

Future of service quality regulation for Heathrow Airport Limited: Consultation on the design principles for a more outcome-based regime

CAP 1476



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Contents

Contents.....	1
Chapter 1.....	3
Summary.....	3
Views invited	3
Chapter 2.....	5
Introduction	5
Background	5
Consumer Challenge Board	5
Developing new arrangements.....	6
Our duties.....	7
Structure of this document	8
Chapter 3.....	9
Overview of the existing service quality regime.....	9
Introduction	9
Existing service quality regulation	9
Performance under the service quality regime	10
Chapter 4.....	11
Key issues.....	11
Introduction	11
Reasons to review the SQRB.....	11
What do we mean by OBR?	13
Pros and cons of OBR.....	15
Chapter 5.....	17
Stakeholder views	17

Introduction	17
Airline community views	17
Current service quality regulation	17
Outcomes	18
Airline community proposed way forward	19
HAL views	20
Current service quality regulation	20
Outcomes	21
Our initial views	22
Current service quality regulation	22
The role of outputs	22
The scope of OBR	23
Chapter 6.....	25
CAA design principles for moving towards outcome-based service quality regulation	25
Introduction	25
Principle 1: OBR should be informed by robust consumer research	25
Principle 2: The structure of OBR should include outcomes, measures, targets and incentives	26
Principle 3: CCB and airlines play a key role in the development of OBR..	28
Principle 4: OBR should build upon the SQRB.....	28
Principle 5: Performance reporting should be comprehensive and targeted at consumers.....	29
Next steps	30
Appendix A	31
Questions	31

Chapter 1

Summary

- 1.1 This consultation sets out our latest thinking on how regulation of the quality of airport operation services provided by Heathrow Airport Limited (HAL) can be improved by strengthening the link with consumer preferences and priorities.
- 1.2 We would like the regulatory regime to be responsive to the outcomes that consumers' value. Developing the current output-based approach to service quality regulation such that it appropriately reflects outcome-based regulation (OBR) will contribute to delivering this objective.
- 1.3 The document sets out our initial views on the five principles that might underpin our approach to OBR and discusses how we think these principles could be implemented in practice. These are as follows:
- Principle 1: OBR should be informed by robust consumer research
 - Principle 2: The structure of OBR should include 'outcomes', 'measures', 'targets' and 'incentives'
 - Principle 3: The Consumer Challenge Board and airlines play a key role in the development of OBR
 - Principle 4: OBR should build upon the SQRB
 - Principle 5: Performance reporting should be comprehensive and targeted at consumers
- 1.4 Following this consultation we will set out our final views on the key principles that will support our approach to service quality in the H7 'Policy Update' document to be published in spring 2017.

Views invited

- 1.5 We welcome views on all the issues raised in this document, in addition to the consultation questions listed at Appendix A. Please [respond via online](#)

[survey](#), or email your response to economicregulation@caa.co.uk by no later than 5pm on Friday 27 January 2016. We cannot commit to take into account any representations received after this date.

- 1.6 If you would like to discuss the issues raised in this document please contact Rob Toal (robert.toal@caa.co.uk) or Beth Corbould (beth.corbould@caa.co.uk).
- 1.7 Representations will be made available on our website. Any material considered confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to disclosure of information under Section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000 and it may be necessary to disclose information consistent with these requirements.

Chapter 2

Introduction

Background

- 2.1 The current regulatory arrangements that apply to HAL (referred to as Q6), which include a price cap and minimum standards for service quality, are due to expire on 31 December 2019¹. Earlier this year we consulted on the strategic themes² that should help to shape the H7 review.
- 2.2 In that consultation we set out our initial view that it would be timely to review the Service Quality Rebates and Bonus (SQRB) scheme to consider whether revisions were required to improve value for consumers. We suggested that it may be necessary to consider significant changes to the SQRB arrangements to ensure that consumers' interests are at the heart of our approach to the economic regulation of airports. This reflects our primary duty to promote the interests of consumers.

Consumer Challenge Board

- 2.3 To support a consumer focused approach to economic regulation we also recently confirmed our intention to establish a Consumer Challenge Board (CCB)³ to help ensure that the H7 review is driven by a robust understanding of what consumers' value.
- 2.4 The role of the CCB is to promote the interests of consumers by focusing on the following key activities:

¹ Q6 was originally intended to end on 31 December 2018; however that has recently been extended. The CAA's decision on this extension can be found on our website: <https://consultations.caa.co.uk/corporate-communications/hal-price-control-2>.

² In March 2016, we launched a review (the H7 review) of the issues that should shape the framework for the next control period CAA (2016) 'Strategic themes for the review of Heathrow Airport Limited's charges: A discussion document': www.caa.co.uk/CAP1383.

³ CAA (2016) 'Decision on the Terms of Reference for the H7 Consumer Challenge Board': www.caa.co.uk/CAP1449.

- providing independent scrutiny and challenge to HAL on the development of its H7 business plan; and
- providing independent advice to the CAA on the overall quality of HAL's business plan, particularly on how, and the extent to which, it has been informed by high quality consumer engagement and the extent to which the outcomes and incentives in the plan reflect the needs of consumers as demonstrated by that engagement.

- 2.5 We are in the process of recruiting the Chair and members of the CCB and expect the group to be up and running early in 2017.
- 2.6 The CCB will not undermine the importance of constructive engagement or the role that airlines can play in the development of robust proposals for H7. It will complement the work airlines do by providing extra assurance on HAL's approach to customer engagement and helping to ensure that this customer engagement is reflected in its business plan.

Developing new arrangements

- 2.7 Reflecting the importance of taking careful account of the views of all stakeholders in developing new arrangements we have had a number of detailed discussions with HAL and with airlines following the publication of strategic themes document in March 2016, to share and discuss ideas related to the development of service quality regulation. In light of these conversations, we are using this document to consult on a set of principles to help shape the design and the functioning of a new outcome-based service quality regime at Heathrow.
- 2.8 The new arrangements are expected to apply for the duration of the H7 price control period which will begin in January 2020. While the length of the H7 period has not yet been determined, if we follow the standard cycle of 5-yearly price reviews, this would suggest the arrangements for service quality are likely to be in place until the end of 2024. Notably this is expected to overlap with a period of significant construction and other works associated with the new runway. This underlines the need to

ensure that the service quality regime remains fit for purpose over the longer term.

Box 1: Outcome-based regulation

In the past, our approach to airport regulation has focused on assessing the level of expenditure that the airport will incur in order to deliver a given level of service and investment (outputs).

We consider that, while this approach has worked well, there may be a risk that regulation could miss the ‘bigger picture’ by not adequately capturing what consumers want and value from the airport service. Some regulators have considered similar issues and have begun to move away from the regulation of inputs and outputs in pursuit of a regulatory approach with high-level ‘outcomes’ at the centre.

‘Outcomes’ in an airport regulation context refer to the range of higher-level consumer objectives that are the most important aspects of the airport service that consumers value.

Some illustrative examples of airport outcomes might be:

- Passengers are satisfied with the airport experience.
- Charges are reasonable.
- The service is provided safely and securely.

Our duties

- 2.9 In developing these principles for consultation we have had full regard to our statutory duties under the Civil Aviation Act 2012 (the Act). The Act gives us a primary duty to further the interests of users of air transport services in respect of our economic regulation functions. Users are defined in the Act as present and future passengers and those with a right in property carried by the service, i.e. cargo owners (we use the term ‘consumers’ for simplicity).
- 2.10 The scope of our primary duty concerns the range, availability, continuity, cost and quality of airport operation services. We must carry out our

functions, where appropriate, in a manner that will promote competition in the provision of airport operation services.

2.11 In discharging our primary duty, we must have regard to a range of other matters under the Act. These include:

- the need to secure that HAL is able to finance its licensed activities;
- the need to ensure that all reasonable demands are met;
- the need to promote economy and efficiency;
- the need to secure that HAL is able to take measures to reduce, control and mitigate adverse environmental effects;
- any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
- better regulation principles.

Structure of this document

2.12 The structure of this consultation is as follows:

- Chapter 3 provides an overview of the existing service quality regime;
- Chapter 4 discusses the reasons for reviewing the quality of service regime for HAL and the key characteristics of an OBR for service quality;
- Chapter 5 sets out the views of HAL and the airline community on these issues and provides an update to our thinking on some of the main concerns raised by respondents;
- Chapter 6 builds on the assessment set out in chapter 5 and describes possible design principles that could be used as the basis for helping to ensure that the approach to regulating HAL's service quality encompasses OBR; and
- Appendix A lists the questions for consultation.