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Sent by email to [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk)

**Re. Future of service quality regulation for Heathrow Airport Limited: Consultation on the design principles for a more outcome-based regime (CAP 1476)**

Dear Rob,

British Airways (BA) welcomes the opportunity to respond to the CAA's consultation on the future of service quality regulation for Heathrow Airport Limited (HAL), and the design principles for a more outcome-based regime. Our response will be formed of this letter covering the key themes we believe are important to the CAA in developing its policy on service quality regulation and outcomes and a proposed service quality scheme structure contained in an appendix.

**Summary**

1. BA welcomes the opportunity to contribute to a review of the successful service quality regulation scheme and the potential development towards outcome-based regulation (OBR). BA argues that:
  - Existing service quality regulation has delivered demonstrable HAL service improvement to airlines and consumers;
  - The CCB should be allowed to review and develop a working understanding of the existing service quality regulation scheme prior to starting the review process;
  - A design principle stipulating that OBR should solely relate to HAL and not extend regulation to other parties should be added to the CAA's initial list of principles;
  - OBR needs to be tailored to the demands of airport regulation recognising that HAL is a single regulated company that does not have a primary/direct commercial relationship with consumers, unlike airlines;
  - HAL is not "best-placed to lead" development of OBR – HAL is responsible for airport operation services; airlines have the direct commercial relationship with consumers; the CCB, Consumer Panel and CAA have a primary duty to consumers; as such BA believes that development of service quality regulation towards outcomes be a tripartite process between the CCB, airlines and HAL with oversight from the CAA;

- Outcomes should be derived from objective tangible measures of HAL operational performance – an airline community proposal for how outcomes could be developed as an evolution of the successful service quality scheme is included;
- Consideration of wider airport performance beyond HAL should not be done using airport regulation which could dilute the focus on HAL and distort competitive airline and other markets – if deemed necessary the CAA should use its other powers to do this; and
- Significant regulatory change during H7 needs to be avoided where the existing airport infrastructure will be dealing with an increased level of flights and volumes of passengers, whilst a runway is being developed and airspace modernisation is delayed, and HAL will need to maintain service levels throughout.

## Context

2. As part of every new price control period it is necessary to review the structures and arrangements in place as part of the regulation of HAL. Service quality regulation has been subject to such review by the CAA, airlines, passenger groups and HAL over the last three control periods ensuring that it remains fit for purpose and is delivering the incentives needed for HAL to provide the level of service airlines require for their passengers and cargo customers. BA agrees with the CAA's focus on "how regulation of the quality of airport operation services provided by HAL can be improved".<sup>1</sup>
3. BA's position, in line with the wider airline community at Heathrow, is that service quality regulation of HAL is a critical component of the CAA's approach to effectively regulating the airport and ensuring that services paid for by airlines, passengers and cargo-owners are delivered. BA welcomes the CAA's statement that it agrees with the airline community "that the current SQRB scheme has an established track record and that service quality performance has improved".<sup>2</sup>
4. BA does not agree that there is a 'compelling' case for significant changes to service quality regulation. Whilst we recognise that the CAA now has a single primary duty to promote the interests of consumers it also had this duty, in conjunction with other duties, under the Airports Act 1986. Consequently we would anticipate that a review of the current service quality arrangements will show that they do act to ensure that consumer interests are at the heart of the CAA's regulation of HAL. Therefore this will continue to be the case as we go into the H7 period and develop a regime that also encompasses broader outcomes for consumers – be they passengers, cargo owners and airlines who are all HAL customers.
5. It should be noted that the existing service quality regulation does effectively deliver certain overall outcomes at Heathrow, even though they are implicit rather than the more explicit approach that the CAA proposes to take now. Existing service quality measures are focused on outcomes such as punctuality (security, flight information, wayfinding, asset availability, control posts and aerodrome congestion term), high levels of customer service (pier service, security, seating, cleanliness and asset availability), and reliability (security, control posts and asset availability). BA and other airlines have advocated these measures inclusion in service quality regulation because they are key to meeting the expectations of our customers, both passengers and cargo owners, in relation to the airport services supplied by HAL even though they often perceive those services as being both supplied by, and the responsibility of, their airline.

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<sup>1</sup> CAP 1476, para 1.1

<sup>2</sup> CAP 1476, para 5.23

## Principles

6. At the highest level BA would like the CAA to add a principle to its initial list stating that service quality or outcome-based regulation (OBR) only applies to the airport operation services provided by HAL<sup>3</sup>, and that airport regulation should not be extended to other parties. This would make explicit the stated position of the CAA in the consultation document and provide clarity for all stakeholders about the scope of airport regulation relating to HAL as the regulated company.
7. The consultation also refers to consumers which BA understands from a CAA perspective relates to passengers and cargo owners. However HAL provides a significant majority of its airport operation services to airlines, which in turn use them to deliver the services that airline customers, both passengers and cargo owners, buy from us. As such BA would deem itself, as an airline, to also be a consumer of HAL airport operation services. BA would encourage the CAA to reflect and expand upon this point in its Spring policy update and we would be willing to have further discussions on this point with the CAA.

## Issues

8. Notwithstanding our position on the design principles for OBR BA has a number of substantive concerns and requests for clarity on the CAA's detailed proposals.
9. Understanding the airport market – BA believes that the CAA proposals need to fully recognise the unique features of the airport regulatory environment. OBR is seeking to build on best practice from other regulated sectors and draws heavily on the water industry<sup>4</sup> in looking to incentivise regulated companies to deliver for consumers in their business plans. However in the water industry there are multiple regulated companies that the regulator can incentivise competitively. In airport regulation that ability for the regulator to competitively incentivise the regulated company, and for the regulated company to respond to that incentive, is absent as there is only one company subject to regulation.
10. Likewise in the water and power industries the regulated companies have a direct commercial link with consumers in that they directly sell their services to them. That is also absent in airport regulation where passengers and cargo-owners contract for services with airlines operating in a competitive market, who in turn rely on the provision of HAL airport operation services to fulfil their contracts with consumers. Even where consumers understand the airport operator is responsible for a service they often revert to their commercial relationship with the airlines in the event of airport operation service failure.
11. In order to address these differences in airport regulation BA believes the CAA needs to be clear about exactly what is in scope of airport regulation. Not focusing solely on HAL's provision of airport operations services and potentially extending the scope of airport regulation to airlines, ground-handlers and other suppliers could distort the competitive market those companies operate in.

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<sup>3</sup> CAP 1476, para 1.1

<sup>4</sup> CAP 1476, Box 2, p.13

12. Introduction of the CCB – One of the key developments for H7 will be the introduction of the Consumer Challenge Board to the review process. By representing consumers and challenging HAL’s business plan they will play a significant role in the review and development of the service quality regulation. Before this process starts BA believes the CCB should be allowed to review the existing service quality regulations for themselves and gain their own understanding of how consumers and airlines benefit from the scheme as well as how it could be further developed. This would allow the CCB to engage more meaningfully in the development of the service quality scheme in conjunction with airlines and HAL.
13. HAL “best placed to lead” - as a regulated monopoly it seems incompatible that HAL should be seen as “best placed to lead” the process of proposing the outcomes, performance measures, targets and incentives in its business plan that will form the basis of its own regulation during H7. Neither do HAL have a direct commercial relationship with consumers, unlike airlines. Furthermore CAA believes HAL needs to develop an understanding of how consumers are affected by the provision of its airport services<sup>5</sup>. If they do not have this knowledge now after 16 years of service quality regulation it would seem more appropriate to rely on the understanding that airlines have of consumers both in terms of what they value and what they are prepared to pay for.
14. Airlines understanding of consumers is far more advanced than that of HAL and should be used as a key input, in conjunction with the Consumer Challenge Board (CCB), into the proposed development of the service quality scheme towards outcomes. BA would strongly advocate a tripartite approach between the CCB, airlines and HAL to propose and agree on such a development. Oversight of this approach, if needed, would be provided by CAA. Such an approach would be more akin to that used in previous regulatory reviews, recognising the value that the CCB and airlines can bring to the process. BA would encourage the CAA to consider this approach.
15. Service Quality and Outcomes – the service quality regulation relies in the main on objective measures of HAL airport operations performance. This includes measures such as security area and control post queue times, and asset availability percentages. BA believes that OBR should continue to build upon the objective measures in the service quality regulation.
16. BA is concerned that HAL’s initial thinking seems to centre almost exclusively on passenger satisfaction measures<sup>6</sup> and “a larger role for perception-based measurement and targets”<sup>7</sup> within OBR. From an airline perspective in terms of the services we require HAL to deliver in order for us to fulfil our contracts with passengers and cargo owners this is not acceptable. HAL’s position would seem to ignore the benefits that the objective measures within the existing service quality regulation have delivered in terms of incentivising improvements in airport operations performance over the last three regulatory periods. Furthermore it is not credible that the one service that HAL and its staff do provide directly to consumers at security search “should not be part of the outcomes framework, and no longer be specifically attached to financial incentives”<sup>8</sup>. Such statements do not demonstrate to BA that HAL understands the need for and the benefits

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<sup>5</sup> CAP 1476, para 4.5

<sup>6</sup> CAP 1476, para 5.16

<sup>7</sup> CAP 1476, para 5.18

<sup>8</sup> CAP 1476, para 5.17

of service quality measures. As such this only reinforces our position that HAL is not “best placed to lead” development of an OBR framework.

17. When measuring the delivery of operational performance only objective measures can provide that function. Key metrics used in BA to measure operational performance include punctuality percentages for Ready-to-Go, On-time and <15 mins departure punctuality as well as schedule regularity (percentage of schedule flights operated). These are objective measures and we would expect to see similar measures as currently used in service quality regulation within OBR for HAL performance.
18. OBR structure – the proposed ‘outcomes – measures – targets – incentives’ structure clearly parallels the existing service quality regulation structure with “outcomes” overlaying that. BA would suggest that measures would be better termed as outputs. The delivery of multiple ‘outputs’ will then determine the successful achievement of overall ‘outcomes’.
19. An example of such a structure has been proposed by BA and the airline community showing how a developed SQRB scheme could be used to deliver outcomes and is attached in Appendix A. It may be the case that outputs (measures) may be linked to multiple outcomes rather than correlating to a single outcome as shown.
20. Outcomes may be broader than the individual airport operation services that HAL provides to airlines and consumers. Even within OBR though, where HAL is providing a quantifiable service then the role of airport regulation should be to ensure that the service is provided for the charges paid.
21. Wider performance – BA notes that CAA believes there is an opportunity for OBR to encompass the whole consumer experience at Heathrow. BA does not disagree with the CAA’s desire to look at issues across the wider spectrum of organisations that deliver services to consumers – both passengers and cargo owners.
22. We do strongly disagree though that using airport regulation of HAL to achieve this is the right way to go about it. BA believes the CAA should use airport regulation to clearly focus on HAL as the regulated company. Widening the remit of OBR and proposing to place a degree of control for that in the hands of a regulated company which will impact the existing competitive markets of airlines, ground-handlers and other suppliers, is not appropriate. It risks diluting the focus on HAL as a regulated company and distorting competitive markets outside of regulation. The CAA should use the other powers it has at its disposal, outside of airport regulation, to consider the wider consumer experience at airports.
23. H7 & OBR – BA agrees with the CAA’s statement that the design of service quality regulation in H7 needs to “ensure that HAL retains sufficient focus on providing services to existing consumers, alongside dealing with issues around runway development”<sup>9</sup>. At the same time as potentially developing a new runway HAL is also proposing to increase the overall level of movements by 25,000 per annum starting in 2021. This will significantly increase passenger numbers and the pressure placed on existing facilities, particularly at peak times on a daily and seasonal basis.

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<sup>9</sup> CAP 1476, para 4.2, bullet 5

Furthermore the delay to the modernisation of the London airspace programme (LAMP2) will increase delay and congestion with impacts on the airport infrastructure.

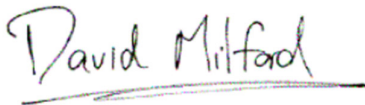
24. Despite the backdrop of runway development BA and consumers will require HAL to continue to deliver and improve upon the airport operations performance. It is because of the additional pressures of increasing passenger numbers, the proposed 25k pa increase in flights starting in 2021, and the continued delay in airspace modernisation that BA has significant concerns. Any changes to the service quality regulation, which has demonstrably delivered significant service improvements to consumers since its introduction, risks reducing the level of service that consumers receive from HAL in the development of a more outcome-based approach. OBR needs to take the existing service quality regulation and the objective measurement of HAL operational performance as its base and then build upon that. BA does not believe that it is in the interests of airlines and consumers to significantly move away from an approach that works at such a critical time and will be needed to maintain service standards that consumers using the additional 25k ATMs should continue to benefit from. Expansion of Heathrow will not lead to any reduction in the level of service required by consumers and airlines from HAL.

### **Conclusion**

25. BA supports the review of the service quality regulation and believes the CAA's approach should clearly focus on HAL's performance in providing airport operation services. Objective measures of how HAL airport operations services perform are needed to ensure that key services are being delivered to all airport consumers – passengers, cargo owners and airlines. It is not appropriate to use airport regulation of HAL, as a regulated company, to focus on other airport stakeholders - the CAA has other powers it can use to achieve this. Ultimately it is essential that HAL maintains and improves service levels in H7 to accommodate increased flight and passenger numbers and to mitigate delays in airspace modernisation that will impact the airport operation. BA would be happy to have further discussions with the CAA on any part of our response in advance of the Policy Update due in the Spring.

If you have any queries on this response please contact me at [david.milford@ba.com](mailto:david.milford@ba.com).

Yours sincerely,



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**APPENDIX A – AIRLINE COMMUNITY PROPOSAL FOR SERVICE QUALITY OUTCOMES STRUCTURE**

