

Economic regulation of Heathrow Airport: Final Decision Appendices A – B

CAP2524E1

Published by the Civil Aviation Authority, 2023

Civil Aviation Authority
Aviation House
Beehive Ring Road
Crawley
West Sussex
RH6 0YR

You can copy and use this text but please ensure you always use the most up to date version and use it in context so as not to be misleading, and credit the CAA.

First published March 2023
Second edition

Enquiries regarding the content of this publication should be addressed to: economicregulation@caa.co.uk

The latest version of this document is available in electronic format at: www.caa.co.uk

Contents

| | |
|-------------------|----------|
| Appendix A | 4 |
| Our duties | 4 |
| Appendix B | 6 |
| Glossary | 6 |

APPENDIX A

Our duties

- A1 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.
- A2 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.
- A3 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”.
- A4 The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.
- A5 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.
- A6 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.

- A7 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

Glossary

B1 The terms used in this document are arranged in the following groups:

- legislation and regulatory processes;
- price controls;
- stakeholders;
- CAA documents – in chronological order;
- stakeholder documents;
- financial;
- capex-related; and
- recurring terms.

Legislation and regulatory processes

| Acronym / term | Description |
|------------------------------|---|
| ACR2011 | The Airport Charges Regulations 2011 (S.I. 2491/2011) |
| AOS | Airport Operation Services, defined in section 68 CAA12. |
| Better Regulation Principles | The principles to which the CAA must have regard under section 1(3)(g) CAA12 and set out in subsection 1(4) CAA12 |
| CAA12 | The Civil Aviation Act 2012 |
| CE | Constructive Engagement: a CAA-mandated process that requires the airport operator to discuss its business plan with the airlines before the CAA develops its proposals for the relevant price control. For H7, CE took place between August 2020 and October 2020. |
| CMA | The Competition and Markets Authority |
| CMA Provisional Findings | CMA provisional findings report in relation to the NERL RP3 regulatory appeal. |
| Companies Act 2006 | The Companies Act 2006 |
| Consumers | “Users” are defined in section 69 CAA12 as passengers and those with “a right in property” (cargo) carried by air transport services and include future users. |
| DCO | Development Consent Order under the Planning Act 2008. |

| Acronym / term | Description |
|----------------|---|
| The Licence | The licence granted to Heathrow Airport Limited by the Civil Aviation Authority under section 15 CAA12 on 13 February 2014. |
| NPS | The Airports National Policy Statement published on 5 June 2018 produced by the Government under the Planning Act 2008 |
| S factor | The security factor in the price control formula that allows a partial pass-through of costs resulting from changes to security standards |

Price controls

| Acronym / term | Description |
|-----------------------|--|
| Q5 | Q5 was the price control for the period from 2008 to 2013, the approach to which was subsequently extended to cover January to March 2014. |
| Q6 / Q6 price control | Q6 was the price control for the period from 2014 to 2018, the approach to which was successively extended to cover 2019 and 2020 to 2021. |
| H7 | The price control period for Heathrow from 1 January 2022 until 31 December 2026. |
| iH7 | The interim H7 price control, running from 1 January 2020 until 31 December 2021. |
| H8 | The price control for Heathrow following H7. |
| PR19 | The five-year price control settlement for water companies in England and Wales for 2020-2024. Ofwat's decision published in December 2019 can be found at: www.ofwat.gov.uk/wp-content/uploads/2019/12/PR19-final-determinations-Overview-of-final-determinations.pdf |
| RP3 | The NATS En Route plc (NERL) Reference Period 3 price control that was originally expected to run from 1 January 2020 to 31 December 2024. |
| RIO2 | Ofgem RIO2 price control, for details please see Network price controls 2021-2028 (RIO-2) Ofgem |

Stakeholders

| Acronym / term | Description |
|----------------|--|
| AOC/LACC | Airline Operators' Committee (for Heathrow) / London (Heathrow) Airline Consultative Committee, set up by IATA to implement a collaborative consultation framework for Heathrow airport. |
| BA/IAG | British Airways plc/International Airlines Group (owner of British Airways) |

| | |
|--------------------|---|
| BA | British Airways |
| CAA (“us”/“we”) | The Civil Aviation Authority |
| CAA Consumer Panel | A non-statutory body established to act as a “critical friend” to the CAA. It provides expert advice to make sure that the consumer interest remains central to CAA policy development |
| CCB | Consumer Challenge Board. The H7 Consumer Challenge Board was established by the CAA in partnership with HAL and the airlines that currently use Heathrow to strengthen the link between consumer outcomes and priorities and the regulation of Heathrow. |
| HAL | Heathrow Airport Limited, the licence holder and operator of Heathrow airport. |
| IATA | International Air Transport Association, a global trade association representing airlines. |
| LACC | London (Heathrow) Airline Consultative Committee, set up by IATA to implement a collaborative consultation framework for Heathrow airport. |
| NERL | NATS En Route plc. |
| VAA | Virgin Atlantic Airways. |

CAA documents – in chronological order

| Acronym / term | Description |
|---------------------------------------|---|
| The Grant of HAL’s Licence | CAP1151 “The granting of the licence for the economic regulation of Heathrow Airport, including price control of airport charges, from April 2014”. See www.caa.co.uk/CAP1151 . |
| The December 2016 Consultation | CAP1476 “Future of service quality regulation for Heathrow Airport Limited: Consultation on the design principles for a more outcome-based regime”. See: www.caa.co.uk/cap1476 . |
| The Planning Costs Recovery Statement | CAP1513 “The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy Statement”. See www.caa.co.uk/CAP1513 . |
| The April 2017 Guidance | CAP1549 “Guidance for Heathrow Airport Limited in preparing its business plans for the H7 price control”. See: www.caa.co.uk/CAP1540 |
| The April 2018 Consultation | CAP1658 “Economic regulation of capacity expansion at Heathrow: policy update and consultation”. See: www.caa.co.uk/CAP1658 |
| The July 2019 Consultation | CAP1819 “Economic regulation of capacity expansion at Heathrow: consultation on early costs and regulatory timetable” See: www.caa.co.uk/CAP1819 |

| Acronym / term | Description |
|--|--|
| The Updated Business Plan Guidance | Guidance included as an Appendix in CAA publication CAP1819 “Economic regulation of capacity expansion at Heathrow: consultation on early costs and regulatory timetable”. See: www.caa.co.uk/CAP1819 |
| The August 2019 Working Paper | CAP1832 “Economic regulation of Heathrow Airport Limited: working paper on financial resilience and ring fencing”. See: www.caa.co.uk/CAP1832 |
| The December 2019 Consultation | CAP1871 “Economic regulation of Heathrow Airport Limited: policy update and consultation on early costs of capacity expansion”. See: www.caa.co.uk/CAP1871 |
| The January 2020 Consultation | CAP1876 “Economic regulation of Heathrow Airport Limited: further consultation on regulatory framework and financial issues”. See: www.caa.co.uk/CAP1876 |
| The April 2020 Update | CAP1914 “Economic regulation of Heathrow: programme update”. See: www.caa.co.uk/CAP1914 |
| The June 2020 Consultation | CAP1940 “Economic regulation of Heathrow: policy update and consultation”. See: www.caa.co.uk/CAP1940 |
| The June 2020 Business Plan Guidance | Guidance included as an Appendix in CAA publication CAP1940 “Economic regulation of Heathrow: policy update and consultation”. See: www.caa.co.uk/CAP1940 |
| The August 2020 Working Paper | CAP1951 “Economic regulation of Heathrow Airport Limited: working paper on capital expenditure efficiency incentives”. See: www.caa.co.uk/CAP1951 |
| The September 2020 Working Paper | CAP1964 “Economic regulation of Heathrow: working paper on the efficiency of HAL’s capital expenditure during Q6, September 2020”. See: www.caa.co.uk/CAP1964 |
| The October 2020 Consultation | CAP1966 “Economic regulation of Heathrow Airport Limited: response to its request for a covid-19 related RAB adjustment”. See: www.caa.co.uk/CAP1966 |
| The February 2021 Consultation | CAP2098 “Economic regulation of Heathrow Airport Limited: response to its request for a covid-19 related RAB adjustment”. See: www.caa.co.uk/CAP2098 |
| The April 2021 Way Forward Document | CAP2139 “Economic regulation of Heathrow Airport Limited: Consultation on the Way Forward”. See: www.caa.co.uk/CAP2139 |
| The April 2021 RAB Adjustment Decision | CAP2140 “Economic regulation of Heathrow Airport Limited: response to its request for a covid-19 related RAB adjustment”. See: www.caa.co.uk/CAP2140 |

| Acronym / term | Description |
|---|---|
| The April 2021 Working Paper | CAP1996 “Economic regulation of Heathrow Airport Limited: working paper on Q6 capital expenditure and early expansion costs”. See: www.caa.co.uk/CAP1996 |
| Initial Proposals | CAP2265 “Economic regulation of Heathrow Airport Limited: H7 Initial Proposals” October 2021. See: consultations.caa.co.uk/economic-regulation/h7-initial-proposals-october-2021/ |
| OBR Working Paper | CAP2274 “Economic regulation of Heathrow Airport Limited: H7 Initial Proposals - Working paper on outcome based regulation” November 2021. See: www.caa.co.uk/CAP2274 |
| Draft Licence Consultation | CAP2275 “Economic regulation of Heathrow Airport Limited: H7 Initial Proposals – draft licence modifications” November 2021. See: www.caa.co.uk/CAP2275 |
| Final Proposals | This document: CAP2365 “Economic regulation of Heathrow Airport Limited: H7 Final Proposals” June 2022. See www.caa.co.uk/CAP2365 |
| Interim Price Cap Consultation for 2023 | CAP2488 “Economic regulation of Heathrow Airport Limited: setting an interim price cap for 2023” December 2022. See: www.caa.co.uk/CAP2488 |

Stakeholder documents

| Acronym / term | Description |
|--------------------------|--|
| ABP | Airlines’ publication, “Alternative Business Plan” submitted to the CAA in February 2021. |
| BBU | HAL’s publication, “Building blocks update with a revised financial forecast submitted to the CAA in July 2020” |
| IBP | HAL’s publication, Initial Business Plan submitted to the CAA in December 2019 in response to the Updated Business Plan Guidance, www.heathrow.com/company/about-heathrow/economic-regulation/h7-update |
| RBP | HAL’s publication, Revised Business Plan submitted to the CAA in December 2020. |
| RBP update / Updated RBP | HAL’s publication, Revised Business Plan updated to take the 2021 situation into account and submitted to the CAA in July 2021. |
| RBP Update 2 | HAL’s publication, Updated Revised Business Plan submitted to the CAA in December 2021. |

Financial

| Acronym / term | Description |
|------------------------------|--|
| CAP1940C | Flint Report on WACC/Cost of Capital April 2020 |
| CAPM | Capital Asset Pricing Model |
| CPI | Consumer Price Index |
| CPI-H | The Consumer Prices Index including owner-occupied housing costs |
| EBIT | Earnings before interest and taxes |
| EBITDA | Earnings before interest, taxes, depreciation and amortisation |
| Equity beta | Company specific estimate of risk relative to the whole market |
| FFO | Funds From Operations |
| FTSE100 | Financial Times Stock Exchange 100 Index |
| iBoxx indices | The Markit iBoxx Corporates Indices represent investment grade fixed-income bonds issued by public or private corporations and are produced by IHS Markit. We have made reference to iBoxx indices to estimate HAL's cost of debt allowance for H7 |
| IMF | International Monetary Fund |
| ILG | Index-linked Gilt |
| IRR | Internal Rate of Return |
| Financing Platform | Arrangements for the issue of bonds under HAL's WBS. Details of the arrangements can be found at: www.heathrow.com/company/investor-centre/offering_related-documents |
| LCC | Low-cost carriers |
| Notional financial structure | Financial structure of the notional company that reflects our views on the efficient balance between debt and equity finance. |
| NPV | Net Present Value |
| OBR | Office for Budget Responsibility |
| OLS | Ordinary least squares |
| P0 | The price per passenger at the beginning of a price control |
| PMICR | Post Maintenance Interest Cover Ratio |
| RORE | Return On Regulatory Equity |
| RPI | Retail Price Index |

| | |
|---------------|---|
| TMR | Total Market Return |
| WACC | Weighted Average Cost of Capital |
| WBS | Whole Business Securitisation |
| Winsorization | A method of replacing the extreme outliers in the data set to limit the effect of the outliers. |

Capex-related

| Acronym / term | Description |
|--------------------------------|---|
| Capex | Capital Expenditure |
| Capex baseline | The forecast of development and core expenditure |
| Capex category | Capex categories include projects that have common outputs / objectives and similar levels of risk and controllability |
| Capital Efficiency Handbook | HAL publication which includes details of the capex governance framework and associated processes. |
| Category A costs | Costs which were incurred by HAL during the Airports Commission process, or before Heathrow was named as the preferred location for new runway capacity on 25 October 2016. For more information please see Appendix C to the July 2019 Consultation |
| Category B costs | Costs associated solely with seeking planning permission for the delivery of new runway capacity at Heathrow. For more information please see Appendix C to the July 2019 Consultation |
| Category C costs | Costs incurred by HAL in connection with implementation and construction of new capacity, up to entry-into operation. For more information please see Appendix C to the July 2019 Consultation |
| Core and development framework | The core and development framework describes the transition of capex from development capex to core capex. Core capex is capex that has been through Gateway 3 (investment decision stage) of capex governance, in line with the approach for the Q6 price control. Development capex is capex at an earlier stage of development |
| DIWE | Demonstrably inefficient and wasteful expenditure |
| Early costs | Expansion-related costs that are incurred by HAL prior to obtaining planning consent |
| <i>Ex ante</i> framework | An <i>ex ante</i> framework where HAL's performance is measured against cost baselines agreed in advance of delivery. |
| <i>Ex post</i> review | A backward looking review using actual figures rather than forecasts. |

| Acronym / term | Description |
|------------------------|---|
| Gateway 3 (G3) | Capex projects follow an eight phase “Gateway” process which aligns with each project’s level of maturity. Project business cases are reviewed at key points (Gateways) throughout their life. Gateway 3 is an investment decision stage of capex governance arrangements, in line with the approach for the Q6 price control. |
| IFS | The Independent Fund Surveyor for Heathrow, which is jointly appointed by HAL and the airlines, with a duty of care to the CAA. The scope of the IFS role is broadly to assure that capital funds are invested efficiently to meet agreed project objectives |
| IPCR | Independent Planning Costs Reviewer appointed by the CAA under the Planning Costs Recovery Policy Statement. |
| IPHS | Interim Property Hardship Scheme |
| Thames Tideway Project | A 25km sewer being built under London. www.tideway.london/ |
| Wind down costs | The costs of pausing and demobilising the expansion programme since March 2020 |

Recurring terms

| Acronym / term | Description |
|-------------------------|--|
| Building blocks | Price control building blocks, including passenger numbers, operating costs, capital expenditure and commercial revenues |
| CdG | Charles de Gaulle Airport |
| Commercial revenues | Revenues HAL derives from services to passengers, such as retail, food and beverage, <i>bureaux de change</i> , advertising and car parking, or from services to airlines, such as office rental, airline lounges and warehousing, discussed in detail in chapter 5 (Commercial revenues). |
| Expansion | HAL’s programme to expand Heathrow airport by the construction of a new northwest runway and associated infrastructure in accordance with the Airports National Policy Statement (see “NPS”). |
| HBS | Hold Baggage Screening |
| Lower Quartile scenario | This scenario uses the lower quartile of the input range used in financial modelling. One end of the input range is HAL’s updated RBP projections scaled to CAA passenger forecasts. The other end of the input range is CEPA/Taylor Airey’s mid case. |

| Acronym / term | Description |
|-------------------------|--|
| mppa | Million passengers per annum |
| OBR | Outcome Based Regulation, the proposed service quality regulation regime for H7, discussed detail in chapter 3 (Outcome Based Regulation). |
| Opex | Operational Expenditure, discussed detail in chapter 4 (Operating expenditure). |
| ORCs | Other Regulated Charges, which are for specified services and facilities that are collected separately from the general regulated airport charges and are, in general, levied on a “user-pays” basis), discussed in detail in chapter 8 (Other regulated charges). |
| Price Control Model | The financial model developed by the CAA to calculate HAL’s revenue requirements for H7. |
| RAB | Regulatory Asset Base |
| Revenue risk sharing | A mechanism that allows Heathrow to share the impact to aeronautical and non-aeronautical revenues due to the difference between outturn and forecast passenger traffic |
| RNS | The London Stock Exchange Regulatory News Service |
| Shock factor | A downward adjustment to volume forecasts to address the asymmetry of risks, see chapter 11 (Allowance for asymmetric risk). |
| SQRB | Service Quality Rebates and Bonuses, the service quality regulation regime for Q6. |
| TRS | Traffic Risk Sharing, discussed in detail in chapter 2 (Regulatory framework). |
| TTS | Track Transit System |
| Upper Quartile scenario | This scenario uses the upper quartile of the input range used in financial modelling. One end of the input range is HAL’s updated RBP projections scaled to CAA passenger forecasts. The other end of the input range is CEPA/Taylor Airey’s mid case. |