

Guidance for Heathrow Airport Limited in preparing its business plans for the H7 price control

CAP 1540



Published by the Civil Aviation Authority, 2017

Civil Aviation Authority
Aviation House
Gatwick Airport South
West Sussex
RH6 0YR

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About this document

This document sets out guidance to Heathrow Airport Limited (HAL) on its business plans for the period after the current arrangements are due to expire at the end of 2019. These plans will need to encompass both its existing business activities and the new runway capacity expansion. The CAA may update or revise this guidance from time to time.

This document also consults stakeholders on two specific issues: whether we should provide a financial incentive on HAL to develop a high quality business plan; and how best to align the regulatory and business planning timetables in light of developments with the wider process for runway capacity expansion.

We will publish a further consultation at the end of June 2017 on the regulatory framework for the price control review.

Views invited

Please email your response to economicregulation@caa.co.uk by no later than 5pm on 2 June 2017. We cannot commit to take into account any representations received after this date.

If you would like to discuss the issues raised in this document please contact Beth Corbould on beth.corbould@caa.co.uk or on 020 7453 6191.

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.

Associated documents

March 2016	Strategic themes for the review of Heathrow Airport Limited's charges: A discussion document Strategic themes for the review of Heathrow Airport's charges: Technical appendices
May 2016	Incentivising the right consumer outcomes - discussion paper
June 2016	Increasing airport resilience - discussion paper
September 2016	Decision on the Terms of Reference for the H7 Consumer Challenge Board (CCB)
October 2016	Notice of proposed modification to Heathrow Airport Limited's economic licence to extend the current price control by one year
November 2016	Terms of Reference: Assessment of airport-airline engagement on the appropriate scope, design and cost of new runway capacity
December 2016	Future of service quality regulation for Heathrow Airport Limited: Consultation on the design principles for a more outcome-based regime
January 2017	Economic regulation of the new runway at Heathrow Airport: consultation on CAA priorities and timetable
February 2017	Airport capacity expansion: Update to DfT

Summary

1. The current regulatory arrangements that apply to HAL (known as Q6), including a price control and standards for service quality, are due to expire on 31 December 2019. HAL is currently at an early stage in formulating its development of business plans for the period beyond 2020. This document provides high-level guidance to HAL on its business plans (which will need to cover both its existing operations and capacity expansion). This guidance includes our expectations on outcome-based regulation (OBR) and consumer engagement following our earlier consultations on these subjects. The CAA may update or revise this business planning guidance from time to time.
2. As well as providing guidance this document takes the opportunity to consult stakeholders on two specific issues. First, whether we should provide a financial incentive on HAL to develop a high quality business plan. Second, how we can best align the regulatory and business planning timetables in light of developments in the wider process for new runway capacity. We will discuss both these issues with HAL and the airline community (and any other interested stakeholders) over the coming weeks.

Background to the H7 review

3. Early in 2016 we initiated our review of the regulatory arrangements that should apply after 2020 (known as H7) by consulting on four strategic themes¹:
 - empowering consumers and furthering their interests;
 - incentivising the right consumer outcomes;

¹ 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', <http://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=7243>

- increasing airport resilience; and
 - promoting cost efficiency and financeability.
4. Based on feedback from stakeholders on the uncertainties associated with possible capacity expansion, we decided in summer 2016 that it would be appropriate to extend the current regulatory arrangements by one year so that they expire at the end of 2019 rather than 2018.
5. We noted that an extension to Q6 would also allow more time for our consumer focused work, including developing our approach to quality of service regulation and establishing (in partnership with HAL and airlines) the Consumer Challenge Board (CCB).
6. In October 2016 the Government announced that its preferred option for the expansion of airport capacity in the South-East of England was the Heathrow north-west runway. Soon after this we issued guidance about our expectations of HAL in its engagement with airlines on the design of new runway capacity². We were also asked by the Secretary of State to advise him about the effectiveness of HAL's engagement process³.
7. In January 2017 we issued our consultation on the priorities and timetable for developing the regulatory framework, such that the regulatory arrangements for HAL would properly take account of capacity expansion, continue to protect consumers, and incentivise HAL to finance and develop new capacity in an efficient way. The four key priorities we identified were that HAL should develop:
- a scheme design to further the interests of consumers by engaging in a transparent and effective way;

² Letter from Andrew Haines to John Holland Kaye regarding CAA's expectations on the appropriate scope, design and cost of the new runway capacity

<http://www.caa.co.uk/WorkArea/DownloadAsset.aspx?id=4294981598>

³ Terms of Reference: Assessment of airport-airline engagement on the appropriate scope, design and cost of new runway capacity

http://www.caa.co.uk/uploadedFiles/CAA/Content/Standard_Content/Commercial_industry/Airports/Economic_regulation/Price_control_files/Section%2016%20ToR%20on%20HAL%20engagement%20with%20airline%20community.pdf

- robust cost estimates and we would need to develop regulatory arrangements to incentivise HAL to deliver the project in a timely and efficient way;
 - proposals for efficient financing and we would need to develop the regulatory framework consistent with this, affordability and financeability; and
 - coordinated proposals for existing operations (i.e. for the H7 price control) alongside its proposals for the new runway and capacity expansion, so that its overall business plan is affordable and financeable.
8. These are consistent with the strategic themes for the H7 review identified above. Priority 1 (a scheme design to further the interests of consumers) will lead to more resilience in the provision of services to consumers. Priorities 2 and 3 are consistent with efficient costs and financing. Priority 4 (that HAL should produce an integrated business plan for its existing activities and capacity expansion) underlines the importance of the H7 review encompassing all of HAL's activities.
9. While capacity expansion is of vital importance to consumers, HAL should also be incentivised not to lose focus on its existing business activities especially in the period between 2020 and the opening of the new runway capacity (assuming that HAL receives planning permission to proceed).

Guidance and incentives for a high quality business plan

10. HAL's business plans should be high-quality, clear, robust, and well-justified by supporting evidence. We expect HAL's initial business plan (IBP) to build on its engagement with airlines this year and provide robust information to facilitate constructive engagement (CE) with airlines on the main options for its final business plan (FBP).
11. HAL's Board should certify that the FBP reflects efficient costs and financing, is affordable, deliverable (including in respect of financeability),

and reflects consumer views and preferences to the fullest extent practicable.

12. As well as the reputational incentives associated with Board certification and public scrutiny we would welcome views on whether we should introduce a financial incentive on HAL to produce a high quality business plan.

OBR and resilience

13. In our December 2016 consultation, we said that we would like the regulatory regime to be responsive to the outcomes that consumers' value and include an outcome-based approach to service quality regulation for H7. Those airlines that responded to our consultation on these matters have argued vigorously that the existing quality of service regime has worked well, and that any changes need to take proper account of the circumstances at Heathrow and the role of airlines in protecting the interests of passengers.
14. We recognise that at Heathrow the airlines have a vital role to play in helping deliver an appropriate quality of service for passengers and in working with HAL to develop a coordinated approach to service provision. For the successful implementation of OBR it will be appropriate for HAL to recognise the role held by the airline community at Heathrow and work with the airlines to develop OBR. This will involve building on the success of the existing Service Quality Rebate and Bonus (SQRB) scheme.
15. This guidance confirms the principles that we think should underpin the outcome-based framework that we will expect HAL to develop as part of its business plan. As part of this, HAL should explore areas where resilience could be more closely aligned to an outcome-based approach to regulation.

Consumer engagement

16. It is important that HAL (which will be responsible for designing and delivering the overall consumer engagement programme), the airline community (who have important insights from their internal customer research to share), and the CCB (who will be scrutinising and challenging HAL on its consumer engagement programme) are clear on our expectations for high quality consumer engagement. In summary HAL should:
- use an appropriate range of data and techniques;
 - understand the needs and requirements of different consumers;
 - engage consumers on complex issues by informing and educating them;
 - carefully design willingness-to-pay studies to increase robustness; and
 - engage with consumers on an ongoing basis.
17. We are also providing guidance to the CCB on how it can best frame its advice to the CAA and the areas where it should focus its attention as it begins to engage with HAL and the airlines.

Aligning the regulatory and business planning timetables

18. In extending the existing price control by a year in 2016 we said we would consider whether there was a case for a further extension to the Q6 price control during 2017. It is now important to review the regulatory timetable again in the light of developments in the wider timetable and process for capacity expansion.

What happens next?

19. We will publish a further consultation at the end of June 2017 on the regulatory framework for the price control review – including our developing

thinking on key aspects of the incentive arrangements for HAL. The June document will also provide the opportunity to update our thinking (in the light of the responses to this consultation) on the regulatory timetable.

Our duties

20. In developing the policy in this document we have had full regard to our statutory duties under the Civil Aviation Act 2012 (the Act), which are summarised in Appendix A.

Structure of this document

21. The structure of this document is:
- Chapter 1 sets out our views on criteria for a high quality business plan and sets out for consultation a possible approach to providing financial incentives on HAL to develop a high quality plan;
 - Chapter 2 provides guidance to HAL on outcome-based approach to service quality regulation and resilience;
 - Chapter 3 provides guidance to HAL on consumer engagement and more detail on the role of the CCB; and
 - Chapter 4 discusses and sets out for consultation the timetable for the H7 price control review.

Chapter 1

Guidance and incentives for high-quality business plans

Background

- 1.1 In previous regulatory reviews, we have taken a light touch approach to setting guidance or requirements for HAL's business plans and business planning processes. In our March 2016 consultation, we said that our approach should evolve and we would provide more high level guidance at an early stage. The intention is to increase transparency with respect to our expectations of HAL and help it to produce more useful business planning information and a higher quality initial business plan (IBP) and final business plan (FBP). This should help to improve the scope and depth of the discussions which take place in constructive engagement (CE) between HAL and the airlines, and thus further improve the FBP which should form a key input to the final H7 price control settlement.
- 1.2 This Chapter sets out:
- guidance to HAL on what we mean by a high quality business plan;
 - how we expect the business plan to facilitate CE;
 - the regulatory and other incentives on HAL to produce a high quality plan; and
 - a brief description of the initial efficiency studies carried out by the CAA as background to HAL's IBP, and to promote early stakeholder engagement.

High-quality business plan criteria

- 1.3 HAL's business plan should be high-quality, clear, robust, and well-justified by supporting evidence. More detailed criteria are set out in Table 1 below.