

By email to:

Andrew Macmillan,
Chief Strategy Officer,
Heathrow Airport Limited,
The Compass Centre,
Nelson Road,
Hounslow,
Middlesex
TW6 2GW

Simon Laver,
Secretariat,
LACC,
Room 2044,
D'Albiac House,
Heathrow Airport
TW6 1SD

Nigel Wicking,
Chief Executive,
Heathrow AOC Ltd,
Room 2040-2042, 2nd Floor,
D'Albiac House,
Heathrow Airport
TW6 1SD

30 July 2020

Dear Andrew, Simon and Nigel,

Hold Baggage Screening Costs - Decision

1. Thank you for your letters dated 25th June 2020 (Heathrow Airport Ltd (“HAL”)) and 25th June 2020 (Heathrow AOC Ltd (“the AOC”)) (together “the parties”) following our letter dated 22 May 2020 (“the May letter”) setting out our “minded to” position on the recovery of Hold Baggage Screening (“HBS”) costs.
2. Those letters provided further comments relating to the disagreement between the parties on how the costs for HBS should be recovered under HAL’s licence¹ (the “licence”).

Summary of the responses of the parties to the May letter

3. HAL stated that its position remains that recovery of these costs through the Other Regulated Charge (“ORC”) mechanism set out in Condition C2 of the licence is the only outcome that would be consistent with:
 - the appropriate use of the “S-factor” provision,² which is designed for use only where there has been a change to security standards;

¹ Heathrow Airport Limited Licence, issued under the Civil Aviation Act 2012.

² Condition C1.4 of the licence sets out provision for an “S-factor” adjustment which is subject to a “dead band” under which HAL would bear additional costs from changes in security standards up to a specified level.

- the appropriate application of the ORC decision tree to allow for the recovery of costs for services provided by HAL, where the usage of the service is not driven solely by passenger numbers; and
 - the maintenance of the “user pays” principle.
4. The AOC asked the CAA to provide evidence that, in the certified Security Standards specified by the CAA to HAL (as defined in article C.1.16 of the licence), HBS is specified as a Security Standard that HAL must deliver. The AOC argued that, if HBS is not included, then there has in fact been a change to the Security Standards and, as such, the CAA’s minded to position would need to be reviewed.
 5. The AOC also requested that the CAA assure that the level of charges for delivering HBS are kept unchanged from when the AOC provided the service.

Definition of Security Standards

6. We considered the purpose and history of the S-factor when developing our minded to position. The S-factor began as a method under which a proportion of the costs of new Government security requirements could be passed through in airport charges and recovered from airlines and passengers. The CAA requires airports to have ‘S’ claims independently audited and copies claims to airlines and others for comments. The final decision on whether to allow expenditure to be passed through is taken by the CAA.³
7. The security activities that HAL delivers are built into the price control through its allowances for operational and capital expenditure. The CAA’s role in certifying Security Standards set out in the Heathrow Licence at C.1.16, (i.e. ‘*as certified by the CAA*’) means that the CAA has certified that a requirement is a new standard and is, therefore, eligible to be passed through into airport charges under the price control.
8. However, in the present case, we do not consider that the passing of responsibility for HBS from airlines to HAL constitutes a new security standard or requirement. Rather, this is a change in responsibility for an existing requirement that in all other respects remains unchanged. As such, this is not a change to the security standards themselves.
9. As set out in the May letter, our approach is supported by the materials issued by the DfT that implemented the change in responsibility. As such, we do not consider that there has been a change in Government security standards, for which the S-factor was established to provide. Therefore, we consider that this cost should not be passed through the price control and borne by HAL under the S-factor dead band.

³ Heathrow, Gatwick and Stansted Airports Price Caps, 2003-2008: CAA recommendations to the Competition Commission March 2002
<https://webarchive.nationalarchives.gov.uk/20140605145804/http://www.caa.co.uk/docs/5/ergdocs/baarecommendationsmar02.pdf>

10. We remain of the view that the costs of HBS fit within the definition of an Other Regulated Charge (“ORC”) because they meet the following criteria:⁴
- a. Heathrow is the sole provider of the service;
 - b. The service is necessary for airport users to fulfil their passenger proposition;
 - c. The usage of the service varies between airport users, so a unit rate based on the user pays principle is appropriate;
 - d. The driver of service usage is not purely related to passenger numbers;
 - e. The usage volume can be measured;
 - f. It is an area where Heathrow and the airlines can work together to drive efficiencies; and
 - g. It has arisen due to an external policy impact over which Heathrow has limited control and therefore should not be able to earn windfall gains.
11. As a result, HAL should be able to recover the additional costs of HBS through the ORC mechanism set out in condition C2 of the licence.

Cost Assurance

12. On cost assurance, the AOC requested that the CAA provide assurance that the level of charges for delivering HBS are kept unchanged from when the AOC provided the service. Our understanding is that the contract for HBS has been transferred from the AOC to HAL on the same terms. Any changes to those terms should be discussed and agreed through the ORCs process.

The CAA’s decision and next steps

13. We appreciate you taking the time to set out your final comments on the issue of HBS costs. Following our consideration of your comments, we have not changed our position on these matters. As such we have decided to maintain our minded to position as set out in the May letter (and above) and have decided that HAL should be able to recover the additional costs of HBS through the ORC mechanism as part of the baggage systems facilities as set out in condition C2 of the licence.
14. We will shortly publish this letter on the CAA’s website,

Yours sincerely



Andrew Walker

**Chief Economist,
Economic Regulation & Competition Policy**

⁴ Heathrow ORC Pricing and Costs Protocol 30 September 2014, Decision Tree on page 16