

Economic regulation of the new runway and capacity expansion at Heathrow airport: consultation on CAA priorities and timetable

CAP 1510

A large, abstract graphic composed of overlapping, semi-transparent circular and polygonal shapes in various shades of blue and purple, occupying the bottom half of the page.

Published by the Civil Aviation Authority, 2017

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

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First published 2017

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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About this document

This document sets out for consultation our priority issues and timetable for the development of the regulatory framework for the capacity expansion (3rd runway, terminals and associated infrastructure) at Heathrow airport. We will publish a further consultation on these matters in June 2017. We will also report on a quarterly basis to the Secretary of State on Heathrow Airport Limited's (HAL's) engagement with airlines on the development of the preferred option for the new capacity, with a final report due in November 2017. The focus of this document is the regulatory treatment of the costs and financing of the construction programme – what we have called 'Category C' costs. We have previously consulted on the costs that HAL will incur in obtaining planning permission ('Category B' costs).

Views invited

1. We welcome views on all the issues raised in this document and in particular the priority issues set out in the Executive Summary and discussed in more detail in Chapters 4 and 5.
2. Please e-mail responses to economicregulation@caa.co.uk by no later than 14 March 2017. We cannot commit to take into account representations received after this date.
3. 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.
4. If you would like to discuss any aspect of this document, please contact Stephen Gifford (stephen.gifford@caa.co.uk).

Chapter 1

Executive summary

- 1.1 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. The CAA has consistently stated that additional runway capacity in the South-East of England will benefit air passengers and cargo owners. More aviation capacity is required to prevent future consumers experiencing higher airfares, reduced choice and lower service quality.
- 1.2 We are now consulting on our key priorities for developing the regulatory framework for the capacity expansion (i.e. 3rd runway, new terminal capacity and associated infrastructure) at Heathrow airport. Our intention is to create a shared vision for priorities to facilitate engagement with HAL, airlines and other stakeholders on both the capacity expansion and the development of the regulatory framework for HAL.
- 1.3 Our processes for the development of the regulatory framework for HAL need to be coordinated with and take account of the wider processes associated with the capacity expansion. These include:
- engagement between HAL, the airlines and other stakeholders on the appropriate scope, design and cost of the capacity expansion, to ensure that it meets the reasonable needs of airlines and consumers. The Secretary of State has asked the CAA to advise him on the effectiveness of HAL's engagement with the airline community;¹
 - a Department for Transport (DfT) led process to develop the National Policy Statement (NPS). A draft NPS will be published for

¹ This work will be conducted under section 16 of the Civil Aviation Act 1982 and as outlined in the letter and terms of reference at <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Approach-to-economic-regulation-of-new-capacity/>.

consultation in early 2017 setting out the Government's rationale for identifying the Heathrow north-west runway as its preferred option for capacity expansion and seeking views from the public on these matters; and

- a HAL-led process to secure planning permission for constructing and opening the new runway through a Development Consent Order (DCO), which starts with an initial consultation in 2017.

1.4 These processes may throw up issues that will have an impact on our timetable and/or approach to the economic regulation of the capacity expansion. We will be alert to this possibility and where appropriate the need to factor such issues into our consultations with stakeholders as we develop policy.

Our main priorities

Priority issue 1: HAL must develop a scheme design to further the interests of consumers by engaging in a transparent and effective way with airlines and other stakeholders on the potential options, costs and value for money.

1.5 We will focus on the following key themes:

- monitoring and assessing HAL's engagement with airlines and other stakeholders on these matters, including whether HAL has done all it can to meet the aspiration that airport charges do not increase in real terms (over the short and longer term), while delivering robust and resilient infrastructure in a timely way and consistent with the needs of consumers; and
- ensuring that there is sufficient independent challenge and scrutiny from a consumer perspective including, where appropriate, by consulting with the Heathrow Consumer Challenge Board and undertaking our own independent research and assessment.

Priority issue 2: HAL must develop robust cost estimates and we need to develop regulatory arrangements to incentivise HAL to deliver the project in a timely and efficient way.

1.6 We will focus on the following key themes:

- reviewing the evidence that HAL and other stakeholders provide on cost efficiency, including evidence on benchmarking and market testing;
- reviewing proposals for ensuring that there is confidence in the independence and robustness of HAL's procurement processes; and
- working with HAL and other stakeholders to develop regulatory arrangements and incentives to drive the efficient and timely delivery of the new capacity.

Priority issue 3: HAL must develop proposals for efficient financing and we need to develop the regulatory framework in a way consistent with efficient financing, affordability and financeability.

1.7 We will focus on the following key themes:

- considering whether there are other long-term regulatory commitments alongside the Regulatory Asset Base (RAB) that will support long-term investor and stakeholder confidence in the regulatory framework;
- ensuring that the package of regulatory incentives on HAL, including those relating to cost efficiency and recovery, provide for an appropriate balance of risk and reward;
- estimating an efficient cost of capital and testing the financeability of HAL's and any alternative proposals; and
- reviewing whether the resulting price path profiles adequately reflect our view of consumers' interests over both the short and longer term.

Priority issue 4: HAL must develop coordinated proposals for existing operations (i.e. for the H7 price control)² alongside its proposals for the new runway and capacity expansion, so that its overall business plan is affordable and financeable.

1.8 We will focus on the following key themes:

- making sure that our testing of affordability and financeability relates to all HAL's activities, as stakeholders care about the overall affordability of its charges and financeability of its expenditure programmes, across HAL's existing business and new capacity.

1.9 **We are seeking comments on any aspect of the issues discussed in this paper and in particular:**

- **whether the four key priorities identified above are the right priorities for us to adopt in developing the regulatory framework for the new capacity at Heathrow;**
- **whether the key themes identified above (under each of the priority issues) as areas of focus for our work on developing the regulatory framework during 2017 are appropriate; and**
- **any gaps in the priority issues or key themes and any more detailed points that stakeholders want to make at this initial stage on the more detailed discussion in Chapters 4 and 5.**

Next steps and timetable

1.10 Responses to this consultation are due by 14 March 2017.

1.11 We will be hosting a series of briefing sessions on the timetable and the priority elements of the regulatory framework between February and May 2017.

² H7 is the next price control period, which is due to start 1 January 2020.

- 1.12 Having reflected on stakeholder feedback to this document we will publish a further consultation paper on the regulatory framework in June 2017.
- 1.13 We will be report to the Secretary of State on HAL's engagement with airlines on a quarterly basis with a final report in November 2017.
- 1.14 In addition to these initiatives we will:
- publish our policy decision on the remaining element of Category B costs (i.e. costs incurred seeking planning consent through the DCO process) in February 2017; and
 - publish an update on the H7 price control review in April 2017, covering the timetable, our expectations for HAL's business plan and the design principles for a more outcomes-based regime.
- 1.15 Our timetable is discussed in more detail in Chapter 6.

Structure of this consultation

- 1.16 This consultation is structured as follows:
- Chapter 2 sets out the background;
 - Chapter 3 summarises our statutory duties as given by the Civil Aviation Act 2012 and discusses how we will fulfil these in the context of development of new capacity;
 - Chapter 4 explains our priorities for HAL to engage with the airlines on scheme design and costs and the work we will undertake to develop incentives to drive the efficient and timely delivery of the expenditure programme;
 - Chapter 5 describes our priorities for developing the wider regulatory framework for HAL, including the importance of creating incentives that are consistent with efficiency, affordability and financeability; and
 - Chapter 6 sets out our timetable.

Chapter 2

Background

Introduction

- 2.1 With the Government's recent announcement that Heathrow airport is its preferred location for capacity expansion in the South-East of England, work will now proceed on a number of fronts. This Chapter explains some of the broader processes relevant to our work on developing the framework for economic regulation.
- 2.2 These include:
- HAL engaging with airlines and other stakeholders during 2017 on the appropriate scope, design and cost of the capacity expansion;
 - the DfT will work on its draft airports NPS and develop related policies such as proposals on noise and airspace. The NPS will provide direction to the Planning Inspectorate and is an early part of the DCO process. Development of the NPS is being carried out by the DfT;
 - HAL-led activities to secure planning permission through the DCO process;
 - the pre-planning construction activities and mitigation measures necessary before planning permission is secured. HAL may seek to purchase residential and commercial properties, acquire land and undertake enabling construction works, as well as agree (and incur) compensation costs for blight and hardship;
 - consumers, airlines and other stakeholders are interested in the overall affordability and financeability of HAL's proposals. Therefore, in addition to HAL's proposals on capacity expansion, it will need to develop proposals for its existing business activities. In due course, it will also need to develop a comprehensive business plan for existing

activities that will be used as part of the Constructive Engagement that will be a key part of the H7 price control review.

2.3 These matters are discussed in greater detail below.

HAL/stakeholder engagement on the scope, design and costs of the capacity expansion

2.4 The capacity expansion needs to provide value for money for consumers and the aviation industry. HAL and the airlines have started a detailed engagement process to review the scope, design and costs.

2.5 The aim of the engagement process is to ensure that the plans for capacity expansion meet the reasonable needs of airlines and other stakeholders. As part of this process it will be important that HAL seeks to meet the aspirations of airlines on affordability (in particular that airport charges do not increase in real terms in both the short and longer-term), while delivering robust and resilient infrastructure that meets the needs of consumers.

2.6 We will monitor and report on HAL's engagement with airlines as it carries out the development of scheme design, which must meet the needs of both stakeholders and consumers. We will also work with HAL and other stakeholders to develop arrangements to drive robust, efficient and timely delivery. These issues are discussed further in Chapter 4.

2.7 The Secretary of State has asked us to provide a final report in November 2017 on the effectiveness of HAL's engagement with airlines.³

Preparation of the National Policy Statement

2.8 The purpose of an NPS is to set out an assessment of the need for Nationally Significant Infrastructure Projects (NSIPs) and is published by the Secretary of State under powers from the Planning Act 2008 and

³ Terms of Reference: Assessment of airport-airline engagement on the appropriate scope, design and cost of new runway capacity. See <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Approach-to-economic-regulation-of-new-capacity/>.

Localism Act 2011. The NPS provides direction to the Planning Inspectorate to make a recommendation to the Secretary of State on DCO applications for NSIPs.

- 2.9 Consultation on the draft NPS for capacity expansion at Heathrow airport is planned for early 2017. Parliamentary scrutiny of the draft NPS will take place by a Parliamentary Select Committee, running at the same time as public consultation. After this scrutiny, the final NPS will be considered by the House of Commons, followed by designation if appropriate.
- 2.10 The NPS is expected to take roughly 12 months to prepare and be designated, although the length of time required is not fixed and could vary from this indicative timetable. The DfT is working towards the designation of the NPS in Winter 2017/2018.

HAL seeks planning permission through the DCO process and the regulatory treatment of planning costs

- 2.11 We understand that HAL will prepare the DCO in 2018 and 2019, and is targeting making an application for development consent in 2020, with a view to securing a DCO in 2021. It aims to consult stakeholders on a draft DCO in the summer of 2017.
- 2.12 HAL will incur expenditure over the next few years in pursuit of planning permission for the capacity expansion. The CAA has recently modified (with effect from 1 February 2017) HAL's licence to allow the recovery of £10 million of efficient Category B planning costs per year.
- 2.13 Category B costs are specifically defined as costs directly connected with, and solely for the purposes of, seeking planning consent through the DCO process.
- 2.14 The licence modification allows costs (up to £10 million per year) to be recovered from higher airport charges in the year they are expected to be incurred or through the K factor in the Price Control Condition. These Category B costs will be subject to an efficiency test by an planning-

focused Independent Fund Surveyor (IFS) (which we will call the Independent Planning Cost Reviewer (IPCR)).

- 2.15 We have also recently consulted on Category B costs over £10 million per year and suggested that these should be capitalised and rolled into HAL's existing RAB and subject to a risk sharing arrangement and an efficiency test by an IPCR. We are due to publish a final policy statement on these matters in February 2017.

HAL undertakes preliminary works in advance of planning permission

- 2.16 Before planning permission is secured, and during the present Q6 period, HAL may seek to purchase residential and commercial properties, acquire land and undertake enabling construction works, as well as agree (and incur) compensation costs for blight and hardship.
- 2.17 These costs are not covered by the processes discussed above in relation to Category B costs. It will be for HAL to make the case and provide persuasive evidence for any special treatment of these costs. If HAL makes such a case we would consult airlines and other stakeholders on the most appropriate regulatory treatment of these costs.

Preparation for the H7 price control review

- 2.18 Airlines and other stakeholders are interested in the overall affordability and financeability of HAL's proposals for the whole airport. So in addition to HAL's proposals on capacity expansion it will need to develop high level proposals for its existing business activities.
- 2.19 We also envisage that HAL will need to develop a more detailed and comprehensive business plan for existing activities (alongside the plans for the capacity expansion) by the end of 2017. This would then be used for the Constructive Engagement phase over the January 2018 to June 2018. We will consult further with stakeholders on these matters in April 2017.

Chapter 3

Our duties and vision for the regulatory framework

Our duties under the Civil Aviation Act 2012

- 3.1 The CAA is an independent economic regulator. Our duties in relation to the economic regulation of airport operation services (AOS), including capacity expansion, are set out in the Civil Aviation Act 2012 (CAA12).
- 3.2 CAA12 gives the CAA a general (“primary”) duty, to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of AOS.
- 3.3 CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of ‘consumers’.
- 3.4 The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.
- 3.5 In discharging this primary duty, the CAA must also have regard to a range of other matters specified in the CAA12. These secondary duties include:
- the need to secure that each licensee is able to finance its licensed activities;
 - the need to secure that all reasonable demands for AOS are met;
 - the need to promote economy and efficiency on the part of licensees in the provision of AOS;
 - the need to secure that the licensee is able to take reasonable measures to reduce, control and/or 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
 - the Better Regulation principles.
- 3.6 In relation to the capacity expansion at Heathrow airport these duties relate to the CAA's functions concerning the activities of HAL as the licence holder at Heathrow.
- 3.7 CAA12 also sets out the circumstances in which we can regulate airport operators through an economic licence. In particular, airport operators must be subject to economic regulation where they fulfil the Market Power Test as set out in CAA12. Airport operators that do not fulfil the Test are not subject to economic regulation. As a result of the market power determinations we completed in 2014 both HAL and Gatwick Airport Limited are subject to economic regulation.
- 3.8 We are only required to update these determinations if we are requested to do so and there has been a material change in circumstances since the most recent determination. We may also undertake a market power determination whenever we consider it appropriate to do so.

Vision for our work on the regulatory framework

- 3.9 We will best further our primary duty to consumers by developing a clear focus and priorities for our work on the regulatory framework for HAL. This should help to manage stakeholders' expectations from the outset and make the engagement process between HAL and airlines smoother and more effective than might otherwise be the case, particularly if our vision for priorities can become a shared vision with HAL, the airlines and other stakeholders. Having a degree of consensus on these broad priorities would help to focus attention on what we are all trying to achieve and facilitate effective consideration of more detailed points that will be required in developing the regulatory framework.
- 3.10 Our basic starting point is that consumers' interests (i.e. our primary duty) would be furthered by additional airport capacity being made available in

the South-East of England. We have said consistently that without this, the increasingly congested airport system would inevitably lead to less choice available to consumers, higher airfares, and less airport resilience. This is something that the Airports Commission endorsed with its work setting out the significant 'shadow costs' for consumers and the UK economy if capacity expansion in the South-East of England were not to proceed. So, from a consumer perspective, the delivery of extra capacity is consistent with furthering our primary duty.

3.11 How the extra capacity is delivered is also relevant to the furthering of our primary and secondary duties. For example, there would be clear advantages if the regulatory process and framework incentivised HAL to:

- engage in a transparent and effective way with the airlines and other stakeholders so the best design can be adopted for the scheme from the outset – one that demonstrably takes into account airlines' and consumers' requirements;
- deliver the agreed design in a timely and cost efficient manner; and
- ensure the outcome appropriately takes into account stakeholders' aspirations for the resulting level of airport charges (as discussed below), while also ensuring it can be efficiently financed.

Stakeholders' aspirations for the level of airport charges

3.12 HAL, the airlines, and Secretary of State have all recently expressed support for making sure that airport charges are maintained as close to current levels as practicable during and after the capacity expansion programme. HAL has interpreted this as making sure its airport charges do not increase in real terms on average over a period of time. The airlines are concerned to ensure that there is clarity over the year-on-year pricing profile and want to see HAL's charges not rising by more than inflation in any year. HAL has responded to this by saying that as an early priority it wants to work with the airlines on design options to see whether such a pricing aspiration is possible.

- 3.13 We expect HAL to rise to this challenge and take all reasonable steps to work with airlines on whether there are credible scheme design options that can meet this price profile aspiration.
- 3.14 This creates a need for the early development of proposals for key aspects of the HAL business plan and the regulatory framework, both to support efficient financing arrangements and allow for proposals to be tested in terms of their affordability and financeability.
- 3.15 Although we must maintain our role in setting the framework for economic regulation and ensuring consistency the proper discharge of our statutory duties, this will best be achieved by close working with HAL, the airlines and other stakeholders. Given the large size and significance of the new capacity, it will be particularly important for HAL to develop well-rounded and evidence-based proposals for how its business plan can be supported by the regulatory framework, which we can then test, evaluate and discuss with other stakeholders. If HAL could do this in a credible manner, it may help all parties gain clarity sooner than might otherwise be the case. It also reflects the fact that, ultimately, the regulatory framework is best viewed as a package of measures that both HAL and the airlines will need to take a view on in terms of its overall acceptability.
- 3.16 In engaging on these matters there would be significant advantages in avoiding the circumstances (which have occasionally appeared to be a feature of previous reviews) where both the airport operator and airlines initially adopt quite extreme or unbalanced positions on certain issues, which reflect their views as much about tactical or negotiation positioning, rather than realistic commercial aspirations.

Chapter 4

CAA priorities for scheme design and delivery

- 4.1 This Chapter describes the CAA's priorities and expectations for scheme design and its delivery in a cost efficient manner.

Priority issue 1

HAL must develop a scheme design to further the interests of consumers by engaging in a transparent and effective way with airlines and other stakeholders on potential options, costs and value for money.

Our expectations and role

Our expectations of HAL

- 4.2 It is the responsibility of HAL to deliver robust proposals for the overall design of the capacity expansion that will be influenced and refined through engagement with airlines and other stakeholders.
- 4.3 We have been clear with HAL that we expect it to do this in good faith and in an open and constructive way. It must seek and respond to airlines views on the overall design of the capacity expansion. This includes taking seriously any well-supported submissions from airlines on the design, phasing and cost of the scheme.
- 4.4 We expect HAL to engage with airlines and other stakeholders both on the detail of scheme design and the costs ('bottom up') but also on the strategic aspiration for the resulting pricing profile, taking into account airlines' views about affordability ('top down'). This includes fully meeting its commitment to the airlines to work with them as a matter of priority to see whether it is practicable for a scheme design to meet their aspiration that airport charges do not rise by more than inflation in any year, while delivering infrastructure that is resilient and fit for purpose.

- 4.5 HAL must set out clearly, and keep under review, the required milestones, its governance processes, how the airlines can influence both the process and outcome, and the justification and evidence for its preferred design options. In developing its plans HAL should also bear in mind the significant benefits for consumers in the timely delivery of additional airport capacity in the South-East of England.
- 4.6 In assessing options we expect HAL to use objective criteria and evidence for how options will ultimately best serve consumers' interests. We expect HAL to demonstrate that its decisions on project design reflect the interests of consumers – taking into account aspirations around future costs, quality and resilience.
- 4.7 In running this engagement process, we expect that HAL and the airlines will draw on the agreed principles of Constructive Engagement.⁴ That is, a process which is collaborative, transparent, with agreed accountabilities, has 'no surprises' and has an efficient dispute resolution process. Above all else, we expect the discussions to be demonstrably consumer-focused.
- 4.8 As we have explained in Chapter 2 over the next 10 months the CAA will advise the Secretary of State on the effectiveness of HAL's engagement with the airlines.

Our expectations of airlines

- 4.9 We also expect airlines to engage in good faith, not least because they have a real commercial incentive in working with HAL in ensuring their future business models can be accommodated within the scheme design. Although we expect HAL to engage with airlines in a manner that will best enable them to participate in the process, it is inevitable that the demands of such a significant and unique programme will require the airlines to dedicate more focus and time to this than would be the case during a normal price control review undertaken by the CAA. This is particularly the case in the first couple of years as the options for design get developed

⁴ See Chapter 5 in 'Strategic themes for the review of Heathrow Airport Limited's charges' CAP 1383.

and appraised, and where a significant proportion of the total costs will be designed in to the expansion plans.

The CAA's role

4.10 In addition to setting expectations for HAL's engagement with airlines and other stakeholders (and monitoring and reporting on progress) on the design of the scheme, we are also keen to ensure that there is independent challenge and scrutiny from a consumer perspective.

4.11 We will do this in a number of ways, including where appropriate:

- seeking advice from the Consumer Challenge Board that is currently being created as part of the H7 process;
- undertaking our own independent research relevant to the consumers' interests; and
- commissioning expert technical consultants to support our assessments, comment on HAL's project design and if necessary analyse possible changes to the design.

Priority issue 2

HAL must develop robust cost estimates and we need to develop regulatory arrangements to incentivise HAL to deliver the project in a timely and efficient way.

Robust cost estimates

Expectations of HAL

4.12 We expect HAL to provide the information that will enable the CAA, airlines and other stakeholders to test its baseline estimates of expenditure for reasonableness and cost efficiency. It should start to do this as early in the process as it can, as a large proportion of the overall cost of major infrastructure projects is influenced by the initial design that is adopted. Cost efficiency therefore needs to be considered from the outset and inform the choice of the design.

- 4.13 It will not be straightforward to estimate the overall cost of the new capacity due to the broad scope and complexity of the investment programme, which may also have a number of novel and unique features. Nonetheless, it will be vital to the credibility of HAL's proposals that it brings forward evidence that clearly shows its estimates of costs are reasonable and efficient.
- 4.14 We expect HAL to be very open about its estimates of costs and ensure that stakeholders are kept updated in a timely manner on these estimates and any material revisions. HAL must also be clear at various points of the process about the degree of confidence it has in its estimates (for example, based on the standard probability scenarios, such as P50%, P90%, etc) and the choices it has open to it to reduce the cost along with any important potential trade-offs, such as the impact on quality and/or resilience. The evidence that it needs to provide includes cost benchmarking of all the key elements of the project with reference to other airports and comparable infrastructure projects.
- 4.15 If it becomes necessary and appropriate to change initial decisions on project design it will be important that HAL discusses these with stakeholders and justifies them with evidence at as early an opportunity as possible. It will also be important that HAL retains incentives to both seek out further improvements and efficiencies in design, and to protect consumers from changes in project specification that increase costs/reduce quality.

The CAA's role

- 4.16 Consistent with our work on scheme design we will incentivise HAL to produce efficient estimates of costs to protect the interests of consumers. We will both review how it has engaged with stakeholders on these matters and independently assess the evidence it will provide on the benchmarking and market testing of costs.

Incentives for efficiency

Incentives on HAL to deliver in a timely and efficient way

- 4.17 As discussed above it is important to identify robust estimates of the costs of the scheme designs. It is also important that the regulatory framework provides incentives for HAL to deliver the capacity expansion in a timely and efficient manner.
- 4.18 The general principle we have adopted in the past is that if HAL has transparently identified and effectively consulted on plans that we agree are in consumers' interests, then it should have the opportunity to recover efficient spending that is consistent with these plans (and where appropriate financing costs consistent with our estimate of the efficient cost of capital). This is similar in principle to the arrangements adopted by other UK economic regulators in dealing with infrastructure investment.
- 4.19 It is also appropriate to develop regulatory mechanisms that provide incentives to encourage efficiency and to deal with the circumstances where there are significant variances between forecast and outturn costs, and these have the potential to impact on the overall financeability and affordability of the capacity expansion. Cost variances will either change the level of HAL's returns, or be passed through in its charges. We will seek to identify a balanced set of mechanisms and incentives to support both the efficient financing of the very substantial expenditure programmes and the efficient and timely delivery by HAL.
- 4.20 It will be important to draw on and review where appropriate the existing set of mechanisms for setting HAL price controls, which have a degree of support from stakeholders and have been used to deliver large capacity expansions such as Terminal 5 (which contributed to an approximate doubling of HAL's RAB) and Terminal 2. These mechanisms include:
- adopting a Constructive Engagement process between HAL and the airlines over HAL's detailed business plan;
 - specifying upfront capital expenditure triggers and financial incentives related to HAL meeting certain delivery milestones on

time. The existing trigger mechanisms reduce HAL's charges if pre-specified project milestones are not met by specific dates, with the overall size of the penalty typically similar to the level of the financial return (i.e. the cost of capital);

- the core and development approach to budgeting that takes into account that some capital projects are more certain in terms of need, scope and budget than others; and
- an IFS scrutinise HAL's activities to provide assurance to both HAL and the airlines as to the efficiency of HAL's expenditures.

- 4.21 HAL will need to work within clear budgets for project delivery. Nonetheless, the regulatory and incentive framework will need to strike an appropriate balance between setting fixed allowances for costs before construction (perhaps with risk sharing arrangements for cost variances) and an approach that reviews HAL's efficiency after construction. Such a review would focus on whether expenditure had been efficient and if not what proportion of the expenditure HAL should be prevented from recovering from airlines and consumers.
- 4.22 The former (called ex-ante incentives) have the potential of providing strong incentives to outperform but they rely on an ability to set relatively robust cost targets (otherwise there is too much value at risk for both HAL and consumers from simple forecasting errors as compared to genuine efficiency/inefficiency exhibited by HAL). To the extent that HAL is expected to bear this (increased) risk it might require compensation in terms of a higher cost of capital than would otherwise be the case.
- 4.23 The latter (known as ex-post incentives) have the benefit of avoiding making relatively arbitrary judgements about cost targets before the scope and cost estimates are sufficiently matured. They also provide an incentive on HAL to deliver efficiently given the knowledge that it faces a financial consequence of not having certain expenditure remunerated in the RAB if it is found to be inefficient. Efficiency is judged using information that was available or could have been reasonably obtained at the time of the decision, to avoid the problem of introducing hindsight bias.

- 4.24 These judgements are not straightforward and there are risks that HAL would focus unduly on process for regulatory approval rather than trying to seek out new efficiencies and deliver in a way that would best protect the interests of consumers. At recent price control reviews the CAA's use of ex-post efficiency assessments of HAL's capital programme has not resulted in significant disallowed expenditure and we are reviewing the effectiveness of these incentive arrangements. There may also be less certainty for consumers in the final level of costs and so airport charges.
- 4.25 In practice a 'one size may not fit all' as different parts of the capacity expansion are likely to have very different characteristics which in turn could influence the choice of delivery mechanisms and efficiency incentives. An unbundled approach has the attraction of better targeting regulatory incentives but the downside of more complexity. The following main project characteristics could be used to determine the cost efficiency and cost sharing arrangements that may be appropriate for different categories of costs:
- the ability to separate the costs, risks and operations of a project from the existing assets;
 - the ability of HAL to control and predict the costs of a project;
 - our ability to define, estimate and assess efficient outcomes and costs;
 - the ability of airlines and other stakeholders to determine efficient outcomes and efficiency; and
 - the scale of cost and risk exposure for HAL, airlines and consumers.
- 4.26 Given the strong links between these factors and the nature of the investment programme we expect HAL to make initial proposals on these matters as soon as practicable and these can then be scrutinised by the CAA, the airlines, and other stakeholders.

Enhancing confidence in HAL's procurement process

- 4.27 HAL will need to provide assurance that there is vigorous and effective competition in the supply chain. This may involve issues such as

addressing perceptions of possible bias if its associated companies compete in the supply chain.

4.28 In the past we have tended to rely on assurances given by HAL and its obligations arising under UK and EU procurement law. We note, however, that the airlines have expressed concern whether maintaining this approach is appropriate for such a significant expenditure programme as required to support the capacity expansion at Heathrow airport. We are also aware that other regulators have introduced additional safeguards for transactions involving related parties. For example, Ofgem (in relation to energy networks) has a mechanism that adjusts price caps to reflect the profit margin earned by related parties under certain circumstances. In the water sector the regulations governing the Thames Tideway Tunnel included a prohibition against related parties of Thames Water bidding for construction contracts unless approved to do so by either Ofwat or the Secretary of State.

4.29 We will review whether our current approach is appropriate but start with the expectation that further safeguards are likely to be required to enhance stakeholder confidence. We would welcome proposals from HAL and airlines that would promote both confidence and competition in the supply chain.

The CAA's role

4.30 We will develop incentives for cost efficiency and proposals which ensure that there is confidence in HAL's procurement processes. We will consult stakeholders on these proposals and would welcome well-supported proposals from HAL and the airlines to complement our work. Other key aspects of the regulatory framework and how we will approach testing financeability and affordability are dealt with in the following Chapter.

Chapter 5

CAA priorities for the regulatory framework

- 5.1 This chapter describes the key priorities and themes for developing the framework for economic regulation, which we intend to consult upon in more detail in June 2017. By setting out our initial views on priorities at a relatively early stage we hope this will help us focus our effort, and our engagement with stakeholders, on the areas that matter most to consumers. The development of these priorities builds on the CAA's previous consultations and policy statements⁵ on capacity expansion over the past couple of years.
- 5.2 Given the large size of the expenditure programme associated with the capacity expansion HAL needs to bring forward proposals based on efficient financing costs. We will develop the regulatory framework such that the efficient financing costs (i.e. the cost of capital) are no higher than necessary. This will mean balancing the advantages of low cost financing, financeability and the desirability of providing incentives on HAL to deliver the project efficiently, in a way that best protects the interests of consumers and promotes overall affordability for airlines. This will require us to assess (in conjunction with HAL and other stakeholders) the risks that HAL should be exposed to and the rewards it can earn as a result – as the cost of capital will be commensurate with the level of risk. While generally speaking a lower cost of capital will reduce the cost borne by airlines and consumers, this will only be the case if HAL retains appropriate incentives to deliver efficiently.
- 5.3 Bearing these broad considerations in mind it will be important to address the following issues in developing proposals for the regulatory framework.
- How to incentivise efficiency and allocate risks:

⁵ See CAP 1221 (October 2014), CAP1279 (March 2015) and CAP1332 (September 2015) which can all be found at <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Approach-to-economic-regulation-of-new-capacity/>.

- incentives for HAL to deliver the capacity expansion in a timely and efficient way have been discussed in Chapter 4 above, and will influence the cost of capital, financeability and affordability;
- we also need to consider how to deal with costs that are optimal to incur ahead of planning consent, what happens to these costs if the project were not to proceed and what happens if there are substantial changes in the scope/design of the capacity expansion programme; and
- we need to decide how the regulatory arrangements should deal with volume risks.
- What regulatory arrangements and commitments would best support the above incentives and promote efficient financing:
 - whether the current RAB model remains appropriate;
 - what other steps we could take to support long-term investor and stakeholder confidence; and
 - whether there might be a role for bespoke commercial arrangements, including alternative delivery arrangements.
- The approach for estimating the cost of capital and testing for financeability and affordability:
 - including consideration of whether we should retain the approach of remunerating assets in the course of construction (AICC).

Priority issue 3

HAL must develop proposals for efficient financing and we need to develop the regulatory framework in a way consistent with efficient financing, affordability and financeability.

How to best develop incentives and allocate risks

- 5.4 One of the key principles that we have set out in our earlier consultations on new capacity is that risk should generally be allocated to those parties who can best manage the risk (including both in operational and financial

terms). This is likely to protect consumers' interests and promote affordability by producing the lowest expected overall cost.

Incentivising efficient and timely delivery

5.5 Incentives for efficient and timely delivery are discussed in Chapter 4. As we have noted taking a balanced approach to cost incentives is key to identifying an efficient approach to financing and the cost of capital.

Dealing with substantial changes in project scope

5.6 It is likely to be necessary to limit the exposure of HAL to (efficient) cost increases associated with changes in project design that are genuinely outside of its control and were not reasonably foreseeable, such as those associated with unexpected changes in statutory or planning requirements. Otherwise the increased risks would tend to increase financing costs and may pose undue risks for financeability. Nonetheless, it will be important that HAL's initial estimates of costs are comprehensive and consistent with the delivery of resilient infrastructure that is in the interests of consumers and meets the needs of airlines. It would not be appropriate if HAL's initial plans omitted reasonably foreseeable requirements.

Dealing with costs that may need to be incurred before planning consent is granted

5.7 As well as general incentives for cost efficiency we need to consider whether special arrangements are appropriate for costs incurred before planning consent is finalised.

5.8 As discussed in Chapter 2 we have issued a licence modification allowing for the recovery of £10 million of planning costs per year and are due to make a decision on the remainder of planning costs in February 2017.

5.9 There are other categories of costs that HAL may need to incur during the Q6 period and before it gains certainty as to the outcome of the planning process, including acquiring land and paying compensation. These costs are not covered by the process discussed above. It will be for HAL to

make the case and provide persuasive evidence for any special treatment of these costs. If HAL makes such a case we would consult airlines and other stakeholders on the most appropriate regulatory treatment of these costs.

Allocation of volume risk

- 5.10 An important category of risks/incentives relate to the revenue drivers for any price control arrangements. Previous price controls for HAL have set a cap on charges on a per passenger basis. This structure means that HAL is exposed to risks from variations in the volume of traffic compared to the assumptions made in setting the price control. It also means that HAL has an incentive to maximise the use the airport capacity. This has helped to moderate the impact of capacity constraints with HAL increasing the number of passengers able to use Heathrow airport.
- 5.11 In other sectors where there are infrastructure providers with significant market power, economic regulators have sometimes adopted a form of a revenue cap, which means the regulated businesses are largely insulated from volume risk. For example, Ofwat has adopted this approach for the wholesale water price controls.
- 5.12 With significant additional capacity becoming available, volume risks could become more of an issue in the future. There may be an important role for airlines in considering whether they can enter into commitments with HAL to help manage volume risks and so reduce the uncertainty about future charging levels.
- 5.13 Nonetheless, our initial view is that it would be in the interests of consumers to retain a strong element of the present volume incentive on HAL to incentivise it to make maximum use of the new capacity. If HAL or the airlines want different arrangements to apply to the capacity expansion then we would expect them to put forward evidence supporting the adoption of different arrangements.

Regulatory arrangements to support efficient financing and long-term investor and consumer confidence

The Regulatory Asset Base

- 5.14 The current form of regulation for HAL is a RPI-X price cap,⁶ underpinned by quality of service regulation and a RAB. These arrangements are broadly consistent with those used by other economic regulators to protect consumers from monopoly power. The RAB is well understood by stakeholders and debt providers and has a long track record of successful use in UK airport regulation. This approach has also been successful in the energy and water sectors in facilitating the relatively low cost financing of large expenditure programmes.
- 5.15 The price cap on airport charges is calculated with reference to allowances for depreciation on the RAB, a rate of return on the RAB (the cost of capital) and the level of efficiently incurred operating expenses. Capital expenditure is not allowed for in the year it is incurred, but is added to the RAB and depreciated over time, to reflect the long life of capital assets. A 'single till' approach is used, which means that commercial revenues (which are significant at Heathrow airport) and other revenues are also taken into account when determining the level of airport charges. This means that the investment associated with these commercial revenues is also included in the RAB.
- 5.16 Where regulators have introduced different arrangements to such a 'building block' approach (i.e. determining price control revenue by adding together estimates of operating expenditure, RAB depreciation and return on the RAB) to setting price controls the new arrangements tend to retain a RAB. For instance, in the case of Offshore Electricity Transmission or the Thames Tideway Tunnel, these arrangements have been supported by a RAB or similar concept. Therefore, it is not clear that there would be significant benefits to introducing a different method to a RAB for the capacity expansion at Heathrow airport. In particular, it now appears to us

⁶ The price cap limits price increases to the rate of inflation plus or minus a certain percentage.

that it is unlikely that a regime where charges are set purely through bilateral commercial agreements between HAL and the airlines will be sufficient to underpin the key risks associated with investment in new capacity.

- 5.17 Nonetheless, we intend to consider whether there are evolutions to the RAB model that would better serve consumers' interests. In our March 2015 policy document⁷ we said we were sceptical of the benefits of a split RAB due to the perceived difficulty in separating the commercial and operational risks of capacity expansion from those associated with the rest of the airport. It is worth noting that we have proposed adopting a hypothecated-RAB arrangement for planning costs as a way of increasing transparency.

Other commitments to support long-term investor and consumer confidence

- 5.18 Given the significant size of the expenditure required for the capacity expansion and that the capacity is not expected to be operational before 2025, it is particularly important to consider whether there are additional long-term regulatory commitments that might support efficient financing.
- 5.19 In addition to the RAB we could make further policy commitments for subsequent regulatory cycles (i.e. to cover the construction and early operational phases of the new capacity). Examples could be to commit to:
- the mechanics of how the RAB will operate over the H8 (2025-2029) and H9 (2030-2034) regulatory cycles (assuming these will have the standard five year duration);
 - principles for the recovery of efficient expenditure;
 - the approach to calculating the WACC or to indexing the cost of debt; and
 - flexibility or restrictions on the capital structure, such as whether to use a notional structure or whether to have a gearing cap.

⁷ CAA (March 2015). Economic Regulation of new runway capacity ([CAP 1279](#)).

- 5.20 Under CAA12 it is difficult for us to set a price control or elements of a licence in such a way that they could never be amended (and we are doubtful it would ever be wise to do so). However, good regulatory practice does depend on regulatory stability and price controls not being subject to unanticipated change once set for a specified period. Stakeholders should be able to treat a commitment by the CAA to keep a policy unchanged for the long term with a high degree of confidence that it would not be changed without very good reason.
- 5.21 While some elements of the regulatory arrangements could be fixed, it may also be appropriate to allow flexibility for particular events or combinations of circumstances that present particular risks. In this context, we note that some regimes in other regulated sectors anticipate and allow for a reopening of the process in the event of a breach in certain thresholds or certain assumptions underlying the price control (both in terms of significant negative and positive variances) or on the occurrence of certain events.
- 5.22 Another possibility would be to introduce longer price control periods, as has been used in some other regulated sectors. While we will consider this further, our starting point is that simply lengthening the next price control period beyond the standard five years is unlikely to yield large benefits on its own. For instance, extending the price control period may mean locking in for longer assumptions on volumes, costs and commercial revenues, which may increase the risks of variances between the forecasts used in setting the price control and actual performance.

Alternative delivery mechanisms

- 5.23 There are advantages in market arrangements that put downward pressure on capital, operating and financing costs. In certain specific circumstances other regulators have been able to introduce regulatory arrangements to provide for mechanisms (including Special Purpose Vehicles (SPVs)) – such as those associated with Offshore Electricity Transmission and the Thames Tideway Tunnel – to capture these benefits.

- 5.24 Without new legislation the CAA does not have the power to mandate that another provider undertakes the runway and capacity expansion at Heathrow airport. If there were to be new legislation a significant amount of work would likely be required, including to determine the appropriate scope and design of new regulatory arrangements. This would have the potential to delay the programme, possibly by many years, which would bring with it significant opportunity costs for consumers in terms of lost choice and value.
- 5.25 There are also some potentially significant differences between the capacity expansion at Heathrow airport and the examples for where SPVs were introduced. For example, the circumstances and characteristics of the investment funded by the associated SPVs was such that the risks and financing could be genuinely ringfenced. It is not clear whether this could be the case for a new runway being added to an existing two runway airport. Its operations are not as separable as the above examples.
- 5.26 Nonetheless, we remain open to the idea that certain parts of the programme could be subject to commercial agreements between HAL and the airlines (or other parties). It might be possible for certain assets to be financed outside the RAB/single till or be designed, developed and delivered by parties other than HAL if there are projects that are reasonably separable from the main investment programme. This may include projects such as car parks and possibly the construction of terminal buildings. In reaching any commercial agreements with one or more airlines (or other parties) HAL would need to take into account the wider interests of all airport users and its obligations under UK and EU competition law.
- 5.27 Different considerations might apply if HAL were to decide to withdraw from the capacity expansion, or if we and/or the Government were to lose confidence in its ability to deliver in a cost efficient way. In these circumstances we might recommend to Government that it reviews the

need to provide the basis for alternative models, if it retains the view that expansion should proceed at Heathrow airport.

The cost of capital, financeability and affordability

- 5.28 We expect HAL to demonstrate its proposals for capacity expansion are financeable and consistent with reasonable commitments on affordability.
- 5.29 We will test its assumptions on financeability and the cost of capital and if necessary develop our own proposals to properly balance the need to attract capital with the need to protect the interests of consumers.

Estimating the cost of capital

- 5.30 The cost of capital is a weighted average of the cost debt and equity finance. The weighting (or gearing) relates to the balance between debt and equity finance.
- 5.31 The cost of equity is usually assessed by using the capital asset pricing model and assumes that investors should only be rewarded for risks that cannot be diversified away. The financing and construction of the capacity expansion will change the risk profile of HAL, changing the profile of construction risk, financing risk and demand risk. The extent of these risks and the way they are allocated between HAL and airlines/consumers will need to be considered in assessing the appropriate cost of equity.
- 5.32 The cost of debt finance can either be fixed as part of the process for establishing the regulatory framework or an approach can be adopted based on debt indexation. To provide us with some initial evidence for this assessment we (together with Ofgem) commissioned CEPA to assess the relative merits of adopting alternative approaches to setting the cost of debt, including a fixed cost of debt, indexation methods and alternative risk sharing approaches.⁸

⁸ CEPA (August 2016). Alternative approaches to setting the cost of debt for PR19 and H7.

Financeability

- 5.33 In previous price control reviews we have made calculations on the basis of a notional capital structure. Under this approach the regulated company is free to make its own commercial decision to choose its actual level of gearing. The notional assumption used for the current regulatory period was 60% gearing.
- 5.34 The rationale for a notional approach is based on the view that the regulated companies and their shareholders should bear the risk of more highly leveraged structures (or gearing above the notional gearing assumptions). We have also chosen not to claw back any tax shield achieved by actual gearing higher than the notional level.
- 5.35 Given that there will be additional risks and challenges associated with the financing and construction of the capacity expansion, we will consider whether there is a need to introduce any new measures to make sure that our estimates of the costs of capital better reflect efficient financing costs and/or improve financial resilience. These measures could include changing the notional gearing level, a gearing cap (as the CAA adopts for its economic regulation of NERL) and cash/asset lockups, as well as requirements to maintain cash reserves or an investment grade credit rating.
- 5.36 In developing our approach to these matters we will need to decide the best approach to testing the financeability. When setting price controls and testing financeability regulators have tended to focus on metrics used by credit rating agencies to assess the riskiness of debt finance, including interest coverage and debt to RAB ratios. We will need to consider if these approaches remain appropriate in the circumstances of the capacity expansion.
- 5.37 The WACC can either be calculated on a pre-tax basis (with the cost of equity grossed up for corporation tax) or on a 'vanilla' basis with corporation tax allowed for separately (as in the case of Ofwat). Given the large size of the expenditure programme that will be associated with the

capacity expansion, we will consider the merits of modelling the impact on corporation tax so that regulatory allowances for tax better reflect the likely costs to HAL (assuming it has a reasonably efficient capital structure).

Affordability and Assets In the Course of Construction (AICC)

- 5.38 Affordability is of central importance to airlines and consumers. As noted above airlines have expressed concerns that capacity expansion will cause airport charges to increase and HAL is exploring whether it is practicable to develop arrangements that would avoid airport charges increasing in real terms.
- 5.39 In setting previous price controls we have allowed HAL to recover the returns on assets that are either in operation or in the course of construction, whereas they only recover regulatory depreciation on the RAB from the point when assets come into operation. We have called this the AICC approach.
- 5.40 This was the approach we used to help support the efficient financing of Terminal 5 and Terminal 2. It is also an approach that has been used by other economic regulators for large scale infrastructure projects. For instance Ofwat has included similar arrangements in the framework to support the financing of the Thames Tideway Tunnel.
- 5.41 In our previous publications on the economic regulation of capacity expansion, we have suggested that the AICC approach could lead to lower financing costs and greater financial sustainability, and a lower (and smoother) pattern of charges over time. Such arrangements might support lower financing costs by:
- allowing HAL to reduce financing costs by increasing its debt capacity faster than would otherwise be the case. This leads to lower airport charges, as debt finance is generally cheaper than equity finance owing to the tax advantages of debt;
 - increasing revenues during the time when upfront design and construction costs are being incurred, lowering the total amount of

external finance required and, therefore, reducing the risk of project failure;

- bringing forward the point where investment is paid back, reducing exposure to demand and other risks later in the life of the project; and
- recovering revenue at a time when demand is relatively inelastic (because of capacity constraints), reducing demand risk compared with the case where revenue is recovered only when the new capacity comes into operation.

5.42 Nonetheless, a strict application of the AICC approach in the context of the capacity expansion may pose challenges in terms of affordability and so may not be appropriate. Airlines have expressed concerns that they could see sharp price rises ahead of opening with prices declining thereafter. This raises an issue for us because we may need to take a view on the balance between the existing and future consumers. In the past we have reached an appropriate balance by smoothing the pricing profile over a number of years (as was the case for Terminal 5).

5.43 Our initial view is that HAL should be allowed to recover returns and regulatory depreciation to the extent that this is consistent with broader commitments that airport charges should not increase in real terms – and provided that these commitments provide meaningful protections for airlines over the next 10 years as well as the longer term. If HAL were to seek higher charges to support the financeability of its expenditure programmes then it would need to provide persuasive evidence to us and stakeholders that this would be in the interests of consumers.

Priority issue 4

HAL must develop coordinated proposals for existing operations (i.e. for the H7 price control) alongside its proposals for the capacity expansion, so that its overall business plan is affordable and financeable.

HAL provides H7 baseline information

- 5.44 Stakeholders are concerned about the overall (i.e. its existing business and the capacity expansion) affordability of HAL's charges and overall financeability of its expenditure programmes. This means there needs to be sufficient information available on both the capacity expansion and its existing business. Bearing this in mind HAL will need to also provide convincing baseline information during 2017 (in particular reasonable and efficient estimates of expected costs and revenues) on its existing operations for the H7 price control period⁹ and beyond.
- 5.45 It will also need to ensure its existing operations are not unduly affected by capacity expansion. In particular:
- that HAL continues to meet its licence obligations in respect of resilience;
 - the impact on resilience of any proposals to increase air traffic movements designed to facilitate the transition to the higher levels of capacity is carefully considered; and
 - HAL has in place robust plans and contingency measures to integrate and minimise disruption from any increase in air traffic movements.

CAA provides guidance on the full business plan

- 5.46 The preparation of a comprehensive business plan by HAL for the next price control period (H7) is required before the start of the formal Constructive Engagement phase in January 2018.

⁹ In December 2016 we extended HAL's existing price control (Q6) by one year.

- 5.47 We set out some initial views on the factors that were likely to influence the development of HAL's business plan in our March 2016 discussion document on the strategic themes for H7. These included issues such as whether and how the business plan could be more consumer-focused, what we expect in terms of the quality of the business plan and the treatment of some of the financial parameters such as inflation and the cost of debt. We have subsequently issued a number of working papers and more formal consultations to consider these issues.¹⁰
- 5.48 Building upon this, we will issue a further update in April 2017 on the H7 review, including on the timetable.

¹⁰ The papers and notes from the associated workshops and seminars are available on our website: <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Heathrow-price-control-review-H7/>.

Chapter 6

Timetable

6.1 Figure 1 summarises our timetable for 2017.

Figure 1: Key consultations and activities in 2017

Date	Consultation / Activities
January	CAA consultation on priorities and timetable (this document)
February	CAA policy decision on the regulatory treatment of further planning costs
March	Responses to this document required by 14 March
April	CAA update on H7 business plan expectations and outcomes framework
June	Further CAA consultation on the framework for economic regulation
November	Final report by CAA to the Secretary of State on HAL/airline engagement

6.2 The major milestones for 2018 and 2019 are shown in Figure 2. Our present intention is to coordinate our work on the new capacity with our work on the H7 price control review in 2018 and 2019. Nonetheless, we are also likely to need to provide a further update on the regulatory arrangements for the new capacity towards the middle of 2018, following the Government's decision on the designation of the NPS, presently scheduled for early 2018.

6.3 As there are a number of processes running in parallel, and led by different organisations with strong interdependencies, the longer-term timetable will need to be flexible to events. It is therefore only possible and sensible at this stage to set an indicative long-term timetable for the regulatory process.

Figure 2: Key milestones and activities 2018-2019

Date		Milestone
2017	December	HAL's detailed business plan on H7 issued to stakeholders
2018	January – June	Constructive Engagement on the HAL business plan
	September	HAL submits revised business plan to the CAA
	December	CAA Initial Proposals
2019	June	CAA Final Proposals
	September	CAA Final decision / statutory notice for licence modifications
2020	January	New licence conditions take effect

- 6.4 The CAA will need to keep this timetable under review pending developments on the NPS and planning process. The timetable may also need to be amended as a result of stakeholder feedback to this consultation. The CAA also has the option to further extend the Q6 price control by another year so that the existing regulatory arrangements expire at the end of 2020, instead of the end of 2019.
- 6.5 The immediate next steps are for interested stakeholders to respond to this consultation. We will also be hosting a series of briefing sessions on the timetable and the priority elements of the regulatory framework between February and May 2017. We will then produce a further consultation on the regulatory framework in June 2017.