



Civil Aviation Authority  
(via email)

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Dear Paul Smith,

### **SPELTHORNE CONSULTATION RESPONSE TO CAP 1782 – Economic regulation of capacity expansion at Heathrow: policy update and consultation**

In this response we will only be commenting on (1) incentives for capital expenditure efficiency and (2) promote economic efficiency.

#### **Incentives for capital expenditure efficiency**

Spelthorne Borough Council (SBC) is of the view that with such a significant programme of expansion at Heathrow likely to be undertaken in the next few decades, it is absolutely critical that the CAA introduces, and HAL is subject to, efficiency incentives.

It is interesting to note that this approach is already applied extensively over a large range of regulated industries, and therefore it is not at all clear why HAL does not agree that such an approach is necessary. On the basis that their vision is 'to give passengers the best airport service in the world' then you would hope that they would at least be willing to embrace the need to bring their airport in line with other industries. The next step would be to come forward as an exemplar and move to the forefront, instead of lagging behind.

CAP 1782 indicates that the CAA's preferred option is for a regulatory approach to be taken. There are clear advantages to this approach insofar as this sets the costs at the time of the price control review. This means that once they are set there is no risk that prices can escalate before they are fixed (as would be the case with the alternative governance model). It is sensible to have a model where a baseline is set, a cap and collar is applied (which HAL needs to work within) and there is a review at the end of the process. However, we would suggest that as part of this model consideration has to be given to how HAL will be penalised if they exceed the cap. It is also imperative to get a full independent review undertaken at the end of the process to ensure full transparency (in the same way that any organisation has to undergo external audits).

The main advantage as far as SBC is concerned is that this regulatory model allows for *all* capital expenditure to be captured rather than the governance model which would only capture those elements which would most benefit from efficiency incentives. It is suggested in the governance model that areas such as surface access and property would be excluded. This appears to be a very significant risk based on the fact that surface access in particular is likely to be a costly element of the expansion. There would be no incentive for HAL to ensure that those costs were kept realistic otherwise.

It is accepted that by setting costs earlier on in the process that there is less scope to set tight incentives. This has got to be balanced against the fact that the regulatory approach will cover

'business as usual - BAU'. HAL has not been clear to date what works will be included as expansion and what will be included under BAU. If the future reconfiguration of the airport (e.g. terminals and associated works) sits under the latter, then this must be covered through the regulatory approach.

Whilst the regulatory model has very clear advantages SBC strongly advocate a 'mix and match' approach to ensure HAL are subject to a more detailed and rigorous approach on those areas where it is easier to do so. This would use the governance model to tie down the detailed costs of certain capital works part way through HAL's price setting process (which would reduce the likelihood of under or overspend) and pick up those elements which cannot be captured by the governance model (which the CAA estimate to be 45%) through regulatory arrangements.

We understand that CAA still need to consider how matters such as the baselines, delivery objectives, incentive rates will be defined, and will comment further once this consultation is released.

### **Promote economic efficiency**

SBC agree with the CAA that there must be a condition in the licence that requires HAL to ensure that it 'conducts its business in an economic and efficient manner'. This must cover efficient operations and maintenance (business as usual) and ensure that any enhancement and development is undertaken in an economic, efficient and timely manner.

We would also support the CAA's view that this is brought in as soon as possible (as part of the interim price control agreement in 2020) rather than waiting until the next full price control review period in 2022. This will ensure that HAL are held fully to account on how they conduct their business.

Imposition of the licence condition would also go some way to 'levelling the playing field' between HAL and the airlines, which is currently very skewed in favour of the former. This cannot be good for the consumer since sufficient pressure cannot be exerted to ensure that HAL is efficient as it could be.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'H Morgan', with a large, sweeping flourish underneath.

Heather Morgan,  
**Group Head of Regeneration and Growth**