

To: Heathrow Airport Limited (HAL), NATS (En Route) plc (NERL) and Airlines

By email

3 September 2024

Dear stakeholder

## **CONSTRUCTIVE ENGAGEMENT FOR NEXT HEATHROW PRICE CONTROL REVIEW**

On 22 August 2024, we published the findings from our review of our approach to setting price controls (“the August 2024 Review”), including the lessons learnt from the Heathrow H7 and NERL NR23 price control reviews.<sup>1</sup> We set out our updated view on the draft timetable for the next Heathrow price control review, including the Constructive Engagement process that will form a key part of that review. We also said that we would publish this letter on the approach to Constructive Engagement.

Appendix A sets out our draft guidance on the Constructive Engagement process for the next Heathrow price control review. It includes our current views on the purpose and scope of each round of Constructive Engagement, the governance arrangements and outputs, and the role of the CAA.

Our views have been informed by the August 2024 Review and views from stakeholders. We have proposed early Constructive Engagement over multiple rounds, to provide greater opportunities for airlines and licensees to reach an industry consensus on key aspects of each price control review, for airlines to have more opportunity to influence HAL’s and NERL’s business plans, and to have the opportunity to discuss our Initial Proposals.

We welcome views from stakeholders on the draft guidance on Constructive Engagement included in the appendix to this letter, including on:

- the purpose, scope and timing of each round of Constructive Engagement;

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<sup>1</sup> Setting future price controls – lessons learnt from the review of approach, CAP3000, August 2024. See: [www.caa.co.uk/Cap3000](http://www.caa.co.uk/Cap3000)

- the governance and outputs; and
- the role of the CAA.

Please submit your feedback to [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk). If you would prefer to discuss the draft guidance, or have any questions related to this document, please contact Alex Bobocica at [alex.bobocica@caa.co.uk](mailto:alex.bobocica@caa.co.uk).

Stakeholders should prepare for the first round of Constructive Engagement on the basis of the draft guidance attached to this letter. We will consider the views from stakeholders and provide an update to the guidance for the later rounds in our draft method statement for the next Heathrow price control review, which we intend to publish in October 2024.

Yours sincerely

*Stewart Carter*

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# Appendix A: CAA guidance on Constructive Engagement process for the next Heathrow price control review

## Introduction

Constructive Engagement involves both high-level and more detailed discussions between the regulated company and its airline customers and has been a key part of the H7, NR23 and preceding price control reviews. Constructive Engagement supports the regulated companies to develop business plans and the CAA to set price controls that take account of current and future customers' requirements and priorities for areas such as service, capacity, resilience and cost.

This document sets out draft guidance on the Constructive Engagement process for the next price control for Heathrow Airport Limited ("HAL"), though parts of it may also be relevant to the next price control for NATS (En Route) plc ("NERL"). Therefore, references to dates in this draft guidance will relate specifically to the HAL price control.

We welcome stakeholder views on this draft guidance. We will consider this as we refine the guidance for the next HAL price control and as we develop guidance for the next NERL price control.

This appendix is structured as follows:

- background on what we said in the August 2024 Review;
- purpose, scope and timing of the rounds of Constructive Engagement;
- governance and outputs from each round of Constructive Engagement; and
- role of CAA.

## Background on the August 2024 Review

In 2023 we completed the price control reviews of HAL (H7) and NERL (NR23). Consistent with best practice and the recommendations of Public Body Review of the CAA,<sup>2</sup> we reviewed our approach to setting price controls to identify opportunities to improve the efficiency, timeliness and effectiveness of the processes and outcomes.

We consulted on initial views on the scope of this lessons learnt review and on the key issues in February 2024<sup>3</sup> and published the findings in August 2024.<sup>4</sup>

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<sup>2</sup> [Civil Aviation Authority review - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/civil-aviation-authority-review)

<sup>3</sup> Setting future price controls – review of approach, CAP 2618, February 2024. See: [www.caa.co.uk/Cap2618](https://www.caa.co.uk/Cap2618)

<sup>4</sup> Setting future price controls – lessons learnt from the review of approach, CAP3000, August 2024. See: [www.caa.co.uk/Cap3000](https://www.caa.co.uk/Cap3000)

The August 2024 Review set out an updated view of the timetable for the next HAL price control review. We also said we would publish a letter on the approach to Constructive Engagement.

We considered Constructive Engagement under the process for setting price controls. We received a range of views from stakeholders on Constructive Engagement during that review including that:

- the CAA should play a more active role in Constructive Engagement and provide clear direction and oversight, as well as moderating on challenging issues where there is disagreement;
- HAL and NERL should be required to provide more information on options and how information reconciles to previous periods;
- the CAA should allow more time for Constructive Engagement, starting earlier and over multiple rounds to allow more time for customers to consider options and to inform business plans as they are being developed; and
- Constructive Engagement should focus on particular issues such as capex, traffic forecasts and service quality targets.

The Advisory Panel for the lesson learnt review said there should be an early start to the Constructive Engagement process, that the CAA should consider how to take account of the views of the wider set of stakeholders as well as airlines and that the CAA's role should not focus on resolving disputes during Constructive Engagement.

Our view was that Constructive Engagement is an important part of the price review process and a key lesson from H7 and NR23 is that this process was not as effective as it could have been in finding areas of consensus between parties. We also said that:

- we agreed on early and multiple rounds of Constructive Engagement, which we reflected in the updated draft timetable, and that we would expect HAL and NERL to provide materials to airlines on the benefits and costs to enable this;
- there will be advantages in focusing Constructive Engagement on areas where dialogue is likely to be most productive, for instance in relation to investment programmes, service quality and resilience. We will also consider how to take account of the views of other stakeholders in addition to the Constructive Engagement with airlines; and
- we could more actively participate during the Constructive Engagement, providing input where appropriate. However, it will remain appropriate that stakeholders attempt to resolve or narrow differences during the Constructive Engagement process.

## Purpose, scope and timing of the rounds of Constructive Engagement

The Constructive Engagement process should start as early as reasonably practicable and consist of multiple rounds, to allow time for airlines to influence HAL's business plan and find common areas in response to our Initial Proposals.

Bearing the above in mind we have proposed that there are four rounds of Constructive Engagement:

- round 1 between October and December 2024 – to identify airline customers' priorities on overarching issues such as service quality, investment and traffic forecasts, and seek to reach agreement on high level options to inform the business plan;
- round 2 between January and March 2025 – to seek to understand parties' views and, where practicable, reach a consensus on detailed building blocks that will comprise HAL's business plan. This should be appropriately targeted to allow in depth discussions of key issues and exclude areas where there is unlikely to be consensus and the CAA will need to consider evidence from a range of sources.
- round 3 between June and July 2025<sup>5</sup> – to seek to understand airline views on HAL's business plan submission, identify areas where there is consensus and provide the CAA with a clear view on priority areas to consider; and
- round 4 between January and February 2026 – to seek to understand HAL and airline customers' views on the CAA's Initial Proposals and identify any areas where there is consensus between HAL and airlines on issues, which either support the CAA's approach or where they consider changes are required.

The section below sets out further detail on each of the four rounds, including the topics to be covered, the outcomes and the information or views we consider should be provided by the relevant party.

Feedback we have received in discussions following the August 2024 Review have identified some challenges with the timing of rounds 3 and 4 and availability of HAL and airline customers. We have updated the timing of round 3 and we welcome views from stakeholders on the timing of these rounds and we will consider these matters further.

Feedback we have received has also highlighted that some of the rounds of Constructive Engagement could be delivered via existing regular HAL and airline forums (for example forums that deal with capital investment). We welcome such an approach if it facilitates effective Constructive Engagement and encourage HAL and airlines to agree the broad approach to these matters as soon as possible.

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<sup>5</sup> Following the publication of our August 2024 Review document, we have updated the timing to make sure outputs are in sufficient time to inform our Initial Proposals.

Regardless of the forum for Constructive Engagement, we strongly encourage stakeholders to embrace the opportunity that Constructive Engagement provides and to adopt a pragmatic and purposeful approach to these discussions. We hope that the structure and guidance set out in the following section will facilitate such an approach.

## Purpose and scope of rounds of Constructive Engagement

### Round 1: October to December 2024

- Scope: Focus on high level strategic issues and options, to cover: service quality, priorities for investment, resilience and traffic forecasts.
- Purpose and desired outcomes:
  - To understand the views of HAL and airlines on the key priorities for the H8 period, in terms of investment, service quality levels and resilience.
  - To discuss the broad benefits and costs of strategic investment options and, where practicable, seek to reach consensus on these.
  - To discuss and seek to reach consensus on the approach to forecasting traffic levels and the impact on investment, service quality and resilience.
  - The outputs should enable HAL to develop its business plan for H8 with a clear understanding of airlines' priorities.
- Information and views to be provided:
  - In advance, HAL to provide its latest views on:
    - traffic forecasts and impact of future traffic on strategic approach to investment, service quality and resilience;
    - initial priorities for investment, with any available supporting analysis on the costs and benefits of different possible options for key choices; and
    - high-level forecasts for investment and service quality performance over H7 and priorities for improvement in the next period.
  - During Constructive Engagement, airlines to provide initial views on main priorities for service quality and investment.
  - CAA to provide the draft method statement which will include business plan guidance, in October 2024 (but with the scope for certain items such as the provision of draft templates for data tables to be provided later in the process).

## Round 2: January to March 2025

- Scope: discussion of detailed price control building blocks: service quality metrics and incentives; cost building blocks (opex, capex, commercial revenues); Other Regulated Charges; capex incentives; traffic forecasts and incentives; level or direction of changes in charges.
- Purpose and desired outcomes:
  - To understand the views of HAL and airlines on HAL's proposed approach to forecasting key building blocks to estimate charges and to developing key incentives, ahead of HAL finalising its business plan. HAL's plan should be informed by customer priorities or there should be a clear understanding where there are differences in HAL and airline views.
  - This engagement will also inform the CAA's Initial Proposals.
  - We propose that this engagement would exclude discussion of cost of capital and cost efficiency. These matters will be considered separately based on evidence from stakeholders.
- Information and views to be provided:
  - In advance, HAL to provide its latest views on:
    - traffic forecasts and scenarios (high, low and base cases);
    - forecasting methodology for each cost building block;
    - current best forecasts for cost building blocks and charges, where available and at an aggregate level;
    - proposed policy approach in relation to ORCs, capex incentives and traffic incentives; and
    - proposed policy approach in any other key areas forming part of HAL's business plan.

This should be more detailed than information provided in round 1.

- During Constructive Engagement, airlines to provide suggestions for improving arrangements for:
  - service quality incentives;
  - capex incentives; and
  - ORCs.

### **Round 3: June to July 2025**

- Scope: to discuss HAL's business plan submission.
- Purpose and desired outcomes:
  - To understand the views of HAL and airlines on the detail of HAL's business plan, identify areas of consensus and areas where views diverge.
- Information and views to be provided:
  - HAL to provide its full business plan, with supporting information, consistent with CAA guidance. We expect the business plan to be submitted in June 2025.

### **Round 4: January to February 2026**

- Scope: to discuss the CAA's Initial Proposals.
- Purpose and desired outcomes:
  - To understand the views of HAL and airlines on the detail of the CAA's Initial Proposals. This engagement will help inform the CAA's Final Proposals.
- Information and views to be provided:
  - CAA to issue Initial Proposals document with relevant supporting documents. We expect the Initial Proposals to be published late 2025.

### **Governance and outputs**

There should be appropriate governance arrangements for each round of Constructive Engagement to support an effective process where there are clearly defined roles, responsibilities and outputs.

We note that there are governance documents already in place between HAL and airlines, for example in relation to capital investment (Capital Governance Handbook and associated handbooks and protocols), as well as the Enhanced Engagement and Governance Protocol. Where stakeholders judge that these arrangements are suitable or can be easily adapted for the upcoming Constructive Engagement process, then such an approach may be the most efficient and effective way forward.

In any case, HAL and airlines should agree (and the CAA will comment on if appropriate), suitable procedures for the upcoming Constructive Engagement process, which can be high level and draw on existing materials. These should be recorded in a working document that set out:



- the forums for each round of Constructive Engagement, whether these are existing or new meetings, and the dates and scope of each meeting;
- a summary of material that should be available and circulated for each meeting;
- procedures covering circulation of meeting materials, requests for further information and responses to these requests;
- the use of consultants to support airlines in the Constructive Engagement sessions, particularly around technical topics; and
- references to any relevant handbooks or protocols (including specific clauses or provisions) that would be relevant for the Constructive Engagement process.

As the first round of Constructive Engagement is due to start in October 2024, HAL and airlines should seek to agree a first draft of these rules of procedure that applies to round 1 of Constructive Engagement (and beyond if appropriate) by the end of September 2024, and should submit this to the CAA as soon as is practicable (which will facilitate any CAA comments on the draft rules).

We have considered different options for chairing new Constructive Engagement sessions (noting these arrangements will already be in place for existing forums). H7 Constructive Engagement meetings were chaired by HAL. For NR23, there were two co-chairs (one appointed by airlines and one by NERL). This provided a balanced chairing of the meetings and the co-chairs were responsible for drafting a report summarising the outcome of the Customer Consultation process (NR23 term for Constructive Engagement).

In discussion with stakeholders ahead of this guidance, a suggestion raised as an alternative or in addition to independent chairs or co-chairs is the role of independent reporter, which could be responsible for agreeing the outputs for each round of the Constructive Engagement process between HAL and airlines.

Our current view is that independent chairs or co-chairs could support balanced discussion during some rounds of Constructive Engagement. We would welcome views whether this is practical to put in place for round 1 of Constructive Engagement, noting the short timescales and potential to draw on existing forums.

We have also considered what the outputs should be from each round of the Constructive Engagement process. We consider that a structured approach to outputs should provide a clear understanding of the outcomes of the Constructive Engagement process. Our current view is that the main outputs should be:

- a note from all Constructive Engagement meetings, to be shared with all participants, and provided to the independent reporter (if appointed); and

- a report produced at the end of each round that summarises the process followed and the key outcomes and conclusions. The report should be shared with HAL and airlines to check factual accuracy. At NR23, a similar type of report was produced that was an important reference document for the CAA and stakeholders during the price control review. We would envisage these reports being placed on the CAA website, so that a full range of stakeholders can see the progress being made on Constructive Engagement and comment on issues as appropriate.

We consider that there may be advantages in stakeholders appointing an independent reporter to produce the report and agree it with stakeholders. We note that the reports for each round of Constructive Engagement do not need to be lengthy or overly detailed.

We consider that the written report produced after each round of Constructive engagement should cover:

- a summary of the process, including meetings held, participants and topics discussed;
- a list of information and documents that were provided, including in response to requests for further information;
- a summary of the areas of consensus and any important caveats; and
- a summary of areas where consensus was not reached, the main reasons why and the positions of each party.

This report to be provided to CAA no later than two weeks after the conclusion of the relevant round of Constructive Engagement, or within a timeframe to be agreed with the CAA.

## Role of the CAA

As set out above, we would expect to participate more actively during the Constructive Engagement process, including:

- setting out the overall framework for the price control review and our business plan guidance in the method statement for the next HAL price control;
- issuing appropriate guidance on the Constructive Engagement process to HAL and its airline customers;
- making sure relevant CAA subject matter experts attend sessions or provide alternative attendees as appropriate;

- requesting that HAL initiates discussions with airline representatives regarding the rules of procedure and the appointment of joint chairs (or a mutually agreeable independent chair), and providing support to this as needed;
- encouraging the appointment of an independent reporter, as required, to produce outputs from each round of Constructive Engagement;
- providing appropriate input during Constructive Engagement meetings to clarify our approach to the price controls and, where necessary, providing direction to discussions to make sure they remain relevant, reasonable and bring out both HAL and airline views;
- maintain an ‘open door’ policy to enable any party (including those not involved directly in the Constructive Engagement process) to raise concerns about the progress or conduct of the Constructive Engagement process;
- encourage both HAL and airlines to approach Constructive Engagement in a pragmatic way and to reasonably seek out areas of consensus. This includes the provision of appropriate information in a timely way as part of the process.

Even with a more active CAA role, it will remain appropriate that stakeholders attempt to resolve or narrow differences during the Constructive Engagement process. We will not seek to resolve disputes around policy during the Constructive Engagement process, as these will be matters for our Initial and Final Proposals.