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

CAP2365

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APPENDIX A

Our duties

A1 The CAA is an independent economic regulator. Our duties in relation to the economic regulation of airport operation services (“AOS”), including capacity expansion, are set out in the CAA12.

A2 CAA12 gives the CAA a general (“primary”) duty, to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of AOS.

A3 CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of “consumers”.

A4 The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.

A5 In discharging this primary duty, the CAA must also have regard to a range of other matters specified in the CAA12. These include:

- the need to secure that each licensee is able to finance its licensed activities;
- the need to secure that all reasonable demands for AOS are met;
- the need to promote economy and efficiency on the part of licensees in the provision of AOS;
- the need to secure that the licensee is able to take reasonable measures to reduce, control and/or mitigate adverse environmental effects;
- any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
- the Better Regulation principles.

A6 CAA12 also sets out the circumstances in which we can regulate airport operators through an economic licence. In particular, airport operators must be subject to economic regulation where they fulfil the Market Power Test as set out in CAA12. Airport operators that do not fulfil the Test are not subject to economic regulation. As a result of the market power determinations we completed in 2014 both HAL and GAL are subject to economic regulation.

A7 We are only required to update these determinations if we are requested to do so and there has been a material change in circumstances since the most recent determination. We may also undertake a market power determination whenever we consider it appropriate to do so.

APPENDIX B

Glossary

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

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

Legislation and regulatory processes

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

Acronym / term	Description
NPS	The Airports National Policy Statement published on 5 June 2018 produced by the Government under the Planning Act 2008
S factor	The security factor in the price control formula that allows a partial pass-through of costs resulting from changes to security standards

Price controls

Acronym / term	Description
Q5	Q5 was the price control for the period from 2008 to 2013, the approach to which was subsequently extended to cover January to March 2014.
Q6 / Q6 price control	Q6 was the price control for the period from 2014 to 2018, the approach to which was successively extended to cover 2019 and 2020 to 2021.
H7	The next price control period for Heathrow, assumed to be in place from 1 January 2022 until 31 December 2026.
iH7	The interim H7 price control, running from 1 January 2020 until 31 December 2021.
H8	The price control for Heathrow following H7.
PR19	The five-year price control settlement for water companies in England and Wales for 2020-2024. Ofwat's decision published in December 2019 can be found at: www.ofwat.gov.uk/wp-content/uploads/2019/12/PR19-final-determinations-Overview-of-final-determinations.pdf
RP3	The NATS En Route plc (NERL) Reference Period 3 price control that was originally expected to run from 1 January 2020 to 31 December 2024.
RIIO2	Ofgem RIIO2 price control, for details please see Network price controls 2021-2028 (RIIO-2) | Ofgem

Stakeholders

Acronym / term	Description
AOC	Airline Operators' Committee (for Heathrow)
BA/IAG	British Airways plc/International Airlines Group (owner of British Airways)

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

CAA documents – in chronological order

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

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

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

Stakeholder documents

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

Financial

Acronym / term	Description

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

WBS	Whole business securitisation.
Winsorization	A method of replacing the extreme outliers in the data set to limit the effect of the outliers.

Capex-related

Acronym / term	Description
Capex	Capital Expenditure
Capex baseline	The forecast of development and core expenditure
Capex category	Capex categories include projects that have common outputs / objectives and similar levels of risk and controllability
Capital Efficiency Handbook	HAL publication which includes details of the capex governance framework and associated processes.
Category A costs	Costs which were incurred by HAL during the Airports Commission process, or before Heathrow was named as the preferred location for new runway capacity on 25 October 2016. For more information please see Appendix C to the July 2019 Consultation
Category B costs	Costs associated solely with seeking planning permission for the delivery of new runway capacity at Heathrow. For more information please see Appendix C to the July 2019 Consultation
Category C costs	Costs incurred by HAL in connection with implementation and construction of new capacity, up to entry-into operation. For more information please see Appendix C to the July 2019 Consultation
Core and development framework	The core and development framework describes the transition of capex from development capex to core capex. Core capex is capex that has been through Gateway 3 (investment decision stage) of capex governance, in line with the approach for the Q6 price control. Development capex is capex at an earlier stage of development
DIWE	Demonstrably inefficient and wasteful expenditure
Early costs	Expansion-related costs that are incurred by HAL prior to obtaining planning consent
Ex ante framework	An *ex ante* framework where HAL's performance is measured against cost baselines agreed in advance of delivery.
Ex post review	A backward looking review using actual figures rather than forecasts.
Gateway 3 (G3)	Capex projects follow an eight phase "Gateway" process which aligns with each project's level of maturity. Project business cases are reviewed at key points (Gateways) throughout their life.

Acronym / term	Description
	Gateway 3 is an investment decision stage of capex governance arrangements, in line with the approach for the Q6 price control.
IFS	The Independent Fund Surveyor for Heathrow, which is jointly appointed by HAL and the airlines, with a duty of care to the CAA. The scope of the IFS role is broadly to assure that capital funds are invested efficiently to meet agreed project objectives
IPCR	Independent Planning Costs Reviewer appointed by the CAA under the Planning Costs Recovery Policy Statement.
IPHS	Interim Property Hardship Scheme
Thames Tideway Project	A 25km sewer being built under London. www.tideway.london/
Wind down costs	The costs of pausing and demobilising the expansion programme since March 2020

Recurring terms

Acronym / term	Description
Building blocks	Price control building blocks, including passenger numbers, operating costs, capital expenditure and commercial revenues
CdG	Charles de Gaulle Airport
Commercial revenues	Revenues HAL derives from services to passengers, such as retail, food and beverage, *bureaux de change*, advertising and car parking, or from services to airlines, such as office rental, airline lounges and warehousing, discussed in detail in chapter 5 (Commercial revenues).
Expansion	HAL’s programme to expand Heathrow airport by the construction of a new northwest runway and associated infrastructure in accordance with the Airports National Policy Statement (see “NPS”).
HBS	Hold Baggage Screening
Lower Quartile scenario	This scenario uses the lower quartile of the input range used in financial modelling. One end of the input range is HAL’s updated RBP projections scaled to CAA passenger forecasts. The other end of the input range is CEPA/Taylor Airey’s mid case.
OBR	Outcome Based Regulation, the proposed service quality regulation regime for H7, discussed detail in chapter 3 (Outcome Based Regulation).

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