

Economic regulation of Heathrow Airport Limited: an update on the CAA surface access policy

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About this document

This paper follows on from the consultations that we published on the regulatory framework to support capacity expansion at Heathrow airport in January, June and December 2017 and April and October 2018.¹ It provides an update of our policy on the surface access costs that Heathrow Airport Limited (“HAL”) should be allowed to recover from airport charges.

As noted above we have consulted a number of times on surface access policy and now regard the high-level policy as set out in this paper as settled. Nonetheless, we will consult where appropriate on the application of this policy to projects or groups of projects that HAL brings forward for funding under these arrangements (and if the application of this policy were to reveal unexpected difficulties we do not rule out consulting further on the underlying policy).

If you would like to discuss any aspect of this document, please contact Abigail Grenfell (abigail.grenfell@caa.co.uk).

¹ All the CAA consultations can be found on our website at: <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/H7/Consultations-and-policy-documents/>

Introduction and Summary

Introduction

1. This paper sets out our policy for allowing HAL to recover, through airport charges, the costs of surface access projects at Heathrow airport, consistent with our duties under the CAA12. We will use this surface access policy to guide the allowances we make for Heathrow Airport Limited's ("HAL") surface access costs (including the contributions it makes to third party schemes) at the next main price control for the period covering the construction of new capacity at Heathrow airport.

The CAA's Surface Access Policy

2. Our previous surface access policy was adopted in our decision on the price caps for Heathrow and Gatwick airports in 2008 (Q5).² It set out how we would make allowances for the costs of surface access projects at regulated airports to be passed on to airlines (and, ultimately, users) through airport charges. It was based on the following key principles:
 - consumers' interests are unlikely to be furthered by airport operators bearing the costs of such projects beyond those which are necessary either (i) to enhance the efficient operation of the airport or (ii) to secure planning permission for expansion; and
 - the users of surface access projects should pay for them as far as this is practicable (the "user pays" principle).
3. In 2017, we said it would be sensible to review this policy to ensure it was consistent with our duties under CAA12 and that it remained appropriate for the issues likely to arise from capacity expansion at Heathrow airport. We discussed

² Airports review – policy issues consultation paper, December 2005 (see Annex D). See: https://webarchive.nationalarchives.gov.uk/20140605144844/http://www.caa.co.uk/docs/5/ergdocs/erg_ercp_airportsreview_dec05.pdf

our surface access policy in consultations issued in June³ and December⁴ 2017 with more detailed updates in April,⁵ May⁶ and October⁷ 2018.

4. In the October 2018 Consultation, we said that the key principles of our surface access policy remained valid, including:

- for a surface access project to warrant funding from airport charges it must be required for the efficient operation of the airport or to meet planning requirements for expansion;
- costs must be efficient;
- direct users must contribute to the costs of the project as far as practicable (the ‘user pays’ principle); and
- residual costs (after direct users have contributed) should be apportioned between airport users and non-airport users according to the benefits they gain.

5. Nonetheless, we also confirmed that, following stakeholders’ responses to the views set out in the April 2018 Consultation, some important refinements to our policy would be appropriate, including that we should:

- take a more holistic approach to allow for multi-modal surface access strategies required under the planning process to meet wider legal and environmental targets;
- allow for journeys to the airport by staff, cargo and in relation to other airport operation services in assessing the benefits of a project or strategy; and
- accept Transport for London’s (“TfL”) representations that apportioning costs on the basis on benefits to the different users alone may not always be appropriate and reiterated that we should include an additional test to establish that, where appropriate, airport users properly fund the efficient incremental costs of surface access projects of connecting the airport to a wider surface access scheme.

³ CAP 1541 Consultation on the core elements of the regulatory framework to support capacity expansion at Heathrow. See: www.caa.co.uk/CAP1541

⁴ CAP 1610 Economic regulation of capacity expansion at Heathrow: policy update and consultation. See: <https://cms.caa.co.uk/CAP1610>

⁵ CAP 1658 Economic regulation of capacity expansion at Heathrow: policy update and consultation April 2018 (“the April 2018 Consultation”). See <https://caa.co.uk/CAP1658>

⁶ CAP 1674 Economic regulation of capacity expansion at Heathrow: working paper on the cost of capital and incentives May 2018. See: <https://www.caa.co.uk/cap1674>

⁷ CAP 1722 Economic regulation of capacity expansion at Heathrow: policy update and consultation October 2018 (“the October 2018 Consultation”). See <https://cms.caa.co.uk/cap1722>

6. This paper summarises the responses to the October 2018 Consultation and explains how we have taken these into account in updating our surface access policy. We make some further revisions to the detail of the policy where appropriate in response to stakeholders' comments. We also provide an update on our engagement with HAL, the Department for Transport ("DfT") and other stakeholders on our processes for assessing potential contributions from HAL to the Western Rail Link ("WRL") to Heathrow airport.

The Airports National Policy Statement

7. On 26 June 2018, following the approval of the House of Commons, the Secretary of State for Transport designated the Airports National Policy Statement ("NPS") under section 5(1) of the Planning Act 2008 ("PA08").⁸ The NPS sets out considerations relevant to any application for development consent to which the NPS relates. In relation to capacity expansion at Heathrow airport these include requirements to develop an appropriate surface access strategy.
8. Capacity expansion at Heathrow airport will lead to substantially more need to access the airport by land for passengers, staff, service providers and freight operators. The NPS requires HAL to show how it will mitigate the impact of expansion on local communities and the wider environment, including demonstrating that capacity expansion will not affect the UK's ability to comply with its legal obligations on air quality and ensuring that access to the airport is high quality, efficient and reliable.⁹ HAL must develop a surface access strategy to:
 - promote sustainable modes of transport;
 - reduce congestion and environmental impacts;
 - reach a target of 50% of all journeys to and from the airport being by public transport by 2030, increasing to 55% in 2040; and
 - decrease staff car journeys by 25% and 50% to the same timescales.
9. HAL will develop its application for a development consent order ("DCO") to permit the construction of new capacity at Heathrow airport in the light of the NPS and the responses to its public consultations on capacity expansion.¹⁰ We understand that HAL's DCO application will include a surface access strategy designed to meet the requirements of the NPS. It is not the CAA's role to decide whether any surface access strategy put forward by HAL meets the requirements of planning law. Our role is to ensure that the allowances we make for costs in

⁸ See:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/714106/airports-nps-new-runway-capacity-and-infrastructure-at-airports-in-the-south-east-of-england-web-version.pdf

⁹ <https://www.gov.uk/government/publications/airports-national-policy-statement>

¹⁰ <https://www.heathrowconsultation.com/>

setting HAL's price control represent efficient costs that are consistent with the surface access policy discussed in this working paper. This assessment will encompass any contributions HAL might make to surface access schemes promoted by third parties and that it is seeking to recover through airport charges (including the WRL).

10. HAL's DCO application will be assessed by the independent Planning Inspectorate, before a final decision on whether to grant a DCO (and on what terms) is made by the Secretary of State, or a designated minister.

Stakeholders' views

11. We received responses to the October 2018 Consultation from eleven stakeholders and these are addressed below. Where we have addressed respondents' comments in previous consultations, we have not necessarily repeated our views in this document. Where comments are outside the scope of this paper, they will, where relevant, be addressed in future CAA publications.

Main issues raised in this paper

12. This paper confirms that the key principles in our surface access policy remain valid, but we have introduced some changes to the drafting of our policy including to reflect the views of respondents to the October 2018 Consultation. The changes include ensuring that our policy allows for the efficient provision of future schemes, provides obligations on HAL to provide high quality information and reflects the importance of taking full account of the interests of consumers. There are also other relatively minor changes that are intended to improve clarity or reflect more accurately our policy intentions.
13. Our focus remains on assessing what level of efficient costs are in consumers' interests and which should, therefore, be passed through to airlines in airport charges. Notwithstanding comments from some respondents, as discussed above, it is not our role to determine whether the surface access strategy will meet the targets set out in the NPS, or to prescribe specific mitigation measures that HAL must include in its strategy.

Next steps

14. As noted above, we have consulted a number of times on our surface access policy and now regard the high-level policy as settled. Nonetheless, where appropriate we will consult on the application of this policy to projects or groups of projects that HAL brings forward for funding under these arrangements (and if the application of this policy were to reveal unexpected difficulties we do not rule out consulting further on the underlying policy).

Our duties

15. In developing this paper, we have had full regard to our statutory duties under the CAA12, which are set out more fully in Appendix A.

Structure of this document

16. The structure of this paper is as follows:
- chapter 1 deals with the responses to the October 2018 Consultation, explains that we are retaining the key principles in our surface access policy but making refinements to the policy where appropriate;
 - chapter 2 provides the detail of our updated surface access policy, including further changes that we have made following the October 2018 Consultation;
 - Appendix A sets out our duties under the CAA12; and
 - Appendix B reproduces a letter we sent to HAL and stakeholders outlining our process for an early assessment of any proposal to make a contribution to the WRL.

Chapter 1

Development of our Surface Access Policy

Introduction

- 1.1 This chapter provides a summary of the October 2018 Consultation on our surface access policy, the main issues raised by consultation respondents and our views on these issues.

The October 2018 Consultation

- 1.2 The October 2018 Consultation explained that:
- the key principles in our policy remained valid and that it is not in consumers' interests to pay for surface access schemes beyond those that are required for capacity expansion or for the efficient operation of the airport, and that the benefits to airport users must outweigh the overall costs to airport users. We also confirmed the importance of the user pays principle;
 - we will take a holistic approach to reviewing the costs and benefits of the airport operator's multi-modal surface access strategy (which will be designed to meet the airport's legal and planning obligations around air quality and congestion) and assess the cost efficiency of the programme;
 - we might not always assess the efficiency of the design and delivery of individual projects ourselves but may rely on other bodies, such as the Office of Rail and Road (ORR), to carry out these assessments where they have the relevant sector expertise; and
 - in assessing the benefits of a surface access project, we would take into account journeys made by staff, cargo vehicles and those providing other services to the airport as well as journeys made by airport users.
- 1.3 We said we would expect HAL to:
- demonstrate both that:
 - a) its overall strategy provides the most efficient solutions to meet essential operational and planning requirements; and
 - b) individual schemes are efficiently costed and provide value for money.

- take steps to minimise the scope for unexpected costs to arise late in the planning process.

1.4 In relation to wider matters we noted that:

- we did not consider it was our role to determine whether a project or strategy would meet the targets required to obtain planning consent. Our role is to assess the overall costs in accordance with our policy;
- we will subject the total costs of capacity expansion (including any contribution toward the cost of surface access schemes to be made from airport charges) to efficiency, affordability and financeability testing;
- there may be advantages in greater coordination of surface access work between stakeholders and stressed that all parties should seek to agree common methods to assess costs and benefits. This could help to ensure that the best options could be developed and, to the extent practicable, agreed before the submission of a planning application; and
- highway diversions that are needed only to allow the physical development of new airport infrastructure, rather than to improve access, would be considered as construction projects, not surface access schemes. In this context we said we expect HAL to seek to agree with Highways England the most cost effective and efficient solutions for future-proofing the M25 motorway and to demonstrate that these provide value for money for consumers.

1.5 We also proposed some further refinements to our surface access policy in the light of responses to the April 2018 Consultation, including that we:

- set out some of the relevant costs that we would take into account in our assessment of the overall cost benefit analysis. This was to make explicit that our policy could be applied to measures required to meet planning obligations, to enhance the efficient operation of the airport or to bring forward investments to meet the timescales for expansion, and also that we would take account of journeys by airport staff, cargo operators and other service providers;
- refined the description of the base case (against which we will measure the costs of a surface access scheme) to address a possible ambiguity in the previous description; and
- acknowledged TfL's view that a calculation on the basis of the relative benefits to airport users and non-airport users alone may not always take account of the specific additional costs of including an airport in a third party scheme that is being developed for other purposes. We asked whether, for projects that are being developed for purposes other than airport expansion,

it would be appropriate to include an additional test to establish whether airport users properly should fund the efficient incremental costs of including the airport in that project.

Responses to the October 2018 Consultation

General comments

- 1.6 A number of stakeholders expressed support for the user pays principle. These included all airline respondents, some local authorities and HAL, which also expressed its support in principle for our overall surface access policy. HAL stated that it is important that its surface access strategy is viewed holistically to ensure that the most efficient mix of infrastructure and policy measures is implemented.
- 1.7 TfL cautioned against a narrow interpretation of the user pays principle, stating that elsewhere this has resulted in rail passengers paying a significant fare premium and this could reduce the potential for rail services to achieve mode shift. It urged us to take a more holistic view of the principle, so that those who use surface access as a whole should bear the costs of improving the overall surface access offer, and stated that it is imperative that sustainable mode shift is at the core of our policy. TfL also highlighted the risk that crowding on public transport services because of constrained capacity could have a disproportionate impact on HAL's ability to secure sustainable mode shift.
- 1.8 By contrast, the Airport Operator's Committee ("AOC") and the London (Heathrow) Airline Consultative Committee ("LACC") stated that they strongly disagree with any weakening in the application or interpretation of the user pays principle. Also, an individual airline respondent expressed concern that we might take a looser view on the range of schemes that should be supported through higher airport charges. It highlighted the risk of "scope creep" on surface access schemes and stated that placing too great a burden of surface access costs on aviation consumers, beyond that needed for the immediate operation of the airport itself, threatens the viability of expansion.
- 1.9 The AOC and LACC urged us to maintain our previously stated position that passengers should not act as the "lender of last resort". Rather than relying on HAL or TfL to demonstrate consistency with the user pays principle, the AOC and LACC said that the CAA should positively assure itself that any spend is consistent with this principle.
- 1.10 Another airline respondent stated that it does not agree that airlines should bear residual costs of surface access schemes that provide wider benefits to the travelling public unconnected with the use of the airport.

- 1.11 HAL said that our holistic view of surface access arrangements should include a long-term perspective and, in particular, should allow for efficient spending that may be required to avoid precluding the provision of future surface access infrastructure. It also stressed the importance of finalising our policy as soon as practicable, urging us to view surface access investment through the lens of our statutory duties. Among other things, it said this would require that our policy encourages the provision of surface access options that meet the requirements of consumers, both in terms of the infrastructure itself and the service levels provided.

Comments on the CAA's role

- 1.12 Several respondents challenged the statement in the October 2018 Consultation that it is not our role to determine whether HAL's surface access strategy will meet the targets set out in the NPS, or to oversee the design and delivery of third party projects such as the proposed rail projects.¹¹
- 1.13 One airline respondent said that part of assessing the costs that aviation consumers should bear should encompass the assessment of the need for that cost in the first instance, and expressed concern that if we do not assess whether HAL's strategy will meet the NPS targets this could be at odds with our proposed new licence condition.¹² This respondent also said that there is a strong case for CAA oversight of HAL's involvement in third party projects and that we could provide early guidance on what quantum of costs would likely be acceptable. It stated that HAL has repeatedly made unilateral surface access commitments without consultation with airlines or the CAA, and that the CAA needs to take a more active role to prevent even more costs being added to the programme and threatening the overall viability of capacity expansion.
- 1.14 The Heathrow Strategic Planning Group also said that it is the CAA's responsibility to ensure that HAL has costed all required surface access costs in its price control business plan. The Richmond Heathrow Campaign questioned how we would be able to assess the efficient level of costs without assessing whether HAL will meet the NPS targets.
- 1.15 By contrast, HAL stated that our clarification of CAA's role set out in the October 2018 Consultation should be made explicit in our surface access policy and

¹¹ We stated in the October 2018 Consultation that these are matters respectively for the planning process and for Office of Rail and Road and DfT.

¹² We have proposed a new condition in HAL's licence promoting economy and efficiency in the operation, maintenance and timely development of Heathrow airport. In the October 2018 Consultation we included 'preparing a DCO application with due regard for the requirements of the NPS' as one example of specific areas that could be identified in the condition where economy and efficiency might be of particular importance. Since then, we have decided not to identify specific areas in the new condition.

supported our proposal to leverage the analysis of other specialist bodies. It also said that our policy should make it clear that decisions on the level of cost recovery from direct users are often outside of its control, for example rail fares and access charges may be determined by external bodies.

Avoiding cross-subsidies from non-airport users

- 1.16 Several respondents commented on the amendment we introduced in the October 2018 Consultation to make it explicit that, while not cross-subsidising other users, airport users should fund at least the incremental costs of infrastructure that has the sole purpose of connecting the airport to the wider transport network.
- 1.17 TfL noted our positive response to the issue it had raised. In contrast, as noted above, several airline respondents expressed strong concerns about a possible weakening of the user pays principle and the risk of ‘scope creep’.
- 1.18 HAL, while agreeing with the principle, said that care should be taken to ensure that airport users are not forced to pay more than they experience in benefits. It drew attention to the potential benefits to local authorities and businesses (as well as airport users and Government) from enhanced public transport connections that serve the airport and said that identifying these wider benefits should become a formal part of the policy to ensure that airport users are not paying for benefits that accrue elsewhere.
- 1.19 Addressing related issues:
- Highways England restated its view of the importance of HAL including appropriate provision for future proofing of the strategic roads network, and said this is both vital to the efficient and resilient operation of the network and also consistent with Highways England’s statutory obligations under its licence; and
 - several local authority respondents highlighted the likely impact of Heathrow expansion on transport networks in their areas, and the need to include the cost of appropriate mitigation measures. One expressed concern that cost pressures on the expansion programme as a whole could lead to a reduction in funding for local surface access improvements. The Richmond Heathrow Campaign said that our policy should include a requirement that HAL’s strategy ensures non-airport users incur no additional disbenefit as a result of the demands that Heathrow expansion places on both the highway and public transport systems.

Detailed comments

- 1.20 In addition to the comments summarised above, two stakeholders suggested some specific changes to the wording of our policy. Some of these changes were to give effect to their suggestions described above:
- HAL suggested a number of drafting changes and additions, including adding a description of our role, clarifying that the policy covers schemes that enhance the efficient operation of the airport (as well those that facilitate expansion) and taking into account the “reasonable needs” of consumers in regard to surface access. HAL also suggested that we should state explicitly that the overall cost benefit test should include the cost of measures required to meet relevant government transport policy or to avoid precluding the efficient provision of potential future surface access schemes and that we should, refer to “cost efficiency” rather than “cost minimisation”. It said the policy should acknowledge the role of other regulatory regimes and sector regulators, state that direct charges *may* (rather than *should*) be used to offset the costs of other modes, refer to wider economic benefits, and state that it should seek consumers’ views on surface access requirements as well as consulting airlines; and
 - one airline respondent also suggested some specific changes, including that HAL *must* (rather than *should*) demonstrate the need for investment, a simpler filter for investments brought forward (i.e. whether a project is needed for expansion rather than basing our assessment on the expected increase in demand), a requirement that each project should have a positive business case, a requirement for HAL to “consider all steps” for seeking direct users’ contributions, and a number of other changes for clarification or consistency. It also said that only projects built by HAL within the airport boundary should be added to HAL’s RAB, and not any contributions made by HAL to wider projects.

CAA’s views

- 1.21 Having considered the consultation responses, we have made some revisions to our surface access policy, as discussed below. Chapter 2 sets out our revised policy, highlighting the changes from the draft policy we consulted on in October 2018.
- 1.22 Where we have not revised our policy to reflect stakeholders’ comments, this is often because we consider the policy already provides sufficient flexibility for us to deal with specific cases. For example, we recognise TfL’s concern that a significant fare premium on new rail services could reduce the potential to achieve mode shift. However, our holistic approach, based on considering whether HAL’s overall surface access strategy represents the most efficient

approach to meeting the obligations in the NPS, will allow us to take account of such trade-offs.

- 1.23 We also recognise Highways England's concerns over future-proofing the M25 and set out our proposed approach in our May 2018 working paper and the October 2018 Consultation. We also explained that, where road infrastructure must be moved to allow for the construction of new capacity, we will treat this as a construction cost rather than a surface access cost. Therefore, it would not be appropriate to revise our surface access policy to address issues relating to the M25.
- 1.24 In some cases, we have not implemented suggested changes because we do not think they are consistent with the policy approach set out in this and previous documents. For example, the suggestion by an airline respondent that each project should have a positive business case might not be consistent with a holistic approach that considers the efficiency of HAL's surface access strategy as a whole and we do not agree that contributions made by HAL to a third party project should automatically be excluded from HAL's RAB.
- 1.25 We also consider that, in most cases, we would not be the appropriate body to oversee the design and delivery of third party projects such as rail projects, as these are normally matters for the ORR and DfT. Our role in these projects is to seek to ensure that any contribution that the airport operator seeks to pass through to airport charges is consistent with our surface access policy, including that it is based on efficient costs. This approach is consistent with our position that we do not seek to determine whether HAL's surface access policy is appropriate from a planning perspective. That said, we will work collaboratively with, and lever on analysis or assessments completed by, other stakeholders (including but not limited to ORR, DfT, Network Rail and TfL) to assure ourselves that airport users' interests are protected.

Changes to policy and important clarifications of policy

- 1.26 We remain of the view that it is not our role to determine whether the surface access strategy will meet the requirements for obtaining planning consent, including the targets set out in the NPS, or to prescribe specific mitigation measures (including some of those suggested by certain respondents) that HAL must include in its strategy. This is a matter for the planning process. Nonetheless, HAL must provide convincing evidence to enable the Planning Inspectorate to make this assessment, working as far as possible with other stakeholders, to minimise the risk of additional, potentially costly, mitigation measures being imposed as conditions of a DCO.
- 1.27 Our role is to assess, bearing in mind the interests of consumers, what level of efficient costs is required to deliver the requirements set out in the NPS. Only these efficient costs should be passed through to airport charges. It will be for

HAL to demonstrate to us with high quality information that, in developing its strategy, it has assessed a full range of options to achieve the most economical and efficient solutions to meet the targets and to minimise the risk of additional mitigation measures being added through the planning process. We have, therefore, reinforced the need for high quality information generally in our policy. We will also expect HAL to provide the Planning Inspectorate with high quality evidence, robust modelling and assurance, that demonstrates its proposals will efficiently and effectively meet the targets set out in the NPS, and we will test the evidence it provides to ensure it meets these standards. We hope that this will provide reassurance to those respondents concerned about our role in this part of the overall process for developing appropriate surface access arrangements.

- 1.28 We also recognise that, in certain cases, the most efficient long-term strategy may require HAL to incur additional costs now so that likely future surface access projects can be delivered more efficiently. There must be a clear justification for such spending, which will be assessed on a case-by-case basis, taking account of (among other things) the probability that the future project will actually be required and the trade-off between current and future expenditures. We have revised the policy in chapter 2 to reflect these considerations.
- 1.29 In line with our primary duty to further the interests of air passengers and cargo owners, it is important that consumers' views are sought and that surface access schemes provide an appropriate level of service. This reflects the wider discussions we have had with stakeholders on the need for better understanding consumer requirements at the airport more generally as part of our proposals to move to a more outputs-based style of regulation. We now recognise this explicitly in our policy. Nevertheless, this does not reduce the importance of other considerations, including the user pays principle and the efficiency, affordability and financeability tests that we will apply to all expansion costs (including surface access).
- 1.30 In line with the principle that airport users should not be expected to cross-subsidise non-airport users of a surface access project, we recognise that there may be projects that provide wider economic benefits to other parties and it may be appropriate to take these into account in assessing the proportion of costs that accrue to airport users. Any decision on whether to include wider economic benefits should be taken on a case by case basis. We have, therefore, included a reference to this in the policy.
- 1.31 Notwithstanding these revisions to our policy, and the further minor changes set out in chapter 2, the key principles on which our policy is based remain consistent with those set out in the October 2018 Consultation, including:
- for surface access costs to be funded from airport charges, it will be important that (i) the relevant projects deliver positive net benefits for consumers; (ii) costs are minimised; (iii) the direct user charges contribute to

the maximum extent practicable; and (iv) the proportion of the remaining costs recovered from airport users is based on their share of the net benefits relative to non-airport users; and

- we will apply a holistic approach that considers the costs and benefits of HAL's overall surface access strategy and whether it represents the most efficient approach to meeting the requirements of obtaining planning consent.

- 1.32 In the first instance, we will look to HAL to demonstrate that its overall strategy is the most efficient approach to meeting the NPS requirements, that individual schemes are efficiently costed and provide value for money, and that it has taken steps to minimise the scope for unexpected costs to arise late in the planning process. HAL should work with other stakeholders to ensure greater co-ordination of surface access work and, as far as is practicable, agree common methods to assess costs and benefits.
- 1.33 In addition to the policy set out in this document, stakeholders should be aware that the total cost of expansion (including surface access costs) will be subject to efficiency, affordability and financeability tests.

Western Rail Access

- 1.34 DfT is working with Network Rail to develop the WRL, which is a project that would provide for a new rail link to allow for services between Reading and Paddington to stop at Heathrow airport and, so, would better connect the airport to Reading, Wales and the south west of England. HAL is considering the costs and benefits of this project to airport users to assess whether it should form part of its surface access strategy to meet the targets for mode share set in the NPS and, if so, what level of contribution to the projects costs HAL could pass through airport charges to airport users in the light of our surface access policy.
- 1.35 Network Rail is planning to submit a DCO application for this project before HAL submits its DCO application for the expansion of Heathrow airport and this requires a minimum degree of certainty on the funding for the WRL. HAL has, therefore, asked us for greater detail on the process we would follow to assess whether a contribution to the WRL could be added to its RAB, and so passed on to airport users through airport charges, before its surface access strategy is finalised.
- 1.36 We wrote to HAL and key stakeholders in April 2019 explaining that our process would include a detailed assessment of HAL's case in accordance with our surface access policy and we would also consult with stakeholders on our findings before providing any assurances, prior to a final decision. We also noted that our final decision on any contribution would be made as part of the H7 price review. A copy of our letter is in Appendix B.

Chapter 2

The CAA surface access policy

- 2.1 Where appropriate this chapter updates the text of our surface access policy set out in the October 2018 Consultation for the changes and refinements discussed in chapter 1. A number of further minor revisions have been made to enhance the clarity of the drafting. Additions are highlighted with underlining and deletions by strike-through text.

Introduction

- 2.2 This policy sets out the criteria against which the CAA would expect HAL to bring forward evidence in support of any proposal to allow surface access costs associated with capacity expansion or to enhance the efficient operation of the airport to be funded from airport charges.
- 2.3 We set out four key criteria that we would expect to be met to allow the costs of surface access projects to be funded through airport charges. In seeking to demonstrate that its proposals meet these criteria, the airport operator must provide the CAA with high quality information suitable to justify its proposals. Criteria (a) and (b) define the total surface access costs that should be considered for funding (or part funding) from airport charges. Criterion (c) apportions costs between direct charges to users of surface access infrastructure and the residual costs to be borne more widely (including by Government) and by airport users in general through airport charges. Criterion (d) apportions this residual between the airport charges and other funding providers (including Government).

The CAA's surface access policy criteria

- 2.4 The criteria are:
- (a) **Overall cost benefit:** airport operators should be able to demonstrate that surface access projects, (considered individually, or as part of a surface access strategy, and jointly with any airport development that they enable) would be likely to deliver benefits in excess of costs from the point of view of airport users over time. In this assessment, the relevant costs may include the costs of measures required to:
- ~~Meet~~ support obtaining planning obligations permission for expansion,
 - enhance the efficient operation of the airport,

- take into account journeys to and from the airport made by air passengers and airport staff; made in relation to cargo operations; and made in relation to ~~providers~~ provision of airport operation services ~~at~~ and retail services to the airport
- bring the investments forward to enable them to meet the timescales needed to support the anticipated increase in demand for surface access brought about by expansion of the airport; and
- make appropriate provision for potential future surface access schemes to the extent it is economically beneficial to do so and consistent with the wider objectives of this surface access policy.

(b) Cost minimisation: the airport operator ~~should~~ must demonstrate that there is a need for the surface access investment, based on the efficient operation of the airport and/or the likely requirements to ~~secure~~ support obtaining planning ~~approval~~ permission for airport expansion. The airport operator must also demonstrate, and that the surface access strategy and individual projects as a whole are not over specified or costed and provide appropriate service levels for airport users. The costs of airport access projects should be measured against a base case which includes planned future upgrades by Government to road and rail infrastructure which would be made assuming that the surface access demand arising from the airport is at a level which arises from its current capability. These costs may include the costs of compensating – or otherwise accommodating on capacity elsewhere – existing non-airport traffic which would be displaced by additional airport demand;

(c) Direct users' contributions/user pays principle: the airport operator should take reasonable steps to ensure that the direct users of surface access facilities defray the costs to be recovered through airport charges to the maximum extent practicable through the application of direct charges for the use of such surface access. Direct charges from one mode of surface access ~~should~~ may be used to offset the costs of another, particularly where this would support measures to encourage modal shift from car to public transport which may be required for the efficient operation of the airport and /or to ~~secure~~ support obtaining planning ~~consent~~ permission for airport expansion; and

(d) Users' reasonable interests: the proportion of net surface access costs borne by the airport operator (after direct users have contributed through direct road or rail charges) should be based on the relative benefits derived by airport users versus non-airport users of the surface access projects required to support airport growth (with airport users not cross-subsidising other users but funding at least the incremental costs of infrastructure that has the sole purpose of connecting the airport to the wider transport network). The relevant costs are compared to the base case of surface access investments which would be

supplied by Government assuming that the surface access demand arising from the airport is at a level which arises from its current capability.

2.5 Consistent with the above approach, efficiently incurred capital elements of the airport operator's residual ~~efficient~~ costs would be added to the Regulatory Asset Base (RAB) and, similarly, any ongoing operating cost and revenues from the surface access projects would be taken into account in the single till calculations used to set the airport operator's price control.

2.6 The airport operator should demonstrate that its strategy and individual projects comply with these criteria through the use of quantitative techniques including:

- *Overall cost benefit criterion*: evidence should be based on the same economic appraisal methodology as used by public transport agencies in assessing road and rail investments;
- *Cost minimisation*: as with other capital expenditure costs associated with airport development, we would expect to scrutinise (with assistance from technical consultants and/ or other regulatory bodies) the scale and costs of surface access projects with the aim of encouraging efficient levels of investment. In addition, where the airport operator is co-funding a surface access project with other transport agencies, we would expect relevant comparator data from other projects funded by other transport agencies to be used to demonstrate the cost efficiency of the airport surface access project;
- *Direct users' contribution*: we would expect airport operators to demonstrate that they had assessed a full range of technically feasible options for placing as much of the surface access costs as possible on the direct users of these transport facilities, taking into account the regulatory regime and decisions of the relevant sector regulator. Evidence on users' responsiveness to charging on surface access, and the impact on overall demand for journeys to and from the airport across all transport modes, should inform the proposals for direct users' cost attribution. Where encouraging modal shift towards public transport is likely to be a planning requirement on the airport operator, evidence on the scope for generating surpluses from road user charging schemes to co-fund public transport services should be presented;
- *Additional benefits enjoyed by users*: evidence should be based on the relative net present value of benefits to:
 - (i) airport users who are also direct users of the new surface access infrastructure; and
 - (ii) "background" non-airport users of the new surface access.

Benefits would be measured according to standard transport appraisal methodology in terms of generalised cost savings in surface travel (net of

any direct charges for fares/tolls). This may, where appropriate, include calculation of the wider economic benefits of schemes.

- We would also expect airport operators to demonstrate that they had actively sought the views of consumers to understand their surface access requirements, both in terms of provision of infrastructure and service levels. Airport operators should also seek the airlines' and other users' views on surface access options and costs. Where consensus had been reached between airport operators and airlines through such engagement, we would expect to attach significant weight to this evidence in reaching our own view on the inclusion of the proposed surface access costs within the RAB. It would not, however, be appropriate for airlines to have a veto over surface access projects being allowed into regulatory consideration for the purposes of setting the price cap, because the interests of the air passenger as a distinct group are likely to be under-represented by airlines on their own, and the beneficiaries of growth will include airlines not currently serving the airport.

Appendix A

CAA duties

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 CAA12.
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. 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”.
4. The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.
5. In discharging this primary duty, the CAA must also have regard to a range of other matters specified in the CAA12. These 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.

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 operator at Heathrow airport.
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 GAL are subject to economic regulation.
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.

Appendix B

Letter to Heathrow Airport Limited regarding the process for an early consideration of a contribution DfT's Western Rail Link project

Andrew MacMillan

Chief Strategy Officer

Heathrow Airport Limited
The Compass Centre
Nelson Road
Hounslow
Middlesex
TW6 2GW

25 April 2019

Dear Andrew,

Surface Access: Regulatory Policy and Processes

Thank you for the meeting on 26 February regarding surface access strategy and the visit to the Terminal 5 station box. It was helpful to understand more about your surface access strategy and the potential importance of the Western Rail Access (WRA) scheme.

You asked if we could set out our timescales and processes for how we might consider allowing a potential contribution towards the WRA in HAL's regulatory asset base (and so to be recovered through airport charges from airlines and consumers).

The starting point for our consideration of these matters will be our surface access policy. We have consulted on this several times over the last two years and there has been broad support for us considering surface access costs on a holistic basis. Nonetheless, we have made some important changes to the detail of the policy, such as explicitly acknowledging the need for additional colleague journeys. We intend to publish a working paper in May/June 2019 that will deal with comments we received to our October 2018 consultation on these matters and will consider whether further changes are appropriate in the light of the responses we receive to it.

That said, at the heart of our surface access policy are tests designed to ensure any allowances for surface costs are consistent with the interests of consumers. These include tests to ensure that:



- the package of schemes is necessary for the efficient operation of the airport and/or to allow for capacity expansion, including requirements of the planning process;
- the costs of the scheme(s) are efficient;
- costs are offset as far as reasonable practicable by direct charges on surface access users;
- any residual costs should normally be shared reasonably between HAL and scheme promoters on the basis of the relative benefits to airport users (including air passengers and cargo owners) and non-airport users; and
- surface access arrangements and costs are consistent with wider objectives for capacity expansion, including that the programme is both affordable and financeable.

Given the potential breadth and importance of these issues and the advantages in taking account of the latest available information, the natural time to consider these matters would normally be during HAL's main price control review in 2020 and 2021. Nonetheless, we can also see that there may be advantages for consumers in an early start to the consideration of these issues if it facilitates the decisions of other scheme promoters to support the development of particular elements of an overall package of surface access measures that best suits the needs of consumers. Such an approach would require:

- consistent with our discussions to date, confirmation that HAL is not seeking to recover this expenditure as early Category C costs (as we have additional tests and processes that are necessary before expenditure can be classified as early Category C spending);
- given the importance of addressing surface access schemes as a package, assessment of the WRA scheme costs to be made in the context of HAL's wider surface access strategy and not unduly focused on that scheme; and
- consultation with the airline community and other stakeholders to support a robust decision-making process.

In considering the WRA scheme separately from the rest of HAL's surface access proposals, we would need to consider the following questions:

- 1) what are the expected costs that HAL would seek to recover from airport charges in relation to WRA;
- 2) are these costs reasonable in the light of our surface access policy; and

- 3) given these costs, could the WRA scheme be an optimal part the surface access arrangements that (overall) will be both necessary and appropriate to support the capacity expansion programme.

While it would be possible for us to form an initial view on questions 1 and 2 ahead of considering question 3, given the advantages of making these decisions on a consistent basis, we assume below that they should, to an extent, be considered in parallel.

Our initial thinking on the processes necessary to support an early and indicative assessment of surface access costs for the WRA scheme is set out below.

Firstly, HAL would need to provide:

- 1) a full justification for your surface access strategy (including your assessment of the options available to meet the surface access obligations in the Airports National Policy Statement) through the WRA scheme;
- 2) calculations of a possible contribution to be made by HAL to WRA, taking account of our draft surface access policy, and
- 3) appropriate assurance that the underlying assumptions and modelling were robust and consistent with protecting the interests of consumers.

Once we had received this, we would assess and consider HAL's submission. The length of time this would take would depend on the quality and complexity of the information received from HAL and the speed with which queries on this information could be dealt. An early and indicative timeframe for this could be three to four months, to include suitably robust governance for our approach to consulting on the issues raised.

During this time, we would expect to consider (inter alia):

- whether alternative schemes and options had been rigorously evaluated;
- the level of uncertainty over the efficiency of the WRA scheme's costs, including whether to seek further independent advice, for example, from ORR;
- the detail of how the benefits accruing to each of (i) airport users and (ii) non-airport users had been estimated and whether this approach was robust, and
- whether the level of costs would be likely to have a material impact on overall scheme affordability and financeability.

Following our initial assessment of these matters, we would need to consult stakeholders and make any changes to our assessment that would be appropriate

given the results of that consultation and/or any new information that had emerged, as well as apply appropriate governance to any decision that we made. This could take a further three to four months (or longer), depending on the responses we received.

It is also important to note that any decisions we made through this process could only be on a "minded to" basis ahead of the main price control review. We would need to consider if any significant new evidence arose at the time of the main price control review. At that later stage, the licence modifications necessary to allow for costs to be recovered from airport charges would, of course, be subject to the statutory appeal rights to the CMA. Such decisions would also, of course, remain entirely separate from the planning processes relating to any application for development consent to be made either by HAL (for capacity expansion) or Network Rail (for the WRA scheme).

Given the potential wider interests of stakeholders in these matters we will discuss these issues further in our May/June 2019 working paper on surface access policy.

I am copying this letter to Caroline Low at DfT, airline members of your Surface Access Stakeholder Board and Graham Richards at ORR.

Yours sincerely



Paul Smith

Group Director, Consumers and Markets