients invested in extensive identification and definition of needs up-front, based on a strategic master plan. Investments should be motivated by business plans and the benefits they would create. Capital works would be broken

¹⁵ Getting the procurement right is crucial. Planning for a Successful Future 2008. *New Civil Engineering*

into related packages which could be competitively procured in the market. Steven was a firm believer in competition. He argued *“Competition is the best way for me to demonstrate value for money to the regulators. Open competition is even better. There is an opportunity for more companies to make money with better margins if they deliver. But there is going to be less opportunity for those companies who sit on their hands and don’t deliver – you are going to have to earn it.... That is not the way we did it here. We ran a competition based on corporate CVs. We didn’t have prices or proposed management teams. That is not the way the system is supposed to work.”* Contract competition would factor in upfront cost as well as total lifecycle cost and exposure to risk for both client and the contractor. Thus Steven was proposing to rip up the long-term frameworks in the BAA’s long established procurement book. Frameworks would only be used for work valued at £25m or less. And even for work between £10m and £25m, he wanted to introduce some competition between the framework companies.

As with the T5C model, an intelligent client BAA would not take a ‘hands on’ design and management approach. Rather, these roles would be tendered to the most suitable candidates. BAA would assume the role of a programme manager collating broad performance measures to ensure the wider programme, budget, and schedule were being met whilst trusting the contractors to handle day-to-day project issues. And Steven also wanted unambiguous contracts. As he said *“it’s not a matter of let’s hold hands and sing kumbaya around the camp fire – it’s more about defining what we are doing and rewarding for performance. I want a cooperative incentivised relationship with my contractors but I don’t want to be their partner. That is important. I want to be their customer.”* For him, contracts should be game plans that set the division of labour whereas partnering was a cop-out that created complacency.

Steven shied away from the fixed-price model adopted for the first phase of T2B concerned it could create a mentality where contractors would charge a premium for the severity of the risks, whilst keeping for themselves all the benefits of improved performance. He also disliked cost plus contracts which he felt encouraged complacency and led to onerous programme management costs for the client. Following the example of T5C, he planned to move towards

target cost and schedule type contracts, an 'incentivised contract arrangement' as he put it.¹⁶ A target cost and schedule contract splits any cost savings made by the contractor during delivery between the client and the contractor provided contractors deliver by a pre-specified date. Similarly, any overspent is split between the contractor and the client. And contractors are penalised if they incur delays. Thus the client and contractor share a mutual interest in delivering on time and to budget. BAA would incur 75% of the potential savings or overspent, and the contractor 25%. Steven would cap however the maximum that contractors could lose relative to their target fee as 10% of the target costs so suppliers would not feel they were 'betting the company or committing suicide'. The target fee would be around 2 to 3%. And BAA would cover in 100% the costs of the impact of changes 'clearly' outside the scope, and contribute to the costs of changes within the scope. The contract would be an open book, and BAA would reserve the right to see books and run audits on a statistically significant sample.

Steven would also overhaul the selection process. Contractors would be selected on the basis of the Most Economic Advantageous Tender (MEAT) rather than low bidder wins. Proposals would be evaluated separately from the technical and commercial points of view by a 5-people jury. On the technical side, the jury would give each proposal a classification from 1 (flawed) to 5 (could not be better) taking into account a raft of weighted criteria for the CVs of the team, experience, safety, innovation, and quality assurance procedures. Commercially, the jury would compare BAA's internal estimate of the 'should be' cost against the contractors' estimate of the 'would be' cost. BAA would readjust the 'would be' cost by adding how different types of risk could affect the reliability and predictability of the contractors' proposed cost. The BAA panel would ask companies questions and consider the contractors' responses in the evaluations. It would also assess the risks of company bankruptcy based on turnover. In his model, Steven would split the contract award into two stages: the first would focus on detailed design; with a detailed design agreed, BAA and the firm would then agree a target cost and completion date.

¹⁶ Technically, he planned to use the standard form of contract produced by the Institution of Civil Engineers (ICE) NEC3 Engineering and Construction Contract Option C: Target contract with activity schedule.

Originally, Steven proposed to introduce a totally independent award fee (1-2% of the target cost) that it would give him unilateral control over a bonus which could be earned by contractors who displayed appropriate behaviours in regards to subjective criteria such as cooperation, adaptability, resilience, or ensuring workers behaved safely or implemented innovative ways to working. Steven said *“I want them [contractors] to make more money but they will have to earn it. If they can come up with an idea that saves us money, I will not only protect their fee but I’ll give them a reward on top.”* The award fee was about how ‘happy the contractor can make the client based on objective and subjective criteria’. Because the award fee was not guaranteed, the project team would struggle to put it into the business plan. This was important for Steven as he thought it was the only way the award fee could work to change the balance of allegiances of the contractors’ team, and get the contractors to start treating him as the ‘boss’. And of course Steven understood the economic downturn would help him to bring down costs. In his words, *“what I am seeing is that most folks, maybe because of the economy, are hungry to get a bigger piece of the pie and are willing to earn it.”*

Finally, Steven argued for a strong set of governance mechanisms whereby changes would need to be thoroughly vetted. Requests for scope changes would need to be discussed at length with the airline community before being sent for consideration by the senior executive of BAA. They would also need to be motivated by a business case **[Exhibit 11]**. Capital programme governance would be delivered through Sponsoring Groups that reported to the Executive. Each Sponsoring Group would be chaired by a member of the Executive acting as Programme Chair/Sponsor. Steven summed up his sentiment on design changes, saying: *“You spend your time up front specifying and if you have to make changes it better damn well be good”.*

Potential for Change in Terminal 2

Although the proposed intelligent client model was geared towards resisting changes to the design, the nature of the Terminal 2 programme created a high potential for design change. The Heathrow East campus needed to meet the diverse needs of the 18 members of the Star Alliance at Heathrow. This was in marked contrast with the T5 programme in which BA was

going to be the sole occupier. Some airlines like BMI were small players in the global marketplace but at Heathrow they were the biggest Star Alliance member. Others like United were very large in the global mix but Heathrow for them was just an important outstation. Some were short haul, others were long haul; some had A380s and others did not. And more airlines were expected to join the Star Alliance over time. The divergent requirements of the airlines were illustrated in late 2008 when BAA were seeking to finalise the design of the passenger boarding gates for T2B. Two designs were proposed: one with a closed gated design and the other an open gated design. With closed gates passengers awaiting their flight are moved into a glass walled waiting area ready to board the flight. With open gates passengers are free to roam the building, visiting retail areas, until their flight is called. BAA's commercial arm preferred to have open gate rooms as this allows BAA to generate income from passengers who shop in the retail area. This point of view was shared by some members of the Star Alliance who felt it improved the passenger experience. However, other Star Alliance airlines preferred closed gate rooms which, because passengers are already waiting at the appropriate gate, offer operational efficiencies, speed the boarding process, and reduce likelihood of missing passengers which helps to improve punctuality. Mark Johnson, the Star Alliance's representative explained: *"we might want open [gates] and we might want closed [gates], there must be a way that we can design the satellite to [be] flex[ible] between those two whilst we haven't got a decision"*. But BAA decided not to wait, and in January 2007 Star complained that BAA had ruled out closed gates, and started a formal dispute. The dispute did not escalate all the way up to CAA, but rather was resolved by an independent BAA director acting as an adjudicator who ruled in that most of T2 would have open gates, but part of T2B would have closed gates. BAA should also safeguard both options in the design so closed gates could be transformed into open gates if BAA managed to address the airlines' concerns with operational efficiency. For this, BAA needed to invest in positive boarding technology that would enable to inform airlines whether the passengers had already passed security, and new technologies to enable passengers to self-validate the boarding tickets.

Simultaneously, the Star Alliance had been pushing for new developments such as changes in the lounges for the commercial important passengers and automated self-baggage drops for international flights¹⁷. These systems, which were already around for domestic flights, had the potential to reduce the operational costs for international flights. BAA had built a trial site, and the airlines were starting to trial a machine. Assuming the results were positive, the parties were debating whether to get them into T2 so as to open it with the latest technology. However, accommodating this late change to the T2A departures area which was designed for 56 standard check-in desks would cost both time, increase risks of delays and malfunction, and add a few extra million pounds. And BAA wasn't sure if airlines understood those implications, and compared airlines to a child entering into a sweetshop: 'some days they might want some pear drops and liquorish; they're not quite sure, but they know they want something. That is the level of flexibility they want to have.' Any further capital investment would have to be negotiated with the airline community at Heathrow and CAA. This negotiation carried a risk for the Star Alliance itself – if their proposed changes failed to be introduced in their own terminal, their idea could still be taken by a rival alliance who would then push to have the technology in their own terminal. If BAA were seen to adopt a tough stance on technological innovation in T2 but then introduced changes elsewhere, it would likely spark another conflict with Star.

Other changes were expected to emanate internally. HAL had yet to appoint the future T2 operations director, and experience suggested that once the operations manager is on board and starts looking in more detail to the design, she is likely to request changes. Feedback from operations teams from other terminals were already giving traction to a raft of changes to the internal layouts of T2A, the so-called programme D, e.g., add more retail area to accommodate changing luxury markets, rearrange the departures lounge, increase the transfers zone, introduce new security arrangements; accommodating programme D was also not going to be cheap. There were also lots of technology cycles much shorter than the T2 programme. And it was unclear when changes were going to stop trickling into the Heathrow East programme.

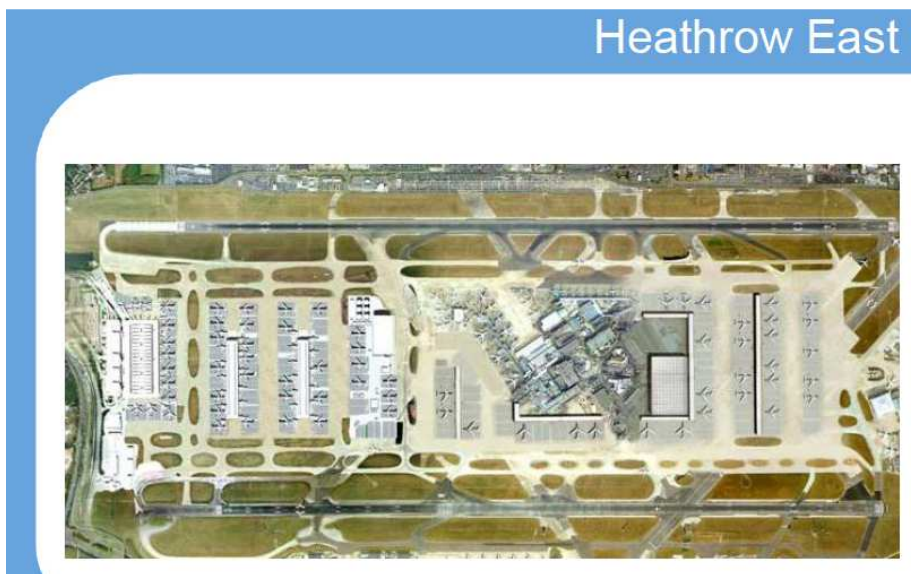
¹⁷ This meant passengers alone and without help from a host would issue themselves the tags, put the tags on the items, and put them on the conveyor belt

Accommodating uncertainty in the design of the gate room, the potential introduction of new technologies, and implementing programme D would incur additional cost and time both to design the solution and then build it. Steven's intelligent client model which worked on the premise that the requirements would be specified upfront would be challenged by such issues. And the sources of change seemed to be many. Would Steven's model further endanger the quality of the relationship between the Star alliance and BAA, and ultimately endanger BAA's legitimacy to operate a regulated asset? Surprisingly, the Star alliance seemed genuinely happy with Steven's appointment as it shared the perception T5 had been an expensive terminal in part due to the one-size-fits-all way through which it had been procured. But to what extent would the BAA executive and its new shareholders endorse Steven's aggressive commercial approach? And how aggressive actually was Steven's approach to capital procurement?

Exhibit 1 – Overview of Heathrow airport and location of the three Airline Alliances (BAA presentation 2005)



Exhibit 2 – The November 2005 Heathrow East proposal presented by BAA



Heathrow East – costs

- Cost - too early to be definitive, but:
 - We have our T5 experience, and our T5 logistics
 - Site needs no new major rail interchange/tunnelling
 - Site needs no new M25 access
 - Site needs no major river/road diversions
 - Site already has major utility and infrastructure provision
 - Piers/apron provision is already in the current Capital plan
- provisionally would suggest + £1-1.5bn

Heathrow East – timeframe

- Any replacement new terminal would not begin construction until January 2009
- Completion would be aimed for 2012 – with the possibility it could complement Heathrow as the appropriate gateway to the Olympic Games

Heathrow East – Constructive engagement

- Regulator wants BAA and airlines to work together to present a common vision and set of priorities for Heathrow
- BAA committed to the process and will take this idea forward with the airlines
- BAA has a proven track record with BA in developing large scale projects in partnership
- Strong desire that STAR Alliance (and possibly Virgin) will be working in partnership with BAA to explore this idea further

Exhibit 3- Planned moves at Heathrow (BAA presentation to Heathrow Airport Charges Consultation in November 2008]

Who goes where and when

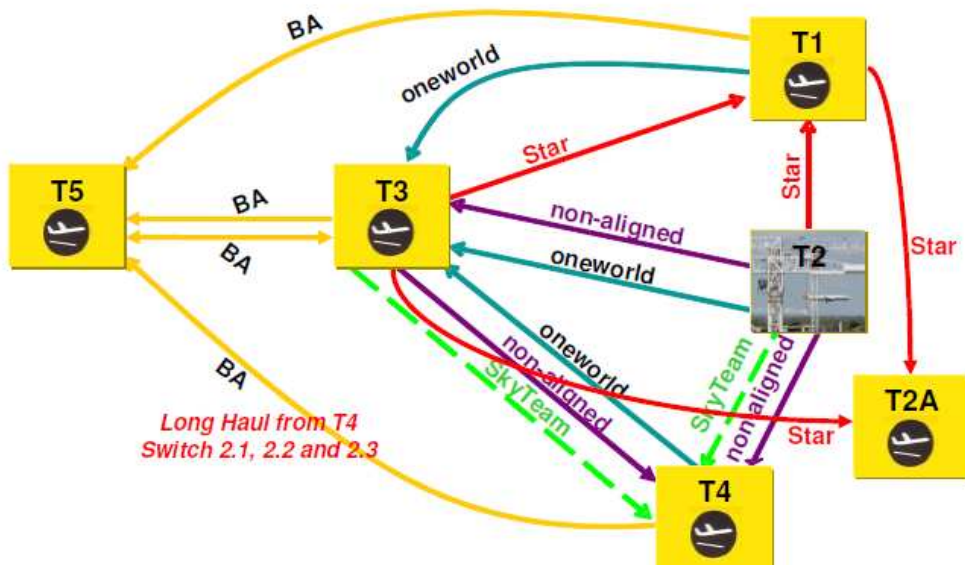


Exhibit 4 – Letters from Mark Johnson, Star representative



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Project Director

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Mike Forster
Business Strategy Director
Heathrow Strategy Department
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30 AUGUST 2007

HET Campus

Dear Mike

BAA/HAL and Star both have the aspiration of generating and using world-class hub alliance facilities on the Eastern Apron. When developed, they will provide additional revenue and generate cost savings for all, being the essence of what was agreed and signed in the HET MOU's.

Three primary factors we believe should be constantly at the fore:

- Building for longevity (where flexibility, contingency and tolerance are evident)
- Building for a hub alliance (of circa 20 airlines whose growth will come from co-location)
- Building facilities as soon as possible to compete with other top European hubs (in which T5 and the western apron of Heathrow will be one), all as set out in the Star HET requirements document.

However, we have a complication in reaching our combined goal, that being the scope of the first phase of development (given a now agreed HET campus 2020 masterplan). The constraints of a quinquennium funding regime and the political benefits of supporting a 2012 Olympic Games deadline have set 2012 as the milestone, giving us all five years to work together to create the best HET Campus first phase facilities.

My letter of the 26th July and your email of the 16th August both discussed the above stated 'first phase' complication; alongside the need to gain bilateral endorsement between stages of design evolution. The following graphic seeks to interpret this complication:



Comments:

- at each stage of the development process an options evaluation and endorsement should be done (moving from say 6 options to 3 options to 1 option)
- In moving from 3 options to 1 option (at each stage), this should be done with close cooperation with stakeholders who should evaluate and endorse final option

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Rechtsform: GmbH - Sitz der Gesellschaft: Frankfurt am Main - Zuständiges Registergericht und Nr.: Amtsgericht Frankfurt am Main HRB 50030 - Geschäftsführer: Jean Ulrich-Albrecht Binderberger.



Whilst we would not wish to have further unilateral decisions on limited information being presented to us as a 'fait accompli', we will register our discord (that in our opinion four foundation blocks in HET Campus Phase 1, building on the masterplan, are not in alignment; that of a 4.5 bay wide building, baggage in HET, appropriate pax and baggage system connectivity and satellites of a length and depth to meet requirements), and now work with your teams in the evolution of scheme designs.

We would hope, in trusting you in that you are 'committed to providing optimal facilities', that our concerns can be placated via your teams analysis and evolution of scheme designs, in particular meeting functional tolerances for a hub alliance campus. We do reserve our position and would want yours to be revised should the evolution via appropriate modeling not secure our joint confidence, when seeking to conclude scheme design.

Your team has presented your concept design review, which appears to be made up of

- a) The Concept Design Review Presentation
- b) The HET/Airline Gateway Review (8th/9th August 2007) Issues Log
- c) The Heathrow East version 3.0 – July 07 laminated sheet
- d) A HET Information Pack (Aug 07) containing GA's, two cross sections, a stakeholder process including a design options matrix, scheme design programme and fixity milestones, review of PET Star requirements, ESR gantry details, and ICS Stage Report.

It would be helpful if the above could be co-ordinated into an appropriate 'concept design' close out document, which we have suggested aligns with the contents of the Star HET requirements document and your design options matrix (a matter raised with Janna who is actioning said request).

Finally could you please advise who is or will be the Design Director of the HET campus? With such as a person in place it should enhance communication channels between key parties and would be a welcome interface through what will be important design evolution stages, reporting up to Hock Lye and yourself, as Chairs for the JSG.

Yours sincerely

Mark Johnson
LHR Project Director

Star PET & JSG

STAR ALLIANCE 

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27 DECEMBER 2007

Delivery of the Star MOU

Dear Mark

At the latter end of 2006 Star Alliance members were asked to undertake a radically new journey towards securing their aspiration of 'Moving Under One Roof'. This culminated in definitive HET Campus designs, revised and signed MOU's and a BAA Capital Investment Plan being submitted to the CAA in July 2007.

The 'plan' as requested by Star members was for a first phase 20mppa 4.5 bay wide HET building (drawn from the 6.5 bay 30mppa BAA planning application): an integrated direct, transfer and arrivals baggage system; BD domestics located in the centre; passenger and baggage connectivity out to a midfield and outer piers; and all appropriately sized for intra connectivity for a hub alliance, having closed gates to meet operational flexibility and efficiencies.

BAA, in seeking to meet achievable goals, offered instead in early 2007 a 4.0 bay wide HET, the link and use of the existing T1 baggage system, BD domestics located in the centre, and only passenger connectivity out to only the mid field pier. However, this was to be delivered for operational use by June 2012, with a definitive 'trust us' statement, offered across from a BAA Director to Star Alliance CEO's as remaining 'scope' items were noted, were contained within the HET Campus masterplan, and would be delivered in HET phase 2.

A substantial 130 page Star HET requirement document was then presented to the BAA, to ensure clarity on operational and functionality needs (as Star is not a single airline into T5). This was received and endorsed by your HET team. In addition we continued to seek from late 2006, till this present time, resolution on major concerns. These included the transition from a T1 baggage system to an integrated system in HET; that the design of HET phase 1 should be borne out of the overall HET campus integrated design; and that designs for connectivity and piers should progress at a viable pace to ensure a HET Campus for June 2012. We have on a constant basis also sought a HET Campus Design Director, so that the responsibility of delivering our MOU was under the guardianship of a known leader.

Your development and stakeholder leader, for the first time last week, presented the airline community with a critical path programme. It indicated that your team would deliver HET phase 1 by September 2013, some 15 months late. We have also been advised, for the first time, through cost cutting and substantial scope and design changes, a December 2012 delivery date might be possible, or even a 'soft' June 2012 facility?

All substantially undermine our MOU and the work we have done over the last 12 months with your scheme design teams, having anticipated closure of baseline general arrangement drawings of HET and piers by the end of 2007.

At the recent JST with all senior LHR airline members present and a senior member of the CAA team, more costs, slower programmes, or reduced schemes were presented, with T5, T3 and T4 gaining the majority of 'green development status', whilst most of the HET campus programme had turned amber or red status.

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Rechtsform: GmbH - Sitz der Gesellschaft: Frankfurt am Main - Zuständiges Registergericht und Nr.: Amtsgericht Frankfurt am Main HRB 50030 - Geschäftsführer: Jaan Ulrich Albrecht Binderberger.



Star Alliance members, by dint of being a size suitable for facilities planned for the Easter Apron of LHR, are at the end of your short-term development and 'transformation' deliberations, without it would appear a guardian to maintain promises, albeit compromises, that were agreed and signed.

In addition we are being asked by the CAA to sign off what should be a finished and formalised Capital Investment Programme between BAA and LHR airlines by the 21st January, within which clear and definitive development 'triggers' should be noted. One power point presentation has eradicated 12 months of planning and constructive engagement, leaving any hope to arrive at agreed and known triggers a total impossibility.

At no time over the last twelve months have your team shared the enormity of a 15 month programme delay, and even a request for clarity at our CEO's once a year meeting on the 13th December 2007 was fed

'BAA remains committed to making HET available for the 2012 Olympics' and 'our focus is to provide STAR passengers and airlines with a quality product as soon as is possible, and to support your hub operation on the eastern apron in a robust and efficient manner'

whilst the whole of BAA senior management knew an Olympic date, to align with the Star MOU, to be an impossibility.

T5 and the solutions for Skyteam and Oneworld hub alliances are clear and known. 2008 and 2009 programmes and adequate capital all align to their MOU's, with timely move sequences that match needs and expectations. Star certainly has not received this support or clarity from senior HET campus management.

So what is Star to do from here, as a shopping list of problems, challenges and changes, rather than solutions, has been BAA's sudden end of year message to Star CEO's?

There have been, and still are solutions, many you might not be aware of given your relatively new role as MD of HAL, albeit lessons learnt from T5 are matters you are well versed in. Could we therefore please meet to discuss a more productive and constructive way forward for 2008, as soon as possible, as to disenfranchise 25% of your customers, needs urgent attention at the very top level in HAL.

Yours sincerely

A handwritten signature in black ink, appearing to read "Mark Johnson", written over a faint, stylized graphic element.

Mark Johnson
LHR Project Director

cc
Star JSG (through to CEO's)
Paul Ellis – LACC Chair
Jim Hunter – AOC General Secretary
David Stewart - IATA LACC
Daniel Storey – Head, Airports Price Control, CAA

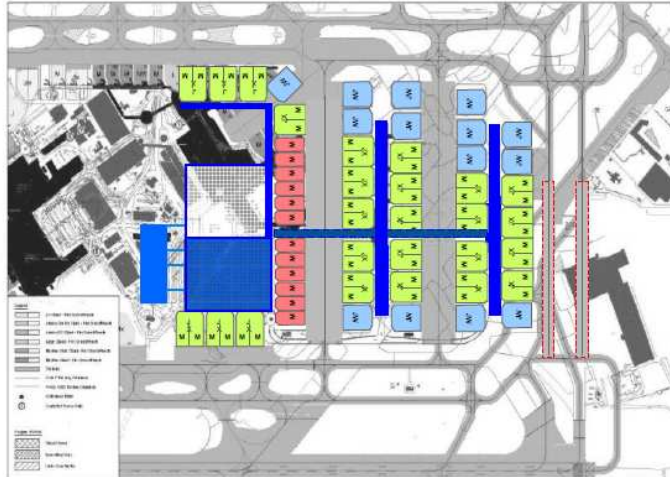
Exhibit 5 - Star Alliance's presentation on Heathrow East (17 January 2008)

1. HET Eastern Apron long term utilisation plan – ultimate situation

HET Eastern Apron long term utilisation plan

Information:

- 40+ mppa terminal
- 2 parallel satellites
- automated connectivity (underground) between terminal and satellites (pax & bag)
- 45 minutes MCT for entire HET Campus
- 30 minutes latest CKIN time before STD for entire HET Campus
- 15-25 (premium-economy) minutes exit time to reclaim hall for arriving passengers – entire HET Campus
- >95% level of pier service
- value for money infrastructure solutions -support efficient and low OPEX operations
- MSCP for HET
- 4 code F taxiways



3. Day 1 of HET opening – Star requirements

Day 1 of HET opening

Information:

- 20 mppa terminal
- MFP (N & C), OMP (N)
- automated connectivity (underground) between terminal and satellites (pax & bag)
- 45 minutes MCT - entire HET Campus
- 30 minutes latest CKIN time before STD - entire HET Campus
- 12-25 (premium-economy) minutes exit time to reclaim hall for arriving passengers – entire HET Campus
- >95% level of pier service
- value for money infrastructure solutions -support efficient and low OPEX operations
- MSCP for HET
- 4 code F taxiways



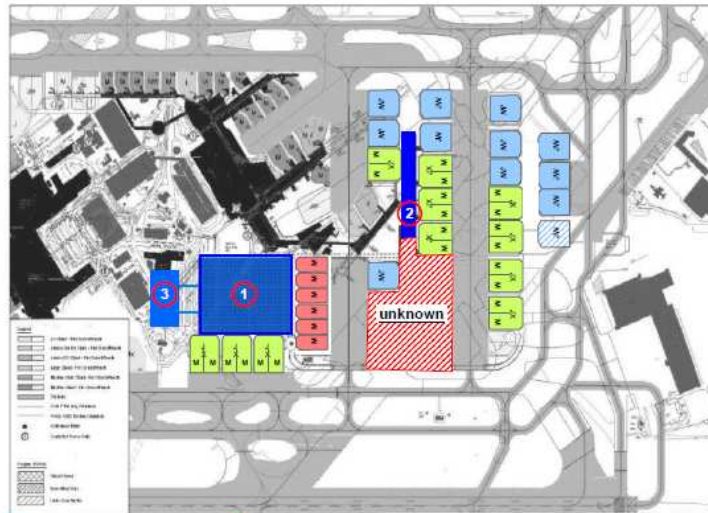
- ① HET (phase 1)
- ② MFP North & Centre;
- ③ Pax & Bag Connectivity
- ④ MSCP

4. BAA 2012 HET Campus - 2008 proposal

BAA 2012 HET Campus

Information:

- 20 mppa terminal
- MFP (North, South - unknown, Centre – unknown)
- 45 minutes MCT - entire HET Campus
- >95% level of pier service – unknown
- MSCP for HET



- ① HET (phase 1)
- ② MFP North, ?
- ③ MSCP

Exhibit 6 – Two Overviews of T2B and T2A phase 1 (BAA Capital Investment Plan 2009)

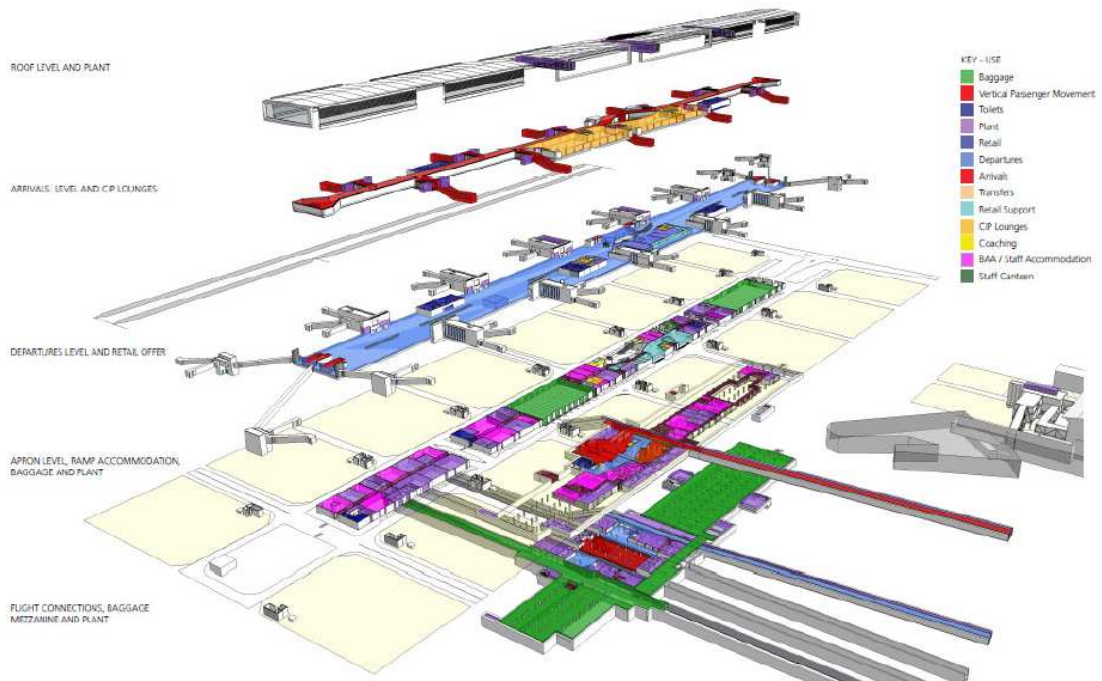


Exhibit 7 – Q5 capital and operating expenditure revisions during the quinquennium review (from CC’s emerging thinking report, April 2008)

TABLE 2 Q5 capital and operating expenditure revisions during quinquennial review, 2007/08p

	BAA Sept 2006 submission	CAA March 2007 submission	BAA May 2007	BAA July 2007	CC Sept 2007	CAA Nov 2007	BAA Jan 2008	CAA March 2008 decision
<i>Capital expenditure (2007/08p)</i>								
Heathrow	2,949 (BAA)	2,949 (BAA)	2,953	3,559	3,535	3,559	3,877	4,542*
Gatwick	438 (BAA)	438 (BAA)	437	845	712†	845	874	874
<i>Operating expenditure (2007/08p)</i>								
Heathrow	3,802	3,534	4,021	4,123	3,850	4,115	4,616	4,226
Gatwick	1,166	1,095	1,280	1,329	1,186	1,281	1,601	1,381

Source: BAA CAA, CC.

*Including PSDH.

†Excluding Pier 7, but it was recognized this should be subject to further consultation.

Exhibit 8- BAA Capital Investment Plan 2009 – Draft Indicative Eastern Campus strategic level programme

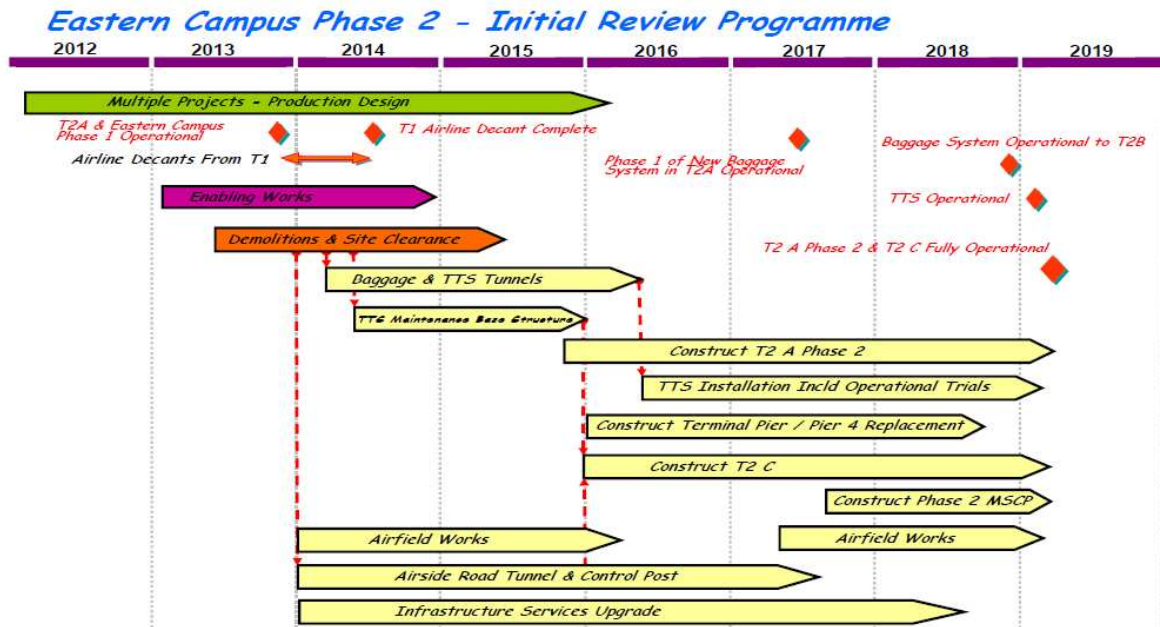
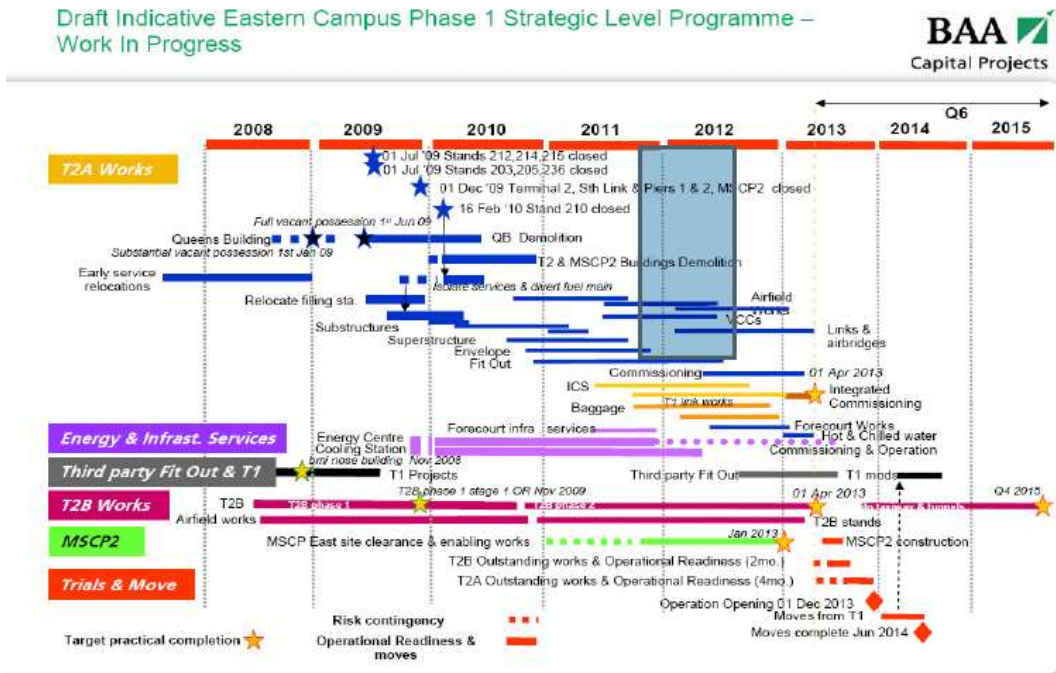


Exhibit 9 - HAL Report and financial statements for year that ended in 31 Dec 2008

HEATHROW AIRPORT LIMITED

**PROFIT AND LOSS ACCOUNT
For the year ended 31 December 2008**

	Notes	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Turnover – continuing operations	2	1,575.6	1,324.8
Operating costs - ordinary	3	(1,287.5)	(892.7)
Operating costs - exceptional	4	(113.2)	(154.2)
Total operating costs		(1,400.7)	(1,046.9)
Operating profit – continuing operations		174.9	277.9
Net interest payable and similar charges – ordinary	6	(444.2)	(185.6)
Net interest payable and similar charges - exceptional	4	(103.9)	-
(Loss)/profit on ordinary activities before taxation		(373.2)	92.3
Tax credit on (loss)/profit on ordinary activities	7	136.1	81.8
(Loss)/profit on ordinary activities after taxation	20	(237.1)	174.1

The notes on pages 28 to 62 form an integral part of these financial statements.

All profits and losses recognised during the current and prior year are from continuing operations.

There are no material differences between profit on ordinary activities before taxation and the retained profit for the year and their historical cost equivalents.

Exhibit 10– Steven Morgan’s Ten Commandments for the Intelligent Client

***The Ten Commandments
for the Intelligent Client***



1. Define the need
2. Specify the requirement
3. Chunk the work into optimum blocks
4. Competitively Select Ideal Sources
5. Devise an **ALIGNING** contract with constructive incentives
6. **Clear out Obstacles** and Support contractors
7. **Enforce contract** up, down, sideways (self performance delivery)
8. Integrate Products
9. Commission
10. **Assess Effectiveness**

Exhibit 11 – The governance of change in BAA under an ‘intelligent client’ model

