

For: (x) <table border="1"> <tr> <td>Executive CLMT</td> <td>X</td> </tr> </table> Meeting Date: 17 th July 2012 Report of: Company Secretary – London Luton Airport Ltd Director of Commercial and Transformational Services Report author: Fiona McGlone Mark Turner	Executive CLMT	X	Agenda Item Number: 7
Executive CLMT	X		

Subject: London Luton Airport – Supplemental Agreement (For Executive Only) Lead Executive Member(s): Lead Member Cllr Simmons Wards Affected: All	Consultations: Councillors Scrutiny Stakeholders Others	(x) <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
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Recommendations 1. Executive is recommended to: a. agree that, on the part of the Council of the Borough of Luton, a Supplemental Agreement, granting an extension of the Concession Agreement dated 20th August 1998 to 31 st March 2031, be entered into; b. agree that, subject to its resolution at (a) above, the Council of the Borough of Luton and the Council's shareholder nominees, being members of London Luton Airport Ltd., holding at the date of the deposit of this requisition not less than one-tenth of such of the paid-up capital of the Company as, at such date, carries the right of voting at general meetings of the Company, require the Directors of London Luton Airport Ltd, pursuant to section 303 of the Companies Act 2006, to convene an Extraordinary General Meeting of the Company for the purpose of considering and, if thought fit, approving the following special resolution:- That London Luton Airport Ltd. enter into a Supplemental Agreement to the Concession Agreement dated 20th August 1998, as approved by the Executive of Luton Borough Council at its meeting held on 17th July 2012; c. agree that the Council of the Borough of Luton and the Council's shareholder nominees, being a majority in number of the Members for the time being of London Luton Airport Limited having the right to attend and vote at the Extraordinary General Meeting of the Company to be held, pursuant to resolution (b) above, at a date and time to be determined, together holding not less than 90 per cent in nominal value of the shares giving that right, hereby agree that the resolutions set out in the notice of such Meeting may be proposed and passed as ordinary or special resolutions at such Meeting notwithstanding that notice of the said meeting may be shorter than any period of notice prescribed by Section 307 of the Companies Act 2006 or within the Articles of Association of the Company and/or by Regulation 38 of Table A of the Companies (Tables A to F) Regulations 1985; d. agree that the shareholder's representative, Robin Porter, Corporate Director of Commercial and Transformation Services, and the Council's shareholder nominees, be instructed to vote in favour of the special resolution set out at (b) above.
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Background

2. London Luton Airport Ltd. (LLAL) and LBC are both parties to the existing Concession Agreement under which London Luton Airport Operations Ltd (LLAOL) manages and operates London Luton Airport. The current concession was granted in 1998 for a period of 30 years, and has resulted in the airport playing an increasingly significant part in the local economy. Passenger capacity, and its effect on the sustainability and competitiveness of the airport, has a significant impact on a range of benefits to the people of Luton, including the use of Gift Aid to support the charitable objectives of local organisations, and contributions to reducing Council Tax through payments for services, and shareholder dividends made, to Luton Borough Council. In addition the airport contributes to the prosperity of the region as a whole, not least through the creation of direct and indirect employment opportunities.
3. LLAL has a long term vision of:
 - an efficient airport, optimised within its existing boundary and using its existing runway, with capacity for 18 million passengers per annum (mppa) by 2025/28
 - a sustainable airport with future-proofed opportunities beyond 2028
 - an approach that provides economic benefit to Luton and the region taking balanced steps to mitigate environmental Impacts
 - an appropriate commercial risk structure
 - an improved experience for passengers and for airline operators
4. In February 2012, LLAOL presented proposals for development that would increase operational capacity to 16mppa by the end of the existing Concession Agreement in 2028 for an investment of some £63 million on a demand-led basis incrementally over that period. LLAL's advisers, however, consider that the passenger capacity created by these works is unlikely to exceed 13.5mppa, and, moreover, that passenger growth in the South East will lead to demand at LLA exceeding 18mppa over this time. To meet this additional capacity requirement, forecast for a period from 2025, would necessitate additional capital investment that would leave the current operator exposed to both passenger growth risk and to a position where they fail to make the necessary return on investment in the later contractual period. They were, understandably, unable to enter into such a commitment and, as a consequence, at its meeting on 14th May 2012, the LLAL Board resolved to reject the LLAOL February proposal, as it would appear unlikely to meet the long-term objectives of their vision for the development of the airport.

The current position

5. The existing Concession Agreement does not compel LLAOL to make any investment at all, and so LLAL have been looking at alternative procurement routes to try to ensure that the airport avoids stagnation, and can play a yet more significant role in Luton's economic growth to 2028 and beyond. These procurement routes require a termination of the existing Concession Agreement, the decision for which can only be taken in the period from 1st October 2012 through to 31st March 2013.
6. Against the threat of a stagnating asset, a reduced revenue return and a loss of an opportunity to ensure airport growth, LLAL itself in January 2012 prepared a design for an 18mppa airport under its futureLuToN:Optimisation programme. This was part of an alternative strategy whereby the existing operation would be terminated and a new concession procured to secure development to 18 mppa by 2025-28, and a deliverable long-term vision that would see further expansion to meet anticipated market demand. This

option would present LLAL with additional considerable commercial risk in relation to the future market interest, in agreeing a new commercial transaction, in the quantum of the termination payment consequent on exercising the break option, and considerable planning risk in relation to future development proposals at the airport.

7. Further negotiations with LLAOL on additional contractual terms, combined with legal advice received from Leading Counsel, have presented an option to agree a 31 month extension to the existing 30-year concession agreement. The period is sufficient for LLAOL to agree terms that contractually commit them to undertake all necessary capital expenditure and developments, undertaken on an incremental basis to build infrastructure and capacity at the airport to meet demand for up to 18mppa by a longstop date of March 2026. Any such investment would require LLAOL to submit a planning application that would be suitable to meet LLAL's objectives, be fully consulted upon, and which would be in line with national, regional and local, planning and aviation policy frameworks.
8. The terms of the agreement between the contracting parties to the Concession Agreement are set out in the Draft Supplemental Agreement attached as Appendix A to this report. At the time of writing, the Supplemental Agreement is substantially complete, and only a few minor drafting changes remain to be made. By the time the Executive meets on 17th July 2012, the agreement will be finalised, and will have been circulated as soon as it is available. A note of changes between the final version and this draft version will be provided for ease of reference.
9. Proposals made previously to extend the contract have been considered to be not compliant with procurement law as they involved joint investment by LLAL and LLAOL, or were such that they necessitated significant change to the existing Concession Agreement. The extension provided for in the Supplemental Agreement has been considered by Rhodri Williams QC who concludes that he considers that there is an exemption found in regulation 17(1)(f) of the Utility Contracts Regulations which would, by analogy, be applicable with the result that LLA Ltd may legitimately negotiate the amendment of the Concession Agreement without the need for a further competitive tender exercise. Should the provisions of regulation 14(1)(d)(i) of the Public Contracts Regulations 2006 be, by analogy, applicable, he would also consider that the additional condition of a 50% limit on the additional consideration payable to the concessionaire would probably be met. He therefore considers that the parties to the Concession Agreement may agree to extend the Concession Period in the manner proposed, without giving rise to a breach of EU public procurement law.
10. The Advice goes on to suggest that a Voluntary Ex-Ante Transparency Notice is placed in the Official Journal of the European Union in order to mitigate any challenge that may be made to the decision not to undertake a competitive tender exercise. The Notice will be placed once the decision has been made to enter into the Supplemental Agreement; the agreement must then be held in abeyance for ten days before it can come into effect.
11. At a meeting the Board of LLAL on the 14th May 2012 the option to extend the contract was fully considered and adopted as the preferred route. Initial Heads of Terms were subsequently signed on 25th May 2012 and these have formed the basis of the Supplemental Agreement.

Goals and Objectives

10. The Supplemental Agreement outlines the rights and obligations of LLAO and LLAL, and aims to replicate the basis of risk allocation that LBC is already party to under the existing Concession Agreement. The works that are to be undertaken are set out in the agreement

and are delivered over three stages/ two phases. Construction of each of the phases of the agreed works is to be completed by each specific longstop date. The due diligence undertaken by York Aviation Ltd (YAL) advising LLAL suggests that the infrastructure has a designed capacity in the region of 17.5mppa with additional capacity in some key areas such as the terminal building.

11. Should the agreed schedule of works not be delivered, then at each longstop date, LLAOL have an obligation to make a compensatory payment for damages, and additionally, LLAL have retained the right to terminate the Concession Agreement at that point for that reason.
12. The Supplemental Agreement does not seek to change any of the terms of the existing Concession Agreement other than to extend the duration of that agreement, and to introduce obligations for the carrying out of development works, and remedies for non-performance in that respect.
13. The Council is obliged to consider whether state aid implications arise from entering into the Supplementary Agreement, specifically because the extension in term is being offered without exposure to competitive tender. It is a matter of principle that where a market price for the services is obtained, there is no state aid. In the proposed arrangement between LBC, LLAL and LLAOL, it is clear that the extension of the contract to 31st March 2031 is exchanged for the undertaking of significant capital works, which would not otherwise be delivered by LLAOL, to a total investment of some £110 million. On assumed passenger growth to 17mppa LLAOL is estimated to benefit by some £49m at net present value (NPV) as they bear the risk of low demand and the whole development cost, whilst LLAL would achieve value of some £107m (NPV). The financial analysis confirms that the contractual benefits that flow to both parties do not result in giving undue advantage to LLAOL at the cost of the public sector and that the arrangement, therefore, does not result in the giving of state aid.
14. The aim of the Supplemental Agreement is to provide a firm contractual position that will enable incremental growth at the airport to be delivered throughout the lifetime of the existing Concession Agreement. In addition to the material benefits of investment in infrastructure providing LLAL with greater revenue-earning potential, which will continue to benefit the people of Luton and the surrounding region, LLAL and LBC will also avoid the significant financial and operational risks associated with a termination and retender, without sacrificing, to any significant degree, the potential for safeguarding the future development of the airport beyond the lifetime of the existing Concession Agreement.
15. The Supplemental Agreement obliges the Concessionaire to commit in good time to using its best efforts to secure planning permission, at its own cost and risk, for works defined in the agreement and shown on the illustrative site plan attached at Appendix B. This plan is at this time indicative only and will be subject to a further round of public consultation, which may result in modification to details. The works as envisaged involve the creation of new stands and taxiways, extensions to, and reconfigurations of, the terminal building and improvements to surface access and car parking.
16. The scale of development proposed to be carried out under the Supplemental Agreement will contribute to the prosperity of Luton and the surrounding region through the creation of an estimated 4,750 new jobs, as well as stimulating the supply chain, increasing inward investment and tourism, and promoting airline growth and the resultant increase in the range of destinations available to fly to and from, thereby making LTN an airport of choice for leisure and business travel across a greater catchment area.

17. In short, the objectives adopted by the LLAL Board were: to secure significant investment in developing the airport, to maintain and increase revenue to LLAL through increasing passenger numbers, to avoid taking on financial and operational risk in securing that development, and to improve the ability of the airport owner to influence the future of the airport.

18. The supplemental agreement, and the revitalised working relationship between owner and operator, of which it is the fruit, achieves each of those objectives to an, on balance, greater degree than any other potential scenario.

Proposal

19. The proposal recommends that the parties to the contract agree to enter into an extension of the terms of the existing Concession Agreement to 31st March 2031 on the basis that the Concessionaire is under an obligation to undertake certain capital works at the Airport as contemplated by the plan and the terms for which are set out in the Supplemental Agreement.

Key Risks

20. A full risk strategy has been developed, and is continually updated. A number of key risks and mitigation steps have been agreed and are in the process of being implemented, as follows :

- Growth at the airport under any development plan will require planning consent. Public consultation will be undertaken by LLAOL in relation to their plan. This is expected to take place later in 2012. In the event LLAOL fails to get planning permission, having followed an appropriate appeals process, a termination of the concession can be triggered by LLAL.
- “Call-in” causes delays to or frustrates LLAOL’s development plans; in the event of call-in of the planning determination by the Secretary of State for Communities and Local Government, there will inevitably be a delay whilst the appropriate process is followed. It would be for LLAOL to mitigate the impact of this and, assuming that permission was forthcoming, still be required to meet the relevant longstop date.
- LLAOL fails to undertake the works that it has committed to do: termination options have been put in at each of the three development phases, so that, if the longstop date is reached without the agreed works having been undertaken, the Concession Agreement can be terminated and LLAOL will pay an amount for damages to LLAL.
- Passenger demand does not meet the anticipated level; it is in LLAOL and LLAL’s joint interest and benefit to have increasing passenger numbers and hence this risk will be managed on a joint basis with support from LLAL to LLAOL.
- Delay in signing the Supplemental Agreement: any delay that results in LLAL missing the opportunity to terminate the existing Concession Agreement, and go in good time to the market for a new Concessionaire, would leave the provisions of the existing Concession Agreement intact, with no obligation on LLAOL to undertake any further development works before the expiry of the agreement in 2028.
- Procurement risk in relation to the extension to the Concession Agreement: to the extent that there is any risk in relation to procurement, this can be significantly reduced by the placing of a Voluntary Ex-Ante Transparency Notice in the OJEU for 10 days prior to the agreement coming into effect. This can be done only once a decision to award an extension has been made. In the unlikely event that there is a challenge to the Supplemental Agreement within the timeframe we will consider whether to execute

the document. A challenge outside that time can emerge within thirty days of the publication of the Notice through the European Commission. If this happened and the challenge proved successful, causing LLAOL not to undertake an element of the development works, LLAL will be able to consider termination (without payment for damages) at the relevant longstop date, and the Concession Agreement will revert to being treated as ending at 20th August 2028.

Consultations

21. We continue to consult with the public, stakeholders neighbouring authorities and affected parties to ensure that we reach a balanced position with regard to environmental impacts. We have been in discussion with the Department for Transport, the Treasury, the relevant aviation authorities and statutory bodies and those that have responsibility for the development of South East Aviation policy and plans. We have also sought the views of the major airline operators at London Luton Airport on the suitability of the proposal to their operations. Luton's Parliamentarians have been briefed at every stage of progress with the negotiations.

22. A new communications plan, developed jointly with LLAOL, will support the signing of the Supplemental Agreement and the promotion of the development proposal.

Appendices attached (in private due to commercial confidentiality):

Appendix A – Draft Supplemental Agreement (final version to be circulated as soon as available)
Appendix B – Illustrative Site Plan

Background Papers:

None

IMPLICATIONS

For Executive reports

- grey boxes must be completed
- all statements must be cleared by an appropriate officer

For CLMT Reports

Clearance is not required

		Clearance – agreed by:
Legal	The legal implications are set out in the body of the report. Leading Counsel's opinion supports the concept of an extension to the term of the existing Concession Agreement, and a commercial analysis of the proposal establishes that no undue advantage is gained by the private sector as a result.	Legal Services on 26 th June 2012
Finance	The financial relationship set out in the existing Concession Agreement,	Finance and Airport Client Manager on 25 th June 2012

	and, by extension, the supplemental agreement, is between LLAL and LLAOL. There are, therefore, no direct financial implications to the Council in respect of the granting of the supplemental agreement. However, the Council will benefit directly from the additional revenues generated by increased passenger numbers through shareholder dividends, and indirectly, through the increased ability of LLAL to support service provision to the people of Luton and the surrounding region through its Gift Aid programme.	
Integrated Impact Assessment (IIA) – Key Points		
Equalities/ Cohesion/Inclusion (Social Justice)	The granting of the Supplemental Agreement as a precondition for development at the airport does not in itself have social justice implications. The prosperity generated by airport development is likely to have a significantly beneficial impact on all sections of the community.	Social Justice Unit on 26 th June 2012
Environment	The granting of the Supplemental Agreement does not in itself have environmental implications. The implications of development at the airport will be dealt with through the planning process.	Strategy & Sustainability Team on 26 th June 2012
Health	The granting of the Supplemental Agreement does not in itself have health implications. The implications of development at the airport will be dealt with through the planning process.	Public Health on 26 th June 2012
Community Safety		

Staffing		
Other		

FOR EXECUTIVE ONLY - Options:

1. To agree the recommendations
2. To not agree the recommendations, in which case the Supplemental Agreement cannot be entered into, and the proposed development will not take place.