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Response to H8 Draft Method Guidance and Business Plan – CAP3044

Thank you for the opportunity to respond to the above consultation, setting out the draft method statement and business planning guidance for H8 (the “Consultation”).

This submission is made jointly by the London (Heathrow) Airline Consultative Committee (“LACC”) and Heathrow Airline Operators Committee (“AOC”), collectively referred as (the “Airline Community”) and sets out agreed principles and outcomes that we believe the CAA’s guidance should seek to address¹, and structured as follows:

1. Context of the Response and Executive Summary;
2. Response to the CAA’s draft “Priorities”, including the overall prioritisation;
3. Response to the Business Plan Incentive proposal;
4. Comments on the Proposed Approach and Business Plan Guidance chapters, grouped by the Consultation sub-topics with paragraph numbering and questions included for reference; and
5. An Appendix setting out some specific proposed drafting in response to the Appendices within the Consultation

For the avoidance of doubt those elements within the Consultation relating to Financial Issues, the RAB and Cost of Capital will be addressed in response to CAA CAP3044A.

1. Context of the Response and Executive Summary

1.1 Context

The Airline Community submit this response in the context of the CAA’s timetable (2027 – 2031) and economic regulatory framework as proposed within the Consultation and relevant CAA publications²

Given the serious concerns previously raised on the overall affordability, both near and longer-term sustainability of charges, and value proposition of Heathrow, this response, and the Airline Community’s engagement in the H8 process as a whole, is without prejudice to any wider views on the overall appropriateness, effectiveness, or construct of the price control regime. We understand

¹ Please note individual airlines, groups and alliances may make their own submissions detailing their specific views on the Consultation.

² “CAA CAP3000 Setting Future Price Controls” and the CAA letter to HAL, NERL and Airlines, “Constructive Engagement for next Heathrow Price Control Review”, dated 3rd September 2024

and strongly support that wider reform beyond what is considered within H8 is an area the CAA have indicated they are considering and, given the challenges raised, look forward to engaging on such.

The Airline Community also continue to remain concerned on the overall timetable and the risk of any compression on the time for meaningful engagement. We have seen delays to CAA publications (H7 Lessons Learnt, this Consultation, OBR Mid-Term Review) as well as gaps within the process. For example, we will be some way through Constructive Engagement (“CE”) before there is firm guidance on the method guidance. This has been compounded with a lack of a visible activity plan resulting in overlapping CAA consultations, processes, and general demands on resource. To that end, we welcome the CAA keeping the timely completion of activities and overall timetable under review; intervening early if it clearly becomes necessary so as to avoid the uncertainty experienced in the H7 process with the late development and engagement of interim charges arrangements.

1.2 Executive Summary

Notwithstanding and in the context of the comments set out in 1.1 above, the Airline Community broadly welcome the overall approach as set out within the Consultation and recognise the CAA has sought to address a number of areas raised by the Airline Community, particularly through the H7 review³.

In particular, we recognise through the Consultation that the CAA has: identified priorities to support the strategic assessment for H8; has sought to sharpen the incentive on HAL in relation to its business plan; and overall has set out specific expectations and context for the plan as a whole and the key ‘building blocks’ that will underpin it.

Notwithstanding the positive developments, there are a number of aspects that we are particularly concerned about, disagree with and / or note generally could be strengthened, and strongly encourage the CAA to address these areas. The full details are set out within the subsequent sections of this response but in summary:

1. **Priorities:** The Airline Community welcome that the CAA has looked to set out proposed priorities to provide transparent guidance for stakeholders in how the CAA will be considering and addressing the demands of H8. However, whilst the priorities proposed have some recognised and supported themes, notably those raised by the Airline Community under our five strategic priorities for H8⁴, we would highlight a serious concern on the lack of any references to affordability. Whilst reference is made to “*charges no higher than necessary*” the priorities fail to properly address the long-term challenge of Heathrow remaining the most expensive airport in the world and given the longer-term ambitions, the overall sustainability in delivering on the priorities the CAA has set out. We firmly believe such a view is clearly in the interest of the consumer and stress this as a priority for H8.

Beyond the above, we provide specific comment against each priority including recommended targeted enhancements, notably around Environmental Performance, Service Quality, Operational and Financial Resilience and Efficient Investment. As an over-arching comment however whilst we understand the priorities are one of strategic intent, we note a general lack of clear guidance on how and against what the priorities will be measured.

In light of the above, we believe that specific reference to addressing the overall level of charge, refinement of the priorities themselves to provide greater clarity and definition, and

³ CAA CAP2618 “Setting Future Price Controls” and CAA CAP3000 “H7 Lessons Learnt”

⁴ As shared with HAL and the CAA through Round 1 Constructive Engagement



that prioritisation will need to be undertaken, particularly in light of the CAA's primary and secondary duties.

2. **Business Plan Incentive:** Whilst recognising the intent of the CAA in introducing a Business Plan Incentive, not least given the challenges experienced in H7 with the lack of quality in HAL's business plans, the Airline Community have significant concerns about the proposal. In particular the symmetrical nature, proposed criteria for achievement and proposed level.

We strongly disagree that HAL should be subject to any bonus. Setting a high-quality business plan should be an expectation of any well-run business; granting that business a bonus to produce such is effectively rewarding the business for operating normally. It should not be possible for HAL to earn incremental revenue from the consumer – with a potential value as much as five times the amount payable to HAL in 2025 for service-related bonuses – for what should be a normal and expected activity.

This concern is compounded given the assessment criteria lacks sufficient detail, suitable benchmark and focuses on achievement against 'process' as opposed to 'ambition'.

3. **Approach and Business Guidance:** As set out above, we broadly recognise and welcome the overall approach and guidance given in the Consultation with feedback on the relevant areas, as well as specific proposed amendments to the guidance, as set out further in the response.

We would raise however an overarching concern on the high-level nature of aspects of the requirements on HAL for cost standardisation, disaggregation and overall evidencing and challenges for ensuring efficiencies. We have provided specific comments and recommendations, particularly to support the CAA and its advisor(s) in undertaking a bottom-up review of the key cost and revenue drivers, as well as assessing the overall effectiveness of the capital incentive regime.

2. Priorities (Chapter 2)

2.1 Overview

Further to our feedback in the H7 Lessons Learnt process, the Airline Community welcome that the CAA has looked to set out proposed priorities to provide transparent guidance for stakeholders in how the CAA will be considering and addressing the demands of H8.

Whilst the priorities proposed have some recognised and supported themes, notably those raised by the Airline Community under our five strategic priorities for H8⁵, we would highlight a serious concern on the lack of any references to affordability. Whilst reference is made to “*charges no higher than necessary*” the priorities fail to properly address the long-term challenge of Heathrow remaining the most expensive airport in the world and given the longer-term ambitions, the overall sustainability in delivering on the priorities the CAA has set out.

Whilst we welcome the references to ensuring overall efficiencies of investment and costs, the emphasis of the Consultation is seemingly an acceptance of trying to contain increases within H8, as opposed to seeking to address or create ‘headroom’ to deliver on priorities in a sustainable manner.

In both the context of the above and the headwind cost pressures envisaged by the CAA⁶, addressing this for H8 is clearly within the consumers’ interest and to whom the CAA holds its primary duty to. As such we strongly encourage affordability to be explicitly included and prioritised.

To that end we also welcome greater clarity on how these priorities interface with and deliver on the CAA’s statutory duties. For example, we note the CAA has included “*improving financial resilience*” within its proposed priorities yet this is a secondary duty to ensuring costs are addressed, particularly when considering the explanatory note of CAA Civil Aviation Act 2012 that “*airport services are expected to be met where airport operators provide the services demanded by passengers at minimum cost*”⁷.

More generally, whilst we understand the priorities are one of strategic intent, we note a general lack of clear guidance on how and against what they will be measured.

In light of the above, we believe that specific reference to addressing the overall level of charge, refinement of the priorities themselves to provide greater clarity and definition, and that prioritisation will need to be undertaken, particularly in light of the CAA’s primary and secondary duties.

2.2 Comments on the individual Priorities

a) incentivising HAL to deliver a high standard of service quality and environmental performance in a timely way, including ensuring that HAL reasonably supports the transition to net zero

2.2.1 Environmental Performance

Whilst the Airline Community are highly supportive of industry efforts on environmental and sustainability matters, it is unclear what “*environmental performance*” the CAA are referring to, particularly given there are already references within the priorities of “*transitioning to net zero*” and

⁵ As shared with HAL and the CAA through Round 1 Constructive Engagement

⁶ Paragraph 2.11 of the Consultation

⁷ Explanatory Note 36 b), Civil Aviation Act 2012

“meeting environmental targets”. Without further definition it is unclear what the CAA are seeking to achieve and, given its reference as a priority, what implications that may have.

Whilst we understand an intent, the CAA will be aware of previous concerns raised that through regulatory intervention on HAL that this does not create perverse or conflicting incentives or behaviours which, whilst may work for Heathrow, may create unintended conflicts elsewhere within the value chain. This is a complex, inter-linked global issue to which parties, including HAL, have been demonstrating a strong desire to address already.

As such we suggest this is either better defined or the reference removed and addressed through the existing draft on “supporting transition to net zero” and “meeting environmental targets”.

2.2.2 Service Quality

Likewise, we welcome further clarity on what the CAA means by a “High Standard of service quality” and how that will be measured.

There is a clear need to progress service standards at Heathrow, and the Airline Community agree this has a high priority, noting that the current MTI levels set for key areas such as Security, Control Posts and Asset Availability have not changed since Q6 (2012).

b) allowing for efficient investment and providing incentives to increase capacity, improve the operational and financial resilience of the airport, meet environmental targets, support technological change and further other objectives that are valued by consumers, now and for the longer-term;

Whilst there are a number of aspects within which reflect the Airline Community’s five strategic priorities⁸ such as addressing operational resilience and efficient investment we have specific comments on certain aspects in particular:

2.2.3 Efficient Investment and increased capacity

As set out within the response, H8 will require ‘trade-offs’ and prioritisation of investments given the potential level of ‘roll-over’ from H7 being proposed and ambitions within HAL’s plans, both for H8 and beyond. This will include finding the right balance of investing in important longer-term delivery projects such as capacity and sustainability, whilst addressing near term service, operational and commercial challenges and opportunities. It will also require consideration of how certain investments are funded and / or delivered by.

For the avoidance of doubt and in-lieu of a tighter definition on “efficient investment” we would suggest the explicit inclusion of “...*efficient targeted investment and ...*” to make it clear that, in the interest of delivering for both H8 and the longer-term sustainability of future plans such considerations will be necessary.

2.2.4 Operational Resilience and Efficiency

Throughout CE, the Airline Community have highlighted the importance of seeking to ensure overall operational efficiency on the basis of this having a positive bearing on all stakeholders in relation to costs, performance and service. This will ultimately benefit consumers in both direct and indirect experience.

⁸ As shared with HAL and the CAA through Round 1 Constructive Engagement

We would recommend therefore that along with improving the operational *resilience* of the airport, there is an explicit reference within on *efficiency* as well. This could be incorporated within the existing text as “...*improve operational resilience and efficiency of the airport, meet environmental.....*”

2.2.5 Financial Resilience

With regards to “*improving the financial resilience of the airport*” the Airline Community are concerned of the implications or inference in its inclusion. The H7 settlement introduced multiple overlapping mechanisms that have created an asymmetric risk profile favouring HAL and which needs to be addressed for H8⁹. Including “*improving financial resilience*” as a priority could imply an approach to H8 that sees HAL being further insulated from risk and a more imbalanced incentive scheme than today.

HAL must have accountability for its financial resilience and the CAA already have to have regard for this matter; it does not seem appropriate therefore to make this a ‘priority’, certainly when compared with other matters raised.

Its inclusion also raises questions as to interface with financeability assessments being considered against the *notional* company, as opposed to “*the airport*”.

c) ensuring current and future consumers and airlines face airport charges that are no higher than necessary, including through incentivising cost efficiency and ensuring that any growth in HAL’s RAB is sustainable.

Whilst recognising at this stage the challenges in determining the overall level of charge and appropriate cost base, as set out earlier in the response the Airline Community are deeply concerned that the over-riding inference is managing increases, as opposed to any particular challenge in seeking to address the overall levels of costs or charges.

We welcome specific measures aimed at addressing costs, including the references to “efficient investment” and “cost efficiency”. However, a lack of explicit reference to addressing the level of charge and framing of terms such as “...*no higher than necessary...*” and “*growth in HAL’s RAB*” sets an emphasis in seemingly an acceptance of trying to contain increases within H8, as opposed to setting as an objective to address. As already mentioned within the response, this is clearly within the consumer’s interest and should be a key priority.

The priority therefore should explicitly be expanded to “c) *seek to address the overall level of costs and airport charges including* ensuring current and future consumers and airlines..... And ensuring that any growth *and overall size* in HAL’s RAB, *both within H8 and the longer-term*, is sustainable.”

2.3 Prioritisation

As covered earlier in response, it is important that priorities do not cause any undue confusion between the CAA’s primary and secondary duties.

To that end we would reiterate the importance of addressing affordability and in light of the above, the need for this to be fully prioritised within the Priorities.

⁹ The Airline Community will comment further on the balance of Incentives and Risk / Reward in its response to CAA CAP3044A



2.4 Wider Matters

The Airline Community welcome the CAA's recognition that notwithstanding the priorities themselves that there are other important, underpinning areas to address as part of H8, including reviewing the functioning of ORCs¹⁰. We welcome further engagement on this through the process, as well as enhancing the capital incentive regime (further comments on which can be found under paragraph 2.7 of this response).

¹⁰ And as further covered in Paragraph 2.80 of the Consultation

3. Business Plan Incentive (Chapter 3)

Whilst recognising the intent of the CAA in introducing a Business Plan Incentive (“BPI”), not least given the challenges experienced in H7 due to the lack of quality in HAL’s business plans, the Airline Community have significant concerns on the proposal. In particular the symmetrical nature, proposed criteria for achievement and proposed level.

In principle, we would note that a well-run business should produce a high-quality business plan and granting that business a bonus to produce a high-quality business plan is effectively rewarding the business for operating normally. We draw the CAA’s attention to its own statements when producing its Service and Investment Plan (SIP) for the RP3 and NR23 periods that: *“the incentive should remain “penalty only” to avoid NERL earning incremental income for what should be a normal and expected activity¹¹”* and highlight the inconsistency with what has been proposed here.

In terms of the proposal itself, the BPI appears to be reflective of frameworks from other regulated sectors, notably Ofgem and Ofwat, where multiple entities operate. This provides a greater ability to measure comparative plans as well as acting as an incentive between the entities themselves; that does not exist in the case of Heathrow. In the absence of comparative plans, this sets a higher bar on the need to set out clear, robust and challenging criteria on which HAL’s business plan would be measured against, and which we do not see within the Consultation.

On the criteria, not only is this currently broadly written but the proposed BPI focuses on ‘process’ aspects we would consider requirements that would be expected of a business plan in any case. For example, around clear presentation, meeting timescales and demonstrating consumer benefits.

To our mind, and in alignment with other regulated sectors such as Ofgem’s Stage A requirements in their RIIIO-3 Business Plan Guidance, such criteria should be a minimum expectation as opposed to providing any form of reward. We would also remind, and as set out in the Consultation, that there were significant failings by HAL on these aspects during H7 which required CAA intervention and as such should be the focus of attention.

We also note that, whilst deemed an important part of the H8 process, there is no direct reference to CE within the guidance. Given the challenges experienced by the lack of quality in HAL’s H7 business plans and that HAL are only set to produce one business plan for H8, we believe the engagement and incorporation of outcomes from the CE process should explicitly form part of any BPI.

Given the above we therefore strongly encourage that should a BPI be included for H8, that it is applied as a penalty incentive basis only, in line with the CAA’s precedence¹², and with developed and explicit criteria, with greater consideration given for quality of ‘ambition’ as opposed to provision of ‘information’ and following process.

In doing so we would add that applying an asymmetric approach to the BPI should not give cause for any adjustment to cost of capital for perceived risk. Doing so would not only undermine the intent of the BPI but penalties would only be applied as a result of failings within HAL’s control and not reflective of the expected performance of the notionally efficient company (used to set the cost of capital).

¹¹ CAA CAP2394b, Paragraph G24, Appendix G

¹² CAA decision to apply a penalty-only incentive to NERL’s capex plan engagement for NR23



Finally, in relation to the proposed level of any BPI, we note a disparity between what is proposed here, and the incentive for service quality metrics – which in 2025 bonus levels equated to £0.04p per passenger, whereas the Consultation is proposing up to £0.20 for the BPI, a fivefold increase.

4. Proposed Approach (Chapter 2) & Business Plan Guidance (Chapter 4)

4.1 Scope of Price Control (Paragraphs 2.52 – 2.54 and 4.6 – 4.8)

The Airline Community outlined our understanding of the context for H8 in our presentation¹³ to HAL and the CAA during CE which correlates to a number of observations within the Consultation, notably on the scope of H8 being solely two runway related with capacity and resilience challenges to address based on future demand.

Whilst the focus remains on H8, we believe it is important to reiterate that having a clear and coherent line of sight as to the longer-term strategy, including proposed investments and overall affordability, and how H8 will enable this, will be critical. It is important therefore that business plans, and the overall approach, must consider and evidence this within its scope.

“Do you agree, as specified in the draft guidance, that all financial, cost and revenue data be provided in nominal and real prices, with real values in 2024 prices (or an alternative price based with clear justification)?”

With regards to the guidance on presenting financial data, whilst we appreciate the CAA is seeking to provide flexibility there is a concern that in doing so it creates unnecessary ambiguity and misses important aspects. As such the CAA should mandate CPI as the standard price base to ensure consistency. Such standardisation is essential for ensuring consistent analysis across different elements of the business plan and enabling meaningful comparisons over time.

Should HAL wish to present information in different indices this could be submitted as supplementary information.

Furthermore, the guidance is unclear on the need to separate out real price effects and efficiency assumptions. Without further separation important cost trends and understanding true costs drivers may be missed. As such we would strongly suggest that the CAA explicitly state HAL should separate figures by:

- Base cost projections;
- Pure inflation effects using CPI;
- Any real price effects;
- Efficiency assumptions; and
- Any other adjustments

In addition to the above recommendations of revising the guidance to explicitly mandate CPI as the primary price base, establishing clear procedures for presenting any supplementary analyses using alternative indices, and developing standard templates that clearly separate different types of price effects we would also highlight the importance of requiring explicit documentation of all assumptions and adjustments to ensure the appropriate level of transparency is provided within the business plan.

¹³ Airline Community presentation, “Constructive Engagement Round 1 – Focus, Priorities and Requirements”, presented 5th November 2024

4.2 Consumer Engagement (Paragraphs 2.55 – 2.59 and 4.6 – 4.8)

“Do you have any views as to the potential focus areas both for consumer research and engagement and for the approach to seeking assurance that HAL’s business plan reflects this evidence?”

The Airline Community are broadly supportive of the proposed approach by the CAA to consumer engagement including the welcomed recognition of the importance airline insight will be. We look forward to working further with HAL on developing this further as set out within the Consultation.

To that end the CAA setting out the minimum information that should be shared by HAL with airlines / relevant stakeholders and consumers would be welcomed to ensure confidence in the process and reduce the scope of particular framing of questions.

Notwithstanding the above, the Airline Community previously raised concerns on the CAA relying on HAL’s consumer insight to which the CAA set out in CAA CAP3000 that they will *“consider further what guidance we should provide licensees on these matters and whether we should carry out our own research to supplement that carried out by HAL”*. To date we have yet to see further details and welcome clarity on such process and timings as well as reiterate our calls for the CAA to undertake such research to avoid a reliance on HAL.

In parallel we are concerned on the lack of clarity for circumstances the CAA has envisaged where HAL’s approach might not fully align with the outcome of its consumer assurance exercise. We suggest clear guidance is given in relation to the requirements and level of justification expected by the CAA so as to avoid any potential conflict and frustrations in the process.

With regards to specific areas of focus and assurance for consumer research, it is envisaged that the outcomes of CE Round 1 should help inform particular areas of focus to which we will follow up with HAL and the CAA accordingly.

4.3 Traffic Forecast and Traffic Risk Sharing (TRS) (Paragraphs 2.60 – 2.63 and 4.12 – 4.14)

The Airline Community welcome that the CAA will be undertaking its own, independent traffic forecast for H8. Similarly, whilst it is envisaged parties should be closer aligned than in H7, and we will work with HAL as set out within the Consultation. Given historical differences (to which we would reiterate the importance of reviewing past forecast vs outturn performances by parties across Q6 and H7), setting a focus for HAL and airlines in reaching a ‘range’ view should also appropriately support the process whilst allowing a focus on the independent work being undertaken by the CAA.

We also welcome the approach of HAL using scenarios, which, as set out in the Consultation, will be important in understanding varying volume effects on individual ‘building blocks’ and the business plan more generally. As set out elsewhere within the guidance, ensuring those clear linkages will be critical in supporting a quality business plan and engagement.

“Do you have agree that factors identified in the draft business plan guidance are those which reflect the key issues that HAL should take account of in developing the H8 traffic forecast?”

With regards to the questions posed in the Consultation, it is unclear how the CAA have identified the factors and the extent to which these will have a bearing on its own, independent assessment; for example the extent to which the CAA’s consultants have informed these factors or might be constrained. We would welcome greater understanding on this particular issue.

Notwithstanding the above, we would note that long term airline capacity growth plans are an important factor in Heathrow's traffic forecast and should be considered by HAL as part of its traffic forecast.

4.4 Service Quality and Resilience (Paragraphs 2.64 – 2.69 and 4.15 – 4.18)

Do you agree with the proposed approach to updating the existing Outcomes and MTI framework following on from its introduction in H7, and that HAL's business plan should take into account both its own consumer research and engagement and their work to understand airlines' consumer engagement and insights?

During the H7 process the Airline Community provided extensive comment on Outcomes and the MTI framework which, in summary, challenged several elements including the Outcomes themselves (to which the Airline Community put forward their own proposals). Full details can be found in our response to the H7 OBR Proposals in CAA CAP2274, with subsequent views shared through the H7 Mid-Term Review process, and which still stand.

In the context of the above, the Airline Community note the CAA's guidance around building on the existing approach with targeted improvements to which we strongly support the comments on building on H7 Mid-Term Review and those raised by the airlines during the 2024 H7 review process.

That being said, we would challenge the guidance provided in the method statement on Service Quality content in the business guidance and note that it is important that HAL are tasked with demonstrating they are taking into account direct feedback from airlines on any required changes to MTI. If HAL are only tasked assessed with engaging with consumers via their own consumer research, then there is a risk that HAL can ignore its airline customers and the operational and customer experience they have.

We would also challenge the extent to which HAL are "*incentivised on baggage services*", as set out in the Consultation¹⁴. As discussed during both H7 and Round 1 of CE, this is a key area for both airlines and consumers to which we believe financial incentivisation is required given the ongoing issues being experienced and disparity of consequences between airlines and HAL.

Is the guidance for resilience covering operations and assets adequate to address the planned growth in H8 within the existing airport capacity?

As set out in the Airline Community "Resilience" CE presentation to HAL and the CAA, we very much welcome the focus both in terms of ensuring resilience is sufficiently considered and addressed within HAL's Business Plan, and also sufficiently reflected within the MTI framework.

Within the presentation the Airline Community set out specific outcomes it was seeking to achieve under the "Primary Objectives", those being: "Reduce / Avoid on the Day Cancellations"; "Reduced Missed Bags"; and "support the return to normal operations during disruption". Underpinning these were particular drivers and areas of focus that have a material bearing, notably Baggage, Flow and Airfield Performance. We would suggest specific consideration is given on these areas, particularly where both airlines and HAL agree on the bearing these have on those priorities valued by consumers around punctuality and reliability¹⁵.

¹⁴ Paragraph 2.64 of the Consultation

¹⁵ As discussed during the "Consumer" Themed CE session; 12th November 2024

We would press, as per our response to the H7 Mid-Term Review the level of measurement of operational measures and the impact this has on incentivising HAL to provide a resilient operation. If operational measure such as “Security” and “Asset Availability” are only measured as a monthly average then there is significant scope for HAL to hit the targets whilst still failing consumers on particular days within a month. A move to daily measurement would provide significantly higher incentive for HAL to deliver a resilient operation that provides good customer service to all passengers day in day out.

4.5 Environment and Sustainability (Paragraphs 2.70 – 2.74 and 4.19 – 4.20)

Do you consider that the new guidance in this area is appropriate for HAL to develop its plans, and for airlines to engage on HAL’s proposals in this area and what, if any, further guidance on environmental sustainability could be included?

The Airline Community are broadly supportive of the proposed guidance though we believe it is important that HAL makes a clear distinction in its proposals between meeting ‘mandates’ or legal / regulatory compliance and where it is seeking to push beyond, either in scale and / or timeliness of delivery.

Furthermore, HAL should be explicit on any initiatives it is considering that will have a bearing on airlines. Given the primary driver of carbon is outside HAL’s control, it is important that expectations on HAL are proportionate and, as set out in our response to the CAA CAP2618 Setting Future Price Controls, does not through regulatory intervention create perverse or conflicting incentives which, whilst may work for Heathrow, may create unintended conflicts elsewhere within the value chain. By way of example, the aircraft engine trade-off of noise vs NOx emissions.

We welcome the clarification in relation to investments that these should be targeted with demonstrable benefits and follow existing capital processes.

4.6 Costs and Revenue Assessment (Paragraphs 2.75 – 2.79 and 4.21 – 4.22 and 4.24)

The Airline Community have two serious over-arching concerns in relation to the proposals to cost and revenue assessment as set out in the Consultation.

Firstly, whilst there are multiple references to real price effects, there is an absence of seeking evidence of, or requiring, any ongoing efficiency improvements. This should be an explicit ask, alongside any further guidance from the CAA’s independent advisors, to allow consideration of the overall level of efficiency and challenge within the plan.

Secondly, the guidance sets out expectations on the integration of opex and commercial revenues with *planned* capital investment but makes limited or inadequate reference to the performance of *historic* investments. Not only is this critical to ensure benefits from previous investments are properly incorporated within the business plan and avoid the risk of consumers paying for any ‘duplication’ of performance improvements and efficiencies but is also particularly important where overall benefit tracking by HAL has been limited to date, as per the discussions through the joint airline / HAL capital governance forums the CAA have been in attendance¹⁶.

For example, HAL’s purchase of Compass Centre (post H7 settlement) should have a material bearing on reducing opex costs but the guidance is not explicit in ensuring this is captured. Similarly, there is

¹⁶ Programme Airline Working Group (PAWG) and Future Portfolio Group (FPG)

no requirement on HAL to specifically incorporate the Covid-19 “Cost of Change” initiative that was agreed to be included onto the RAB to enable permanent efficiency savings, nor the outcome of the recent outsourcing activities it undertook in 2024 and which were publicly forecasted to save £40m.

Do you agree that the categorisation of costs, revenues and capital expenditure in HAL’s regulatory accounts provides an appropriate basis for the specification of data to be submitted in the H8 business plan? If not, please describe what alternative categorisations you think should be considered, and why.

With regards to the question on using HAL’s regulatory accounts, the Airline Community would disagree that this is an appropriate basis to specify the data required as part of HAL’s H8 business plan. Instead a greater degree of granularity should be required, particularly in order to assist the CAA and their advisors in bottom up-benchmarking, the proposal for which we strongly support.

4.6.1 Opex Costs

- People Costs: Given this accounts for one of the largest components of HAL’s cost base, we believe this warrants further breakdown to allow greater understanding and benchmarking. In particular we would propose Security; Operational; Non-Operational and Pensions;
- Other Operating Costs: This accounts for nearly a quarter of total expenditure yet lacks any meaningful breakdown within the accounts. It is therefore difficult to determine value for money, particularly given this will cover services where suppliers hold significant market power, such as NATS and UKPNS.
- General Expenses: These should be categorised as within and outside management control; and
- Areas of Significant Cost Change: Enhance disclosure of any anticipated increases / decreases should be explicitly called out to allow for appropriate understanding and consideration, for example Business Rates or the delivery of the Next Generation Security programme.

4.6.2 Commercial Revenues

Whilst the broad categorisation is generally acceptable, we recommend property-related revenues are called out to allow for proper assessment and consideration of the ongoing value and contribution being made, particularly in light and in support of the wider review of the RAB.

Similarly to opex; any areas of significant variations anticipated should be disclosed to allow for greater understanding and scrutiny.

4.6.3 Capital Costs

The Airline Community would highlight that through the capital governance process, including wider reporting requirements, a much greater level of detail is provided and information available than that within the regulatory accounts. As such, this should form the basis to allow for a greater understanding of both the proposed capital envelope; sub-Programmes and major projects; and intended benefits.

As well as a by Programme / Project level, a breakdown of envisaged Risk, Leadership and Logistics and Programme Costs should also be made explicit to understand a significant proportion of the overall portfolio spend (conservatively < 20%).

We also note that the CAA have made reference to appoint expert advice in support of its assessment of HAL's masterplan¹⁷. Whilst we strongly support this approach, particularly in understanding the longer term costs and viability of HAL's proposals, we would highlight that such costs within H8 may be *relatively* limited in so far as they primarily relate to costs around the planning process. We would strongly encourage the CAA to ensure the scope of any such support goes beyond just the 'masterplan' element but considers the overall portfolio and underlying programmes.

As part of the final business planning guidance, we intend to specify further data to facilitate additional benchmarking. Please provide any suggestions you have for what this may cover, focusing on those areas of costs and revenues having the biggest impact and most amenable to benchmarking analysis (including identification of potential data sources).

As set out above, the Airline Community welcome the CAA's intention to undertake a more rigorous benchmarking of HAL's business plan to allow greater scrutiny and confidence within the plan and look forward to engaging with both the CAA, their advisors, and HAL in identifying areas and formats for particular focus.

As set out in our response to H7 Lessons Learned, there are a number of key areas already identified through the CAA consultant reports, and these remain a good basis on which to start.

Notwithstanding these, we make the following observations for consideration, noting these will continue to develop as we go through CE.

We would also note that 'commercial sensitivity' should not be allowed to be a barrier to allowing the CAA sight of the necessary data.

4.6.4 Opex Benchmarking

- Passenger Security: Given this is a significant cost component we believe this will be important. Such areas should include: Staff productivity metrics, processing rates, training and management costs. Furthermore, we would highlight that it is essential to understand HAL's plan for the use of the Next Generation Security systems being delivered in H7 and how that will reduce opex. In particular the reduction in overall numbers of CSA lanes and the significant opportunity in H8 to centralise x-ray image monitoring and therefore reduce staffing costs and increase throughputs. (So called "multiplexing" which is already deployed by HAL in the Control Posts – so is proven technology)
- Security Control Posts: As well as their distinct nature, given these are now outsourced this should also provide a greater degree of actual costs and efficiencies.
- Facilities Management and Maintenance Contracts: Key areas, particularly those that relate to MTI and fall outside the scope of ORCs, such as cleaning, should be assessed.
- Key External Contracts: Areas such as NATS, UKPNS and Consultancy contracts. As well as cost breakdown this could include service level assessments and evidence of market testing

4.6.5 Commercial Revenue Benchmarking

We would note historic assessments, such as retail revenue per passenger, property yields, and car park revenues, are suitable areas for consideration.

¹⁷ Paragraph 2.79 of the Consultation

4.6.6 Capital Costs Benchmarking

In relation to capital costs, we would encourage the CAA to seek to understand and benchmark key cost drivers. This could be done by particular project type, noting variabilities (e.g. airside operational projects, landside civils etc), as well as assessing the underlying cost drivers that make up the cost plan. In particular this would include understanding: Risk; Programme Costs; and Leadership and Logistics, key components within the overall cost plans.

This should consider and build on the current work being undertaken by G&T as part of the “H7 Independent Review to Process”.

4.7 Cost Incentives (Paragraphs 2.81 – 2.85 and 4.21 – 4.22 and 4.24)

Given the nature of the capital governance and the ongoing engagement between HAL and airlines, we agree with the CAA the merit in HAL raising any points on the current arrangements with airlines¹⁸. A significant amount of work by all parties has been undertaken in implementing the new regime and it would be useful to collectively review what further enhancements could be made.

Do you agree that the guidance we have provided on capex efficiency incentives will result in a business plan submission by HAL which will facilitate the CAA’s assessment of the effectiveness of capex efficiency incentives in H7, with a view to making improvements for H8? If not, what additional information should CAA request in order to facilitate this assessment?

One area of concern raised by parties at the time ex-ante was to be introduced was in relation to the extent risk may be inflated to account for a move to ex-ante. Understanding from HAL: (i) what amounts for risk have been included within the G3s vs actual outturns; and (ii) level of change control post G3 would be an important assessment in understanding whether there has been any such materialisation of those concerns raised.

Additionally, the proscribing and reporting of benefits linked to investments has long been a topic of discussion through the joint HAL / airline Programme Airline Working Group (to which the CAA attends). In support of understanding both the overall efficiencies of cost as well as the effectiveness of the current capital incentive and governance arrangements, we would suggest a review on the overall performance of proscribed vs actual benefits would be very useful, particularly as this won’t be captured in any review of Delivery Obligations (“Outputs” having primarily been set against delivery of physical assets). Given HAL’s own Gateway Lifecycle implemented in Q6 had a specific milestone for benefit realisation, there should be a depth of evidence that the CAA, and its consultants, could call upon in fully understanding this.

We would also strongly recommend the CAA consider and build upon where necessary, the findings of the H7 Independent Reviews on Processes and Standards to identify and help inform any potential changes in the governance or incentive approach.

¹⁸ Paragraph 2.85 of the Consultation

Appendix 1 Suggested Amendments to Business Plan Guidance

In addition to the points raised earlier in this Section 4, the Airline Community make the following, specific recommendations to the proposed Business Plan Guidance drafting as set out in Appendices A – F of the Consultation:

| <u>Reference</u> | <u>Proposed Amend</u> | <u>Rationale</u> |
|-----------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <u>A.1 - Scope</u> | “The business plan should be: designed to reflect consumers’ <i>and airline customer</i> views and preferences to the fullest extent practicable;” | Reflective of our comments in the importance of evidencing the outputs of Constructive Engagement |
| <u>A.1 - Scope</u> | “The business plan should provide a level of detail on projects <i>and initiatives</i> which reflects the time periods for delivery: projects that are further in the future will typically have less detail” | To avoid any confusion that it is not simply projects e.g capex projects, but rather is wider and includes areas that have a bearing on consumers and stakeholders. For example, post H7 settlement changes to charges for Fast Track |
| <u>A.1 - Scope</u> | “The business plan should link revenues and costs to scenarios for passenger numbers, taking account of expected developments in capacity and other matters, <i>including investments and initiatives delivered (actual or forecasted) both before and within H8.</i> ” | Important that the plan is explicit in showing what has been delivered to date based on investments and actions taken. This should avoid any ‘duplication’ and support a greater degree of transparency. |
| <u>A.1 - Scope</u> | “Price Base and Inflationary Assumptions....” | The text should be replaced to reflect the comments and proposals in Paragraph 4.1 above |
| <u>C.1 - Traffic</u> | “Jointly agreed scenarios should take account of a range of factors, including: <ul style="list-style-type: none"> • <i>Airline fleet and capacity growth plans</i>” | Airline capacity growth plans are an important factor in LHRs traffic forecast and should be considered by HAL as part of its traffic forecast. |
| <u>D.1 – Service Quality & Resilience</u> | “Updates should take into account any HAL consumer research and engagement <i>and feedback from airlines</i> (see Appendix B) that informs | It is important that HAL are tasked with demonstrating they are taking into account direct feedback from airlines on any required changes to MTI. If HAL |

the business plan and that HAL should work with airlines to understand their own consumer engagement and to review and agree updates to the framework where possible.”

are only tasked with engaging with consumers via their own consumer research then there is a risk that HAL can ignore its airline customers and the operational and customer experience they have.

“In making its proposals HAL should demonstrate how it has taken account of consumer insights, *feedback from airlines* and other developments in the sector. It should also demonstrate the links between service levels and value for money, and remain responsive to consumers’ *and airlines* evolving needs throughout the H8 period.”

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| <p><u>D.1 – Service Quality & Resilience</u></p> | <p>HAL should consider how the Outcomes and MTI scheme framework could help maintain and improve operational and asset resilience during the H8 period, <i>including particular consideration for Baggage systems, ATC performance and Security.</i></p> | <p>Reflect the importance of these areas, as discussed during CE and covered further under Paragraph 4.4 above.</p> |
| <p><u>E.1 – Environmental Sustainability</u></p> | <p>HAL should set out the progress that it has already made in this area, including any significant projects and the outcomes that have, <i>or are forecasted to</i>, been delivered as a result of environmental sustainability investment during H7</p> | <p>To capture ‘inflight’ activities and investments and avoid any potential ‘duplication’ within H8.</p> |
| <p><u>E.1 – Environmental Sustainability</u></p> | <p>HAL should clearly set out any relevant environmental obligations, its environmental objectives <i>and how they relate</i>, and the plans it intends to take to address those obligations and objectives during H8 to support its transition to net zero.</p> | <p>It is important to clearly understand what HAL are undertaking to ‘meet’ legal / regulatory requirements and proposals that may go beyond (quicker, further etc) and HAL driven.</p> |
| <p><u>F.1 – Costs Opex</u></p> | <p>Opex for each year of Q6, H7 and H8 should be provided, split by each category of opex <i>set out in HAL’s</i></p> | <p>See comments in 2.61</p> |

~~regulatory accounts as set out XXXX.~~

Actual data should be provided up to and including the 2024 financial year, forecast data should be provided for 2025 financial year onwards.

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| <p><u>F.1 – Costs Opex</u></p> | <p>Where future opex (either in aggregate or for individual opex elements) varies across the scenarios, the assumed relationship between opex and traffic (and/or passenger numbers); <i>capital expenditure; and / or proposed service targets</i> should be clearly stated and explained.</p> | <p>To capture other variances that need to be reflected within the plan</p> |
| <p><u>F.1 – Costs Opex</u></p> | <p>HAL should provide evidence that costs projections are robust and efficient <i>with evidence of considered initiatives to address the overall level</i> . For example, we expect costs to have been market-tested or benchmarked, and that all evidence and assumptions relating to costs are clearly outlined.</p> | <p>It is important to clearly understand what HAL are undertaking to ‘meet’ requirements and proposals that may go beyond (quicker, further etc) or not legal or regulatory obligations</p> |
| <p><u>F.1 – Costs Opex</u></p> | <p>HAL should show that its opex and commercial revenue forecasts are consistent with <i>both completed and planned capital investment</i>. We also expect costs to be transparently linked to outcomes, and that costs reflect past performance together with realistic assumptions about the scope for future efficiency</p> | <p>To ensure the benefits of those investments already made are explicitly captured</p> |
| <p><u>F.1 – Commercial and Other Revenues</u></p> | <p>Commercial and other revenues for each year of Q6, H7 and H8 should be provided, split by each category of revenue set out in HAL’s regulatory accounts (plus any additional revenue categories HAL expects to receive during H8)XXX.</p> | <p>See comments in 2.62</p> |
| <p><u>F.1 – Commercial and Other Revenues</u></p> | <p>HAL should provide forecast revenue data on this basis for each of the high, low and base case traffic forecast scenarios as discussed in Appendix C on traffic forecasts. Where future commercial revenue varies across the</p> | <p>To capture other variances that need to be reflected within the plan</p> |

scenarios, the assumed relationship between the commercial revenue item and traffic (and/or passenger numbers) *capital expenditure; and / or proposed service targets* should be clearly stated and explained.

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| <p><u>F.1 – Commercial and Other Revenues</u></p> | <p>HAL should demonstrate that its forecasts are integrated with other areas of the business plan, and that its opex and commercial revenue forecasts are consistent with <i>both completed and</i> planned capital investment.</p> | <p>To ensure the benefits of those investments already made are explicitly captured</p> |
| <p><u>F.1 – Commercial and Other Revenues</u></p> | <p><i>HAL should provide evidence that commercial revenue projections are robust and efficient. For example, we expect costs to have been market-tested or benchmarked, and that all evidence and assumptions relating to revenues are clearly outlined</i></p> | <p>To evidence the overall level of efficiency and robustness</p> |
| <p><u>F.1 – Capex</u></p> | <p>Total capital expenditure for each year of Q6, H7 and H8, <i>and where such commitments would go beyond H8</i>, should be provided, with historical information reconciled to HAL’s regulatory accounts. Actual data should be provided up to and including the 2024 financial year, forecast data should be provided for the 2025 financial year onwards.</p> | <p>Ensure greater clarity on relationship to longer term plans, and commitments being made into H9</p> |
| <p><u>F.1 – Capex</u></p> | <p>HAL should provide all capex data in both nominal terms and in an appropriate and consistent price base as set out in Appendix A on scope, making clear the assumptions it is making on inflation (and including the basis/source for future inflation forecasts).</p> <ul style="list-style-type: none"> • Where real price effects are assumed in the capex forecasts, the assumptions should be clearly stated and the basis/source for such | <p>Should be updated to reflect comments under 4.1</p> |

assumptions should be clearly explained.

F.1 – Capex

The business plan should contain detail on the overall capex portfolio and all the capex programmes within this portfolio. Each capex programme should be described in detail including the work that has supported the development of the programme – including the needs case, strategic optioneering, estimates of efficient costs by each year and key cost drivers, outputs and consumer benefits. Also, HAL’s views on the breakdown of programme costs between “core” and “development” capex should be provided, *included anticipated committed spend (‘roll-over’) from H7 into H8, and beyond H8 into H9.*

As seen in the crossing between economic control periods there is a degree of capital ‘roll-over’ which is committed within one period but impacts another. As part of understanding the longer-term view HAL should be identifying the extent to which proposals within H8 would have a bearing beyond.

F.1 – Capex

Evidence should be provided that alternative approaches, such as opex solutions *and alternative delivery models*, have been considered to achieve maximum value for money in delivering outcomes for consumers.

Important that HAL considers alternative delivery options, for third party investors / builders / operators, as per Q6 hotel development arrangements.

F.1 – Capex Incentive

HAL should set out its views on how the ex ante capex efficiency framework has been operating in H7. This should include information and data on:

Performance of risk estimation at G3 to actuals;

Level of change control post G3

Proscribed vs actual benefits

See Paragraph 4.7 ~ An area of concern raised at the time of implementing ex-ante was the extent to which it may drive increase risk provisions within the capital projects. Likewise benefit realisation continues to lack proper transparency. Including specific reference would help in understanding the extent to which that has materialised, either through risk provision and / or level of change control