

Provisional assessment of airport-airline engagement on new runway capacity at Heathrow airport – February 2018

Advice to the Secretary of State for Transport under
Section 16 of the Civil Aviation Act 1982

CAP 1638

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About this document

This document is our penultimate report to the Secretary of State for Transport (SoS) on how well Heathrow Airport Limited (HAL) has engaged with, and responded to, the airline community on the appropriate scope, design and costing of the proposed new runway and additional capacity at Heathrow Airport.

The Terms of Reference (ToR) for this work require us to provide reports to the SoS on a regular basis. This report describes the progress that HAL and the airlines have made since we provided our last update in September 2017 and sets out our overall findings on a provisional basis. We will provide our final report to the SoS on these matters in April 2018.

This report also sets out our provisional views for a process to follow on from our Section 16 reporting that will support effective airport-airline engagement and protect the interests of consumers. We invite stakeholder feedback by no later than Thursday 29 March 2018.

Summary and Next Steps

Introduction

1. In October 2016, the Government announced that its preferred location for the expansion of airport capacity in the South East of England was the Heathrow north-west runway. Shortly afterwards, the SoS requested, under section 16 of the Civil Aviation Act 1982, that we review and advise him on how well HAL is engaging with, and responding to, the airline community on the appropriate scope, design and costing of the new runway and capacity at Heathrow Airport.
2. The ToR ([see here](#))¹ for this “Section 16” work envisaged that we would report on the following three phases of airport-airline engagement:
 - a. [a review of the engagement process](#), including factors such as the scope and content of the discussions, the quality and maturity of the engagement as well as whether recommendations made by us to improve the process had been implemented;
 - b. [the identification and evaluation of the outputs from the engagement process](#), by critically assessing the extent to which the engagement process has delivered tangible changes to the scope, design and cost of the scheme; and
 - c. [an assessment of the overall effectiveness](#) of how well HAL has engaged with, and responded to, the airline community. This covers a number of dimensions including the involvement of consumers, cost efficiency, acceptability and any risks that remain unresolved.
3. The engagement process began in earnest in December 2016 with HAL organising a series of airline immersion events and gathered further momentum during 2017. Throughout the process we have been involved, observing and reporting on the format and quality of engagement, and making recommendations on how the process could be improved. We provided the SoS with an [‘initial-health’ check in February 2017](#),² followed by [further updates in May 2017](#)³ and [September 2017](#).⁴
4. We are now using this report to provide our provisional views on the overall effectiveness of airport-airline engagement as required by the ToR. For the avoidance of doubt, this penultimate report does not represent our final assessment and it will be updated to take into account stakeholders’ views and any further developments in the remaining period. We will continue to monitor the engagement process and welcome stakeholder

¹ [Terms of Reference](#)

² [February report](#)

³ [May report](#)

⁴ [September report](#)

feedback ahead of our final Section 16 report in April 2018. Our final report should help inform the SoS's decisions on seeking parliamentary approval for the designation of the Airports National Policy Statement (NPS), which we understand is scheduled to be laid in parliament in the first half of 2018.

5. In parallel to the Section 16 process, we have been consulting on the core elements of the regulatory framework to support capacity expansion at Heathrow airport. Our latest consultation in December 2017 (CAP 1610)⁵ discussed issues around:
 - the relationship between the regulatory framework and alternative delivery mechanisms;
 - the cost of capital;
 - financeability;
 - financial resilience;
 - the regulatory treatment of early construction costs; and
 - the further extension of the existing Q6 price control period.
6. Our next update on the regulatory framework will be published in April 2018 in parallel with our final Section 16 report.
7. As the airport-airline engagement process gathered pace in 2017, it became clear that the airlines wanted to discuss and challenge key aspects of the overall scheme design, including issues such as the length and position of the new runway. The Government has also consulted on successive drafts of the NPS during 2017. The detailed discussions between the airport and the airlines and the advantages in adopting a coordinated approach to consultation with the draft NPS meant that HAL did not produce its public consultation on the overall scheme until 17 January 2018.
8. In order to take in to account the results of this public consultation and the finalised NPS, HAL has said it will not be practicable for it to produce a preferred masterplan for capacity expansion before Q3 2018. This is important context to the timetable and our Section 16 reporting, as it will limit our ability to report on the outputs from and the overall effectiveness of the process, as envisaged in the original ToR.
9. To address these challenges, we set out initial proposals in this report for a process to follow on from our Section 16 reporting that will support effective airport-airline engagement and protect the interests of consumers. Before we discuss these next steps, we summarise the views of both HAL and airlines on the key issues before providing our provisional assessment of the engagement process and its overall effectiveness.

⁵ See [CAP 1610](#)

10. In our September Section 16 report, we asked HAL and airlines to produce a joint statement on the outputs from the engagement process and its overall effectiveness. Appendix 1 of this document sets out, in full, the sections of the joint statement that relate to the outputs from the engagement process and the effectiveness of the engagement process and, as such, provide further details of HAL's, and the airlines', views on capacity expansion.

HAL's views

11. HAL has stressed that expanding Heathrow is a unique opportunity to address the airport capacity and connectivity shortage of the United Kingdom. It notes that the benefits of Heathrow expansion should flow to airport users (i.e. future passengers and cargo owners) and the wider economy.
12. It also said that building momentum in the first year since the Government announcement supporting Heathrow expansion was critical to setting the foundations for successful delivery of the programme. It has needed to make substantial progress to mobilise the programme, engage openly and constructively with the local community, the airline community and other stakeholders, and to identify the key issues for its January 2018 public consultation. HAL has said that, only once it has considered the responses to this consultation and the implications of a finalised NPS, will it be able to produce its preferred masterplan for overall scheme design in Q3 2018.
13. HAL has explained that it has created a well-resourced engagement framework, which is addressing key challenges and putting airlines', passengers' and cargo owners' interests at the heart of its approach to capacity expansion. After listening to, and taking on board, the concerns of the airlines regarding affordability, it has brought forward an option (the Westerly Option) that it estimates could reduce the costs of capacity expansion by approximately £2.5 billion. It has also told us that it is committed to delivering expansion affordably, as demonstrated by the development of this capital plan, which it considers to be consistent with a path of airport charges close to current levels. HAL defines "current levels" as being consistent with the timing of the SoS's announcement on expansion (i.e. October 2016).
14. HAL has welcomed the participation of airlines in the engagement process, but expressed reservations about some aspects of the approach taken by airlines to engagement, including whether they have too narrow a focus on their own commercial interests, and whether certain media interventions might unnecessarily distract from the process of capacity expansion.

Airlines' views

15. Airlines acknowledged that progress has been made through the engagement process. Nonetheless, they have also said that HAL's proposals, the assessment of affordability, and information on cost efficiency, are all at a relatively immature stage of development. Noting that more detailed information on these issues will not be available until later in the process, airlines have told us that they are unable, at this stage, properly to assess the risks and costs and, ultimately, the affordability and viability of HAL's proposals for capacity expansion.
16. Citing the above difficulties, airlines have recently requested that the process for capacity expansion should include an additional gateway, designed to provide them with a formal opportunity to express views on (i) whether sufficient comfort is available on overall scheme affordability, and (ii) whether the scheme should proceed, before HAL incurs significant early construction costs or submits a DCO (Development Consent Order) application.
17. The airlines have also retained a sharp focus on affordability. Shortly before we issued this report, airlines made a submission that they currently consider affordability to mean no real increase in airport charges (charges rising by no more than inflation in any year) measured from the end of the current price control period, rather than from 2016 (when Heathrow was chosen as the Government's preferred location for capacity expansion and airlines raised their initial concerns on affordability).
18. Some airlines have also indicated that HAL should not be the sole developer of the expansion programme, citing ongoing concerns regarding the scope for third party development at Heathrow airport which they consider could introduce greater competition in delivery.
19. Finally, airlines have also expressed reservations about the timelines to reach a single preferred and properly costed masterplan by Q3 2018, which they consider to be very ambitious.

CAA's initial assessment

Approach to assessing airport-airline engagement

20. Since the Section 16 process began, we have tried to adopt an evidence based approach with a view to producing a balanced assessment of the effectiveness of airport-airline engagement. In developing our views and monitoring progress for this update, we have relied upon information from a number of sources including:
- a. our own observations of the key meetings and the associated papers and discussions;
 - b. a joint statement provided by HAL and the airlines;
 - c. other submissions made by the parties;
 - d. regular bilateral discussions that we have held with both HAL and the airlines;
 - e. feedback from discussions with DfT officials;
 - f. reports prepared by the Independent Funds Surveyor (IFS); and
 - g. our own analysis (including financial and affordability modelling, and advice that we have received on cost efficiency from our expert consultants (Arcadis).
21. Based on the above information, we set out below our provisional views on how well HAL has engaged with and responded to the airline community on the appropriate scope, design and costing of capacity expansion at Heathrow airport.

Phase (i) a review of the engagement process

22. HAL has worked hard to engage in good faith and respond to the requirements and challenges set by the airlines. It has shown flexibility and a willingness to listen, and invested significant resources in its efforts to make the multilateral engagement process effective. HAL has also engaged with airlines on a bilateral basis, including those with a significant presence at Heathrow airport.
23. Overall the quality, maturity and intensity of the engagement process has improved markedly since the process started in December 2016. HAL and the airlines have been on an iterative engagement journey characterised by an initial phase of mobilisation followed by a process of learning by trial and error and ongoing improvement.
24. In response to feedback from airlines, our May 2017 Section 16 report highlighted a number of areas where HAL could improve its governance arrangements and engagement processes. HAL responded positively to these recommendations and introduced a number of changes and improvements to its approach.
25. The governance arrangements are now working better, with a regular rhythm of meetings across the key topic areas. We anticipate that the engagement framework will continue to evolve, and that it should remain flexible to accommodate developments in the capacity expansion programme.

26. The scope of engagement has been extensive, particularly through the Airline Working Groups (AWGs), which were convened on a fortnightly basis from August 2017. These have covered a wide range of topics, including capacity and efficiency, land use, runway operations, sustainability, surface access, terminals and satellites, the sub-masterplan assembly process, resilience and airline requirements. The AWGs have been the forum at which HAL has gathered airlines' and cargo carriers requirements on key aspects of the scheme design.
27. Our September 2017 report acknowledged that HAL had made significant progress on governance issues, but said that further progress was necessary on how consumer interests are being represented in the process and in relation to information on cost efficiency and affordability. Since our September report, HAL appears to have made only limited further progress in addressing these recommendations, particularly on cost and affordability. This has restricted the ability of airlines to engage across a full range of issues, and means that consumers' views will need to be better represented in the process as HAL formulates its preferred masterplan.
28. In January 2018, we wrote to HAL requesting that it provide a detailed timetable for producing estimates of the costs for its masterplan options. These estimates were to be developed as soon as possible, in a way consistent with best practice, and in a way that allowed the identification of both the risks and choices available, and the degree of confidence that can be derived from what may be relatively early cost estimates.
29. HAL responded to this request on 16 February 2018 and has highlighted two key stages of the process that will support the provision of enhanced cost estimates: its Q3 2018 target for producing a single preferred masterplan; and its Q3 2019 target for further developing its masterplan to support the submission of its DCO. It has estimated tolerances for its various cost estimates, with estimates provided in Q1 2018 having tolerances of -25% to +45%, those in Q3 2018 -20% to +35% and those in Q3 2019 -15% to +30%. Its full response is set out in Appendix 2, and we would welcome stakeholders' views on the information that HAL has provided on these matters.
30. In February 2018, HAL also provided us with a copy of the IFS report on the costs of the Westerly Option. This IFS report built upon an earlier, more detailed, review of HAL's cost estimates for an earlier version of the expansion scheme. It provided a review of the high level adjustments between these earlier costs and HAL's plans for the Westerly Option. We welcome this increase in transparency, but note that the provision of this report at such a relatively late stage means that its impact on the engagement process ahead of this report is necessarily limited. As we explain further below, the IFS report expresses some reservations about HAL's cost estimates.
31. We recognise that HAL has made efforts to engage with non-incumbent carriers and look to HAL to explore further how this might be taken forward and developed as the processes to support capacity expansion continue.