

Guidance on capital expenditure governance

CAP 2605

Published by the Civil Aviation Authority, 2023

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First published 2023
Second edition

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About this document

Our Final Decision on the price review (“H7”) of Heathrow Airport Limited (“HAL”), published on 8 March 2023, set out a new framework for the incentives that are intended to drive efficiencies in how HAL plans and delivers capital expenditure (“capex”). Alongside the Final Decision, we published a consultation on “Draft guidance on capital expenditure governance”.

We explained in that consultation that we considered there were opportunities to improve the existing arrangements through which HAL engages with stakeholders, notably airlines, as part of the process of managing capex projects. The consultation document set out our proposals for enhancing the existing capex governance arrangements to improve the quality of engagement that takes place and enable the effective implementation of our Final Decision on capex incentives.

HAL applied and was granted permission to appeal against the Final Decision on several grounds, including one relating to the new framework for capex incentives. HAL did not make a formal request to the CMA to suspend the licence modifications that were designed to implement the new H7 arrangements and capex incentives while the appeal was ongoing.

On 17 October 2023, the Competition and Markets Authority (“CMA”) issued its final determination in the H7 licence modification appeals. The CMA upheld the CAA’s approach in relation to the new framework for capex incentives.

We received three responses to the March 2023 Consultation on capital expenditure guidance. This document sets out the CAA’s updated guidance on capital expenditure governance for the H7 period.

Chapter 1

Introduction

Background

- 1.1 It is important that HAL undertakes capex in an economical and efficient manner. This helps to ensure it is able to operate, maintain and develop airport services so that the reasonable demands of users of air transport services are met and that costs are kept down.
- 1.2 We aim to incentivise capex efficiency both through the way we design and set price controls and through wider licence obligations on HAL. As part of this approach, HAL is required by its licence to comply with certain conditions that relate to how it develops and delivers capex.¹ These include a requirement for HAL to carry out appropriate consultation with users, airlines, and other relevant stakeholders, and obtain airline approval for projects passing through project gateway “G3”.²
- 1.3 As part of its licence obligations, HAL is required to consult on, use reasonable endeavours to agree and publish a protocol setting out how it will satisfy its obligation to consult on capex investment. This protocol must reflect any elements set out in relevant guidance from the CAA, which we must first consult upon. At present, HAL issues the documentation that aligns with this requirement through the procedures in the Capital Efficiency Handbook, which airline stakeholders can access by means of a SharePoint site.
- 1.4 In the H7 Final Decision, issued in March 2023, we decided to introduce a new framework of forward looking (or *ex ante*) capex incentives through which the efficiency of HAL’s capital investment will be assessed by comparing out-turn costs of an individual project against that project’s previously agreed cost baseline.
- 1.5 At the time of issuing the H7 Final Decision, we identified areas where there appeared to be scope to further enhance the existing governance arrangements for capex, and we consulted on draft guidance for capital expenditure governance (the “March 2023 Consultation”).³ This consultation also covered

¹ See, in particular, Condition B.3 (Promoting economy and efficiency) and Part F (Consultation conditions).

² The governance process around capital expenditure requires a project to proceed through a number of gateways as it is developed and delivered. Gateway 3 (“G3”) is the point in the process where the requirement, scope and budget is agreed jointly by HAL and airlines. This is the Gateway through which a project progresses from ‘Development’ to ‘Core’.

³ CAP2524G “Draft guidance on capital expenditure governance”, www.caa.co.uk/CAP2524G

guidance to ensure that the governance arrangements are appropriately developed to take account of the development of *ex ante* capital efficiency incentives.

- 1.6 In the March 2023 Consultation, we explained that we were mindful of the need to minimise any additional cost and undue time delay to the delivery of projects that our framework of *ex ante* incentives might otherwise cause. The development of this guidance was, therefore, also intended to ensure that the resources and time of both HAL and airlines are focussed on those aspects of expenditure where airline scrutiny is likely to be most valuable.
- 1.7 The deadline for responses to the March 2023 Consultation was 28 April 2023, and we received responses from three parties: HAL, British Airways and the AOC/LACC (“the Airline Community”).

H7 appeal

- 1.8 On 17 April 2023, ahead of submitting its response to the capex governance consultation, HAL applied for permission to appeal against the H7 Final Decision on a number of different grounds, including the introduction of the H7 *ex ante* capex incentives framework. On 11 May 2023, the CMA granted permission to appeal to all appellants, on all grounds appealed. We note that HAL did not apply to the CMA to suspend the H7 licence modifications relating to the capex incentives framework while the appeal was ongoing. As a result, those obligations have had effect since 1 May 2023.
- 1.9 The CMA issued its provisional determination in the appeal on 8 September 2023. On 17 October 2023, the CMA issued its final determinations on the appeals and published them on 18 October 2023. In the CMA’s final determinations, the CMA concluded that the CAA had not been wrong to introduce capex incentives for H7 in the manner set out in the H7 Final Decision and implemented through HAL’s licence.

Next steps

- 1.10 With the conclusion of the H7 appeals in October 2023, we are now formally issuing the guidance we consulted on earlier this year. This guidance reflects feedback received from stakeholders in response to the March 2023 Consultation, further work undertaken by HAL and airlines on a bilateral basis since the publication of that consultation, as well as any issues arising out of the H7 appeals, where we considered that there was scope for the CAA to provide more clarity or guidance in relation to the capex governance arrangements, in order to facilitate the effective implementation of the *ex ante* capex incentives framework for H7.
- 1.11 While this guidance is primarily directed towards HAL, we recognise that the effective planning and delivery of capex also requires engagement from airlines:

as well-informed users of the airport's infrastructure and services they can help to promote efficient and timely investment in the interests of consumers. In fulfilling this role, it is important that airlines' requirement for information is proportionate and directly relevant to the development of the capex project being discussed, or the wider programme of which that capex project is a part.

- 1.12 We note that as HAL and airlines start to work together to bring forward projects under the new *ex ante* capex incentives framework, additional questions and issues might arise, where one or both parties might consider further guidance from the CAA would be useful. We intend to continue working with HAL and airlines and provide any additional guidance (including by updating this guidance document as appropriate) and support when specific issues are raised with us.

This document

- 1.13 This document sets out guidance for HAL on capital expenditure governance for the purposes of Condition F1.4 of HAL's licence.
- 1.14 Chapter 2 provides a summary of the draft guidance we set out in the March 2023 Consultation, and the stakeholder feedback we received on it. It also summarises any further developments on capital governance matters since we issued the March 2023 Consultation, including further work undertaken by HAL and airlines, and any issues coming out of the H7 appeals, which we consider are relevant for this guidance. Finally, chapter 2 sets out our views on the feedback received in response to the March 2023 Consultation, and how we have taken this feedback into account in the updated guidance.
- 1.15 The full text of the guidance for the purposes of Condition F1.4 of HAL's licence is set out in Appendix A. We have set out updated guidance in each of the areas covered by the draft guidance, namely:
- a) standard information provision;
 - b) assessment of information;
 - c) delivery obligations; and
 - d) accessible information on projects and performance.

Chapter 3 sets out our updated view of the role of the CAA in the H7 capex governance process, including in relation to disputes and the timescales for the implementation of the H7 *ex ante* framework.

CHAPTER 2

Development of guidance on capital expenditure governance

- 2.1 During Q6 and iH7,⁴ HAL had in place a governance framework to support its delivery of capex projects. For the most part, this framework appears to have been a reasonably effective means of engaging with airlines in the development of a capex project and securing their agreement before commencing delivery.
- 2.2 Nonetheless, we identified a number of potentially important ways to enhance these processes. We also identified areas where, due to the introduction of the *ex ante* capex incentives framework for H7, we needed to provide further guidance on capex governance arrangements.
- 2.3 In the March 2023 Consultation, we set out guidance in several different areas relating to capex governance, which is summarised in this chapter.
- 2.4 We received three responses to the consultation, from HAL, British Airways and the Airline Community, and we summarise below the feedback received from each party, in relation to each area of our draft guidance. We have also summarised any subsequent developments, for example processes and templates, that HAL and airlines have since agreed on a bilateral basis, and any issues coming out of the H7 appeals which we consider are relevant for this guidance.
- 2.5 Finally, this chapter sets out our views on the feedback received in response to the March 2023 Consultation, and how we have taken this feedback into account in the updated guidance.
- 2.6 The full text of the guidance for the purposes of Condition F1.4 of HAL's licence is set out in Appendix A. We have set out updated guidance in each of the areas covered by the draft guidance, namely:
- a) standard information provision;
 - b) assessment of information;
 - c) delivery obligations; and
 - d) accessible information on projects and performance.

⁴ Q6 is the price control for the period from 2014 to 2018, the approach to which has subsequently been successively extended to cover 2019-2021. iH7 refers to the Heathrow Interim H7 price control, running from 1 January 2020 until 31 December 2021.

Standard information provision

Summary of the draft guidance

- 2.7 In the March 2023 Consultation, we acknowledged that, during Q6/iH7, HAL appeared to have provided airlines with the information that allowed them to approve spend and outputs associated with most projects. However, we were aware of airline concerns that, for certain projects, they did not receive what they considered to be essential information at the most appropriate time. We also noted HAL's concerns that, on occasion, airlines can request additional information which HAL did not consider relevant to that stage of the governance process, resulting in additional time and resource being diverted to provide the material requested.
- 2.8 We proposed, therefore, that the information airlines receive at various stages of project development (that is, the project "gateways") should be standardised. This should provide HAL and airlines with a baseline expectation on what common information will be made available to support decision making.
- 2.9 We included an appendix to the consultation setting out the type of standard questions we would expect HAL to address for each project, based on a similar set of common requirements that were initially identified by airlines. We noted that, in response to the airlines' proposal, HAL had proposed a structure to the provision of information, highlighting the project gateway at which the requested information would be provided.
- 2.10 We sought feedback from stakeholders on the proposed set of standard questions, and the project gateways at which HAL should provide answers to the questions.

Stakeholders' views

- 2.11 HAL agreed with the CAA's proposal to establish a common standard of information required across the appropriate gateway stages. It said that the list of standard questions proposed by the CAA provided a useful reference point in the discussions between Heathrow and the airlines, but that ongoing collaboration between Heathrow and airlines was focused on developing a more targeted set of standard questions, along with the gateway at which each question should be answered and indicative answer templates. HAL said that these discussions were ongoing, and that the list of standard questions would not be finalised by the time the consultation closed.
- 2.12 It also noted that while having a standardised list of questions is a step in the right direction, this would not address what HAL perceived to be a lack of clarity from the CAA on when a question has been sufficiently answered. HAL said that this was one of the main points of contention between itself and the airlines.

- 2.13 HAL suggested that where airlines do not consider that HAL has answered a question sufficiently, the appropriate next step would be for airlines to use the escalation process in place, as set out in the Enhanced Engagement & Governance Protocol⁵ before the issue is brought to the CAA. As part of any escalation process, HAL considered that airlines should clearly outline why the information already shared by HAL did not enable them to make an informed decision.
- 2.14 HAL recognised that there may be situations in which it needs to address information requests falling outside the pre-agreed set of questions, but that these situations should be exceptions, rather than apply to every investment decision.
- 2.15 British Airways and the Airline Community also agreed with the CAA's proposal to have a standard set of questions to be answered by HAL, for each project, as part of the capex governance process. They also highlighted that airlines had been working with HAL to develop this set of standard questions and proposed that this exercise should be allowed to continue in parallel with the CAA's work on producing final guidance, with the conclusion being submitted to the CAA as a joint response.
- 2.16 British Airways and the Airline Community both highlighted that they did not see the standard list of questions as exhaustive, but more as a minimum expectation from HAL, to facilitate approval of project budgets. As such, British Airways and the Airline Community argued that their inclusion in the future protocol should not restrict HAL from providing broader information where the airlines request it.

Further developments

- 2.17 Since we published the March 2023 Consultation, HAL and airlines have been working together to develop a bilaterally agreed list of standard questions, along with a mapping of these questions to the different project gateway stages (and specifically Gateways 2 and 3).
- 2.18 We have noted that the standard list of questions has been incorporated into a template which will be used as part of the governance process, on a trial basis. This has been uploaded onto the Development Information Portal used by HAL and airlines to share information as part of the capex governance process.

⁵ This is a document which sets out the arrangements for HAL and the airline community approach to developing plans and capital investment and all associated engagement and governance across control periods. This is in the process of being updated by HAL and airlines to reflect the H7 framework.

Our views

- 2.19 We note that since we issued the March 2023 Consultation, HAL and airlines have undertaken further work and have developed a version of the governance template which includes standard questions to be answered for each project.⁶
- 2.20 We note HAL's comments on the level of detail requested by airlines for certain projects. We agree with HAL's overarching comment that follow-on questions should be proportionate and targeted at enabling airlines to make an informed decision about the G3 approval. However, we have not to date seen evidence of systematic issues arising in relation to additional requests for information from airlines. The number of escalations to the CAA during Q6/iH7 has been small,⁷ leading us to conclude that HAL and airlines have been able to agree on the level of information and detail to be provided for most projects in order for airlines to approve a G3 investment decision.
- 2.21 Furthermore, we note that in Q6/iH7, there were no lists of standard questions in place. The introduction of a standard list of questions should itself reduce the number of instances where there is disagreement about the level of information provided for a specific project.
- 2.22 Therefore, we do not consider that it is necessary or proportionate for the CAA to provide specific guidance on when a question has been sufficiently answered, particularly as this will vary on a project-by-project basis.
- 2.23 However, we are open to revisiting this issue and providing more guidance on standard information provision, particularly if we note a high number of disputes being brought to the CAA, following the appropriate escalation process, during the remainder of the H7 period.
- 2.24 For the reasons set out above, we are of the view that the draft guidance we consulted on in March 2023 remains appropriate. We have set out the text of the guidance in full in Appendix A.

Assessment of information

- 2.25 We explained in the March 2023 Consultation that, while the provision of high quality and meaningful information is essential for effective capex governance, for much of the key information relating to each project, airlines have sufficient experience and insight to appraise the material issued by HAL. However, we

⁶ We understand that this template is still in development and has not yet been formally agreed.

⁷ As noted in HAL's Notice of Appeal, there have been only two formal escalations to the CAA in relation to capital expenditure (both by HAL), none of which occurred during the original regulatory period from 2014 to 2018 (one was in January 2019 and one in December 2022). See HAL Notice of Appeal, paragraph 311.2: https://assets.publishing.service.gov.uk/media/652fbfff92895c000ddcb970/Non_Confidential_HAL_Notice_of_Appeal.pdf

considered that there would be benefit from supplementing these arrangements by providing airlines with additional support in relation to:

- the assessment of common standards and processes; and
- more detailed reviews for certain projects (to be identified by HAL and airlines, subject to certain criteria).

2.26 We cover each of these two areas below, summarising the guidance we consulted on, stakeholder feedback and any further developments since, and our views.

Review of common standards and processes: summary of the draft guidance

2.27 In relation to common standards and processes, we considered that there would be benefit in an independent review of the standards and processes that HAL commonly applies across projects or projects within a programme, to give all parties the confidence that these are appropriate and up to date. In addition, we said that HAL should clearly document the standards and processes it has in place for its capex activities, when these were put in place and/or last reviewed and the sort of projects where it expects these standards and processes to apply.

2.28 We explained that this review (or reviews) should consider the extent to which HAL's process and standards reflect best practice elsewhere in the construction industry, or other relevant comparators. The review could either conclude that HAL's processes and standards are appropriate or identify where these should be updated or enhanced in keeping with best practice.

2.29 Where the review has been completed and concluded that HAL's approach is appropriate, further airline scrutiny of these standards/processes should not be required on individual projects as part of the process of securing airline agreement.

2.30 We highlighted that the approach taken to this review should not unnecessarily delay the progression of projects through to construction in H7.

2.31 We said that it would be important that the organisation undertaking the assessment can provide a fully independent view with reference to wider best practice, and the preferred provider should be agreed on between HAL and airlines. We also said that we expected that the review should be funded through HAL's capex allowance.

2.32 We sought feedback from stakeholders on the proposal to require an independent assessment of the standards and processes that HAL commonly applied to capex projects.

Stakeholders' views

- 2.33 HAL said that its standards and processes are regularly reviewed to ensure they remain current and consistently reflect industry best practice. It quoted the CAA-commissioned Arcadis review of Q6 projects and the regular reviews undertaken by the Independent Funds Surveyor (“IFS”)⁸ as evidence that HAL’s capex is efficient. HAL said that it considered the review proposed by the CAA will have limited, if any, added benefit on the assurance on standards and processes already conducted by Heathrow and external reviewers.
- 2.34 British Airways and the Airline Community supported the independent review of HAL’s standards and processes and agreed that the review should be proportionate. British Airways suggested a list of priority areas for the review such as “Leadership & Logistics”, “Risk Management”, “Procurement” and “Design Standards”. The Airline Community suggested that a review of processes should be undertaken early in the H7 period and should include reviewing the appropriateness of the Leadership & Logistics allocation for the H7 portfolio.
- 2.35 British Airways and the Airline Community suggested that a prioritisation discussion would need to be held with HAL to determine which standards it would be most beneficial to review first.

Our views

- 2.36 In response to the points raised by HAL about the suitability of its existing standards and processes, we note that neither the Arcadis review of Q6 capex, or the regular IFS reviews, were/are intended to review the appropriateness of the standards and processes HAL has in place. Therefore, we do not consider that the existence of those other pieces of work renders a review of standards and processes unnecessary.
- 2.37 We acknowledge HAL’s point that its standards and processes are reviewed on a regular basis and confirm that our guidance should not be read as mandating a review of all standards and processes used by HAL as part of developing capex projects and programmes.
- 2.38 Instead, we suggest that such a review should focus on standards and processes that have not been reviewed recently (for example in the last three years) or where the reviews that have been undertaken do not provide clear evidence of efficiency and appropriateness and where the standards and processes are likely to have a significant impact on project costs.

⁸ The IFS, as defined in the Q6 Capital Efficiency Handbook, provides an on-going assessment of the reasonableness of all key decisions made on key projects undertaken by HAL and, that in undertaking projects the capital is being used effectively to deliver the outcomes determined by the business case.

- 2.39 As explained in the draft guidance, we expect HAL to document the standards and processes it has in place for its capex activities, when these were put in place and/or last reviewed, and the sort of projects where it expects these standards and processes to apply.
- 2.40 This will enable HAL and airlines to work together to identify the scope and priority of the review of standards and processes.
- 2.41 For the reasons set out above, we consider that the guidance we consulted on in March 2023 remains appropriate, with a clarification around the scope of the review covering those standards and processes which have not been reviewed recently. We have set out the text of the guidance in full in Appendix A.

In-depth review for specific projects: summary of the draft guidance

- 2.42 In the March 2023 Consultation, we explained that, for projects that are more complex, or more costly, or which have a greater impact on airline operations (either during construction or post-delivery), we consider that there is likely to be benefit from a more detailed review where this provides airlines with assurance around the process followed by HAL in developing its preferred scheme.
- 2.43 We explained that, during 2022, airlines had highlighted a need for independent support in relation to specific capex projects. We agreed that the quality of existing airline scrutiny, and airlines' ability confidently to approve G3 investment decisions, would likely be enhanced by expert support, particularly for projects that may not directly relate to airline operations.
- 2.44 We also said that we would not want any additional use of consultants to be at the expense of airlines directly inputting their internal knowledge and expertise to these processes.
- 2.45 In the March 2023 Consultation, we considered whether this independent assurance / in-depth review role could be undertaken by the IFS, which is already involved in the HAL capex governance process and appears to have the necessary capability to undertake this role in combination with its existing function.
- 2.46 We explained our view that a provisional decision on which projects should be subject to a more detailed review should be made at Gateway 1 or earlier, and only revisited in the event of a material change in the project scope or cost. To support engagement with airlines on this, we set out that HAL should produce annually, and at least six months in advance of the start of the year, a list of all projects that are due to proceed through G3 in that year. This should form the basis of consultation with airlines on which should be subject to a more detailed review.

- 2.47 We said that the output from the independent in-depth review would be a report jointly issued to the airlines and HAL on the reasonableness of the approach that HAL has taken. We explained that it was not the role of the independent reviewer to “co-design” or propose a preferred and alternative solution, as ultimately HAL must be responsible and accountable for the efficiency of capex solutions and the impact they have on the functioning of the airport.
- 2.48 As for which projects should be in scope for a more detailed review, we explained that we considered a cost threshold would be too “blunt” an approach. This is because it may be essential to evaluate in depth certain projects of a lower value, but which are relatively more complex and/or likely to have a critical impact on airline operations. Equally, there could be larger value projects that are comparatively straightforward and do not warrant additional scrutiny, for instance a major lift/escalator replacement programme involving the repeated installation of the same asset.
- 2.49 We recognised concerns expressed by HAL that a more detailed assessment would involve additional time, cost and resource compared to the existing arrangements, and explained that there would need to be some restraint on the frequency with which more detailed reviews are undertaken.
- 2.50 We also asked:
- HAL and airlines to identify those projects that are due to proceed through G3 in the subsequent 12 months, and that would be a suitable for a more detailed review;
 - stakeholders to comment on whether they thought the IFS should support a more detailed review of certain projects, or whether a different approach to supporting these assessments should be developed;
 - for comments on our proposal to require HAL to publish a list of projects due to proceed through G3, at least 6 months in advance of the start of each year, and we also asked stakeholders to set out which projects that are due to proceed through G3 in the next 12 months they considered would be suitable for a more detailed review; and
 - for each project that stakeholders thought should be subject to more detailed review, we asked some specific questions around the rationale for in depth review, when this should be undertaken, and what percentage of the overall cost of the project should be allocated for this review.

Stakeholders' views

- 2.51 In response to the March 2023 Consultation, HAL said that it was working with airlines to explore the appointment of third-party independent experts (or subject matter experts) to assist with project development, reporting to both Heathrow

and the airlines. HAL explained that the first area being trialled for in-depth review was the T2 Baggage programme.

- 2.52 HAL said that it would be crucial that any independent reviews are targeted and add value and, to that end, proposed the use of a £25m⁹ cost threshold to determine project eligibility for additional reviews. HAL explained that the cost threshold was similar to the existing definition of Key Projects (subject to Triggers in Q6).
- 2.53 On the CAA's proposal for HAL and airlines to identify projects suitable for more in-depth review that are due to proceed through G3 in the subsequent 12 months, HAL said that this would be a challenge due to the dynamic nature of the capital portfolio. Specifically, HAL argued that identifying the exact projects requiring additional scrutiny up to 18 months in advance would not give Heathrow sufficient flexibility to respond to portfolio changes. HAL argued that the CAA proposal does not address scenarios where a project reaches G3 earlier than scheduled and is not part of the agreed list, or a project is delayed and does not reach G3 during the intended year.
- 2.54 HAL explained that it currently published a monthly list of upcoming capital projects which covered the planned G2 and G3 gateways until the end of calendar year 2023. This is issued to the CPB and Future Portfolio Group, two forums attended by airlines. HAL proposed to select projects for in-depth scrutiny as part of the programmatic approach adopted by Heathrow and airlines and that the selection of projects requiring additional reviews should occur within the P2 Tranche gateway¹⁰.
- 2.55 British Airways and the Airline Community agreed with the CAA's proposal for in-depth independent scrutiny for some projects, in recognition of the imbalance in technical knowledge and expertise between HAL and the airlines. They explained that the airlines had agreed with HAL to run a 12-month trial for the procurement of subject matter expertise for key projects within the portfolio, starting with T2 Baggage. British Airways explained that the basis of the trial is that the subject matter experts would be jointly appointed and managed by airlines and HAL.
- 2.56 British Airways and the Airline Community both argued that the approach of a jointly appointed independent reviewer (or subject matter expert) for capex projects does not meet the objective of the airlines having their own independent

⁹ In 2022 prices.

¹⁰ During Q6, HAL has been developing an approach to the governance of programmes known as the "programmatic approach" which incorporates and builds on the existing Heathrow Gateway Lifecycle. The P2 Tranche Gateway is a stage in the programmatic approach at which The Sponsoring Group, which governs the delivery of programmes, has been granted the authority to deliver the programme.

resources working on behalf of the airlines. British Airways considered that it is important that such experts are independent of HAL to ensure that they have freedom of operation and can provide the best-quality advice to support the airlines through the capital governance process, and asked the CAA to make a statement in the final guidance to specify that the independent consultants would be working on behalf of the airlines. The Airline Community explained that the subject matter expert should be contracted and managed by the airlines with appropriate safeguards on supplier selection and governance.

- 2.57 British Airways also explained that they did not envisage the outputs of the independent expert's work necessarily being a written report, but something more informal and delivered in parallel to the HAL engagement, such that, by the time the project reaches its investment decision (G3), the airlines would have been briefed and have sufficient knowledge to make an informed decision on the case being presented.
- 2.58 British Airways and the Airline Community said that the IFS would not necessarily be best placed to undertake the role of subject matter expert. This is because the IFS does not provide input to, or an assessment of, the proposed scope, solution, options or delivery approach, with associated cost proposal, and these are the elements that the airlines require additional support with. British Airways also explained that the skill set required will vary depending on the project to be assessed.
- 2.59 British Airways and the Airline Community also agreed that a decision on which projects would be subject to additional review should be made as early as possible in the project lifecycle and agreed that a list of projects due to proceed through G3, as proposed by the CAA, would be beneficial and provide visibility across the portfolio. British Airways explained that HAL's new programme governance framework should provide greater visibility of the expected timing of gateways as programmes pass their P2 and P2 Tranche milestones.
- 2.60 British Airways and the Airline Community also supported the CAA's proposal not to set a financial value threshold to determine whether additional independent review is necessary. They said that suitability for more in-depth review should be considered on a case-by-case basis, recognising the need to be proportionate, and to not cause unnecessary delay, but at the same time to ensure that the airlines are able to be effective in the governance process.

Further developments

- 2.61 As explained in the section above, we are aware that HAL and airlines have been working together to put in place a twelve-month trial for subject matter expert support on the T2 Baggage programme. We have seen and reviewed the scope of this trial.

2.62 We understand that HAL and airlines are also having discussions, through governance forums, about likely further support during the H7 period, and the possible budget that might be required across the portfolio. We support this work.

Our views

2.63 In terms of a financial threshold for the selection of projects for in-depth review, we have considered HAL's request for a threshold of £25 million. However, we consider that the arguments we made in the March 2023 Consultation around a "blunt" financial threshold stand. We will monitor how many projects are selected, and what kind of projects they are, to help guard against these arrangements introducing excessive burden. We remain committed to minimising the additional burden of these arrangements, and to updating this guidance as necessary.

2.64 We also continue to remain of the view that the reviewer (or reviewers) should be jointly appointed by HAL and airlines, and report to both parties, and be funded from HAL's capex allowance. We acknowledge the airlines requests for the reviewer to be appointed by them, and accountable to them. We note that nothing in this guidance prevents the airlines from appointing their own separate advisors if they consider this to be necessary for specific projects. However, for advisors appointed from the H7 capex budget, and with a clear and specific role in the capex governance process, we consider that joint accountability to HAL and airlines would be most appropriate and effective in facilitating constructive engagement.

2.65 We have also considered some of the specific points raised by HAL and airlines and consider that the approach we proposed should be updated or further clarified in some areas.

2.66 Firstly, we note the points raised mostly by airlines around the role of the IFS, and acknowledge the IFS might not be best placed to act as a subject matter expert on all projects, particularly when reviewing the approach HAL has taken to:

- articulating the need for a project;
- choosing a solution;
- capex/opex trade-offs; and
- procurement processes.

as set out in the March 2023 Consultation. Therefore, we confirm that we support the trial developed by HAL and airlines for the T2 Baggage programme and the use of consultants other than the IFS to undertake some of these in-depth reviews.

- 2.67 Secondly, in terms of the outputs from this work, we acknowledge that a report issued to HAL and airlines might not always be the most timely output, and that the subject matter experts should instead offer input and advice throughout the capex governance process. However, we stress the importance of HAL and airlines specifying a clear scope, output and approach to documenting the subject matter experts' work, to ensure transparency and accountability of these consultants.
- 2.68 We do not agree with HAL's arguments on the difficulty of producing a list of all projects that are due to proceed through G3 in each year annually, and at least six months in advance of the start of the year. Producing this list is a requirement of this guidance. We consider that the timeframe we have specified is sufficiently short to allow HAL to have a good (if not perfect) view of what projects are likely to progress to G3. We also want to clarify that this list can be updated and change if circumstances change. The reason for producing it is to facilitate discussions with airlines about what projects would benefit from in-depth review over the next twelve months, and to allow such in-depth review to be commissioned in good time. However, it should not be seen as being "set in stone" and should not preclude HAL from bringing other projects forward, or delaying the G3 for certain projects, where this is appropriate.
- 2.69 For the reasons set out above, we are of the view that the guidance we consulted on in March 2023 remains appropriate, with some additional clarification around the potential role of the IFS as in-depth reviewer, the outputs of the work undertaken by the reviewer and the status of the list of projects due to proceed to G3 in the subsequent twelve months. We have set out the text of the guidance in full in Appendix A.

Delivery Obligations

Summary of the draft guidance

- 2.70 In the Final Decision, we required all projects going through G3 to have Delivery Obligations ('DOs') specifying the key indicators that will show if the project has delivered what was intended and agreed by HAL and airlines. We explained that DOs should be described in terms of outputs, quality (in terms of design and/or planning standards) and delivery timescales, although these may vary depending on their relevance for an individual project. Performance against these DOs will be used to adjust capex baselines for the purpose of reconciliation with out-turn expenditure.
- 2.71 In the March 2023 Consultation, we set out our view that the content of DOs (outputs, quality and timescales) could be discussed and agreed through existing governance arrangements. We also explained that our expectation was that these elements should be covered by the standard set of questions/information provision described in the section above and agreed by no later than G3.

- 2.72 We set out that DOs should specify the key aspects of the infrastructure that drive the cost and anticipated benefits of the project. This would vary between projects but might include elements such as specific items of equipment (such as a new baggage system), number of units (for example, X new air bridges), size and the performance capability that these dimensions are intended to achieve (which might be expressed, for instance, in terms of the number of bags or passengers per hour that a facility is capable of processing).
- 2.73 We also said that, when setting DOs, HAL and airlines can choose to either specify the key dimensions of the infrastructure to be delivered or, if there is agreement between airlines and HAL to avoid that level of granularity, the overall performance capability.
- 2.74 The Final Decision also required a weighting to be applied to each DO, indicating what proportion of the overall baseline would be associated with performance against that Obligation. We recognised that this aspect of setting DOs is not an activity that is currently undertaken. We explained that, in order to streamline the process of setting DOs, in the first instance, we expect these weightings to be evenly allocated across DOs. Should airlines or HAL request a different allocation on an individual project, then this should be supported through a clear justification as to why this would be appropriate. We proposed that an alternative allocation of weightings should be agreed by no later than Gateway 2.
- 2.75 In response to HAL's requests that the CAA provide detailed instruction and templates for establishing DOs, we explained that we did not consider this to be either necessary or appropriate. We explained that we expect HAL and airlines to agree a process for identifying and documenting DOs (and the measures of performance against these). Whatever approach is decided upon, we said it must ensure that, at G3, HAL and airlines have agreed and documented the DOs for the project that they consider appropriately reflect the key drivers of cost. We also said HAL and airlines should ensure that for each DO there is an objective metric in place that can be used to determine if the associated Obligation has been met.
- 2.76 We encouraged all parties to apply a process and approach to documentation that is proportionate to the size and complexity of the project. We anticipated that a relatively streamlined approach can be applied for most projects. The process should ensure that projects that are likely to involve more extensive discussion should be clearly identified at an early stage.
- 2.77 We also recognised that there may be a requirement for further input from CAA to help address issues that emerge once the activity of defining DOs begins in earnest. We committed to providing ongoing support where we consider this to be necessary and sought feedback from stakeholders on whether there was any further guidance that the CAA could reasonably provide at that stage that would be helpful in setting DOs.

Stakeholders' views

- 2.78 HAL noted that the CAA's decision to introduce DOs as a feature of the new H7 capex incentives framework was the subject of HAL's application for permission to appeal the H7 Final Decision and did not provide any further feedback in its response on any of the matters relating to DOs that we included in our consultation.
- 2.79 British Airways and the Airline Community supported the introduction of DOs and saw them as a strong component of the move to *ex ante* incentives in H7 that would benefit all stakeholders.
- 2.80 British Airways welcomed the clarity we provided in the consultation that DOs should be tailored to the specific project, and specifically agreed with performance capabilities being recognised as acceptable DO metrics.
- 2.81 Both British Airways and the Airline Community agreed that the introduction of DOs should not be overly burdensome, and that the information needed to set DOs should be available from HAL and reviewed for each project seeking investment.
- 2.82 British Airways agreed that it would be prudent for equal weightings to be set across all the DOs as the default position and welcomed the opportunity for these to be adjusted (following justification at the appropriate time) if deemed appropriate to reflect a particular criticality of one of the elements.
- 2.83 The Airline Community confirmed that they were not seeking any further guidance from the CAA on DOs at this stage other than a clear timetable from the CAA for the introduction of DOs, noting that a number of H7 projects had already progressed through G3 at the time of the CAA's Final Decision and capex governance consultation. We address this issue in the next chapter.
- 2.84 British Airways suggested that reviewing the performance of a project against the DOs should be done as soon as practicable after each project finishes (for example, when the asset is in full operation) and that the point at which this should be done should be agreed when the DOs are set. This may include a commissioning period, for example, if required to demonstrate a capability has been delivered.

Further developments

- 2.85 As explained above, as part of its appeal, HAL challenged the CAA's decision to introduce DOs as a feature of the new H7 capex incentives framework.
- 2.86 Following an in-depth and rigorous assessment of the Parties' submissions and supporting evidence, the CMA determined that the CAA's final decision was not wrong in law, and that the CAA did not make an error in the exercise of discretion in relation to capex incentives. We also note that the March 2023

Consultation was referred to by the CMA in its final determinations, without criticism (albeit that the draft guidance was not itself subject to appeal).

- 2.87 Nonetheless, we have reviewed the CMA's final determination, as well as other relevant documents submitted in the appeal process, to identify any areas where more guidance or detail would be useful to HAL and airlines.
- 2.88 Many of the issues raised in HAL's Notice of Appeal (and response to the CMA provisional determination) relate either to HAL's views on the additional burden imposed by the introduction of DOs, and the definition of DOs.
- 2.89 We note that the CMA's final determination clearly acknowledges that while "*the regime applies the same requirement – for HAL to agree DOs with airlines – to all projects, [...], the Final Decision explicitly identified that DOs may be adapted to reflect the characteristics of a particular project, and the CAA said it had made it clear that it was open to HAL and airlines to agree DOs that suit the circumstances of each project.*"¹¹
- 2.90 As set out in the CMA's final determination, in its closing statement, HAL argued that the CAA has raised a number of new options around DOs at the oral hearing on capex incentives (referred to as Ground E in the appeal documentation), including that: DOs can be agreed in relation to outcomes, rather than outputs; DOs not being required where there is an overlap with the Outcome Based Regulation regime; and DOs potentially having a 0% time weighting.¹²
- 2.91 We note that the CMA did not agree with HAL that the CAA's comments at the oral hearing were inconsistent with the DO requirements set out in our Final Decision. We are also of the view that these comments are fully consistent with the flexibility envisaged in the draft guidance we consulted on in March 2023.
- 2.92 In addition, we note that many of these issues had previously come up during the H7 implementation workshops we ran in the lead-up to the H7 Final Decision and had been discussed with HAL and airlines as possible features of the DO regime.

Our views

- 2.93 Consistent with the CMA decision in the H7 appeal, we remain of the view that DOs are required for all projects progressing through G3. We have however provided additional clarification around DOs, building on the guidance we consulted on in the March 2023 Consultation.
- 2.94 We are clarifying that:

¹¹ CMA Final Determination, paragraph 11.60 (a), page 464

¹² CMA Final Determination, paragraph 11.61 (d), page 466.

- DOs can be agreed for tranches of projects, as defined under the Programmatic Approach developed by HAL and airlines for H7, if it is appropriate to do so and agreed on by all parties involved in the governance process (that is, HAL and airlines);
- outcomes (rather than outputs) can be used to define DOs, for certain projects, if there is agreement between HAL and airlines to do so at the appropriate stage of the governance process, and SMART metrics can be defined for the outcome measures selected;
- where a specific project has close links to consumer outcomes and, therefore, to metrics within the Outcome Based Regulation (OBR) framework, HAL and airlines should take this into account when setting DOs and avoid setting individual DOs which have significant overlap with the incentives created through the OBR metrics. However, we note that for most capex projects, regardless of their impact on consumer outcomes, we would expect the DOs to specify some type of output from that project, and some timing requirements. It is important that any capex that HAL commits itself to is appropriately incentivised in terms of efficiency of the spend (which is what the *ex ante* framework seeks to incentivise) as well as the way that capex project impacts consumers; and
- HAL and airlines, can agree in a particular case, not to define a DO in relation to the timing or, indeed other two elements (output and quality) we have specified that DOs should include (essentially assigning a weighting of zero to one of those elements).

2.95 We are of the view that the guidance we consulted on in March 2023 remains appropriate, with some additional clarification as set out in paragraph 2.94. We have set out the text of the guidance in full in Appendix A.

Accessible information on projects and performance

Summary of CAA guidance

- 2.96 In the March 2023 Consultation, we outlined that to support effective engagement on projects, including the assessment of performance, HAL would need to make available certain information to airlines and other stakeholders. This includes the information that needs to be provided on individual projects, but also more high-level information to support the consultative process.
- 2.97 Throughout the consultation document, we described the type of high-level information that we proposed to require HAL to provide. For clarity, we restated these requirements in one place under the heading of accessible information.
- 2.98 We asked for any stakeholder feedback on the proposed requirements for HAL to provide accessible information on projects and performance.

Stakeholders' views

- 2.99 In its response, HAL provided a table setting out how it planned to make the necessary information available to stakeholders.
- 2.100 British Airways and the Airline Community agreed with the information requirements set out by the CAA in the draft guidance. British Airways said that the existing Development Information Portal SharePoint site would be the obvious location as per all other capital governance documentation. The Airline Community also supported this approach.
- 2.101 In relation to the list of projects due to proceed to G3 in the next twelve-month period (paragraph 3.33 of the draft guidance), the Airline Community explained that HAL is currently required to produce an annual Strategic Capital Business Plan ("SCBP"). Recognising that gateway dates might change, the Airline Community suggested that the SCBP could be used as the annual record to capture the position of those G3 investment decisions due in the next 12 to 18 months, as well as provide a look back as to the extent of which the previous G3s were achieved or moved.

Our views

- 2.102 In several areas, HAL's proposals for information provision did not match the requirement proposed in the draft guidance, including for the reason that HAL did not agree with the need for DOs. This matter has now been settled by the CMA's final determination.
- 2.103 For the avoidance of doubt, we expect HAL to provide all the information set out in the draft guidance. We have repeated this below and have provided further clarification for each requirement, in light of feedback received from stakeholders.
- Documentation on HAL's approach to consultation on capex.
 - HAL's consultation response highlighted that it was planning to provide this information through a SharePoint site, which we consider is suitable and should be done as soon as practicable.
 - Standards and processes in place for capex activities, when these were put in place and / or last reviewed and the sort of projects where it expects these standards and processes to apply.

- HAL explained that it has a comprehensive reference document listing all the standards and processes which apply to capital projects, and that it can make this document available to the relevant stakeholders through a SharePoint site. We consider this is a good starting point but note that the requirement we have set out goes beyond a list of standards and requirements, and that the document should set out when the standards were put in place or last reviewed, and what types of capex projects it expects these standards and processes would apply to. We expect HAL to provide all the information set out in this guidance in relation to standards and processes and confirm when it has done so.
- Annually, and at least six months in advance of the start of the year, a list of all projects that are due to proceed through G3 in each year.
 - HAL explained in its response that the current list of Key Projects subject to IFS review is managed by the IFS Co-ordinators and stored on a common SharePoint site. It proposed a similar process should apply to the projects under additional scrutiny. Overall, we consider that this would be a sensible process but also highlight that the process for selecting projects for in-dept scrutiny should be agreed with airlines through the normal governance forums. For the avoidance of doubt, we expect HAL to produce the list of all projects that are due to proceed through G3 in each year at least six months in advance of the start of the year. This list should be as final as possible, but we recognise that changes can occur either in advance of the start of the relevant year, or during the year. The aim of this list is to facilitate discussion around which projects are selected for in-depth scrutiny between HAL and airlines, rather than being a binding and complete list of all G3s coming up.
- HAL should also set out how it will report to stakeholders on its performance against DOs.
 - In its response, HAL did not set out how it planned to meet this requirement, arguing that this was due to the ongoing appeal. With the appeal now concluded, we are reiterating the importance of these matters and expect HAL to set this out as soon as possible.

2.104 We are of the view that the guidance we consulted on in the March 2023 Consultation remains appropriate, with some additional clarification as set out above. We have set out the text of the guidance in full in Appendix A.

CHAPTER 3

Role of the CAA and next steps

- 3.1 This chapter sets out our views on
- the CAA's role in the capex governance process; and
 - the timescales for implementing the new *ex ante* framework in H7.

Role of the CAA

- 3.2 The March 2023 Consultation also covered our views on the CAA's role in the governance process and specifically in terms of dispute resolution. While this was not formally part of the draft guidance, we have received stakeholder feedback on our role, which we have summarised in this section.
- 3.3 We have set out our updated views on the role of the CAA, but we note there is further work to be done by HAL and airlines in this area, in terms of agreeing an escalation process. This might need to be reflected by the CAA in its own approach to handling any disputes which are brought to us; we will keep our own approach to considering disputes under review during H7.

Summary of the March 2023 Consultation

- 3.4 In the March 2023 Consultation, we explained that, with the publication of the guidance, the quality of the information shared by HAL with airlines should improve, better enabling airlines to offer their informed input to, and agreement with, HAL's capex proposals. We did, however, recognise that disagreements may arise.
- 3.5 We explained that, in the first instance, we expected HAL and airlines to work together constructively to resolve disputes in a timely manner. To support this, we asked HAL and airlines to agree an appropriate process for escalating disputes where these cannot be resolved at working level. We expected this escalation route to have been fully utilised ahead of any disputes being brought to the CAA. We invited HAL to submit to us the proposed process it has agreed with airlines for resolving disputes.
- 3.6 Should HAL and airlines not be able to resolve disputes through these arrangements, we recognised that it may be necessary for them to be brought to the CAA for our consideration. Where this is the case, we explained that any decision we make would be informed by our consideration of our statutory duties, including whether we considered HAL had acted in a manner likely to promote the timely and appropriate enhancement and development of the Airport in an economical and efficient manner.

- 3.7 The draft guidance set out the basic governance activities and information provision that we considered were likely to be consistent with an economical and efficient approach to capex delivery. We explained that the guidance should serve as an indicator of what we may consider in relation to a dispute. Where HAL can demonstrate that it has complied with protocols that align with this guidance and that independent consultants have not identified clear inefficiencies, then we explained that we would likely support HAL's approach.
- 3.8 We said that we would also have regard for the reasonableness of the conduct of both parties in considering any disputes. In particular, we would consider whether parties have sought to resolve issues constructively, engaged in a timely manner and raised issues as soon as reasonably possible.

Stakeholders' views

- 3.9 In its response, HAL said that it considered that there were several steps which still needed to be completed in relation to the implementation of the H7 *ex ante* framework, and that it considered it was premature to agree an escalation process with airlines at that stage. HAL proposed that this is instead agreed as part of the capital protocol to be agreed with airlines. Therefore, HAL did not set out any proposed escalation process in its response.
- 3.10 HAL also explained that it did not agree with the approach we had proposed in the March 2023 Consultation for dispute resolution, namely that this should be considered on a case-by-case basis. HAL argued that it is critical that the CAA follows a clear, well-defined and predictable process which quickly and responsively considers the issues at hand and ensures it makes timely decisions to avoid the risk of unnecessary delay in the interests of consumers.
- 3.11 British Airways acknowledged the need for a dispute resolution process, guidance as to how and what can be escalated to the CAA and clarity over the role of the CAA in such disputes. It explained that it was waiting for HAL's proposal for a dispute resolution process, in order to discuss and reach agreement on it.
- 3.12 The Airline Community noted the current dispute resolution in place, involving escalation to the Capital Portfolio Board, Joint Steering Board and ultimately to the CAA. It noted that, to date, escalations had been infrequent and where arisen had been managed within this process. They said that the dispute resolution process was not an area that has been discussed in detail with HAL to date, although it noted that it would be an item for the H7 Capital Protocol and therefore require the agreement of HAL and airlines.
- 3.13 The Airline Community sought to understand whether the CAA considered that there were any specific areas for improvement or overhaul in terms of the existing dispute resolution process. The airline Community encouraged

consistency, where possible, across the broader H7 framework including Other Regulated Charges (ORCs) and the OBR.

Our views

- 3.14 Having considered stakeholder views, we consider that the appropriate role for the CAA in any disputes relating to the capital governance process is that set out in the March 2023 Consultation. Matters relating to ORCs and the OBR will be dealt with separately, consistent with a proportionate and targeted approach to regulation.
- 3.15 We consider that the high-level approach we set out in the March 2023 Consultation was sufficiently clear and detailed. Specifically:
- we expect HAL and airlines to discuss and agree an escalation process as part of the discussions on the H7 Capital Protocol. Overall, we support HAL and airlines building on the existing dispute resolution process, involving escalation to the Capital Portfolio Board, Joint Steering Board and ultimately to the CAA. We note that it is important that HAL and airlines explicitly consider how suitable this escalation process would be with the governance arrangements that are put in place to implement the H7 *ex ante* framework; and
 - where disputes are escalated to the CAA, we confirm that our decision in each case would be informed by consideration of our duties, including whether we considered HAL had acted in a manner likely to promote the timely and appropriate enhancement and development of the Airport in an economical and efficient manner. Our guidance on capex governance should serve as an indication of what we may consider in relation to a dispute.

Next steps and implementation

- 3.16 As explained in the introduction and in the March 2023 Consultation, we remain committed to monitoring the implementation of the new *ex ante* capex incentives framework and to updating this guidance as necessary should any issues arise where more clarity or guidance from the CAA would be useful.
- 3.17 We expect HAL to use reasonable endeavours to update the existing capex governance protocols to be consistent with this guidance before the end of December 2023, consistent with its obligations in Condition F.1 of its licence.
- 3.18 As explained in the March 2023 Consultation, when we issued the draft guidance earlier this year, we expected HAL to act reasonably to ensure that projects that had not yet progressed through G3 were developed in line with the draft guidance. We are reiterating this expectation in relation to this updated guidance.
- 3.19 We also consider that, in the light of this requirement, and the fact that HAL did not ask for the suspension of the H7 licence modifications while its appeal to the

CMA was ongoing, HAL should have made sufficient progress in terms of working through the draft guidance to enable it to update the capex governance protocols by the date set out in paragraph 3.17.

- 3.20 We note that in practice, no projects have to date gone through G3 with DOs defined in line with the *ex ante* capex framework. For the avoidance of doubt, any projects which have gone through G3 consistent with the existing capex governance framework which applied in Q6 and iH7 will be liable for *ex post* review by the CAA in the context of the development of future price controls.
- 3.21 In order to complete the implementation of the *ex ante* framework, there will be a requirement for all projects going through G3 (subject to any streamlining agreed by HAL and airlines) to have DOs defined. However, we note that as no projects have gone through G3 with DOs to date, and HAL and airlines are yet to formally agree the relevant capex governance protocols consistent with the draft CAA guidance or this updated guidance, it will not be possible for this to happen immediately.
- 3.22 Our view is that all projects going through G3 should have DOs defined (subject to any streamlining agreed by HAL and airlines), no later than 1 March 2024. This will be nearly one year after the publication of the CAA's draft guidance, and over four months following the publication of the CMA's final determination.
- 3.23 However, we note that, for certain larger projects (over £20 million), under the Q6 framework HAL and airlines should have already been working to define Triggers. As was explored in detail as part of the H7 appeal process, Triggers share many similarities with DOs. Bearing this in mind, we consider that as soon as practicable for such projects coming to gateway G3, HAL and airlines should seek to re-work triggers into DOs (and so where practicable have DOs in place for these projects ahead of the 1 March 2024 deadline).

APPENDIX A

Guidance on capital expenditure governance

Introduction

- A1 This appendix sets out an updated version of the guidance we consulted on in the March 2023 Consultation, reflecting feedback received and further developments. We will keep this guidance under review and update it as necessary.
- A2 We have set out updated guidance in each of the areas covered by the draft guidance, namely:
- standard information provision;
 - assessment of information;
 - delivery obligations; and
 - accessible information on projects and performance.

Guidance on capital expenditure governance

Standard information provision

- A3 An effective capex governance process depends on the quality of information that HAL provides for each project.
- A4 Currently HAL appears to provide airlines with the information they require to approve spend and outputs associated with most projects. However, we are aware of airline concerns that, for certain projects, they do not receive what they consider to be essential information at the most appropriate time. We also note HAL's concerns that, on occasion, airlines can request additional information which HAL does not consider is relevant to that stage of the governance process, resulting in additional time and resource being diverted to provide the material requested.
- A5 Therefore, we consider that a standardised set of questions/information should be established and applied to each project. This should provide HAL and airlines with a baseline expectation on what common information will be made available to support decision making.
- A6 The information should as a minimum address the following aspects of a project:
- project need

- project outputs and delivery timetable
- operational impact
- what will constitute the completion of the project
- options considered
- risks / opportunities
- costs
- quantifiable benefits and significant non-quantifiable benefits
- standards and processes applied

A7 We note that HAL and airlines have been working together to develop a standard template for the gateway process, which covers the questions to be answered by HAL, and the information to be provided, at each stage of the governance process up to and including G3. We support this work and for the template to be used for all projects passing through G3 going forwards. We also support this template being updated as necessary on the basis of agreement between HAL and airlines.

A8 We recognise that for individual projects, other information may be required. The standardisation of common questions/information should not restrict HAL from providing airlines with other information, where that is relevant for the purpose of facilitating a timely and high-quality project decision.

A9 Airlines may also request that HAL provides 'follow-on' information, where they consider that the initial response from HAL prompts the need for additional detail or justification. We would, however, expect any such additional information to be requested in good time before when the relevant decision needs to be made and not relate to new issues that could have reasonably been identified earlier. Any party requesting this information should clearly justify the relevance of the material and consideration should be given to the cost/resource and time associated with providing that information.

A10 If the burden of providing this information appears to be more than its value or relevance, then HAL should seek to agree a different and better approach with airlines and should not be obliged to provide unnecessary material ahead of seeking airline agreement.

Assessment of information

Review of common standards and processes

A11 Some of the information that HAL may be required to provide airlines as part of the governance process is likely to relate to the standards or processes that it

applies on a common basis across most, if not all, projects. These may relate to HAL's approach to the following activities, among others:

- design and planning standards
- asset management strategy/policy
- business case development
- quality assurance procedures
- procurement policies
- approach to risk management
- project controls

- A12 In combination, HAL's approach to these activities is likely to have an important impact on the cost of projects. Therefore, when airlines are asked to agree the cost of a project, they should have assurance that HAL's standards and processes are appropriate and efficient.
- A13 However, undertaking a meaningful assessment of HAL's management of these activities is likely to require insight into the equivalent arrangements that are commonly applied across the construction industry. This skill set, and the related experience, may not be fully and readily accessible to airline stakeholders.
- A14 We also consider that, in general, HAL is unlikely to vary its approach to these activities radically for each project, or projects within a programme. It would, therefore, appear to be disproportionate for airlines to make a separate assessment of HAL's approach to these activities for each individual project.
- A15 The standards and processes that HAL commonly applies across projects or projects within a programme should be independently reviewed to give all parties the confidence that these are appropriate and up to date. As part of this process, HAL should clearly document the standards and processes it has in place for its capex activities, when these were put in place and/or last reviewed and the sort of projects where it expects these standards and processes to apply.
- A16 The focus and timing of this review (or reviews) should be tailored to reflect standards and processes that are likely to be the most important drivers of cost for upcoming projects. In addition, the review (or reviews) should focus on standards and processes that have not been reviewed recently (for example in the last three years) or where the reviews that have been undertaken do not provide clear evidence of efficiency and appropriateness and where the standards and processes are likely to have a significant impact on project costs.
- A17 HAL and airlines should be able to agree whether this review should be a single assessment covering all relevant standards and processes for H7 investment (for

instance, those which have not been reviewed recently) or should be undertaken in phases throughout the period. The approach taken to this review must not unnecessarily delay the progression of projects through to construction. We would expect the assessment of relevant standards and processes should only be a requirement for a G3 investment decision where this is a reasonable requirement and where the standards are a significant driver of costs.

- A18 This review (or reviews) should consider the extent to which HAL's process and standards reflect best practice elsewhere in the construction industry, or other relevant comparators. The review should either conclude that HAL's processes and standards are appropriate or identify where these should be updated or enhanced in keeping with best practice.
- A19 The review(s) can be undertaken outside of the Gateway process that individual projects must proceed through. Where the review has been completed and concluded that HAL's approach is appropriate, then further airline scrutiny of these standards/processes should not be required on individual projects as part of the process of securing airline agreement.
- A20 We are not specifying how many of these reviews need to be undertaken. It may be that a combination of standards and processes can be collectively assessed across HAL's entire capex plan. However, there may be certain groups or programmes of projects that warrant a separate and more bespoke assessment of HAL's standards and processes. We expect HAL and airlines to agree the scope, focus and timing of these reviews.
- A21 It is important that the organisation undertaking the assessment can provide a fully independent view with reference to wider best practice. The selection of the preferred provider should be agreed between HAL and airlines, and the report(s) should be directly issued to both parties at the same time.
- A22 This review or reviews should be funded through HAL's capex allowance.

In-depth review for specific projects

- A23 For projects that are more complex, or more costly, or which have a greater impact on airline operations (either during construction or post-delivery), we consider that there is likely to be benefit from a more detailed review where this provides airlines with assurance that, in developing its preferred scheme, HAL has appropriately considered factors such as the:
- underlying drivers for a project and how these may change under a range of plausible scenarios;
 - different solution options that have been considered, including the assessment of relative costs, risks, benefits and operational impacts of each option (that is, a business case assessment);

- opportunities where HAL has sought to seek capex/opex efficiencies by co-ordinating works with other schemes;
- procurement process that HAL has undertaken to secure value for money;
- benchmark cost information that HAL has used to assure the efficiency of the project budget; and
- approach to the identification and management of risks.

- A24 The assessment of this type of information for a specific project is likely to require the input of independent consultants with expertise in project/programme development and construction. This set of skills and experience can help to compare HAL's approach against good industry practices.
- A25 We consider that a provisional decision on which projects should be subject to a more detailed review should be made at Gateway 1 or earlier, and only revisited in the event of a material change in the project scope or cost. We consider that it is reasonable and efficient for HAL has an early understanding of the nature of the assessment for each project.
- A26 To support engagement with airlines on this, HAL should produce annually, and at least six months in advance of the start of the year, a list of all projects that are due to proceed through G3 in each year. This should form the basis of consultation with airlines on which should be subject to a more detailed review.
- A27 In this guidance, we are not specifying the organisation that we consider should undertake such in-depth reviews. We are aware that HAL and airlines have been working together to run a 12-month trial for the procurement of subject matter expertise for key projects within the portfolio, starting with T2 Baggage. We support this trial and encourage HAL and airlines to take its outputs into account when selecting an organisation (or organisations) to undertake further in-depth review of projects during H7.
- A28 In terms of the outputs of these in-depth reviews, we support the principle of the organisation (or organisations) undertaking the reviews providing input and advice to HAL and airlines throughout the capex governance process. However, we stress the importance of HAL and airlines specifying a clear scope, output and approach to documenting the reviewer's work, to ensure transparency and accountability of these organisations. Where the independent reviewer's advice identifies concerns with HAL's approach, then we expect HAL to use reasonable endeavours to address these, before proceeding to the next gateway stage.
- A29 To be clear, it is not the role of the independent reviewer to "co-design" or propose a preferred and alternative solution. Ultimately HAL must be responsible and accountable for the efficiency of capex solutions and the impact they have on the functioning of the airport.

- A30 We are not specifying a financial value be applied as the sole means of determining which projects are subject a more detailed review. We consider that it may be essential to evaluate in depth certain projects of a lower value, but which are relatively more complex and/or likely to have a critical impact on airline operations. Equally, there could be larger value projects that are comparatively straightforward and do not warrant additional scrutiny, for instance a major lift/escalator replacement programme involving the repeated installation of the same asset. However, we expect there to be a reasonably strong degree of correlation between the size of projects and those selected for additional assessment.
- A31 We do, however, acknowledge that a more detailed assessment for some projects will involve additional time, cost and resource compared to existing arrangements. Bearing this in mind, there should be a proportionate approach to the frequency with which a more detailed review is undertaken, to avoid excess costs and delays to the delivery of projects.
- A32 We encourage HAL and airlines to work constructively and use the information coming out of the T2 Baggage trial, to assess the amount of resource, cost and time that might be associated with in-depth reviews over the course of H7. We will also keep these arrangements under review and, if we consider it to be necessary, we may issue further guidance on the number of projects that we consider should be subject to a more detailed review.

Delivery Obligations

- A33 Consistent with our Final Decision for H7, we require all projects going through G3 to have Delivery Obligations (“DOs”) specifying (through SMART¹³ targets) the key indicators that will show if the project has delivered what was intended and agreed by HAL and airlines. These DOs should be defined in terms of outputs, quality (in terms of design and/or planning standards) and delivery timescales, although these elements may be varied depending on their relevance for an individual project. Performance against these DOs will be used to adjust capex baselines for the purpose of reconciliation with out-turn expenditure.
- A34 DOs should provide an objective means of establishing whether a project has been delivered in line with the assumptions that informed its original budget and delivery programme. We consider that all stakeholders will benefit from these matters being assessed in an objective manner and against metrics that have been established at the time the budget was set.

¹³ Specific, measurable, achievable, relevant, and time-bound.

- A35 To clarify, DOs can also be agreed for tranches of projects (rather than individual projects), as defined under the new Programmatic Approach developed by HAL and airlines for H7, if it is appropriate to do so and agreed on by all parties involved in the governance process (that is, HAL and airlines).
- A36 In discussions with stakeholders, there was some uncertainty around how DOs should distinguish between the efficiency with which a capital project has been delivered and the operational performance of the associated assets. To clarify, DOs should specify the key aspects of the infrastructure that drive the cost and anticipated benefits of the project. This will vary between projects but might include elements such as specific items of equipment (such as a new baggage system), number of units (for example, X new air bridges), size and the performance capability that these dimensions are intended to achieve (which might be expressed, for instance, in terms of the number of bags or passengers per hour that a facility is capable of processing).
- A37 In terms of a DOs, HAL and airlines can choose to either specify the key dimensions of the infrastructure to be delivered or, if there is agreement between airlines and HAL to avoid that level of granularity, the overall performance capability.
- A38 If the performance capability is the chosen DO, then it will be necessary to measure whether this has been delivered in practice through a demonstration that the expected performance capability specified in the original project design can be achieved in practice. This assessment must be undertaken within a finite time period. In this example, we would anticipate that testing of the expected performance capability would be an essential feature of the handover of the asset into the operation of the airport. Once the facility has been handed over, however, its ongoing level of operational performance should be subject to incentives through the OBR framework.
- A39 Outcomes (rather than outputs) can also be used to define DOs, for certain projects, if there is agreement between HAL and airlines to do so at the appropriate stage of the governance process, and SMART metrics can be defined for the outcome measures selected.
- A40 Where a specific project has close links to consumer outcomes and, therefore, to metrics within the OBR framework, HAL and airlines should take this into account when setting DOs and avoid setting individual DOs which have significant overlap with the incentives created through the OBR metrics. However, we note that for most capex projects, regardless of their impact on consumer outcomes, we would expect the DOs to specify some type of output from that project, and some timing requirements. It is important that any capex that HAL commits itself to is appropriately incentivised in terms of efficiency of the spend (which is what the *ex ante* framework seeks to incentivise) as well as the way that capex project impacts consumers.

- A41 The existing governance arrangements require airlines to agree the key deliverables for each project and, for most projects, particularly those that are not subject to triggers, this appears to involve relatively few meetings and information that is presented at a summary level. We see no reason why these arrangements would not continue to be suitable for most projects for the purpose of agreeing DOs.
- A42 We recognise that, for more complex projects, the process could become more involved. Again, we do not see any reason why in principle this would be different from the current arrangements. Experience at Heathrow and from other relevant infrastructure sectors is that projects that are more critical and complicated will involve more discussion (with airlines) before agreement can be reached.
- A43 Our H7 Final Decision also requires a weighting to be applied to each DO, indicating what proportion of the overall baseline would be associated with performance against that Obligation. We recognise that this aspect of setting DOs is not an activity that is currently undertaken. The use of weightings is for the purpose of calculating a baseline adjustment. In our view, this establishes the relative importance of different aspects of a project that may impact on its cost, and that should be considered in the process of making an adjustment to the capex baseline.
- A44 In support of seeking to streamline the process of setting DOs, in the first instance, we expect these weightings to be evenly allocated across DOs.
- A45 Should airlines or HAL request a different allocation on an individual project, then this should be supported through a clear justification as to why this would be appropriate, and an assessment undertaken by both HAL and airlines of the potential impact of this. An alternative allocation of weightings should be agreed by no later than Gateway 2. An early understanding of priorities is necessary for HAL to ensure its planned delivery approach reflects the relative importance of each DO.
- A46 HAL and airlines can agree in a particular case, not to define a DO in relation to the timing or, indeed the other two elements (output or quality) of DOs. This essentially means assigning a weighting of zero to one of those elements.
- A47 Throughout this guidance we have referred to G3 as the critical gateway when budgets and DOs should be agreed. To be clear, we recognise that any changes (to budget or DOs) that are subsequently agreed through the established Change Control process supersede those that were first established at the original G3. Should there be a requirement to stop a project permanently after it has been through G3, we expect the Change Control process to make the necessary adjustments to the project cost and DOs to reflect the work undertaken to that point.

- A48 We do not consider that it is either necessary or appropriate for the CAA provide detailed instruction or templates for establishing DOs. We expect HAL and airlines to agree a process for identifying and documenting DOs (and the measures of performance against these). Whatever approach is decided upon, it must ensure that, at G3, HAL and airlines have agreed and documented the DOs for the project that they consider appropriately reflect the key drivers of cost. HAL and airlines also need to ensure that for each DO there is an objective metric in place that can be used to determine if the associated Obligation has been met.
- A49 We encourage all parties to apply a process and approach to documentation that is proportionate to the size and complexity of the project. We anticipate that a relatively streamlined approach can be applied for most projects. The process should ensure that projects that are likely to involve more extensive discussion should be clearly identified at an early stage.
- A50 Through the process of agreeing documentation to support the setting of DOs, HAL should also set out how they will report to stakeholders, and the CAA, on their performance against DOs. As part of this, we will expect to see HAL provide information on a project-level basis that sets out:
- baseline capex agreed at G3;
 - DOs agreed at G3;
 - performance against DOs once the project is completed;
 - adjusted baseline capex reflecting performance against DOs; and
 - actual expenditure incurred.
- A51 This reporting, which we consider should be done at least on an annual basis, but could potentially be more frequent, will support the process of adjusting capex baselines for any under delivery, to enable the end of period reconciliation process to take place.
- A52 If there are specific aspects to this process where stakeholders require further guidance, then we will take this into consideration. We will expect requests of this nature to explain why they require more information on a process that will be undertaken by the CAA. Having considered this, we may provide further guidance in due course.
- A53 We recognise that there may be a requirement for further input from CAA to help address issues that emerge once the activity to apply these begins in earnest. We commit to providing ongoing support where we consider this to be appropriate.

Accessible information on projects and performance

- A54 To support effective engagement on projects, including the assessment of performance, HAL will need to make available certain information to airlines and other stakeholders. This includes the information that needs to be provided on individual projects, but also more high-level information to support the consultative process.
- A55 In this guidance, we have described the type of information that we require HAL to provide and provided further clarifications reflecting points raised by respondents to the March 2023 Consultation. Table 1 below summarises the requirements for information to be provided by HAL consistent with this guidance. This should not be read as superseding any existing information provision by HAL, but where necessary, HAL may incorporate the requirements below into existing documents it makes available to stakeholders.

Table 1: Information to be provided by HAL

Type of information
<p>Documentation on HAL's approach to consultation on capex.</p> <p>HAL explained that it was planning to provide this information through a SharePoint site, which we consider is suitable and should be done as soon as practicable.</p>
<p>Standards and processes in place for capex activities, when these were put in place and/or last reviewed and the sort of projects where it expects these standards and processes to apply.</p> <p>HAL explained that it has a comprehensive reference document listing all the standards and processes which apply to capital projects, and that it can make this document available to the relevant stakeholders through a SharePoint site.</p> <p>We encourage HAL to make this document available to airlines and agree this is a good starting point but note that the requirement we have set out goes beyond a list of standards and requirements, and that the document should set out when the standards were put in place or last reviewed, and what types of capex projects HAL expects these standards and processed would apply to.</p>
<p>HAL should produce annually, and at least six months in advance of the start of the year, a list of all projects that are due to proceed through G3 in each year.</p> <p>HAL explained in its response that the current list of Key Projects subject to IFS review is managed by the IFS Co-ordinators and stored on a common SharePoint site. It proposed a similar process should apply to the projects under additional scrutiny. We consider that this would be a sensible process but also highlight that the process for selecting projects for in-dept scrutiny should be agreed with airlines through the normal governance forums and in accordance with this guidance.</p> <p>For the avoidance of doubt, we expect HAL to produce the list of all projects that are due to proceed through G3 in each year at least six months in advance of the start of the year.</p>

This list should be as final as possible, but we recognise that changes can occur either in advance of the start of the relevant year, or during the year.

HAL should also set out how it will report to stakeholders on its performance against DOs.

HAL has not yet set out how it plans to meet this requirement. We are reiterating this requirement and expect HAL to set this out as soon as possible.

- A56 We expect HAL to provide the above information in a format that is easy to understand and in a location that is accessible for airline stakeholders. In support of this, HAL should seek airline views on their preferences for receiving this information.