


# Economic regulation of Heathrow Airport Limited: H7 Initial Proposals

## Working paper on outcome based regulation

CAP2274

A large, abstract graphic composed of overlapping blue and purple shapes, resembling a stylized 'C' or a wing, occupies the lower half of the page. It features a gradient from light blue to dark blue and purple.

Published by the Civil Aviation Authority, 2021

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First published November 2021

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## About this document

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

### Views invited

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

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

Please e-mail responses to [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk) by no later than **Friday 7 January 2022**.

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

We expect to publish the responses we receive on our website as soon as practicable after the period for representations expires. Any material that is regarded as confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to information under section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

If you would like to discuss any aspect of this document, please contact [freya.whiteman@caa.co.uk](mailto:freya.whiteman@caa.co.uk).

## Chapter 1

# Introduction

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1.1 The October 2021 Initial Proposals<sup>1</sup> set out details of our proposed approach to implementing outcome based regulation (“OBR”) in the H7 price control for Heathrow Airport Limited (“HAL”). We intend that OBR will replace the current service quality rebates and bonuses (“SQRB”) scheme.

1.2 Our Initial Proposals:

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

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

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

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<sup>1</sup> CAP 2265D: Economic regulation of Heathrow Airport Limited: H7 Initial Proposals Section 3: Incentives and other issues, chapter 14: see [www.caa.co.uk/CAP2265D](http://www.caa.co.uk/CAP2265D).

- 1.4 Chapter 4 of this working paper should be read alongside CAP2275<sup>2</sup> which sets out draft modifications to HAL’s licence (including in relation to OBR), consistent with the approach to setting the H7 price control as described in the Initial Proposals.
- 1.5 There are some outstanding issues that will need to be addressed before finalising the OBR framework for H7. Some of these will require further stakeholder engagement.
- 1.6 For the definition of the measures we propose to use for OBR, we note that:
- discussions between HAL and airlines are continuing on some issues, such as how control post queues are currently measured, how they should be measured during H7 to reflect the impact of new technology and opportunities for more accurate queue measurement;
  - further engagement is required on the grouping of control posts;
  - further engagement is required to finalise the details of some new measures, including the availability of check-in infrastructure, timely delivery from departures baggage system and airport departures management;
  - further engagement with the airline community is required on “exclusions” (the limited circumstances that will not count towards HAL failing a particular target), covering both the new timely delivery from departures baggage system measure and the existing availability measures for which HAL has proposed a number of new exclusions; and
  - we said in the October 2021 Initial Proposals that we would give consideration to whether a further measure of baggage performance (such as HAL’s proposed baggage misconnect rate) would be useful in addition to our current proposals.
- 1.7 In relation to targets, we understand HAL will propose new targets for some new measures in Q4 2021 and during Q1– Q3 2022 when sufficient baseline data has been gathered. We will discuss these issues with stakeholders ahead of the Final Proposals.
- 1.8 As for the licence changes to implement the OBR framework, we will discuss relevant issues (including those raised in Chapter 4 below and CAP2275) with stakeholders ahead of publishing our Final Proposals.
- 1.9 Nevertheless, the proposals set out in the October 2021 Initial Proposals and in this working paper represent an important step forward in moving towards an outcomes-based approach to service quality regulation for H7. They build on the constructive discussions that have taken place between HAL and airlines, and set out our views on a number of issues where parties were unable to reach agreement and how they further consumers’ interests. As well as carefully considering all consultation responses to both the October 2021 Initial Proposals and this working paper, we will continue to engage with stakeholders on both our

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<sup>2</sup> CAP 2275: Economic regulation of Heathrow Airport Limited: H7 Initial Proposals – Draft Licence Modifications: see [www.caa.co.uk/2275](http://www.caa.co.uk/2275)

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

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

## Chapter 2

# Targets

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## Introduction

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2.1 This chapter sets out our Initial Proposals on the performance targets that HAL must meet to avoid:

- paying rebates (for measures with financial incentives); and
- recording a failure in published performance reports (for all measures).

The performance levels that HAL must meet to qualify for bonuses are described separately in Chapter 3 below.

2.2 In the October 2021 Initial Proposals, we noted that HAL had provided us with two separate sets of performance targets in its updated Revised Business Plan:

- targets associated with its “optimal” capital expenditure (capex) plan, which HAL stated requires a full RAB adjustment for covid-19 related losses. These focus on maintaining the service levels HAL had provided in Q6 for H7 and making targeted improvements in three areas: punctuality, baggage and the passenger experience; and
- targets associated with a lower “safety only” capex plan. The targets it proposed for security queues, in particular, were very much lower than the optimal plan targets as well as being subject to a very wide range. Some availability targets HAL proposed were also lower, as was the target it proposed for overall satisfaction.

2.3 We asked Arcadis to assess these targets and provide a view on the level of performance that should be achievable based on the expenditure allowances in our Initial Proposals. Arcadis has now completed this assessment and its report will be published shortly on our website.<sup>3</sup>

## Summary of Arcadis’ assessment

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2.4 We asked Arcadis:

- to consider the justification and evidence available to support the lower targets associated with HAL’s safety only capex plan, and to provide a view on whether the higher targets associated with HAL’s optimal capex plan were likely to be achievable given the expenditure allowances included in our Initial Proposals; and

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<sup>3</sup> See CAP 2274A: OBR Targets Assessment: see [www.caa.co.uk/CAP2274A](http://www.caa.co.uk/CAP2274A).



- more generally, to consider HAL's historical, recent and expected future performance and to provide a view on whether HAL could be reasonably expected to exceed some of the optimal capex plan targets in H7.

2.5 In relation to the first of these questions, Arcadis considered that the optimal plan targets could be delivered with the expenditure allowances included in our October 2021 Initial Proposals based on the information provided. Among other things, Arcadis observed that:

- although HAL had set out some supporting rationale for lower targets, Arcadis had not seen clear evidence, data or modelling to justify the levels of degradation between the optimal plan and safety only plan targets;
- much of the information presented by HAL failed to take account of the extent to which it has already been exceeding its current performance targets; and
- HAL should share further information and data, including from current trials, with stakeholders to provide greater transparency and clarity.

2.6 Some of the most significant differences between the two sets of targets were for security queues. HAL said that, under its "safety only" capex plan, a combination of fewer lanes compliant with new security screening requirements and reduced flow rates would lead to a significant increase in the number of passengers having to queue for more than ten minutes during H7. However, Arcadis found a lack of substantive data or modelling evidence to support HAL's revised targets, and considered that the expenditure included in HAL's safety only plan should be sufficient to allow HAL to meet its optimal plan targets for security queues.

2.7 HAL had stated that some of the other lower targets, particularly for asset availability measures, reflected a need for increased maintenance expenditure during H7, reflecting a combination of asset age and underinvestment in asset maintenance and replacement in 2020 and 2021. This increased expenditure was part of an Enhanced Service Overlay that was not included in its operating expenditure (opex) forecasts for a low RAB adjustment scenario. While Arcadis considers the concept of the Enhanced Service Overlay is reasonable, in practice, the opex allowances included in our Initial Proposals do include some or all of the additional maintenance and covid-19 related expenditure projected by HAL.<sup>4</sup> This should reduce the risk of HAL being unable to meet its optimal plan targets. We have, therefore, not taken account of the lower safety only plan targets when developing the targets set out below.

2.8 In relation to the second question, Arcadis considered that there are a number of measures for which it is realistic and achievable for HAL to perform at a level higher than its "optimal plan" targets. This view is based on HAL's strong historical performance, the lower passenger volumes anticipated in the early years of H7 and the expenditure allowances included in our Initial Proposals.

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<sup>4</sup> Our opex allowances are within a range between HAL's updated opex forecasts (scaled to our "mid case" passenger forecasts), which include the full Enhanced Service and covid-19 overlays, and CEPA/Taylor Airey's "mid case" scenario which includes an additional £7 million per year of maintenance expenditure to maintain service quality standards as well as a time-limited allowance for covid-19 related costs.

## 2.9 These measures include:

- cleanliness, for which Arcadis considered performance in the range of 4.20-4.30 to be reasonable and achievable compared with the current target of 4.00 and the optimal plan target of 4.05. HAL's performance has been comfortably above the current target throughout Q6 and improving over time in most terminals. In addition, Arcadis noted that lower passenger numbers during H7 and the covid-19 related opex that CAA has allowed should help make a higher target achievable;
- wayfinding, for which Arcadis considered performance in the range of 4.20-4.25 to be reasonable and achievable, compared with the current target of 4.10 and the optimal plan target of 4.15, with the potential to review during H7 based on performance. It considered that the approach HAL used to set the optimal plan target was unduly negative, noting that HAL had earned significant SQRB bonuses for wayfinding during Q6, that performance was continuing to improve over time, and that, except for Terminal 1 (now closed) HAL has exceeded every target since 2008. Arcadis noted HAL's concerns about future performance degradations, but also highlighted the positive benefits of lower passenger numbers (which increase line of sight and visibility of signage due to less congestion) and the high levels of performance experienced recently;
- Wi-Fi performance, for which Arcadis considered performance in the range 4.00-4.20 to be reasonable and achievable, compared with HAL's optimal plan target of 4.00. It considered there is little evidence to substantiate a substantial drop in performance from the high levels experienced in Q6 and especially in the most recent years. While Arcadis noted consumers' rising expectations around Wi-Fi performance, it also noted that the impact of lower passenger numbers during H7 should ease pressures on the availability and speed of Wi-Fi;
- transfer search and staff search queues, for which Arcadis considered there are opportunities for HAL to achieve 96-97 per cent of queue times less than ten minutes, compared with the current and optimal plan targets of 95 per cent, given HAL's strong historical performance. However, it also noted that consideration should be given to the impact of disruption from the security compliance transformation programme;
- control post queues, for which Arcadis considered there was potential for HAL to achieve 95-96 per cent of queue times less than 15 minutes (compared with the current and optimal plan targets of 95 per cent) or, alternatively, to reduce the queue time requirement below the current 15 minutes. This was based on strong historical performance, though again Arcadis noted the potential impact of disruption from the security compliance transformation programme;
- the "two train" availability target for the T5 track transit system, for which Arcadis considered that future performance of 97-99 per cent was reasonable, compared with the current and optimal plan targets of 95 per cent. This reflects historical performance and the fact that our opex allowances include some or all of the increased maintenance expenditure forecast by HAL;

- pier served stand usage, for which Arcadis considered that there is scope to increase the target to 95-97 per cent, compared with the current and optimal plan targets of 95 per cent. This reflects HAL's strong historic performance, the lower passenger numbers expected in early H7 and the asset related opex that CAA has allowed, though Arcadis also acknowledged that performance in Terminal 3 was close to the current target in 2017-2019; and
- PRS/PRM satisfaction, for which Arcadis considered there is scope for some further stretch, though it also recognised that recent performance will have been affected by lower passenger volumes and suggested that the optimal plan target could be viewed as a baseline.

## Our Initial Proposals

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- 2.10 In the light of Arcadis' assessment, set out above, that HAL's optimal plan targets could be delivered with the expenditure allowances included in our Initial Proposals, we are currently minded to set performance targets for H7 at least at the level of HAL's optimal plan targets. For the majority of targets that we can set at this stage, we propose to adopt HAL's optimal plan targets.
- 2.11 We have carefully considered Arcadis' conclusions on possible stretch targets. In doing this, we have adopted a deliberately cautious approach bearing in mind the challenges that HAL faces in reinstating services after a period of very low passenger volumes, possible uncertainties about changes in passengers' priorities or expectations, and the specific impacts of installing new security screening equipment.<sup>5</sup>
- 2.12 We have therefore adopted HAL's optimal plan targets in most cases and proposed higher targets in only three cases – cleanliness, wayfinding and Wi-Fi performance. These are all measures that are important to passengers and where HAL has been performing at levels comfortably above its proposed targets since 2016, with performance levels generally increasing over time.
- 2.13 Overall, we consider the targets in our Initial Proposals for H7 and set out in Table 2.1 below strike the right balance between:
- setting achievable targets that continue to offer consumers and airlines a good service and providing a degree of challenge for HAL; while
  - recognising covid-19 related difficulties and uncertainty.
- 2.14 Even where we have set targets at a higher level than HAL's own optimal plan targets, HAL should not incur rebates as long as it can maintain the performance levels it achieved during the middle and later parts of Q6.
- 2.15 Table 2.1 sets out our proposed targets consistent with our Initial Proposals for H7. It also includes information on the comparable SQRB targets and HAL's

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<sup>5</sup> As noted in the October 2021 Initial Proposals, in our proposed mid-term review of the OBR framework we expect to be able to deal with any issues that need to be considered (including opportunities for improvement) following the installation of this new equipment as well as the new queue measurement system.

proposed targets (including its optimal capex plan targets and safety only plan targets).

- 2.16 We note that a number of targets in the table below have not been set as baseline data is still being gathered. These are discussed further below under next steps.

**Table 2.1: Current and proposed performance targets**

	Measure	Q6 SQRB	H7 HAL proposals		H7 CAA initial proposals
			Optimal capex plan	Safety only capex plan	
Survey-based measures with financial incentives	Cleanliness	4.00	4.05	4.00	4.15
	Wayfinding	4.10	4.15	4.10	4.20
	Helpfulness/attitude of security staff	-	4.10*		4.10
	Wi-Fi performance	-	4.00	3.93	4.05
Operational measures with financial incentives	Security queue time – central search (% of queue times < 5 minutes)	95%	95%	33%-75%	95%
	(% of queue times < 10 minutes)	99%	99%	46%-89%	99%
	Security queue time – transfer search (% of queue times < 10 minutes)	95%	95%	46%-89%	95%
	Security queue time – staff search (% of queue times < 10 minutes)	95%	95%	46%-89%	95%
	Control post vehicle queue time (% of queue times < 15 minutes)	95%	95%	46%-89%	95%
	Availability of lifts, escalators and travelators	99%	99%	97%	99%
	Availability of check-in infrastructure	-	-	-	-
	Availability of arrivals baggage carousels	99%	99%	98%	99%
	Availability of Terminal 5 track transit system				
	– 1 train target	99%	99%	97%	99%
	– 2 trains target	97%	97%	95%	97%
	Availability of stands	99%	99%	98%	99%
	Provision of stand facilities	98%-99%**	99%	97.25%	99%
	Pier-served stand usage	95%	95%	94%	95%
	Runway operational resilience	As per approach in licence			
	Hygiene safety testing	-	100%* Amber Test results resolved < 24 hours and Red Test results resolved < 4 hours	-	100% Amber Test results resolved < 24 hours and Red Test results resolved < 4 hours
Timely delivery from departures baggage system	-	-	-	-	

	Measure	Q6 SQRB	H7 HAL proposals		H7 CAA initial proposals
			Optimal capex plan	Safety only capex plan	
Survey-based measures with reputational incentives	Overall satisfaction	-	4.26	4.17	4.26
	Customer effort (ease)	-	-	-	-
	Enjoy my time at the airport	-	-	-	-
	Airport that meets my needs	-	-	-	-
	Feel safe and secure	-	97.5% of passengers agreeing*	-	97.5% of passengers agreeing*
	Ease of access to the airport	-	-	-	-
	Helpfulness/attitude of airport staff	-	-	-	-
	Being able to social distance if I want to	-	-	-	-
	Ease of understanding Heathrow's Covid-19 safety information	-	-	-	-
	Passengers with reduced mobility – overall satisfaction	-	4.00	3.92	4.00
Operational measures with reputational incentives	Departures flight punctuality – % of flights departing off stand within 15 minutes	-	80.5%	78.4%	80.5%
	Airport departures management (% of flights taking off within x minutes of standard time)	-	-	-	-
	Airport arrivals management (wheels down to doors open)	-	-	-	-
	% of UK population within 3 hours (and one interchange) of Heathrow by public transport	-	-	-	-
	Passenger injuries per 1,000,000	-	4.5*	-	4.5
	Immigration queue times	-	95% < 45 mins (non-EEA) or 25 mins (EEA)	-	95% < 45 mins (non-EEA) or 25 mins (EEA)
	Reduction in Heathrow's carbon footprint	-	-	-	-

\* These targets are from HAL's Revised Business Plan (rather than the update), and are based on HAL's then proposed £3.5 billion capex plan.

\*\* Provision of stand facilities combines four SQRB metrics all of which had separate targets in Q6 at either 99% or 98%

## Next steps

- 2.17 We invite stakeholder views on our proposed targets for H7.
- 2.18 As noted above, there are currently a number of targets missing from our proposals. We understand HAL will propose new targets for some of these measures in Q4 2021 and during Q1– Q3 2022 when sufficient baseline data has been gathered. Where applicable, we will discuss these proposals with stakeholders ahead of publishing our Final Proposals.

- 2.19 We will work with stakeholders on these and other issues, including definitions and exclusions that still need to be finalised for some of the new measures. Where any issues cannot be resolved in time for us to include in our Final Proposals, we will set out a process and timetable for addressing these during the early part of H7.

## Chapter 3

## Rebates and bonuses

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### Introduction

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- 3.1 In the October 2021 Initial Proposals, we confirmed that we intend to retain the current financial envelope for potential rebates and bonuses, with a maximum exposure of seven per cent of HAL's airport charges revenues for rebates and 1.44 per cent of airport charges revenues for bonuses. And we said that the monthly rebate associated with each measure should continue to be calculated as one sixth of the annual maximum, rather than one twelfth as proposed by HAL.
- 3.2 We also noted that HAL had included proposals in its Revised Business Plan for the allocation of rebates and bonuses between those measures it considered should be subject to financial incentives. However, we stated that we had some reservations about these proposals, which were sensitive to the specific way that HAL had generated weightings for different measures or groups of measures from the findings of a single consumer research study, and which led to some counter-intuitive changes from the current allocation of rebates.
- 3.3 Our approach to calculating rebates and bonuses is set out below.

### Initial proposals

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#### Rebates

- 3.4 Our approach to the allocation of rebates for the measures subject to financial incentives is set out in Table 3.1 below. Slightly different rebates apply to Terminals 2-4 and to Terminal 5, as there are no rebates for pier-served stand usage at Terminal 5 but (unlike other terminals) there are rebates for the track transit system. For comparison, Table 3.1 also includes the allocation of rebates under the current SQRB scheme and the proposals included in HAL's revised business plan.
- 3.5 As noted above, we had some reservations about HAL's approach to allocating rebates in its Revised Business Plan. Therefore our starting point for considering the proposed allocation of rebates for H7 was the current set of rebates under the SQRB scheme and, in particular, the proportion of the potential total rebate set at seven per cent of airport charges revenues allocated to each measure. We consider that the current SQRB scheme has generally worked well, and provides a more suitable starting point than HAL's proposed rebates, but we will engage with stakeholders further on these matters and consider whether there is evidence (including from consumer research) that suggests that specific measures should have either more or less weight than shown in Table 3.1 below.
- 3.6 From the starting point of the existing rebates we then needed to adjust the allocation to accommodate several new measures that will be subject to financial incentives in H7. The impact of adding these new measures is only partially

offset by the removal of two passenger satisfaction measures that we propose will not be retained for H7. When considering how much weight to attach to each of the new measures, we were generally guided by the importance of similar measures in the current SQRB scheme and also the extent to which any new rebates might potentially overlap with one or more existing rebates.

3.7 The proposed allocations of rebates shown in Table 3.1 are, therefore, based on the following steps:

- in the two cases where several existing measures are to be combined into a single new measure,<sup>6</sup> we assigned each new measure the same weight as the combined total of the individual measures they are replacing;
- for each of the two new passenger satisfaction measures (which were subject only to reputational incentives in Q6), we assigned the same weight as the current passenger satisfaction measures;
- for hygiene safety testing, we assigned half of the weight of the current cleanliness measure as we considered that there is likely to be a degree of overlap between the aspects of HAL's performance picked up by the cleanliness and the hygiene safety testing measures. We recognise that cleanliness and hygiene may be more important to consumers in the future than they were in Q6, but note that our approach will still lead to an increase of 50 per cent in the total weight attached to cleanliness and hygiene measures;
- for timely delivery from departures baggage system, we assigned the same weight as the current availability of arrivals baggage carousels measure. Though this leads to an increase in the overall weight assigned to baggage system measures, these measures are important to consumers and they pick up different aspects of HAL's performance because the departures baggage system is separate from the arrivals baggage carousels;
- we slightly adjusted the weights assigned to the track transit system which only applies to Terminal 5 and to pier-served stand usage which only applies to Terminals 2, 3 and 4, so that these are now the same and this removes the need for other rebates to vary between terminals; and
- for availability of check-in infrastructure, we assigned the same weight as one of the existing central (5 or 10 minutes) or transfer search measures. This is because failures of check-in infrastructure, like poor performance in security screening, risk creating queues and delays for consumers.

3.8 In addition to the above adjustments, we reduced the weight attached to the runway operational resilience measure (previously called the aerodrome congestion term) by half. These rebates are specified as a fixed amount per incident, depending on the number of movements affected by each incident, and

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<sup>6</sup> These are the availability of lifts, escalators and travelators (which replaces the separate 'general' and 'priority' measures for passenger sensitive equipment) and the provision of stand facilities (which replaces the separate measures for the availability of jetties, fixed electrical ground power, stand entry guidance and pre-conditioned air).



are also subject to an overall cap of one per cent of airport charges revenues. We reduced the size of this cap as the current cap is disproportionately large compared with the penalties that HAL might incur for individual incidents.<sup>7</sup>

- 3.9 Finally, we applied a small *pro rata* reduction to the weights assigned to all measures to ensure that HAL's total potential exposure remains at seven per cent of airport charges revenues despite the introduction of several new rebates.

**Table 3.1: Current and proposed maximum rebates (% of airport charges revenues)**

		Q6 SQRB*	H7 HAL proposals	H7 T2-4 CAA proposals	H7 T5 CAA proposals
Passenger satisfaction	Departure lounge seating availability	0.36	-	-	-
	Cleanliness	0.36	0.36	0.33	0.33
	Wayfinding	0.36	0.46	0.33	0.33
	Flight information	0.36	-	-	-
	Helpfulness/attitude of security staff	Reputational	0.32	0.33	0.33
	Wi-Fi performance	Reputational	0.32	0.33	0.33
			<b>1.44</b>	<b>1.46</b>	<b>1.32</b>
Security queue times	Security queue time – central search (% of queue times < 5 minutes) (% of queue times < 10 minutes)	1.00	0.80	0.93	0.93
	Security queue time – transfer search (% of queue times < 10 minutes)	0.50	0.40	0.47	0.47
	Security queue time – staff search (% of queue times < 10 minutes)	0.38	0.40	0.35	0.35
	Control post vehicle queue time (% of queue times < 15 minutes)	0.38	0.40	0.35	0.35
			<b>2.26</b>	<b>1.99</b>	<b>2.10</b>
Passenger operational	Availability of passenger sensitive equipment - general	0.35 / 0.25	-	-	-
	Availability of passenger sensitive equipment - priority	0.35 / 0.25	-	-	-
	Availability of lifts escalators and travelators	-	0.33	0.65	0.65
	Availability of arrivals baggage carousels	0.35 / 0.25	0.40	0.33	0.33
	Availability of T5 track transit system	0.00 / 0.30	0.33	-	0.25
	Hygiene safety testing	-	0.36	0.17	0.17
			<b>1.05</b>	<b>1.42</b>	<b>1.15</b>
Airline operational	Availability of stands	0.20 / 0.25	0.40	0.19	0.19
	Availability of jetties	0.20 / 0.25	-	-	-
	Availability of fixed electrical ground power	0.15 / 0.20	-	-	-
	Availability of stand entry guidance	0.25 / 0.30	-	-	-
	Availability of pre-conditioned air	0.20 / 0.25	-	-	-

<sup>7</sup> To breach the cap in 2019, for example, would have required there to be more than 130 separate days on which the most serious category of incident (one which delays 20 or more movements) occurred.

		Q6 SQRB*	H7 HAL proposals	H7 T2-4 CAA proposals	H7 T5 CAA proposals
	Provision of stand facilities	-	0.40	0.74	0.74
	Pier-served stand usage	0.25 / 0.00	0.33	0.25	-
	Timely delivery from departures baggage system	-	-	0.33	0.33
	Availability of check-in infrastructure	-	-	0.46	0.46
		<b>1.25</b>	<b>1.13</b>	<b>1.97</b>	<b>1.72</b>
	Runway operational resilience	1.00	1.00	0.46	0.46
	<b>Total</b>	<b>7.00</b>	<b>7.00</b>	<b>7.00</b>	<b>7.00</b>

\* Where two figures are given, the first is for Terminals 2 and 3 and the second is for Terminal 5. The current rebates for Terminal 4 are similar to those for Terminals 2 and 3, although with airline operational rebates adjusted as there is no metric for the availability of pre-conditioned air for Terminal 4.

- 3.10 Ahead of the Final Proposals, we are open to considering specific evidence from stakeholders on any adjustments to our proposed allocation of rebates and why the rebates for any specific measures should be either higher or lower than those shown above. Any evidence provided (including from consumer research) should explain how proposed adjustments will further consumers' interests.

## Bonuses

- 3.11 Currently HAL can earn bonuses in relation to four passenger satisfaction measures. To earn a bonus for one or more of these measures, it must meet a performance threshold (which is set higher than the target for rebates) in all four terminals in a particular month, and the bonus for that month will be based on the level of performance in the worst-performing terminal.
- 3.12 In the October 2021 Initial Proposals, we stated that we propose to maintain HAL's maximum potential bonus receipts at the current 1.44 per cent of airport charges revenues (whereas in its Revised Business Plan HAL had proposed a significantly expanded range of bonuses with a potential maximum of 3.55 per cent of airport charges revenue). We also noted that two of the four measures (flight information display screens and departure lounge seat availability) for which HAL can earn bonuses in Q6 were not included in our proposed measures for H7. We therefore said we would consider whether to add a small number of extra measures to the group for which HAL can earn bonuses.
- 3.13 We propose that the two other current measures for which HAL can earn bonuses (cleanliness and wayfinding) will be retained for H7 and we consider that they should continue to be subject to both potential rebates and potential bonuses. These are issues that are important to consumers and where improved performance may directly benefit them.
- 3.14 We are currently minded to allow HAL to earn bonuses in relation to two further measures:
- central search (the proportion of passengers queuing for less than five minutes); and
  - the new timely delivery from departures baggage system measure.

- 3.15 These are both measures that are important to consumers, and where performance above the target for rebates should continue to deliver direct benefits: fewer passengers queuing for more than five minutes, and fewer missing bags. While it is important to recognise the limitations of willingness to pay studies, research commissioned by HAL<sup>8</sup> suggests that current passengers value a two minute reduction in security queues<sup>9</sup> at 1.27 per cent of the air fare, and a reduction in the proportion of bags not travelling on the same flight (from 9 in 1000 to 7 in 1000) at 0.95 per cent of the air fare.
- 3.16 In contrast, many of the other measures that we could have considered for bonuses relate to the availability of equipment and/or services that are provided to airlines. In these cases, the relationship with consumer benefits is likely to be more indirect, for example because alternative facilities may still be available even if certain equipment is temporarily out of use. Moreover, many of the existing availability measures already have targets set at 99 per cent. In such cases, it is less clear that passengers would gain significant benefits from HAL delivering even higher performance levels, or that it would be cost effective for HAL to aim for such very high performance levels. For both of these reasons, therefore, the argument for considering bonuses for these measures appears weaker.
- 3.17 As with the current SQRB bonuses, we propose that each of the four eligible measures in H7 should be subject to the same maximum of 0.36 per cent of airport charges revenues. We also propose that the overall method for calculating and paying bonuses should remain unchanged. However, we propose that HAL should only be able to earn bonuses for central search performance if, in the same month, it also meets the targets for helpfulness/attitude of security staff. This is to guard against a deterioration in consumers' experience if the prospect of bonuses were to encourage HAL staff to rush passengers through the security screening process.
- 3.18 Table 3.2 summarises our Initial Proposals for bonuses in H7. As with HAL's current bonuses, they will be based on the score of the worst performing terminal each month. HAL will start earning a bonus on a sliding scale basis once this level of performance exceeds the lower threshold in Table 3.2. HAL will earn the maximum bonus for the month (one-twelfth of the annual maximum) if this level of performance reaches the upper threshold.
- 3.19 We have set the lower thresholds for bonuses 0.2 points above performance target for Quality of Service Monitor ("QSM") scores, and two percentage points above the performance target for security queues. This compares with the current thresholds for SQRB bonuses (all QSM scores) which are between 0.1 and 0.3 points above the relevant performance targets. To earn significant bonuses, HAL will need to provide consumers with very high levels of service.

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<sup>8</sup> Systra, "Understanding consumer need priorities in a (post) Covid-19 world", November 2020.

<sup>9</sup> This is a change from "9 out of 10 times you will go through security in less than 5 minutes" to "9 out of 10 times you will go through security in less than 3 minutes".

- 3.20 We will keep the operation of these bonuses under review, and the proposed mid-term review will provide an opportunity to consider any further evidence on the value to consumers of performance over and above the current OBR targets.

**Table 3.2: Proposed bonuses**

	Maximum bonus (% of airport charges revenues)	Lower performance threshold	Upper performance threshold
Cleanliness (QSM score)	0.36	4.35	4.65
Wayfinding (QSM score)	0.36	4.40	4.70
Central search (percentage of queue times less than 5 minutes)*	0.36	97.00	99.00
Timely delivery from departures baggage system	0.36	To be updated	To be updated

\* Bonuses are conditional on HAL also meeting the targets for helpfulness/attitude of security staff.

- 3.21 Ahead of the Final Proposals, we are open to considering specific evidence from HAL and the airlines on any adjustments to our proposed bonuses. Any evidence provided should explain how proposed adjustments further consumers' interests.

## Next steps

- 3.22 We invite stakeholder views on our proposed approach to calculating rebates and bonuses. Where possible, views provided should set out specific reasons and supporting evidence to justify a change from the proposals set out above and explain how such changes further consumers' interests.

## Chapter 4

# Licence changes

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## Introduction

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- 4.1 This chapter summarises the key proposed changes to HAL’s licence that will be required to implement our Initial Proposals on OBR.
- 4.2 The implementation of OBR will require a number of detailed changes to HAL’s licence, including to Condition D1 and Schedule 1 (which currently sets out the SQRB scheme). The key proposed changes fall into the following broad categories which are set out in the section below:
- terminology;
  - structural; and
  - substantive.
- 4.3 This chapter also summarises proposed changes to condition D1.9 and to the dispute resolution mechanism for service quality alleviations for exclusion ‘o’ currently in paragraph 2.28 of Schedule 1 of HAL’s licence.
- 4.4 Further detail on the changes described in this chapter are set out in CAP2275. This includes a “clean” version of Schedule 1 to HAL’s licence which is accompanied by an explanatory table to help stakeholders understand in more detail the key proposed changes summarised below.

## Initial Proposals – summary of key licence changes

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- 4.5 The key proposed licence changes likely to be needed to implement OBR include the following:

### *Terminology*

- 4.6 Changes that update, clarify or remove existing terminology, definitions and provisions to reflect the proposed OBR framework. Among other changes, we propose to refer to the new arrangements as the service quality “measures, targets and incentives” (MTI) scheme, which replaces the “SQRB” scheme. We have also included some drafting changes to provide more clarity.

### *Structural*

- 4.7 Changes that re-order and streamline Schedule 1 to improve signposting and make the MTI scheme more transparent. Among other things, we propose to:
- consolidate the existing tables in Schedule 1 which are currently set out for each terminal to reduce duplication and make it easier for stakeholders to understand how rebates for individual measures compare across terminals; and

- move some existing provisions into separate Annexes to Schedule 1 to improve signposting. These include the Quality of Service Monitor survey (“QSM”) and other survey questions for relevant measures, exclusions for availability measures and details of the renamed runway operational resilience measure.

### *Substantive*

4.8 Changes that reflect our proposed OBR framework as set out in the October 2021 Initial Proposals and this working paper including:

- measures: the removal and merging of existing measures and adding of new proposed measures with financial and reputational incentives;
- metrics: updating existing metrics and adding metrics for new proposed measures, which are grouped into the following categories: survey-based, queuing times, availability-based and other metrics;
- targets: reflecting the proposed targets set out in Table 2.1 above;
- rebates: reflecting the proposed rebates set out in Table 3.1 above;
- bonuses: reflecting the proposed bonuses as set out above in Table 3.2 as well as our proposal set out in paragraph 3.17 above that HAL should only be able to earn bonuses for central search performance if in the same month it also meets the targets for helpfulness/attitude of security staff; and
- publication requirements: updating the requirement for HAL to publish its performance for relevant measures in each terminal at the airport (currently set out in paragraph 5.1 of Schedule 1). The changes we propose include removing existing measures which will no longer apply under OBR and adding those new measures that are most directly relevant to consumers.

4.9 We also propose the following changes:

#### *Condition D1.9*

4.10 We noted in the October 2021 Initial Proposals that we may propose a change to the scope of condition D1.9 to allow stakeholders to agree, as part of continuous improvement, wider changes to the OBR framework than are currently allowed.

4.11 We propose the following changes:

- to remove the current restriction on modifying elements (now called measures) under condition D1.9(a); and
- to remove the current restriction on modifying the table of bonuses in Schedule 1.

4.12 See CAP2275 for further information.

#### *Dispute resolution mechanism for service quality alleviations (exclusion ‘o’)*

4.13 The covid-19 pandemic highlighted some weaknesses in the current dispute resolution mechanism within the Service Quality Protocol required under Condition F1 of the licence. This protocol specifies that parties can escalate a dispute to the CAA but gives no powers to the CAA to make a determination. For

example, service quality alleviations for availability-based measures due to major operational disruption under paragraph 2.28(o) of Schedule 1 (“exclusion (o)”) must be agreed by the Airline Operators Committee (AOC). The CAA has no dispute resolution role within the licence and there are no provisions in the protocol that require the parties to abide by any CAA determination or decision.

- 4.14 We consider it is important that there are clear and robust dispute resolution mechanisms that are well understood by stakeholders. We propose an additional provision in Schedule 1 relating to exclusion (o) that allows the CAA to make a binding decision where agreement cannot be reached between HAL and the airline community on the application of this specific exclusion. See CAP2275 for further information.

## Next steps

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- 4.15 We welcome views on the proposed changes to HAL’s licence to implement OBR as summarised in this chapter and set out in CAP2275.