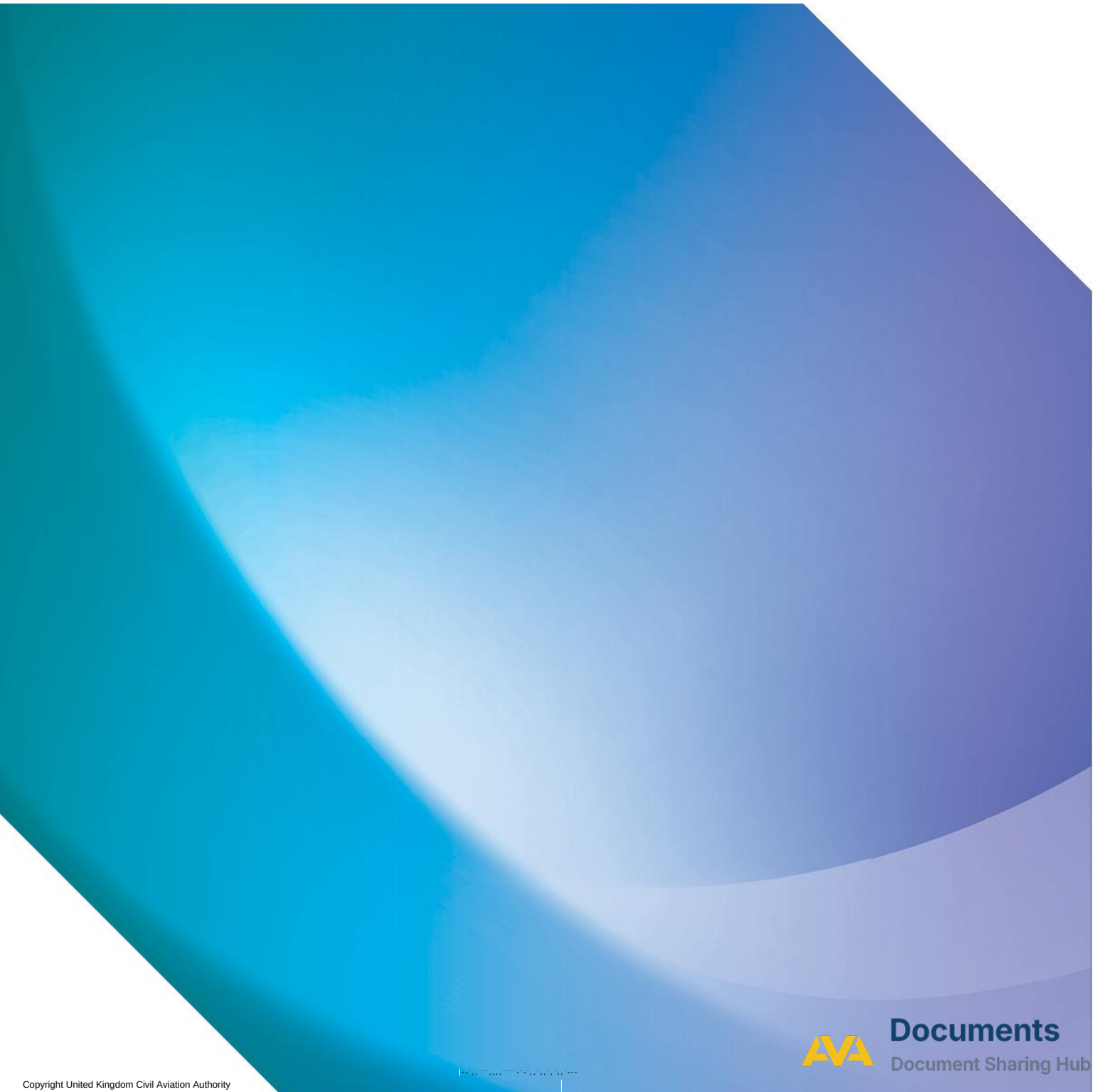


Proposal to extend by one year the current price control on Heathrow Airport Limited

CAP 1436



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Enquiries regarding the content of this publication should be addressed to: economicregulation@caa.co.uk

Consumers and Markets Group, CAA, 4th Floor, CAA House, 45-59 Kingsway, London WC2B 6TE

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Executive summary

Background

1. The current regulatory controls on the charges and services that Heathrow Airport Limited (HAL) offers to airlines, and ultimately to consumers¹, are due to expire on 31 December 2018.² In March this year, we launched a review (referred to as 'the H7 review') of the appropriate regulatory arrangements that should apply in the next regulatory period from 1 January 2019.
2. We published a discussion document in March 2016³ and undertook a series of industry workshops and seminars where we sought views from all interested parties on the process, strategic themes, and the relevant issues that should shape the CAA's methodology for the H7 review.
3. The discussion document noted that the H7 review would take place against the backdrop of the Government developing its response to the work of the Airports Commission (the Commission) on new runway capacity in the South East of England.
4. In written responses to the document⁴ and through subsequent discussions, industry stakeholders suggested that we should consider extending the current Heathrow price control period by at least one year.
5. Stakeholders suggested that flexibility with respect to capacity expansion was critical and that the level of uncertainty over the Government decision on the location of the new runway would not only impact on the schedule, scope and content of the review, but also the quality of the work that could

¹ For the sake of simplicity we use the term 'consumers' to mean both present and future passengers and cargo owners.

² The current price control period runs from 1 April 2014 to 31 December 2018 and is sometimes referred to as the Q6 period.

³ www.caa.co.uk/CAP1383

⁴ The responses to the consultation are available on the CAA's website <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Heathrow-price-control-review-H7/>.

be undertaken by stakeholders. With the additional time created by an extension, HAL noted that it would be able to enhance the quality and consumer focus of the H7 business plan. Airlines noted the need for significant staff resource to engage in expansion plans across the industry and said that better alignment between H7 and new capacity would reduce nugatory work and the complexity of H7.

6. Following the result of the referendum on UK membership of the EU on 23 June 2016, the Secretary of State for Transport announced that the decision on airport expansion would be delayed until at least October 2016. Initial discussions with stakeholders suggest that this development is likely to strengthen their arguments in favour of an extension to the current arrangements.

Our proposal to extend the current arrangements

7. In light of these developments, and our ongoing dialogue with the industry, we have carried out some analysis of the options and implications of extending the current control period. The rationale for any extension needs to be considered against our statutory duties under the Civil Aviation Act 2012 (the Act) including our general duty to further the interests of users.
8. Our current view is that an extension by one year (Q6+1) would be in the interests of users on the basis that it will reduce the risk that the H7 process is sub-optimal due to runway uncertainty and lower levels of industry engagement.
9. An extension will improve industry engagement as it will allow stakeholders to plan their engagement on H7 with more certainty and allow resources to be prioritised towards new runway capacity should a Government location decision be made. We have consistently said that new runway capacity is likely to deliver considerable consumer benefits including more choice, lower airfares and higher service quality.

10. We recognise that extending the price control would not eliminate uncertainty associated with capacity expansion which is likely to persist well into the planning stage of the process. However, without an extension, it will be difficult for stakeholders to focus on a business plan whilst there is significant uncertainty over whether the airport is a 2 or 3 runway operation.
11. We consider that an extension will have beneficial effects on our plans to strengthen the consumer elements of H7. For example, an extension would enable more time to develop our work in areas such as establishing a Consumer Challenge Forum (CCF), outcome based regulation and increasing resilience. The extension will also give HAL more time to engage with consumers and stakeholders to develop a business plan that is designed to deliver the outcomes that consumers value. The rest of H7 activity (e.g. Constructive Engagement, Initial and Final Proposals) will move back by around one year.
12. We do not favour extending by two years or more because the likelihood of variances from the current assumptions is significantly greater and there is no precedent for a rollover of this duration. We welcome views on whether one year is the appropriate duration for such an extension.
13. There is a possibility that uncertainty around the location of new runway capacity will still be present at this time next year. Our current view is that we would not undertake another extension just because of continued runway uncertainty. However, a further extension might be warranted if this helped better align H7 with the planning process for the new runway or gave stakeholders more time to scrutinise the design and cost of the new runway. The CAA's legislative framework means that our decision on this matter must be taken at the relevant time, based on the facts prevailing at that time, and judged against our statutory duties.

Our proposal to roll over the current price control

14. On the implementation of the one year extension, we consider that it is in the interests of users for a simple rollover of the existing cap in the final year of Q6, i.e. a price path of Retail Price Index (RPI) -1.5%. A straightforward rollover would be consistent with our approach to the extension of Q5 and our discussions with industry stakeholders indicate that this is also their preferred option. In addition, undertaking anything other than a simple rollover would defeat the objective of freeing up time for the industry to have scope to focus on new runway capacity.
15. In proposing a one year extension to the existing control period, we are mindful that HAL's regulatory accounts show that it has outperformed the assumptions during Q6 so far, although there is no guarantee that this will continue for the duration of the control period. A rollover of the existing cap would imply a degree of simplification, as there will be inevitable variances from the prevailing regulatory assumptions on opex, capex, traffic, revenues, the Weighted Average Cost of Capital (WACC) etc. We welcome views on this issue.
16. In summary, we are now consulting on the rationale and implications of extending Q6 by one year based on a simple rollover of the existing price cap.

Next steps

17. We would welcome responses to the issues raised in this consultation and the proposed timetable for the review by 5pm on Friday 2 September 2016 after which we will publish our decision together with an updated timetable for the H7 review. If applicable we will also take the necessary steps to modify HAL's licence.
18. During the consultation period, we will be hosting a roundtable discussion in August 2016 to explore the issues raised in this consultation with interested stakeholders.

Chapter 1

Introduction

Purpose of this document

- 1.1 This document invites representations on a proposal to modify HAL's economic licence to extend the current price control by one additional year so it lasts until 31 December 2019. The key proposal is that the current price control formula in HAL's licence, RPI-1.5%, would continue into the additional year.

Views invited

- 1.2 Any representations about the proposals in this document should be sent, if possible by e-mail, to economicregulation@caa.co.uk by 5pm on Friday 2 September 2016 2016. Alternatively, comments may be sent by post to:

Rod Gander
Consumers and Markets Group
Civil Aviation Authority
CAA House
45-59 Kingsway
London WC2B 6TE

- 1.3 We expect to publish the representations on our website for other interested parties to read as soon as practicable after the period for written representations expires. Any material that is regarded as confidential should be clearly marked as such. Please note that we have powers and duties with respect to information under section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

- 1.4 If you have any questions on this document please contact Rob Toal on 020 7453 6211 (or by e-mail to robert.toal@caa.co.uk).