

Annex 2: Supplementary response to CAA Final Proposals

Comments on the Competition
Commission's provisional price
determination on Northern Ireland
Electricity

Date: 25th November 2013

1 Executive summary

- 1.1.1 While there may be circumstances where the CC and CAA would reasonably take different approaches on certain issues, it is also important to note that general principles of good regulation, including the use of incentives where appropriate, should apply across sectors.
- 1.1.2 Heathrow's initial comments on the provisional CC NIE decision so far relate to:
- (a) Inefficient spend – Heathrow encourages the CAA to take into consideration the CC's principles that inefficient spend should not be evaluated only with the benefit of hindsight, and cannot be demonstrated purely by econometric benchmarking.
 - (b) Deferred investment – unlike the CC, the CAA does not explicitly acknowledge the potential efficiency of investment deferral. As such, the CAA may be reducing Heathrow's incentives to react appropriately to changing market conditions.
 - (c) Real price effect (RPE) – unlike the CC, the CAA does not make any adjustments for RPE. This practice may have the potential to underestimate the true inflation that applies to Heathrow's cost base.
 - (d) Cost risk sharing – while the CC and CAA consider many similar principles relating to efficiency, they have reasonably taken different approaches as appropriate to the regulatory context for each business and the CC and CAA's own regulatory judgement.
 - (e) Cost pass-through – the CC and CAA consider the case for pass-through based on similar principles, including some concept of "controllability", how uncertain the size of the cost is, and its likely scale. Any remaining difference in the precise treatment of cost pass-through may however be justified on the basis of the specific context.
 - (f) Pension deficits – the CC and CAA both consider that at least some proportion of pension deficit recovery costs should be fully passed through. However, the CC's approach to splitting NIE's pension deficit into "historic" and "incremental" deficits may be less applicable to Heathrow.

2 Introduction and context

- 2.1.1 This document is a response to the Civil Aviation Authority's (CAA) letter dated 18 November 2013¹, and is a supplement to Heathrow's main response² to the CAA's Final Proposals (FPs)³ for the economic regulation of Heathrow for the five years from 1 April 2014 (Q6). The letter sought any additional views on relevant developments since the publication of the FPs, for example the Competition Commission's (CC)'s provisional

¹ CAA letter dated 18 Nov 2013, "Request for additional points on the Q6 airport price control consultation process" <http://www.caa.co.uk/docs/78/request%20additonal%20points%20Q6%20heathrow.pdf>

² Heathrow, "Response to CAA Final Proposals CAA/Q6/94", 4 Nov 2013.

³ CAA, "Economic regulation at Heathrow from April 2013: final proposals" ("FPs"), 3 Oct 2013.

findings on the Northern Ireland Electricity (“NIE”) case (the “provisional CC NIE decision”⁴).

- 2.1.2 This document outlines Heathrow’s initial comments on the provisional CC NIE decision in relation to the CAA’s FPs. However, given the limited time to respond, this document does not represent the entirety of Heathrow’s views, nor are the comments necessarily final.
- 2.1.3 As context, it is important to note that there may be circumstances where the CC and CAA would reasonably take different approaches on certain issues. For example, the CC and CAA are making determinations under differing terms of reference; the NIE price control was referred to the CC on public interest grounds⁵.
- 2.1.4 In contrast, the CAA’s duties derive from the Civil Aviation Act 2012 (“the Act”), and are more specific in furthering “*the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services*” (emphasis added).⁶ The CAA must also have regard to financeability for licence holders and secure that all reasonable demands for airport operation services are met⁷, plus general duties including carrying out regulatory activities in a “*proportionate and consistent*” way⁸, targeting regulation “*only at cases in which action is needed*”⁹ and having “*a duty not to impose or maintain unnecessary burdens*”.¹⁰ Any decisions reached by the CAA in relation to the potential basis on which regulation would be applied at Heathrow Airport¹¹ would of course need to be consistent with the CAA’s own duties.
- 2.1.5 Moreover, there are potentially a number of significant differences between Heathrow’s and NIE’s businesses which may limit the extent to which direct comparisons of the approaches adopted by the CC and the CAA can be drawn. For instance:
- (a) The operating context and drivers of operating expenditure (opex) and capital expenditure (capex);
 - (b) The differential risks faced by the businesses under their respective regulatory frameworks, for example in relation to volume risk; and

⁴ CC, “Northern Ireland Electricity Limited Price Determination: A reference under Article 15 of the Electricity (Northern Ireland) Order 1992 – Provisional determination” (“provisional CC NIE decision”), 12 Nov 2013.

⁵ See provisional CC NIE decision §1. The CC is required by Article 15(1) of the Electricity (Northern Ireland) Order 1992 to consider: (a) whether the Price Control Conditions in each Licence operate or may be expected to operate against the public interest; (b) whether the continuation of each Licence operates or may be expected to operate against the public interest absent the inclusion of further conditions designed to improve the recording, reporting, monitoring and verification of information related to the Price Control Conditions and related conditions of the Licences; and (c) if so, whether the effects adverse to the public interest which those matters have or may be expected to have could be remedied or prevented by modifications of the Conditions of each Licence.

The public interest scheme is defined in various pieces of legislation – see provisional CC NIE decision §7. The public interest scheme is set out in its entirety in the Energy (Northern Ireland) Order 2003 (the Energy Order), the Electricity Order and Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 (the EU Electricity Directive).

⁶ The Act S1(1), CAA FPs Figure 2.1.

⁷ The Act S1(3) points (a) and (b), CAA FPs Figure 2.1. The CC’s public interest scheme also contains such considerations – see provision CC NIE decision §7.

⁸ The Act S1(4), CAA FPs Figure 2.1.

⁹ The Act S1(4), CAA FPs Figure 2.1.

¹⁰ The Act S104, CAA FPs Figure 2.1.

¹¹ The Act prohibits an operator of a dominant airport area at a dominant airport from charging for airport operation services unless it has a licence granted by the CAA (CAA FPs §1.8). Heathrow notes that the CAA must reach a final conclusion on Heathrow’s Market Power Test (MPT) to determine whether Heathrow requires such a licence (CAA FPs §1.9).

- (c) The recent and more immediate regulatory context, for example, Heathrow has not been able to earn its cost of capital in recent periods whereas NIE had substantially outperformed its capex allowance in the last price control.¹²

2.1.6 However, it is also important to note that general principles of good regulation, including the use of incentives where appropriate, should apply across sectors. Examples of such principles highlighted in the CC's report (and addressed in more detail below) include the following:

- (a) Principles relating to the appropriate treatment of costs, for example ensuring a balance is reached between encouraging efficient investment and avoiding assessment of costs based on the benefit of hindsight, as well as recognising that deferral of investments may be efficient in certain circumstances.
- (b) How risks might be shared between the operator and users, and under what circumstances costs should be passed through.

2.1.7 Bearing in mind the potential for common principles but different approaches in practice, this document comments on how the CC and CAA treat a number of areas of interest. The remainder of the document will be structured as follows:

- (a) Section 3 discusses the CC's and CAA's approach to **inefficient spend**;
- (b) Section 4 examines the CC's treatment of **deferred investment**;
- (c) Section 5 looks at the applicability of the CC's approach to **real price effects** (RPEs);
- (d) Section 6 outlines key considerations behind **cost risk sharing** as highlighted in the provisional CC NIE decision;
- (e) Section 7 considers the similarities and differences in the CC and CAA's approach to **cost pass-through**; and
- (f) Section 8 discusses the CC's treatment of **pension deficits** as compared with the CAA's approach.

3 Inefficient spend

3.1.1 The CC includes a provision in NIE's licence to allow the regulator to adjust for costs that it finds to be "*demonstrably inefficient or wasteful*".¹³ The CAA takes a similar approach in the FPs by disallowing £30m of capex from Q5 that it deems inefficient, based on applying a similar test of "*whether the expenditure would have been incurred by an efficient operator*".¹⁴

3.1.2 However, the CC additionally recognises two principles in applying the inefficient spend clause:

- (a) "*If something only turned out to be inefficient or wasteful **with the benefit of hind-sight, rather than with information reasonably available at the time,***

¹² Provisional CC NIE decision §15.2.

¹³ Provisional CC NIE decision §5.123.

¹⁴ CAA FPs §9.6.

we would not expect it to be considered to be demonstrably inefficient or wasteful" (emphasis added).¹⁵ This is a particularly important consideration in determining capital efficiency; using only the benefit of hindsight is likely to expose Heathrow to unnecessary *ex post* risks on its investment projects. This is especially important given the wide range of projects that Heathrow undertakes, many of which take place within a particularly challenging operating environment given geographic and capacity constraints.

- (b) *"The type of high-level econometric models used for benchmarking purposes in this inquiry...can help produce estimates of a regulated company's expenditure requirements over a future period...**But such econometric models do not (by themselves) demonstrate inefficient or wasteful expenditure**"* (emphasis added).¹⁶ As such, the CC avoids an overly formulaic benchmarking approach, a useful principle that the CAA might consider when assessing evidence on efficiency. If anything, it is likely that the degree to which econometric evidence can accurately identify whether Heathrow Airport is operating efficiently may be less than expected in the case of transmission and distribution companies, given the critical importance of capacity utilisation and the nature of airline business models in the airport context.

- 3.1.3 The CC agrees with NIE that these principles are "very important", to the extent that they should be reflected in licence modifications.¹⁷
- 3.1.4 Heathrow notes that the CAA did not explicitly consider these principles when assessing the Q5 disallowance, particularly in relation to the benefit of hindsight. Given their importance in balancing efficiency with the incentive to invest, Heathrow encourages the CAA to take these principles into consideration in any assessment of potential future efficiency.
- 3.1.5 Heathrow also notes the CC applies the inefficient spend clause across both capex and opex, conceptually for neutral incentives across both types of expenditure. In practice, however, the CAA itself notes that Heathrow already *"has an incentive to operate within its opex allowance"*¹⁸, so that further action on this point is unlikely to be required.

4 Deferred investment

- 4.1.1 The CC identifies a potential risk of NIE having financial incentives to defer network investment to the detriment of consumers, where this *"stems in part from the opportunity for NIE to seek (and be allowed) additional revenue in subsequent price control periods to cover any costs it expects to incur to make up for the consequences of its investment deferral in the past"*.¹⁹
- 4.1.2 To address this risk, the CC proposes a cost assessment at the next price control review that would prevent "double-funding" of deferred network investment.²⁰ In the next control period, NIE would have to submit forecasted network investment, and an estimate of "pre-funded costs", where the latter reflects the value of network investment that has already been included as part of the current price control (and thus should be excluded

¹⁵ Provisional CC NIE decision §5.126(a).

¹⁶ Provisional CC NIE decision §5.126(b).

¹⁷ Provisional CC NIE decision §5.129.

¹⁸ CAA FPs §6.25.

¹⁹ Provisional CC NIE decision §5.154.

²⁰ Provisional CC NIE decision §5.155.

from the next price control).²¹ The CC suggests that a starting point for assessing pre-funded costs may be “*shortfalls against planned volumes*” (“*eg such shortfalls would not lead to pre-funded costs if they have not increased future investment requirements*”).²²

4.1.3 The CAA identifies a similar issue in the FPs, observing that “[u]nder previous price controls there was limited protection against over-estimation of the capital programme when the control was set, followed by much lower spending”.²³ Given this, the CAA is proposing to implement safeguards in Q6, including²⁴:

- (a) Triggers on a significant proportion of capex;
- (b) Construction that is never begun also does not earn a rate of return; and
- (c) The CAA can disallow expenditure from the RAB in the event the expenditure is determined to be inefficient.

4.1.4 The CAA further highlights a related risk that Heathrow is not “intertemporally indifferent” in the FPs, where if capex is not subject to triggers, Heathrow could potentially “*make a cashflow gain by delaying or cancelling projects for which expenditure is allowed at the price review, since by doing so, HAL could accumulate forecast depreciation on those projects and over-recover significantly during Q6*”.²⁵ To address this, the CAA has committed to assess and reduce Heathrow’s revenues for any over-recovery in the next price control period.²⁶

4.1.5 As such, having identified similar risks, the CC and the CAA have taken different approaches to addressing these. Neither approach would appear to be necessarily superior to the other.

4.1.6 Even so, Heathrow notes that the CC’s aim in preventing deferred investments from being double-funded – a principle that Heathrow supports – does not prevent it from **explicitly acknowledging that deferrals of investment can be efficient**. The CC states that “...we have also recognized that some investment deferral may be efficient”²⁷, going on to observe that “...the regulated company may have a profit opportunity, or financial incentive, to spend less than envisaged at the price control review. Such profit opportunities can help encourage the company to operate efficiently.”²⁸ This principle is reflected in the design of the CC’s approach, which seeks only to avoid duplicate funding, rather than imposing a retrospective claw-back of any timing benefit that the company may have achieved as a result of the deferral.

4.1.7 In contrast, the CAA does not explicitly acknowledge the potential efficiency of deferrals in some circumstances, particularly where investment priorities are revised in light of market developments. Rather, the CAA’s approach suffers from some disadvantages:

- (a) Triggers are activated without explicit consideration of whether deferral was more efficient at the time than proceeding as planned; and

²¹ Provisional CC NIE decision §5.158.

²² Provisional CC NIE decision §5.160.

²³ CAA FPs §4.25.

²⁴ CAA FPs §4.25.

²⁵ CAA FPs §5.36.

²⁶ CAA FPs §5.42.

²⁷ Provisional CC NIE decision §5.133.

²⁸ Provisional CC NIE decision §5.135.

- (b) The CAA's incentives are asymmetric, where delays and over-recovery result in the removal of returns and clawbacks, but increased efficiency from delaying projects are not positively incentivised.

4.1.8 As such, it could be argued that the CAA goes further than the CC in significantly reducing Heathrow's incentives to dynamically and efficiently manage its investments, regardless of context. Given there may be situations where changes in the priority or nature of investments are required to respond adequately to changing market conditions, the CAA may be unduly reducing Heathrow's incentives to react appropriately.

4.1.9 On the other hand, although the CC has correctly identified the principle of potential efficiency in delayed investments, the CC's solution could encounter significant issues in practice. As the CC acknowledges, the cost assessment that it proposes would entail a "*partly qualitative exercise*"²⁹, which could make any judgments on "pre-funded costs" difficult to evidence.

4.1.10 Therefore, while it is important for the CAA to recognise the principle of potential efficiency in its treatment of deferred investments, neither the CC's nor the CAA's approach is necessarily superior to the other in practice.

5 Real price effects

5.1.1 In its provisional NIE decision, the CC uses the retail price index (RPI) as an inflation measure to forecast costs over the control period, but adjusts this for real price effects (RPE) i.e. input-specific price changes. The CC does this based on four main categories of costs: labour; general materials (which includes the resource cost of building and infrastructure materials); specialist materials (which for NIE includes electricity distribution and control equipment inflation); and plant and equipment (including machinery and equipment, and plant and road vehicles). RPI was applied to all other costs.³⁰

5.1.2 In contrast, the CAA applies RPI with no adjustments for RPE.³¹ Although the CAA observes that "[t]he inflation measure used in the price cap should be the relevant inflation index for the cost base", it has chosen to continue to use RPI since it "*is still used by most regulators in price control reviews*" and "*for consistency with past decisions*".³²

5.1.3 However, there is some indication that the CAA's practice may be underestimating the true inflation that applies to Heathrow's cost base. For example, the CC's forecasts of NIE's labour RPE are consistently positive (i.e. above RPI) over the period 2014/15 to Sep 2017.³³ This suggests the applicable labour RPE for Heathrow is likely to be positive and larger in magnitude than the CC's forecast for NIE, given that London labour rates are likely to rise faster than those in Northern Ireland.

²⁹ Provisional CC NIE decision §5.160.

³⁰ Provisional CC NIE decision Table 11.3.

³¹ CAA FPs §2.73. For capex expenditures, there was previously an allowance for Construction Price Inflation (COPI) to rise faster than RPI (§4.71). However, based on forecasts for COPI over Q6 which indicated that it would not exceed RPI, such an allowance was not included in CCA's final proposals (§4.75).

³² CAA FPs §2.70.

³³ Provisional CC NIE decision Annex 11.1, §12. The six months to Sep 2017 is the furthest date for which the CC has provided RPE estimates.

- 5.1.4 The CC also points out that “[w]age differences between different parts of the UK could lead to substantial differences in costs³⁴, and as such carries out relatively detailed regional wage adjustment calculations for NIE in the context of cost benchmarking. Given the CAA has not undertaken a similar exercise, it is unclear whether the CAA has underestimated benchmarks for Heathrow’s costs, given the higher cost of employing staff in London.
- 5.1.5 As such, there may be a case for the CAA to examine the impact of adjusting for RPEs, potentially using the CC’s work as a starting point (e.g. the estimates for “general materials” and “plant and equipment” RPE are likely to be relevant for Heathrow as well).

6 Cost risk sharing

- 6.1.1 In its provisional decision, the CC discusses the principles of cost risk sharing, in particular highlighting that a cost risk mechanism can help reduce consumers’ and NIE’s financial exposure to under or over-estimated costs.³⁵
- 6.1.2 However, the CC observes that such a mechanism also carries risks – if the degree of pass-through is too high, NIE’s incentives to operate and spend efficiently could be undermined, and NIE may even have positive financial incentives to spend unnecessarily (e.g. to grow its regulatory asset base (RAB)). NIE’s operations and reporting could also be distorted if pass-through differs by type of expenditure.³⁶
- 6.1.3 Although the CAA does not explicitly discuss general cost risk sharing principles, it does similarly consider efficiency, incentives for overspend and the sharing of risk between Heathrow and users when assessing inefficient spend, deferred investment and cost pass-through. Heathrow’s comments on the CC’s and CAA’s approaches to these areas are outlined elsewhere in this document.
- 6.1.4 The exact form and relative merits of the CC’s chosen cost risk sharing mechanism, however, should be viewed in the context and history of NIE’s regulation. For example, the CC particularly focuses on avoiding potential financial incentives for NIE to distort its working and accounting practices to favour specific categories of expenditure “*given the concerns that the UR [NIE’s regulator] has raised about changes in NIE’s capitalization practices in the past*”.³⁷ This specific point is unlikely to apply to Heathrow, implying the CAA could reasonably take a different approach.
- 6.1.5 Furthermore, Heathrow notes that the CC has chosen to implement a fixed rate of 50% cost risk sharing on any difference between forecasted and outturn expenditure³⁸ (across capital and operating expenditure apart from a few exceptions³⁹). However, the CC has chosen the sharing factor of 50% based on Ofgem precedent⁴⁰, which it considers the most relevant.⁴¹ The CC observes “[t]he choice of percentage is a matter of regulatory

³⁴ Provisional CC NIE decision §8.38.

³⁵ Provisional CC NIE decision §5.71 to §5.72.

³⁶ Provisional CC NIE decision §5.73.

³⁷ Provisional CC NIE decision §5.85.

³⁸ Provisional CC NIE decision §5.45.

³⁹ Provisional CC NIE decision §5.115(b).

⁴⁰ Provisional CC NIE decision §5.111.

⁴¹ “The most relevant regulatory precedent is from Ofgem’s regulation for GB energy networks.” Provisional CC NIE decision §5.104.

*judgement*⁴²; therefore, this percentage would not be necessarily applicable to Heathrow.

- 6.1.6 On the other hand, the CAA has considered similar principles, but has taken a different approach in a detailed analysis and consideration of how to treat each cost as appropriate to the regulatory context for Heathrow and the CAA's own regulatory judgment. There is no indication from the CC's decision that this is not appropriate. As such, there is no need for action on current Q6 proposals on cost risk sharing, but any new proposals should be considered in line with the principles of financial exposure, efficiency and overspend outlined.

7 Cost pass-through

- 7.1.1 Although the discussion of cost pass-through is largely specific to each business' cost base, Heathrow notes that the CC and the CAA consider the case for pass-through based on similar principles, including some concept of "controllability", how uncertain the size of the cost is, and its likely scale:

- (a) The CC comments on the risks of passing through costs in full (including the risk of exposing consumers to unnecessarily high costs), and observes that "[f]actors which underpin views about the extent to which costs are 'controllable' by NIE will be relevant" to these risks.⁴³ However, the CC notes that "controllability" is "not the only consideration", and gives examples of other potential relevant factors, including "the time and effort to get a reasonable expenditure forecast" and "the scale of the cost item".⁴⁴
- (b) The CAA's three criteria for considering a case for pass-through mirrors this: "the regulated company has little or no control over the cost item"; the cost is "likely to be a significant proportion of the regulated company's total costs"; and the cost is "of uncertain magnitude" i.e. difficult to reasonably forecast.⁴⁵

- 7.1.2 The one common cost item that both the CC and the CAA discuss in relation to pass-through is business rates, where both NIE and Heathrow face cost uncertainty when these are revalued (in April 2015 in Northern Ireland⁴⁶, and in 2017 in Great Britain⁴⁷). However, the CC and the CAA differ on the extent to which the cost should be shared between the operator and the users:

- (a) The CC seems to consider that NIE would have some influence over the outcome of the revaluation, through making representations and even through appeals.⁴⁸ As such, the CC "...consider[s] it important to ensure that NIE is not financially indifferent to the out-come of the anticipated Northern Ireland ratings revaluation", and therefore proposes that NIE's rates are treated in the same way as its other costs (i.e. subject to 50% cost risk sharing).⁴⁹

⁴² Provisional CC NIE decision §5.111.

⁴³ Provisional CC NIE decision §5.323.

⁴⁴ Provisional CC NIE decision §5.323.

⁴⁵ CAA FPs §2.46, cited in a different order. The CAA's criteria appear to cumulative, whereas the CC's wording implies that one or more of the factors cited may be considered, suggesting the CAA's hurdle for considering cost pass-through may be potentially higher than the CC's.

⁴⁶ Provisional CC NIE decision §5.326.

⁴⁷ CAA FPs §2.42.

⁴⁸ Provisional CC NIE decision §5.326.

⁴⁹ Provisional CC NIE decision §5.327.

- (b) The CAA similarly considers that Heathrow “...has the ability to have some influence on rates revaluation”.⁵⁰ However, the CAA also considers that its criteria for pass-through (as outlined above) have been met in this case⁵¹, and therefore included a pass-through factor of 80% (less than 100% to reflect some degree of influence for Heathrow) for any unanticipated increase in rates.⁵²

7.1.3 However, given the similarities in principle between the CC and the CAA as already outlined, this difference on the issue of rates is likely to reflect a degree of judgement and nuance rather than any fundamental divergence of policy. In particular, the CAA have considered the issue of rates for Heathrow in detail, having also sought consultancy advice on rates during the initial proposals phase.⁵³

8 Pension deficits

8.1.1 The CC’s main focus in its assessment of pension costs is the basis on which the deficit of NIE’s defined benefits (DB) schemes should be recovered; Heathrow focuses its comments on this issue.⁵⁴ The CC decides that the pension deficit should be split between “historic” and “incremental”, based on a defined cut-off date.⁵⁵

8.1.2 The CC justifies this mainly on the basis of the decreasing proportion of NIE’s employees who are protected persons⁵⁶, where this proportion has fallen and is likely to continue to fall over time, meriting a different treatment of the historic deficit versus any new incremental deficit.⁵⁷

8.1.3 Based on this split, the CC proposes that the historic deficit is fully passed through to consumers since NIE currently has limited ability to influence the magnitude of this deficit⁵⁸, with recovery payments being made based on a defined valuation of the deficit at one point in time⁵⁹ and a specified period of recovery.⁶⁰ Any incremental deficit is fully absorbed by NIE, reflecting its greater ability to influence forward-looking costs.⁶¹

8.1.4 The CAA similarly recognises that Heathrow’s pension deficit costs should be fully recovered. The CAA justifies this on the basis of a Government Actuary Department review. The review found that – based on the historic treatment of BAA’s pension deficit costs – the economic regulatory principle of users meeting total pension costs including deficit contributions (and therefore also benefitting from any surplus) has been, and should be, applied to Heathrow.⁶²

8.1.5 However, unlike the CC, the CAA does not split Heathrow’s pension deficit between “historic” and “incremental” deficits. On the contrary, the CAA observes that “[t]he deficit is caused by a shortfall on asset returns, accrued over many years. It is very difficult to

⁵⁰ CAA FPs §2.48.

⁵¹ CAA FPs §2.47.

⁵² CAA FPs §2.48.

⁵³ CAA FPs fn 9.

⁵⁴ Provisional CC NIE decision §12.1.

⁵⁵ Provisional CC NIE decision §12.20. The CC follows Ofgem precedent in adopting 31 Mar 2012 as the cut-off date (§12.21).

⁵⁶ Protected persons’ pension benefits cannot be reduced without their consent by statute, for both their past and future service. This applies to some former nationalised industries (Provisional CC NIE decision §12 fn 14).

⁵⁷ Provisional CC NIE decision §12.19.

⁵⁸ Provisional CC NIE decision §12.22.

⁵⁹ Provisional CC NIE decision §12.33. The CC has chosen the most recent valuation for this purpose (at 31 Mar 2012) rather than the last formal triennial valuation.

⁶⁰ Provisional CC NIE decision §12.27. The CC has chosen a period of 15 years to avoid a relatively heavy burden on current customers.

⁶¹ Provisional CC NIE decision §12.23.

⁶² CAA FPs §6.77.

*attribute a portion of the deficit to excessive benefits in specific years*⁶³, suggesting that the deficit should not be split by any particular cut-off date.

- 8.1.6 Furthermore, the concept of a split between “historic” and “incremental” may be less applicable to Heathrow than NIE, for example, Heathrow’s DB scheme only closed in 2008⁶⁴ (whereas NIE’s closed in 1998⁶⁵). Given this, there is unlikely to be a sufficient drop-off in DB participants on Heathrow’s scheme to merit a historic versus incremental split in its deficit.
- 8.1.7 As such, Heathrow considers that the CAA has taken a similar approach to the CC on pensions, but has not split Heathrow’s pension deficit based on a cut-off point as appropriate to Heathrow’s specific circumstances.

9 Conclusion

- 9.1.1 It is important to note that while there may be circumstances where the CC and CAA would reasonably take different approaches on certain issues, general principles of good regulation – including the use of incentives where appropriate – should apply across sectors. In particular, Heathrow encourages the CAA to take into consideration the CC’s principles that inefficient spend should not be evaluated only with the benefit of hindsight, investment deferral may be potentially efficient, and that RPE should be potentially considered when applying inflation.

⁶³ CAA FPs §6.78.

⁶⁴ CAA, “Economic regulation at Heathrow from April 2014: initial proposals”, Apr 2013, §5.8.

⁶⁵ Provisional CC NIE decision §12.6.

