

Future of service quality regulation for Heathrow Airport Limited: Consultation on the design principles for a more outcome-based regime

CAP 1476



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Chapter 1

Summary

- 1.1 This consultation sets out our latest thinking on how regulation of the quality of airport operation services provided by Heathrow Airport Limited (HAL) can be improved by strengthening the link with consumer preferences and priorities.
- 1.2 We would like the regulatory regime to be responsive to the outcomes that consumers' value. Developing the current output-based approach to service quality regulation such that it appropriately reflects outcome-based regulation (OBR) will contribute to delivering this objective.
- 1.3 The document sets out our initial views on the five principles that might underpin our approach to OBR and discusses how we think these principles could be implemented in practice. These are as follows:
- Principle 1: OBR should be informed by robust consumer research
 - Principle 2: The structure of OBR should include 'outcomes', 'measures', 'targets' and 'incentives'
 - Principle 3: The Consumer Challenge Board and airlines play a key role in the development of OBR
 - Principle 4: OBR should build upon the SQRB
 - Principle 5: Performance reporting should be comprehensive and targeted at consumers
- 1.4 Following this consultation we will set out our final views on the key principles that will support our approach to service quality in the H7 'Policy Update' document to be published in spring 2017.

Views invited

- 1.5 We welcome views on all the issues raised in this document, in addition to the consultation questions listed at Appendix A. Please [respond via online](#)

[survey](#), or email your response to economicregulation@caa.co.uk by no later than 5pm on Friday 27 January 2016. We cannot commit to take into account any representations received after this date.

- 1.6 If you would like to discuss the issues raised in this document please contact Rob Toal (robert.toal@caa.co.uk) or Beth Corbould (beth.corbould@caa.co.uk).
- 1.7 Representations will be made available on our website. Any material considered confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to disclosure of information under Section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000 and it may be necessary to disclose information consistent with these requirements.

Chapter 2

Introduction

Background

- 2.1 The current regulatory arrangements that apply to HAL (referred to as Q6), which include a price cap and minimum standards for service quality, are due to expire on 31 December 2019¹. Earlier this year we consulted on the strategic themes² that should help to shape the H7 review.
- 2.2 In that consultation we set out our initial view that it would be timely to review the Service Quality Rebates and Bonus (SQRB) scheme to consider whether revisions were required to improve value for consumers. We suggested that it may be necessary to consider significant changes to the SQRB arrangements to ensure that consumers' interests are at the heart of our approach to the economic regulation of airports. This reflects our primary duty to promote the interests of consumers.

Consumer Challenge Board

- 2.3 To support a consumer focused approach to economic regulation we also recently confirmed our intention to establish a Consumer Challenge Board (CCB)³ to help ensure that the H7 review is driven by a robust understanding of what consumers' value.
- 2.4 The role of the CCB is to promote the interests of consumers by focusing on the following key activities:

¹ Q6 was originally intended to end on 31 December 2018; however that has recently been extended. The CAA's decision on this extension can be found on our website: <https://consultations.caa.co.uk/corporate-communications/hal-price-control-2>.

² In March 2016, we launched a review (the H7 review) of the issues that should shape the framework for the next control period CAA (2016) 'Strategic themes for the review of Heathrow Airport Limited's charges: A discussion document': www.caa.co.uk/CAP1383.

³ CAA (2016) 'Decision on the Terms of Reference for the H7 Consumer Challenge Board': www.caa.co.uk/CAP1449.

- providing independent scrutiny and challenge to HAL on the development of its H7 business plan; and
- providing independent advice to the CAA on the overall quality of HAL's business plan, particularly on how, and the extent to which, it has been informed by high quality consumer engagement and the extent to which the outcomes and incentives in the plan reflect the needs of consumers as demonstrated by that engagement.

2.5 We are in the process of recruiting the Chair and members of the CCB and expect the group to be up and running early in 2017.

2.6 The CCB will not undermine the importance of constructive engagement or the role that airlines can play in the development of robust proposals for H7. It will complement the work airlines do by providing extra assurance on HAL's approach to customer engagement and helping to ensure that this customer engagement is reflected in its business plan.

Developing new arrangements

2.7 Reflecting the importance of taking careful account of the views of all stakeholders in developing new arrangements we have had a number of detailed discussions with HAL and with airlines following the publication of strategic themes document in March 2016, to share and discuss ideas related to the development of service quality regulation. In light of these conversations, we are using this document to consult on a set of principles to help shape the design and the functioning of a new outcome-based service quality regime at Heathrow.

2.8 The new arrangements are expected to apply for the duration of the H7 price control period which will begin in January 2020. While the length of the H7 period has not yet been determined, if we follow the standard cycle of 5-yearly price reviews, this would suggest the arrangements for service quality are likely to be in place until the end of 2024. Notably this is expected to overlap with a period of significant construction and other works associated with the new runway. This underlines the need to

ensure that the service quality regime remains fit for purpose over the longer term.

Box 1: Outcome-based regulation

In the past, our approach to airport regulation has focused on assessing the level of expenditure that the airport will incur in order to deliver a given level of service and investment (outputs).

We consider that, while this approach has worked well, there may be a risk that regulation could miss the 'bigger picture' by not adequately capturing what consumers want and value from the airport service. Some regulators have considered similar issues and have begun to move away from the regulation of inputs and outputs in pursuit of a regulatory approach with high-level 'outcomes' at the centre.

'Outcomes' in an airport regulation context refer to the range of higher-level consumer objectives that are the most important aspects of the airport service that consumers value.

Some illustrative examples of airport outcomes might be:

- Passengers are satisfied with the airport experience.
- Charges are reasonable.
- The service is provided safely and securely.

Our duties

2.9 In developing these principles for consultation we have had full regard to our statutory duties under the Civil Aviation Act 2012 (the Act). The Act gives us a primary duty to further the interests of users of air transport services in respect of our economic regulation functions. Users are defined in the Act as present and future passengers and those with a right in property carried by the service, i.e. cargo owners (we use the term 'consumers' for simplicity).

2.10 The scope of our primary duty concerns the range, availability, continuity, cost and quality of airport operation services. We must carry out our

functions, where appropriate, in a manner that will promote competition in the provision of airport operation services.

2.11 In discharging our primary duty, we must have regard to a range of other matters under the Act. These include:

- the need to secure that HAL is able to finance its licensed activities;
- the need to ensure that all reasonable demands are met;
- the need to promote economy and efficiency;
- the need to secure that HAL is able to take measures to reduce, control and 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
- better regulation principles.

Structure of this document

2.12 The structure of this consultation is as follows:

- Chapter 3 provides an overview of the existing service quality regime;
- Chapter 4 discusses the reasons for reviewing the quality of service regime for HAL and the key characteristics of an OBR for service quality;
- Chapter 5 sets out the views of HAL and the airline community on these issues and provides an update to our thinking on some of the main concerns raised by respondents;
- Chapter 6 builds on the assessment set out in chapter 5 and describes possible design principles that could be used as the basis for helping to ensure that the approach to regulating HAL's service quality encompasses OBR; and
- Appendix A lists the questions for consultation.

Chapter 3

Overview of the existing service quality regime

Introduction

3.1 In this chapter, we describe the current arrangements for the regulation of service quality at Heathrow Airport and provide headline information on HAL's performance in the current Q6 price control period.

Existing service quality regulation

3.2 We currently regulate the quality of services provided by HAL through the SQRB scheme. The scheme has been in place since 2003 (Q4) following recommendations by the Competition Commission that there should be incentives for airport service quality.

3.3 Since then, the overall structure of the SQRB scheme has remained largely unchanged although it has been reviewed and modified at each price review. The regime has been periodically tested with consumer representative bodies (such as the Passenger Services Sub Committee of the Heathrow Airport Consultative Committee at Q6).

3.4 There are currently five broad areas covered by the SQRB:

- passenger satisfaction with cleanliness, departure lounge seating, flight information and way-finding;
- security, which includes queuing time standards for central search, transfer search, staff search and control posts;
- passenger operational elements, which measures the availability of passenger-facing equipment in terminals such as lifts and escalators;
- airline operational elements, which measures availability of airline facing equipment such as stands, jetties, and fixed electrical ground power; and

- the aerodrome congestion term, which measures the number of delayed air traffic movements due to material events in the airfield.

3.5 Under the SQRB scheme, if HAL's performance falls below a certain level, it will have to pay a proportion of charges back to the airlines. These rebates are paid to airlines on a monthly basis and the maximum amount of rebates that is at risk is capped at 7% of annual airport charges. The scheme also includes a bonus element based on passenger satisfaction measures. The maximum additional revenue achievable from passenger satisfaction bonuses is capped at 1.44% of annual airport charges.

3.6 We also regulate some aspects of quality that lie outside of the SQRB scheme. For instance, under the operational resilience licence condition, HAL is required to "*secure the availability and continuity of Airport Operation Services, particularly in times of disruption, to further the interests of passengers and cargo owners in accordance with best practice and in a timely, efficient and economical manner.*"

Performance under the service quality regime

3.7 The scheme enables us to monitor and enforce the standards that airlines and passengers should expect from HAL in exchange for the charges that the airport receives. In the Q6 period to date, HAL has generally performed strongly on service quality, as illustrated by the table below.

Table 1: HAL's service quality performance (April 2014 - September 2016)⁴

Q6	Overall number of SQRB standards	Number of SQRB standards passed	Percentage of SQRB standards passed
2014	776	753	97%
2015	984	961	98%
2016 (to Sept.)	666	666	100%

Source: HAL data, CAA analysis

⁴ The number of standards measured varies because of the opening of Terminal 2 in June 2014, and the closing of Terminal 1 in June 2015.

Chapter 4

Key issues

Introduction

4.1 In this chapter we explain why we think it is timely to review the existing service quality arrangements. We then consider whether OBR is likely to have benefits for consumers at Heathrow before going on to provide our thoughts on how a new set of arrangements could work. Finally we summarise some of the advantages and disadvantages of such an approach.

Reasons to review the SQRB

4.2 We consider that the case for reviewing the approach to regulation of service quality at Heathrow is compelling. In particular, there have been a number of significant changes at the airport which are likely to directly or indirectly impact the level of service quality provided.

- **Change in ownership.** At the time the scheme was designed around 2003, Heathrow was part of the BAA group of airports and service quality regulation was also applied to Gatwick and Stansted airports. While bespoke arrangements were developed for each airport, the overall structure and framework for the SQRB was tailored to reflect the fact that BAA owned a number of regulated airports and there should be some common standards for the regulation of service quality. Heathrow is no longer part of a group of airports.
- **Updated facilities.** Over the last decade, Heathrow has invested over £10bn in capital expenditure to update and modernise the facilities at the airport. This includes the new Terminals 5 and 2 as well as significant refurbishments to Terminals 3 and 4 and other passenger facing facilities. We consider that these changes are likely

to have had a major impact on the passenger experience at the airport.

- **New legislation.** The current arrangements were introduced and developed under the Airports Act 1986 which required the CAA to balance 4 co-equal duties around furthering the interests of users, promoting efficiency, encouraging investment and imposing the minimum restrictions possible. The introduction of the Act replaced these duties with a single primary duty which requires us to further the interests of passengers and cargo owners.
- **Emerging best practice.** We recognise that airport regulation has some unique features compared to other regulated sectors, but where appropriate we want to build on best practice approaches to service quality regulation being developed in other sectors.
- **Wider developments at Heathrow.** The H7 period is currently expected to run until the end of 2024⁵ so it is important that the arrangements for regulation of service quality are designed in a way that they remain fit for purpose over that time period and ensure that HAL retains sufficient focus on providing services to existing consumers, alongside dealing with issue around runway development.

⁵ As noted in Chapter 2 the duration of the H7 price control period has not yet been determined so this timescale is illustrative at this stage of the process.

Box 2: Case study from the water industryOfwat: PR14

A key feature of Ofwat's PR14 price control review was the emphasis on company ownership of their business plans including a greater focus on what companies deliver for their customers (i.e. outcomes) rather than how they deliver it. Ofwat's outcomes framework was not prescriptive, but rather allowed companies to identify and propose outcomes and associated performance commitments and delivery incentives, based on extensive customer engagement. Nonetheless, Ofwat also retained certain key aspects of the previous quality of service regime (such as the service incentive mechanism), strongly encouraged companies to develop financial incentives rather than relying only on reputational incentives, and scrutinised the suitability of the performance commitments and delivery incentives proposed by companies.

What do we mean by OBR?

- 4.3 Our view of an outcome-based approach to service quality regulation is one in which a comprehensive view of consumer preferences is developed based upon wide-ranging and robust consumer engagement covering all of the key consumer groups that use the airport. This research then needs to be appropriately translated into a small number of outcomes that are most important to consumers and the airport will be accountable for delivering (such as 'reasonable charges', 'safe and secure service', 'reliable infrastructure', 'satisfied passengers' etc.). From these high-level outcomes, performance indicators should be developed to measure progress towards these outcomes and as a basis for setting incentives.
- 4.4 We consider that HAL is best placed to lead this process and to initially propose the outcomes and associated performance measures, targets and incentives in its price control business plan. Nonetheless, HAL will need to cooperate and take careful account of the views of the CCB and the airlines in developing its approach to customer engagement and outcomes.

- 4.5 HAL will need to develop a systematic and detailed understanding of how consumers' experiences – whether directly or indirectly – are affected by the key processes and services it provides as the airport operator. In doing so we would envisage HAL working very closely with the airline community to ensure that their considerable intelligence on consumer preferences is fully reflected in the process. We also see a key role for the CCB to challenge and scrutinise HAL at all stages of this process, and to provide views on how well the proposed outcomes and performance indicators reflect the preferences of passengers.
- 4.6 We recognise that outcomes may not always be wholly within the airport control. For example, an outcome which considered passenger satisfaction overall would likely be impacted by the performance of other stakeholders that provide services at or to the airport such as NATS, surface access providers (rail companies, London Underground), airlines, ground handlers and the UK Border Force. However, it will be important that the performance measures focus on those areas where HAL's performance directly impacts on consumer experiences. Outcomes can also be multi-dimensional meaning that it may be appropriate to measure performance through a range of indicators, and so it is likely that we will need to broaden the approach to service quality regulation as compared to the existing SQRB.
- 4.7 These factors mean that moving towards OBR would represent an important evolution of the SQRB scheme. As a consequence it will be important for the CAA to carefully consider any disadvantages associated with these changes and how the impact of these difficulties can be minimised.
- 4.8 The outcome framework, when finalised, would be included within HAL's licence as part of the H7 determination and the airport would be responsible for delivering the outcomes and associated measures over the control period.

Pros and cons of OBR

4.9 We think that if carefully designed and implemented, OBR would help ensure consumer views and priorities are at the heart of airport regulation. Potential advantages of OBR are that:

- it can provide stronger incentives to HAL to focus its attention on what passengers value, giving stakeholders confidence that the regulatory regime is appropriately targeted;
- it could incentivise more innovative solutions and to respond to a changing environment;
- it could help focus the attention of all stakeholders on the needs of consumers, rather than targeting their efforts at influencing the regulatory regime; and
- it could improve transparency and encourage the airport to improve its engagement with all of the stakeholders that affect the consumer experience.

4.10 We have observed that in other sectors, particularly in the water industry, OBR has provided strong incentives on regulated companies to fully reflect consumer views and improve their services accordingly.

4.11 On the other hand, there could be disadvantages and challenges associated with implementing such an approach, including:

- the existing SQRB is well established and understood by all stakeholders so moving to a new approach could generate a number of risks that may be difficult to quantify in advance;
- adopting such an approach may require cultural change by HAL and other industry stakeholders such as airlines, who may not be persuaded of the advantages of such a change, relative to the existing SQRB scheme; and
- OBR needs to be implemented carefully so that consumer interests are properly protected, the incentive arrangements build on the success of the existing arrangements and that the interests of

airlines and other stakeholders are not unduly prejudiced by the development of the new arrangements.

Chapter 5

Stakeholder views

Introduction

5.1 In this chapter we first set out a summary of our understanding of how the airlines and HAL view the key issues set out in the previous chapter. We then go on to analyse and assess these views to help inform the development of the principles for the introduction of the OBR as set out in chapter 6.

Airline community views

5.2 We have consulted with the airline community on an ongoing basis since publishing our H7 strategic themes consultation. In addition to the responses we received, we heard feedback at our industry workshop and seminar, and in a number of bilateral meetings to explore ideas in greater detail. Airlines have engaged constructively on this issue including by submitting a helpful discussion paper setting out their views on the SQRB scheme and a consideration of the outcome-based framework that we have proposed. We summarise below the key points from their paper.

Current service quality regulation

5.3 In general terms, the airline community welcomes our continued consumer focus as part of H7. Airlines also note that the level of service provided by HAL to passengers, cargo owners and airlines is key to the overall airport experience (that airport charges support) and is a fundamental part of the H7 review.

5.4 Airlines consider that the SQRB scheme has a tried and tested track record of providing benefits such as:

- establishing a baseline of service quality that all passengers, cargo owners and airlines can expect to receive in exchange for the funds HAL is allowed to earn through the regulated settlement;
- providing a suite of incentives on HAL to deliver the levels of service required by consumers and measured by standards set by the CAA;
- ensuring visibility for all parties on the performance of HAL with respect to the elements in the SQRB; and
- providing a proxy for what would happen in a competitive environment.

5.5 Taken together, airlines consider that the SQRB scheme has led to significant improvements in the overall service quality experienced by passengers and cargo owners, demonstrated by improved performance and the upward trend in 'overall satisfaction' in the ASQ survey⁶.

Outcomes

5.6 On that basis, the airline community does not agree that there is a good case for fundamental changes to service quality regulation at Heathrow to be revised wholesale. While the airlines support continued ongoing improvements to the SQRB scheme – much as increasing performance standards, and considering expanding the scope to include the dimensions of the baggage system operated by HAL – they have identified a number of concerns with a move towards OBR:

- Delivery of overall outcomes will be the result of many parties such as HAL, NATS, airlines, handlers etc. Therefore, by placing more emphasis on outcomes, the regime could end up, even as an unintended consequence, setting performance standards for non-regulated parties (including airlines and Government bodies). Airlines stress that this could (a) lead to HAL being able to avoid, defer and dilute the impacts of the service quality scheme that is designed to measure its performance and (b) create unnecessary

⁶ The Airport Service Quality (ASQ) passenger satisfaction survey is a global benchmarking programme of the Airports Council International (ACI) measuring passengers' satisfaction whilst they are travelling through an airport.

distortions in the competitive market where airlines compete on the basis of price and quality offered to consumers.

- There may be practical difficulties in implementing OBR, and outcomes may not be able to replicate the benefits the SQRB scheme offers. For example, many key aspects of airport operation are unseen by passengers and cargo owners, and thus may not be sufficiently understood or captured by consumer research.
- Outcomes may be complex, difficult to define and measure, and lack performance baselines. As such outcomes may imply more subjectivity which is complex for the airlines and airport to both determine accountability and attribute to actual airport performance.
- OBR could mean there will no longer be a direct link between the airport charges paid by airlines for passengers and cargo owners and the services that they all receive from the airport.

5.7 The airline community also suggests that it is important to note the difference between outputs and outcomes and that outputs are the most important and measurable contributing factor in the delivery of the anticipated outcomes.

Airline community proposed way forward

5.8 The airline community notes that the individual elements of the SQRB scheme should, in aggregate, result in a number of possible passenger/cargo owner-focused service quality 'outcomes'. On that basis, airlines accept that a number of anticipated outcomes could be developed and set out in the H7 settlement.

5.9 However, airlines have also suggested that outputs must be defined to deliver the anticipated outcomes. They consider that the elements of the SQRB scheme are already established and have proven themselves as clear, objective and quantifiable measures of the service quality provided by HAL. Therefore, the SQRB scheme elements should be retained as the building blocks from which outcomes can be defined and articulated.

- 5.10 The airline community proposes that this approach would preserve the benefits of the SQRB scheme while ensuring that the focus of service quality regulation is exclusively on the services delivered by the airport.

HAL views

- 5.11 In the same way that we have engaged with the airline community, we have had ongoing discussions with HAL to understand its views on our proposal to move to OBR, and on how such an approach could work in practice. HAL has also engaged with us constructively in an effort to help shape the framework for H7.

Current service quality regulation

- 5.12 HAL considers that the current approach to service quality regulation presents a number of shortcomings. For example, there are elements of the passenger journey potentially not covered, and the scheme constrains HAL's ability to explore alternative approaches to provide an agreed outcome e.g. service tailored to different passengers' needs.
- 5.13 HAL also considers that as the scheme is largely unchanged since 2003 there is now a need to review whether it aligns with what current and future passengers want. Such a review should include the views of the CCB in order to help ensure that consumers' interests are properly taken into account. HAL also considers that some of the incentives in the SQRB scheme could be improved, by rebalancing the rebates and bonuses such that they are more symmetrical, focusing on outcomes rather than outputs, and including sliding scale targets that provide clear linkages to passenger benefits.
- 5.14 HAL considers that the current SQRB does not provide strong incentives for collaboration across stakeholders that provide services throughout the passenger journey. HAL suggests that it is in the interest of passengers to consider ways in which more collaborative behaviour can be incentivised.

Outcomes

- 5.15 With regard to the concept of outcomes, HAL considers that our initial thinking goes in the right direction but in some respects does not reflect regulatory best practice.
- 5.16 HAL has therefore started to develop its own thinking of how OBR could work. HAL's proposal is that high-level outcomes are defined based upon consumer research. These could then be broken down into more detailed, lower-level outcomes that could be more easily linked to measures, targets and incentives. For example, a high-level outcome such as "happy passengers" could be broken down into lower-level outcomes such as "terminal navigation" and "appearance". HAL proposes that passenger satisfaction (as measured by surveys) could play a more prominent role within the framework. For example, passenger satisfaction could measure success for "departures experience" and "arrivals experience", with some of these measures already included in the current SQRB scheme.
- 5.17 HAL proposes that output-based measures, for example "queuing time" and "asset availability", should sit outside OBR. HAL considers that these outputs could potentially continue to be measured and reported on, but that they should not be part of the outcomes framework, and no longer be specifically attached to financial incentives.
- 5.18 Targets for each measure could be established with both reputational and financial incentives available based on the degree of control the airport has over the activity. HAL considers a larger role for perception-based measurement and targets is implied by an OBR approach.
- 5.19 Under HAL's proposal a combination of research techniques (stated preference, revealed preference, trials, etc) would be used to help inform the framework. Criteria would be developed for measures of success and cost-benefit analysis could be used to inform targets.
- 5.20 HAL considers that the scheme should comprise of both penalties and rewards. Penalties would be required in areas where HAL is not delivering the levels of quality that have been allowed for in costs. It considers that

rewards should incentivise HAL to outperform where this is proven to be cost beneficial.

Our initial views

5.21 We have taken the views set out above into account and further developed our own thinking in a number of areas in response to the comments and suggestions that have been made.

Current service quality regulation

5.22 Given the reasons set out in chapter 4 we remain of the view that it is appropriate to review the SQRB scheme and to consider whether revisions can be made which improve value for consumers.

5.23 We agree with the airline community that the current SQRB scheme has an established track record and that service quality performance has improved. However, we also think that the existing arrangements can be developed and extended to ensure that service quality regulation properly reflects the interests of consumers.

The role of outputs

5.24 HAL has implied that the measurable targets in an outcome-based regime should be formed primarily from passenger satisfaction surveys. Our view is that a regime focussed on outcomes would naturally imply a greater role for measuring passenger satisfaction. However, we are also mindful of the comments made by airlines that we should not disregard the advantages of the existing output measures and incentives. Therefore, we look to HAL to develop a balanced approach and retain the key features of the SQRB where appropriate. Changes to the incentives may be appropriate, for instance to properly align with how much consumers value the associated service or to integrate with the wider package of incentives, but we would expect the metrics associated with the SQRB to be retained as part of the new arrangements (at least for the H7 period).

- 5.25 More generally, we consider that OBR would allow HAL and the airline community to consider more flexible and bespoke targets to better reflect the needs and expectations of consumers. Examples of this may include bespoke arrangements for each terminal, or for different segments of passengers.

The scope of OBR

- 5.26 The scope of OBR is likely to require further consideration and debate among the interested parties. As it stands, the SQRB scheme is focused exclusively on the performance of HAL as the regulated business with substantial market power.
- 5.27 The airline community have expressed strong reservations against any scheme that would consider the performance of parties at the airport other than HAL. They suggest that such an approach could potentially distort the competitive market within which they operate.
- 5.28 In considering these issues in relation to Heathrow, we are clear that by introducing OBR we are not attempting to bring other parties operating at the airport into service quality regulation. However, we consider that one potential benefit of OBR is the opportunity to shine a light on the whole consumer experience at the airport.
- 5.29 We note that within its service quality reports, Gatwick Airport Limited (GAL) currently publishes the performance of ground handlers and airlines with regard to baggage performance⁷. GAL has set targets for the ground handlers and airlines to meet in terms of the time taken to deliver bags to the baggage carousel for arriving passengers.
- 5.30 This issue of wider airport performance was considered by the Department for Transport (DfT) at the time that it was developing the Act. In Chapter 8 of the Decision Document on Reforming the Framework for

⁷ GAL's monthly service quality performance reports: <http://www.gatwickairport.com/business-community/about-gatwick/performance-reports/monthly-performance-reports/>.

the Economic Regulation of Airports⁸, DfT notes that the CAA would have no means of directly regulating third parties, while also observing that:

“if the CAA concluded that if an airport was subject to competition it would be better incentivised to: i) ensure coordination between the services it provides directly and those which it subcontracts/rents out to third parties; or ii) influence the quality of service provided by third parties with which it contracts, then we would expect the CAA to take appropriate action, perhaps initially by putting in place incentives for the airport operator to deliver outcomes which more closely mirror those of a competitive, well-functioning market. This would be in line with its primary duty to promote the interests of passengers.”⁹

- 5.31 Our current view is that it may be premature to draw a conclusion on how transparency of wider performance at the airport could be developed. Clearly, the focus of our regulation will continue to be on the airport operator given that it has substantial market power. Nonetheless, where increased transparency is likely to have benefits for consumers then we will consider how this could be incorporated into the arrangements.
- 5.32 For the avoidance of doubt, we consider that hard measures, targets and incentives developed as part of the H7 review (such as those based on the existing SQRB) are only likely to be appropriate for aspects of service delivered by HAL, as the economically regulated business.
- 5.33 We welcome the views of stakeholders on the implications of increasing the level of transparency on the different services which consumers experience at the airport.

⁸ [Reforming the Framework for the Economic Regulation of Airports, DfT decision document \(PDF\)](#).

⁹ Paragraph 8.26 of DfT decision document.

Chapter 6

CAA design principles for moving towards outcome-based service quality regulation

Introduction

6.1 In this chapter we describe the principles that we think should be used to shape the new arrangements. We recognise that some stakeholders are cautious about the prospect of transitioning from the current SQRB scheme to a new OBR. We also understand the importance of addressing upfront the practical issues and challenges that arise from implementing a new set of arrangements. Our expectation is the principles will go some way to addressing these concerns and we would encourage all stakeholders to continue engaging on these issues prior to us setting out our firm position on our approach to service quality regulation in our H7 Policy Update document in spring next year.

6.2 These are:

- OBR should be informed by robust consumer research
- The structure of OBR should include ‘outcomes’, ‘measures’, ‘targets’ and ‘incentives’
- CCB and airlines play a key role in the development of OBR
- OBR should build upon the SQRB scheme
- Performance reporting should be targeted at consumers

6.3 Each of these is discussed further below.

Principle 1: OBR should be informed by robust consumer research

6.4 We remain of the view that the industry - rather than the regulator - is best placed to take responsibility for engaging with consumers, gathering evidence on what they value, and translating this engagement into appropriate outcomes which can be incorporated in to the regulatory

regime. As we set out in the CCB's Terms of Reference¹⁰, we expect HAL to carry out detailed consumer research and engage with airlines to develop a well-rounded view of the consumer experience for its business plan.

- 6.5 HAL should lead this process, and work very closely with the airline community and the CCB as it develops an OBR framework. All aspects of the framework should be discussed and, in so far as possible, agreed with these stakeholders prior to the publication of the initial business plan.

Principle 2: The structure of OBR should include outcomes, measures, targets and incentives

- 6.6 We consider that there should be 4 key features of an OBR framework.

Outcomes

- 6.7 Outcomes are the over-arching objectives that summarise the most important aspects of the airports services that consumer's value. They should be simple and easy to understand for consumers. They can encompass those aspects for airport performance that impact on other stakeholders but are nonetheless important to consumers – such as the provision of services to airlines and environmental performance.

Measures

- 6.8 Each outcome should have one or more associated performance measures that measure progress towards the outcome. The overall package of measures should cover all aspects of airport operations that are either directly or indirectly important to consumers. For the avoidance of doubt this should include aspects of service which may not be visible to consumers such as the availability of ground power, pre-conditioned air, etc.

¹⁰ 'Decision on the Terms of Reference for the H7 Consumer Challenge Board (CCB) ' (2016): www.caa.co.uk/CAP1449.

- 6.9 Measures can comprise a mixture of traditional outputs (e.g. security queue time) and metrics based on the stated or revealed preferences of consumers (e.g. passenger survey results).

Targets

- 6.10 Targets should be based on evidence and take account of the following factors:
- customer preferences and satisfaction with respect to historical and current performance levels,
 - the scope for improving performance (including consideration of innovative ways of working) without incurring significant extra costs on the basis of setting demonstrably challenging targets for management, and
 - the willingness to pay of consumers and airlines to pay for investment to further improve performance beyond that possible using existing facilities. This willingness to pay information should be used as part of process of robust investment appraisal to identify the most cost beneficial option to deliver service improvement.

Incentives

- 6.11 Each target should include an appropriate incentive. We expect the majority of targets to include financial incentives although reputational could also be considered where appropriate. Incentives can be both positive (reward) and negative (penalty) and sliding scales may be included where these can be justified.
- 6.12 Incentives must be justified and calibrated with respect to consumer priorities. Incentives should be clear, easy to understand and credible. We expect HAL in discussion with the CCB and airlines to develop a credible and balanced set of incentives. We also need to consider the likely impact of these incentive arrangements on creating a balanced risk and reward package for H7, and so it may be necessary for us to propose adjustments to the incentive package later in the price review.

Principle 3: Airlines and CCB play a key role in the development of OBR

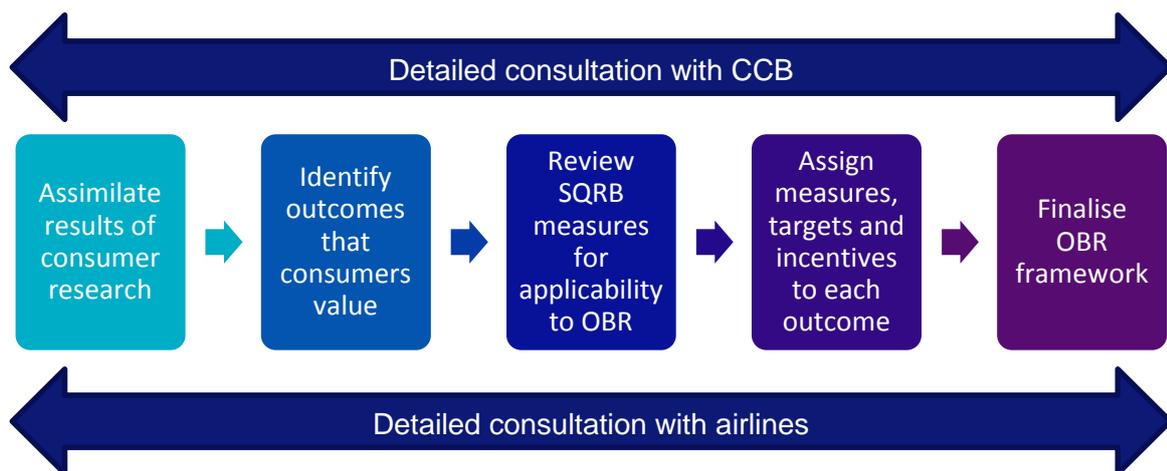
- 6.13 We consider that airlines have a crucial role to play in developing the new arrangements. We are aware that airlines collect considerable intelligence on their customers, and that some of this intelligence will relate to their experiences of using Heathrow. Airlines also have particular insight in to the ‘behind the scenes’ operations of airports that are crucial to the smooth functioning of the passenger experience.
- 6.14 As noted in Chapter 2, we are currently in the process of establishing a Consumer Challenge Board (CCB)¹¹ to help ensure that the H7 review is driven by a robust understanding of what consumers’ value.
- 6.15 The role of the CCB is to promote the interests of consumers by providing challenge to HAL on the development of its H7 business plan and advise us on the overall quality of HAL’s business plan and the extent to which it has been informed by high quality consumer engagement. Thus, we expect HAL to work very closely with the CCB.
- 6.16 For these reasons, HAL will be required to consult extensively with both the CCB and with airlines throughout the process.

Principle 4: OBR should build upon the SQRB

- 6.17 As we have previously stated, OBR should aim to build upon and improve the aspects of the SQRB which currently work well. We consider that HAL should follow a clear process in developing the OBR framework having due regard to the applicability of the existing SQRB arrangements as illustrated in Figure 1 below.

¹¹ CAA (2016) ‘Decision on the Terms of Reference for the H7 Consumer Challenge Board’: www.caa.co.uk/CAP1449.

Figure 1: Process for developing outcomes framework



6.18 A regime which is founded upon detailed and robust consumer research is the most important development of the arrangements that we want to see for H7. HAL will need to consider carefully how to conduct this research and how to ensure that consumers fully understand not only the importance of the services that HAL provides that directly impact on their experience, but also that it provides services to airlines that are important to their experience. The evidence and results of this research should be used to identify the broad high level outcomes that consumer's value. HAL will also need to assign measures, targets and incentives to each outcome. In doing so, it is imperative that this process builds on the success of the existing SQRB arrangements.

6.19 Where HAL proposes that existing SQRB outputs and incentives should not be included within the OBR framework, it should provide an explanation for why the incentive is no longer appropriate and why its exclusion does not jeopardise the interests of consumers (including indirectly by failing to incentivise the provision of services to airlines). As a minimum we would expect HAL to retain and make transparent all the metrics associated with the existing SQRB.

Principle 5: Performance reporting should be comprehensive and targeted at consumers

6.20 We consider that the development of OBR for H7 represents a good opportunity for us to also consider HAL's obligations and practices in

reporting performance on service quality. At the moment, HAL publishes some information on its website and provides performance statistics within the terminals. We expect HAL to use the OBR framework to consider whether the existing reporting practices are adequate for a more comprehensive and consumer focused approach to regulation and transparency. HAL should discuss this in detail with the CCB and with airlines and propose any changes that may be required as part of its H7 initial business plan.

Next steps

- 6.21 We welcome stakeholders' views on all of the issues raised in this document and specifically on the questions at Appendix A. We will also discuss the issues raised in consultation and the responses to it with the CCB, when it is established in early 2017.
- 6.22 We will reflect on this consultation and confirm our views on the principles and our approach to OBR in the H7 'Policy Update' document that we will publish in spring 2017. We will then expect HAL to reflect our principles and approach in its initial business plan.

Appendix A

Questions

1. Do you agree with the case for change in service quality regulation at Heathrow airport, as outlined in Chapter 3?
2. Have we accurately reflected stakeholder views, as outlined in Chapter 4? Do you have any comments on our proposals regarding the level of stakeholder engagement we require of HAL in developing an outcomes framework?
3. Do you have any comments on the proposed principles?
4. Do you consider there are further principles that should be included, or principles that should be removed?
5. Do you have any comments in terms of the proposed structure of the OBR framework, specifically:
 - a. outcomes;
 - b. measures;
 - c. targets; and
 - d. incentives?
6. Do you agree that consumers would benefit from increased transparency on the performance of other parties providing services who play a major role in their experience at the airport?