

Economic regulation of Heathrow Airport Limited: H7 Initial Proposals

Working paper on outcome based regulation

CAP2274

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About this document

This working paper follows on from the October 2021 Initial Proposals consultation and provides further details of our proposed approach to implementing outcome based regulation (“OBR”) in the H7 price control for Heathrow Airport Limited (“HAL”). It sets out our Initial Proposals on targets, rebates and bonuses and summarises the key proposed changes to HAL’s licence.

Views invited

We welcome views on all the issues raised in this working paper which should be considered alongside:

- the October 2021 Initial Proposals;
- CAP2274A – OBR Targets Assessment; and
- CAP2275 – Economic regulation of Heathrow Airport Limited: H7 Initial Proposals – Draft Licence Modifications

Please e-mail responses to economicregulation@caa.co.uk by no later than **Friday 7 January 2022**.

We cannot commit to take into account representations received after this date.

We expect to publish the responses we receive on our website as soon as practicable after the period for representations expires. Any material that is regarded as confidential should be clearly marked as such and included in a separate annex. 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.

If you would like to discuss any aspect of this document, please contact freya.whiteman@caa.co.uk.

Chapter 1

Introduction

1.1 The October 2021 Initial Proposals¹ set out details of our proposed approach to implementing outcome based regulation (“OBR”) in the H7 price control for Heathrow Airport Limited (“HAL”). We intend that OBR will replace the current service quality rebates and bonuses (“SQRB”) scheme.

1.2 Our Initial Proposals:

- confirmed that we propose to accept HAL’s proposed outcomes;
- provided a list of the 35 measures that we are currently minded to adopt. These include:
 - four survey-based measures with financial incentives;
 - fourteen operational measures with financial incentives;
 - ten survey-based measures with reputational incentives; and
 - seven operational measures with reputational incentives;
- confirmed that we continue to consider that “knife edge” incentives should be used to determine OBR rebates in H7;
- stated that we propose to maintain the current financial envelope of potential rebates and bonuses, with a maximum exposure of 7 per cent of airport charges revenues for rebates and 1.44 per cent of airport charges revenues for bonuses. We also stated that monthly rebates should continue to be calculated as one sixth of the annual maximum for each measure; and
- described our proposed approach to the “continuous improvement” of OBR during the course of H7, including our proposal for a one-off mid-term review.

1.3 This working paper provides further details of other aspects of our proposed approach to implementing OBR:

- Chapter 2 sets out our Initial Proposals for targets for measures (for some new measures baseline data is still being gathered to inform the setting of appropriate targets);
- Chapter 3 sets out our Initial Proposals for the calculation of rebates and bonuses for those measures subject to financial incentives; and
- Chapter 4 summarises the key changes to HAL’s licence that will be required to implement our Initial Proposals on OBR.

¹ CAP 2265D: Economic regulation of Heathrow Airport Limited: H7 Initial Proposals Section 3: Incentives and other issues, chapter 14: see www.caa.co.uk/CAP2265D.

- 1.4 Chapter 4 of this working paper should be read alongside CAP2275² which sets out draft modifications to HAL's licence (including in relation to OBR), consistent with the approach to setting the H7 price control as described in the Initial Proposals.
- 1.5 There are some outstanding issues that will need to be addressed before finalising the OBR framework for H7. Some of these will require further stakeholder engagement.
- 1.6 For the definition of the measures we propose to use for OBR, we note that:
- discussions between HAL and airlines are continuing on some issues, such as how control post queues are currently measured, how they should be measured during H7 to reflect the impact of new technology and opportunities for more accurate queue measurement;
 - further engagement is required on the grouping of control posts;
 - further engagement is required to finalise the details of some new measures, including the availability of check-in infrastructure, timely delivery from departures baggage system and airport departures management;
 - further engagement with the airline community is required on "exclusions" (the limited circumstances that will not count towards HAL failing a particular target), covering both the new timely delivery from departures baggage system measure and the existing availability measures for which HAL has proposed a number of new exclusions; and
 - we said in the October 2021 Initial Proposals that we would give consideration to whether a further measure of baggage performance (such as HAL's proposed baggage misconnect rate) would be useful in addition to our current proposals.
- 1.7 In relation to targets, we understand HAL will propose new targets for some new measures in Q4 2021 and during Q1– Q3 2022 when sufficient baseline data has been gathered. We will discuss these issues with stakeholders ahead of the Final Proposals.
- 1.8 As for the licence changes to implement the OBR framework, we will discuss relevant issues (including those raised in Chapter 4 below and CAP2275) with stakeholders ahead of publishing our Final Proposals.
- 1.9 Nevertheless, the proposals set out in the October 2021 Initial Proposals and in this working paper represent an important step forward in moving towards an outcomes-based approach to service quality regulation for H7. They build on the constructive discussions that have taken place between HAL and airlines, and set out our views on a number of issues where parties were unable to reach agreement and how they further consumers' interests. As well as carefully considering all consultation responses to both the October 2021 Initial Proposals and this working paper, we will continue to engage with stakeholders on both our

² CAP 2275: Economic regulation of Heathrow Airport Limited: H7 Initial Proposals – Draft Licence Modifications: see www.caa.co.uk/2275

Initial Proposals and the outstanding issues that need to be addressed before developing our Final Proposals.

- 1.10 As noted in the October 2021 Initial Proposals, before we issue our Final Proposals we will consider whether there might be an argument for delaying the introduction of some (or all) of the new measures, for example until the beginning of 2023, to allow for an orderly transition to the new arrangements.
- 1.11 Further changes will be required to the OBR framework during the course of H7. The expected installation of new security screening equipment and a new queue measurement system will require changes to some metrics including security and control post queues. We consider these are best addressed once the new equipment has been installed, rather than trying to anticipate in advance the detailed changes that will be required. In addition, the “continuous improvement” process and proposed mid-term review described in the October 2021 Initial Proposals will provide an opportunity to address issues arising from the introduction of the new OBR framework.
- 1.12 Taken together, we consider our proposed approach to OBR as set out in the October 2021 Initial Proposals and this working paper furthers consumers’ interests by ensuring that the services HAL provides meet their needs in terms of the range, availability, continuity and quality of airport operation services.
- 1.13 Among other things, we consider that the proposed OBR framework will:
- strengthen the focus on consumers’ needs and priorities;
 - incentivise HAL to deliver more innovative solutions and service improvements as circumstances change; and
 - improve transparency, and encourage HAL to exercise its co-ordinating role across the airport to improve outcomes for consumers.