



London (Heathrow) Airline Consultative Committee

**Response to CAA Consultation on Strategic Themes for the Review  
of Heathrow Airport Limited Charges (H7)**

29 April 2016

## **Introduction**

The Heathrow Airline Operators Committee (AOC) and the London Airports Consultative Committee (LACC) welcome the opportunity to submit this joint response to the CAA on its H7 Strategic Themes consultation.<sup>1</sup>

The Airline Community welcomes the opportunity to engage with the CAA, Heathrow Airport and other stakeholders throughout the H7 review. As we have done in previous reviews we will continue to keep our passengers at the heart and forefront of our thinking and proposals

The H7 review is very important to the Airline Community at Heathrow given our passengers currently pay amongst the highest airport charges in the world and this review will once again set the charges levied on the airlines and through them to passengers and those with an interest in cargo. It will also set the level and type of capital investment which will determine the nature of air transport operations at Heathrow for many years to come. This is particularly the case with reference to the automation of passenger/cargo processing which is likely to be a feature of the H7 discussions to much greater extent than ever before.

We are also cognisant of the ongoing discussions around the possible expansion of Heathrow Airport and note this will add to the significance of the H7 review.

The CAA has set out a number of questions in its consultation paper on which it has invited responses. This has been a helpful feature of the consultation paper and we have structured our response as answers to these questions. We hope this is helpful and look forward to working with the CAA on this pivotal regulatory review.

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<sup>1</sup> CAP 1383 – Strategic themes for the review of Heathrow Airport Limited charges (H7) – A discussion document.

## CAA Questions

1. Do you agree that there has not been, or likely to be, a material change of circumstances to require a new MPD for HAL before January 2019?

1.1 The Airline Community considers that there has not been a material change of circumstances for HAL with respect to its substantial market power (SMP) since the commencement of the Q6 period. We also do not foresee that this likely to change over the next few years. Therefore, we agree with the CAA's assessment that there does not need to be a further Market Power Determination (MPD) at this stage and we also agree that HAL will continue to hold SMP for many years after 2019.

2. How best can the CAA proceed with the H7 programme given the uncertainty about new runway capacity?

2.1 The Airline Community recognises that the H7 review takes place against a backdrop of the Government developing its position with respect to airport expansion in South East England. Therefore, we welcome the CAA recognising the uncertainty introduced by this to the H7 review. This is both in terms of the schedule, scope and content of the review. Given this uncertainty the CAA should fully consider the merits of extending the Q6 period.

2.2 We also consider that the scope of any benchmarking studies will need to be reassessed again in the light of any emerging expansion plans. It should also be noted that, depending on policy development around any expansion, it would be in the interests of consumers for there to be a review of regulatory framework – particularly the treatment of risk allocation.

3. Is there a case for the CAA to consider extending the current Q6 arrangements until there is a higher level of certainty over the runway developments?

3.1 As mentioned above, the level of uncertainty regarding a Government decision on airport expansion in the South East would point to there being a case for an extension to the Q6 period. This would be in the interests of airport consumers as the H7 review would be commenced within a context of more certainty which, in turn, would reduce the complexity for the CAA and, indeed, all stakeholders in considering how to address the risks associated with the airport expansion – many of which are, as yet, unknowns.

3.2 We recognise that an extension to Q6 would require some consideration between stakeholders on the treatment of several capital projects within the Q6 portfolio. In our view this would actually be an opportunity as it would enable the 'late start' from HAL on a number of projects to be delivered. These are projects such as those within the Passenger Automation and Resilience portfolios which the airlines are committed to and are keen to progress in the interests of their passengers at Heathrow.

#### 4. Do you agree with the proposed strategic themes for H7?

4.1 The Airline Community notes the four strategic themes set out by the CAA of:

- A) Empowering consumers.
- B) Incentivising the right consumer outcomes.
- C) Increasing airport resilience.
- D) Promoting cost efficiency and financeability.

Our high level and initial comments on each of these is set out below:

##### **A) Empowering consumers**

Consumers (both passengers and those with an interest in cargo) are of primary interest to airlines. This is because, in the case of airlines, their customers are also their consumers – recognising that a consumer of a product is not always a customer. This distinction is worth noting when considering the *customers* and *consumers* within an airport context. In fact, the businesses of airlines are entirely dependent on airlines being able to sustainably and consistently meet the needs of their customers & consumers. Therefore, the voices of these consumers are heard through the needs and proposals expressed by airlines in a regulatory review. In the Q6 review the CAA indicated that it was working to the rebuttable assumption that airlines represented passengers. This assumption was not rebutted in Q6 or since then. Therefore, it continues to hold true. The airlines have a vast amount of consumer research which can be applied to the H7 review and this can be further developed as an input to the CAA. In addition to this, the interests of consumers are also already promoted and protected through the existing EU and local protection legislation.

Within this context, we are continuing to consider the Consumer Challenge Forum (CCF) and welcomed the opportunity to have discussions on the CCF with the CAA and HAL at the 27 April seminar. Although the CCF has been previously referenced by the CAA it has not been

clear to us what role the CCF is intended to have. This is particularly the case where the views of passengers are already represented through a broad spectrum of research which includes: CAA research, Airline research, HAL research, ACI (ASQ) research, the voice of the Passengers Services Sub-Committee of Heathrow Airport Consultative Committee. Our thoughts on the CCF have been focussed on a consideration of both its role and structure. Our comments on these are set out below:

## **A      *Role***

In the CAA seminar we highlighted the following two questions to all present:

- 1) What is missing from the passenger research already available to require the need for a new group? and
- 2) What output is expected from the CCF?

We welcomed some of the clarity which began to emerge in the seminar on these two questions. This being that the CAA saw the CCF as a body which could provide both a challenge and assurance function in the H7 process.

### *i)      Challenge function*

The CCF would challenge HAL and Airlines to robustly demonstrate that the passenger/consumer/cargo needs presented by either party as drivers for proposals/investments etc in the H7 review were drawn from objective & robust research and evidence. It would also take a view on the interpretation of the research in the proposals of either party.

### *ii)     Assurance function*

The CCF would provide an assurance function to the CAA that the proposals in Heathrow Airport Business Plan were based on the consumer (passenger & cargo) needs which have been demonstrated in the consumer research.

## **B      *Structure***

We agree with the CAA that:<sup>2</sup>

The independence of the CCF is absolutely fundamental to its function: in order for the CCF to provide credible and effective challenge to HAL it must be independent of HAL. Furthermore, if the CCF is seen by other stakeholders as 'captured' or susceptible to capture by HAL, it will not be seen as legitimate.

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<sup>2</sup> Paragraph 25: Annex A – Empowering consumers and furthering their interests – Discussion paper.

Within this context we are concerned that the currently proposed arrangements for the CCF would appear to be at odds with the CAA position above. For example:

- HAL setting up and running the CCF (paragraph 18)
- (not withstanding some minimum standards) HAL and the CCF to work together to determine the appropriate operating model for the CCF (paragraph 20)
- [CAA] would expect HAL to maintain the continuity of the CCF's expertise and experience through its management of appointments (paragraph 39)

As indicated at the seminar the Airline Community will undertake an expedited review of the proposals set out by the CAA regarding the role and structure of the CCF. Once we have had an opportunity to do this within our representative governance structures we will revert to the CAA with the output of those discussions. We look forward to working with the CAA and stakeholders on this in the coming months.

In the meantime, and with regard to the nature of consumers, we think the CAA should make a distinction between current and future users of air transport services. We note the CAA vision<sup>3</sup> states that some people choose to fly and some don't. We see merit in this vision. However, we would highlight that on some occasions passengers have a choice about flying whilst on other occasions they do not (e.g. work related travel compared to discretionary leisure travel). It is not simply a choice between travelling and not travelling. Thus recognising the importance of choice should be at the forefront of empowering consumers. It is helpful to consider the concept of choice when considering prefunding within the context of the possible expansion of Heathrow Airport. If the CAA was to allow prefunding they would be imposing on current passengers the charges associated with future costs without a provision of choice to passengers – many of whom have already had no choice in whether they fly or not.

## **B) Incentivising the right consumer outcomes**

We agree with the CAA that there is a risk in price cap regulation for the regulated company to reduce costs without regard to possible detrimental impacts of this on the quality of service provided. Therefore, having in place a system (or systems) for measuring the delivery by Heathrow Airport of the outputs expected of it by the CAA will be a key part of

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<sup>3</sup> CAA Vision – 'Making aviation better for those that choose to fly and those that don't.' Paragraph 2.14 of CAP 1383 –Discussion document.

the overall regulatory deliverable from the H7 review. The CAA has a record in this area of both innovation and balance. In our view the SQRB has played a key role in Q5 and Q6 by applying an incentive on the airport to maintain quality at the level set by the CAA. However, we recognise that it could be further improvements can be made for the consumer e.g. by adding baggage and increasing the level of overall incentives and we look forward to working with the CAA and HAL on this over the coming months.

### **C) Increasing airport resilience**

The development of resilience at Heathrow Airport is of fundamental importance to the airlines; particularly, at the current level of airport utilisation. In considering resilience, the airlines would ask the CAA to note two things at present:

- The pursuit of airport resilience through the economic regulation of HAL should be focussed on what is required/deliverable from the airport in return for the charges the CAA allows it to levy on airlines, and
- Resilience is a function of airspace as well as airport considerations and the CAA should consider how it can pursue airspace resilience through its regulation of NATS.

Substantial progress has been made in addressing some of the infrastructure issues at Heathrow, particularly to enhance the resilience of the airport and to cope with changes by the airline community to their fleet mix. The increasing trend towards larger aircraft is a response to the capacity limitations at the airport and to accommodate increased passenger demand. Investment in new facilities, procedures and systems such as Collaborative Decision Making are paying dividends, have avoided a decline in punctuality and further improvements are planned in the Q6 project pipeline. Planning for H7 has commenced in accordance with the CAA's mandate and further work is anticipated to further refine and jointly develop the Airport Operational Efficiency work programme in the next 18 months.

However further progress in enhancing operational performance including punctuality and resilience will not be possible without changes to airspace policy in the UK and the removal of blockages surrounding critical programmes such as the delivery of NATS' London Airspace Management Programme (LAMP) Phase 2 project.

Furthermore, the local expectation is that Europe's Air Traffic Management System has struggled to cope with peak demand in the summer months and a further deterioration is

expected in Summer 17. Further action at European level is urgently needed to overcome some of the tactical and structural issues associated with the lack of a Single European Sky

#### **D) Promoting cost efficiency and financeability**

This theme also has a direct impact on passengers and is supported by the airlines at Heathrow. A fundamental part of the H7 review will be ensuring that Heathrow airport provides its services and facilities with the level of efficiency that would occur if it faced direct competition from a comparable airport within its immediate environs. Part of achieving this will be based on the CAA taking a view on the efficiency and financeability of a notional company rather than making allowances for any embedded characteristics of Heathrow airport.

4.2 Finally, we would highlight (and welcome) the alignment between the CAA strategic themes and those of the Airline Community, which were developed without reference to, or in discussion with, the CAA. The strategic themes of the Airline Community for H7 are:

- 1) **Service** (for our passengers through)
- 2) **Facilities** (which are fit for purpose and deliver)
- 3) **Resilience** (in a way which demonstrably provides)
- 4) **Value** (to airlines, passengers and those with an interest in cargo)

#### **5. How can consumer engagement throughout the H7 process be improved?**

5.1 Having developed Constructive Engagement (CE) the CAA has already led the way amongst regulators on the subject of consumer engagement in regulatory reviews between the company being regulated and its customers. One of the keys to improving this will be ensuring that the airlines have complete and relevant access to the information from HAL that will enable meaningful further engagement. This is both in terms of the nature of the information and the timeliness of its provision.

5.2 We welcome the indication that expects to undertake a series of consultancy studies in two phases. We hope the CAA will promote and facilitate the engagement of the airlines with the selected consultants in order for their input and views to be taken into account throughout the studies.



6. Are the CAA's proposed steps (see Box 2) sufficient to ensure that consumers' interests are at the heart of the H7 programme?

6.1 In previous reviews the voice of passengers has been represented by the airlines who compete amongst each other for the business of passengers. In addition to this, the airlines specifically sought the input of the [previous] Air Transport Users Committee and the Passenger Services Sub-Committee of the Heathrow Airport Consultative Committee for their views on the extent to which the areas covered in the SQRB met the service priorities of passengers. So seeking the input of passenger representatives has been business as usual for the airlines. We look forward to continuing this approach jointly and transparently between stakeholders.

6.2 With regard to the points in Box 2:

1. It is unclear to us what is intended (and on what basis) by the CAA comment that the CCF would be expected to take a view on the acceptability of the HAL Business Plan to consumers. We consider that more work needs to be done on this before the establishment of a CCF in order for their contribution not to be diluted by an unarticulated (or even assumed) range of expectations amongst its members.
2. We agree the need for an evidence based understanding of consumers' priorities and welcome the intention of the CAA to work with industry to release the value in the consumer research undertaken by the airlines.
3. We welcome the CAA's intention to require both HAL and the Airlines to demonstrate that their plans are aligned to the aspirations of consumers.
4. The CAA is correct in emphasising again the need to understand the cargo dimensions of airport operations at Heathrow.
5. We note the important role of the Consumer Panel within the CAA and would welcome discussions with the CAA on how their input contributes to the review within the context of the establishment of the CCF.

7. Do you agree in principle that the CAA should look to move toward more outcomes-based regulation and to what extent should this complement or replace the existing SQRB scheme?

7.1 The Service Quality Rebate and Bonus (SQRB) scheme has delivered substantial benefits to passengers by providing an incentive to Heathrow Airport to deliver the service quality set

by the CAA for a regulatory period. In addition to this the SQRB benefits passengers through a well-defined set of outputs expected from Heathrow Airport. There is always merit in reviewing the effectiveness of the SQRB e.g. considering if it is in the interests of passengers to lift some of the performance standards and include elements such as the HAL dimensions of baggage system operations. However, we would highlight that the SQRB has consistently proved its effectiveness and therefore any other (new and untested) form of measuring the delivery of outcomes from HAL should be in addition to the current SQRB not instead of it.

7.2 We look forward to working with the CAA on this over the course of H7 and would, in the meantime, highlight that the SQRB scheme achieves two important functions for passengers and airlines:

- It is at the heart of incentivising the right outcomes at Heathrow Airport, and
- It simulates what would happen with respect to the delivery of service between a customer and a supplier in a competitive and commercial environment - a key objective of economic regulation.

7.3 We note that the CAA has recently published a specific paper looking at outcome based regulation and will host seminar on this on 03 May. Given the recent receipt of the paper and that the seminar will be held after the submission of this response we are likely to make a further submission on this issue to the CAA.

## 8. [How can the Licence regime improve airport operational resilience and mitigate disruption?](#)

8.1 At the outset of our response to this question we would highlight a number of key points:

- The Airline Community at Heathrow is conscious that resilience is not an abstract concept to them; it is something they are committed to in the interests of their passengers.
- The Airlines operating at Heathrow are already doing a lot to improve resilience at Heathrow and much of this activity is required as a mitigation for the absence of the activities that should, in some cases (e.g. baggage, fuel storage), have been already undertaken by HAL.

- We are reliant on Heathrow Airport for the provision of resilient infrastructure. However, this must still be provided efficiently and be subject to both efficiency and effectiveness testing.

8.2 Bearing these points in mind we look forward to working with the CAA to promote the resilience of Heathrow Airport. However, we would highlight that this should not result in obligations being placed on airlines through a Licence which is there to address the substantial market power of HAL – the regulated company. In our view the best method of promoting resilience is to facilitate a meaningful discussion between HAL and the airlines on this issue and ensure that any emerging investments are provisioned in the H7 settlement.

9. [Do you support our broad approach to promoting efficiency and financeability and do you agree that the specific issues raised \(CPI v RPI, debt indexation, etc\) are relevant for this review?](#)

9.1 We welcome the indication that the CAA will continue to undertake a comparative analysis of the efficiency of HAL with respect to its costs and revenues. We consider that this analysis should not just be a comparison with comparator airports but also with other industries as well which undertake significant investment in infrastructure. It will be important for some of the wider infrastructure investment analysis to be of companies which operate in a competitive environment to determine the extent to which the behaviour of HAL reflects (or not) what would be likely to occur in a competitive environment.

9.2 The CAA is correct in highlighting that a challenging and high quality Business Plan from HAL would add be a useful input to the early stages of the H7 review. However, we note that there will be room for subjectivity amongst stakeholder as to what constitutes a high quality Business Plan. We hope the CAA involves all stakeholders in developing its expectations and definition of what it will require as a high quality plan.

9.3 We welcome the CAA indication that it will base its analysis on the costs and efficiencies that would be expected from a notional company rather than HAL's actual capital structure.

9.4 The Airline Community is supportive of using the WACC as the measure of return set for HAL for H7. In doing so we would highlight a couple of points:

- The WACC set by the CAA should not be based on what the HAL shareholders would 'expect' from their investment. Rather the WACC should be set at the level that is warranted from an investment in a regulated infrastructure investment company with

substantial market power.

- The assumption of the WACC will be a key dimension of the HAL Business Plan. We believe the CAA should require HAL to use the current WACC as an assumption in its Business Plan and for HAL to provide its own assumption (and the basis for this) of the WACC it uses in its Business Plan. Heathrow Airport has made comments about the Q6 WACC recently – including directly to the CAA at a senior level. Therefore, we assume HAL has been undertaking a thorough analysis of this issue and will be well placed to give its views on the WACC it thinks will be appropriate for H7.

9.5 We note that HAL would prefer for the CAA to provide a range estimate for the WACC. In our view the CAA would need to undertake a thorough and transparent analysis of all factors which input to the WACC before providing a range estimate. Therefore, we would urge the CAA to be cautious about providing any estimate at the outset of the H7 review. We also note that in paragraph 5.11 the CAA indicated that it expects HAL to provide visibility to the airlines [in CE] of its financial assumptions and specifically HAL's assumptions on the WACC. This is a prudent approach from the CAA which we hope is followed through by requiring HAL to provide its estimate of the WACC (and the basis for it) at the outset of the process.

9.6 We note the issues associated with Debt Indexation and the use of RPI/CPI set out by the CAA and discussed at the 20 April seminar. We look forward to considering these issues further over the course of the H7 review.

9.7 We welcome the indication by the CAA that it intends to continue with the Single Till at Heathrow. This form of setting prices has been well reviewed and repeatedly found to be the model which best replicates both the nature of commercial revenue and the integration of the airport infrastructure at Heathrow.

10. [Do you agree in principle with the continued use of Constructive Engagement and do you have any observations on how the process might be improved?](#)

10.1 The innovation of Constructive Engagement (CE) introduced by the CAA into the framework of airport regulation was very welcome by the Airline Community and we remain committed to it for the H7 review. In keeping with this, we agree with the high-level principles for CE set out by the CAA in Box 3. Whilst CE is principally a discussion between HAL and the Airlines we welcome the indication by the CAA that is open to, where appropriate, playing a

more active role in the CE discussions for H7 than it has in previous reviews. We look forward to considering how this can best be achieved.

- 10.2 We note that the CAA also sees a role for the CCF in the CE discussions. There will need to be careful consideration of how best to achieve this in order to be able to make optimal use of the CCF input within a context of multi-stakeholder engagement.
- 10.3 As indicated at the CAA seminar on 20 April, the Airline Community considers the latest proposals on the scheduling of CE to be in the best interests of all stakeholders. Therefore the Airlines are supportive of a period of CE before (and inputting to) the first HAL Business Plan. The publication of the HAL BP should then also be followed with a period of CE as a mechanism for continued transparent discussions between parties on the contents of the BP. We would recommend that the overall period of CE be about 10 – 11 months with 3 - 4 months being in advance of the BP and 6- 7 months being after the BP.
- 10.4 As agreed with HAL at the 20 April CAA seminar, we think the process of CE should commence with a jointly agreed road map of the issues to be discussed and the structure of the engagement forums in which the CE discussions will take place. We look forward to engaging with HAL on this and would welcome the participation of the CAA in this process to assure itself that the emerging proposals will meet its H7 requirements from CE.

## 11. Do you agree with the proposed timetable for the review?

- 11.1 Subject to our comments about the possibility of extending the Q6 period and the timetable for CE we are supportive of both the overall timetable and the high-level phases for the H7 review set out by the CAA.

## 12. Are there any other issues you consider material to the H7 review?

- 12.1 We welcome the CAA indication that it is ‘keen to take into account relevant best practice from other UK economic regulatory regimes, where it is appropriate to do so.’ In our view the words ‘relevant’ and ‘appropriate’ are key here. When considering features of regulation in other sectors stakeholders will need to give careful consideration to the context of those policies and the extent to which they can be replicated without unintended consequences within airport regulation. It remains unclear what is the scope of the CAA’s vision and interests regarding those consumers who choose not to fly. It would be helpful if

the CAA was more specific noting that airlines are subject to national, European and International regulations regarding compliance with best practices for environmental management and the relevant mitigations.

- 12.2 We note the CAA's discussion on Licence-backed commitments in Appendix 7 and welcome the CAA's initial position that these are likely to be impractical for HAL given the CAA's findings in its 2014 Market Power Determination. We believe the CAA is correct in its initial view that licence-backed commitments should not be implemented at Heathrow and look forward to reviewing the output of the CAA's review of the approach at Gatwick.