

Heathrow response to CAA's Draft guidance on ORC protocols and dispute Resolution (CAP2524F)

CAA-H7-807

Date: 28 April 2023

Prepared by: Heathrow Airport Limited

Status: Non-Confidential

1. Introduction

- 1.1. This document sets out Heathrow's comments in response to the draft guidance from the CAA on the Other Regulated Charges ("ORC") protocol. Heathrow is committed to working collaboratively with the airport community to develop a protocol which supports the successful functioning of ORCs and our feedback is provided in line with that purpose.
- 1.2. ORCs cover a range of services which Heathrow provides to airlines and businesses which operate at the airport. These services are critical for the successful functioning of the airport. As with all of the services at Heathrow, it is important they are delivered efficiently in the interest of consumers, supported by proportionate and efficient governance.
- 1.3. We consider that the existing Q6 ORC protocol generally worked effectively, with the exception of an unprecedented pricing dispute during the Covid-19 pandemic. Therefore, the Q6 protocol should be used as the basis for the H7 regulatory period.
- 1.4. Given the challenges of implementing the H7 determination regarding ORCs and the CAA's proposed 'independent review', it is vital that the CAA issue the final guidance in a timely manner such that Heathrow can work with the airport community to develop a revised protocol which will ensure the efficient functioning of ORCs at Heathrow and deliver the best service to consumers.
- 1.5. Clear guidance from the CAA is critical in supporting the development of a new protocol for H7. Areas where we require additional clarification include the level of information provision which the CAA considers to be reasonable, how the new protocol can be binding on all parties and the functioning of the dispute mechanism process.

2. Key context

- 2.1. In the current ORC provision model, Heathrow recovers the costs of providing ORC services directly from the airport community and does not earn a margin on them, instead engaging with the airport community on the costs within the framework. In this model, the airline community are being charged for the costs which Heathrow incurs in providing services to them, under a regulatory framework. This is different from the airport community procuring a service, which would have associated service levels and a risk premium embedded in the price. In the event of any deviation from the current model, Heathrow would need to reconsider the cost of providing all services on such a basis, which would inevitably involve the application of a premium to ensure that the appropriate balance of risk when providing such services was achieved. In addition, a complex layer of administration would need to be developed to correctly attribute fault given the airport operational environment and interplay between, for example, airline punctuality and the provision of ORC activities such as the PRM service. Needless to say, this would introduce significant cost and complexity to the ORC process which Heathrow does not believe is appropriate or required. To date,

airlines have been unwilling to fund such a risk premium and have preferred to maintain a pure cost recovery model.

- 2.2. We share the view of the CAA that the ORC protocol, and therefore any dispute mechanism process, should be binding on all. However, we are unclear as to how the CAA propose to achieve this and require further clarification on the mechanism to enable legally binding obligations on all parties, including airlines and non-airlines who are not bound by the terms of the Heathrow economic licence.
- 2.3. Finally, we cannot, when drafting the protocol, ignore the impact of the Final Decision. We ask the CAA to engage with us on elements which we require further clarity on from the Final Decision, such as the outcome of the independent review, the absence of an adjustment term in the price control and the definition of windfall loss and gains. We need clear guidance from the CAA to successfully implement the protocol guidance with the airline and non-airline communities.

3. Principles for the ORC protocols

- 3.1. Heathrow largely supports the high-level principles which have been set out by the CAA to guide the development of the ORC protocol. However, there are some areas where we require clarification to enable successful protocol development and implementation.
- 3.2. We agree that the development of the protocol should be a collaborative process. Heathrow's role as the provider of ORCs is to balance the sometimes-competing interests of different users while ensuring that we are delivering the service levels expected by consumers. We note that the revised condition F1.3 of the H7 Licence requires Heathrow to use "*reasonable endeavours to agree and make available to the Relevant Parties and the CAA one or more protocols...*" and this will inform our approach to the development of the ORC Protocol.
- 3.3. We support the principle that the ORC protocol should adopt best practices in consultation and engagement and that there should be clear frameworks for governance groups, underpinned by terms of references. The Q6 ORC Protocol provides a strong basis for successful collaboration and engagement. We engage extensively with airlines and additionally have commenced regular engagement with non-airlines to further promote the transparency of ORC costs. We would like to build on this to ensure proportionate and effective governance with an appropriate quorum for the remainder of H7. We support the principle of ensuring reasonable transparency on costs, including consultation with service users on the scope of ORC-related procurement.
- 3.4. Under existing arrangements, we consistently provide a large volume of detailed information to airlines. In response to feedback, this has been increasing both in respect of quality and quantity. We remain committed to providing high quality information relating to ORCs to provide transparency to the airport community. In addition, we respond to regular ad hoc requests for information and further 'deep dives' into service performance, which in our view, goes beyond our licence obligations. Such activities are often time consuming and resource intensive, and lead to secondary or even tertiary requests for information, which distract from our primary

objective of delivering efficiency of service. We therefore require additional clarity on what level of information provision the CAA considers to be reasonable.

- 3.5. We support the position of the CAA not to seek to separate ORC provision into a new legal entity. We are confident that the existing corporate structure can support successful engagement with the airport community on ORCs as has been achieved in Q6.
- 3.6. Consistent with the position of the CAA, we agree that it is important that any mechanism is binding on all parties to ensure it is effective. We are however not clear how the CAA intends that the protocol will be legally binding on airlines¹ and non-airlines and we request that the CAA address this issue and provides guidance on the precise mechanism it envisages could be used to ensure this. Moreover, we ask the CAA for additional clarity on the respective roles envisaged for airlines and non-airlines in the developing and agreeing the ORC protocol.
- 3.7. We support the principle of equivalence in ensuring that services are fit for purpose and serve the interests of consumers where existing contractual mechanisms exist. Airlines already benefit from service rebates or gain share arrangements for the two largest services by revenue (baggage and the PRM service), where, within existing contracts with third parties, service mechanisms exist. These two services represented more than two-thirds of ORC income in 2022. We continue to support returning funds to airlines through our existing process, in line with the general 'cost-recovery' principles of ORCs. As the opportunity arises to tender services in these areas, we will engage with airlines through the ORC process and consult on service level standards.
- 3.8. However, for all other ORCs, where no existing contractual mechanisms exist, or where services are provided directly by Heathrow, such as the ID Centre, we note the unintended consequence of a need to provide service rebates. In this case, as in many at Heathrow, where the efficiency of the service is directly linked to the inputs by airlines and other customers, there will be additional costs generated in the process of attributing the cause of service failings. We note the example of the ID Centre, where we have seen a general decline in the quality of applications, with in excess of 70% of applications not meeting the requirements and therefore leading to long processing times. Moreover, poor operational performance (such as low airline on-time performance and low rates of pre-notification of demand, in the case of the PRM service) has a material impact on the efficiency and performance of the service. The attribution of fault in the case of service failings would be a complex exercise with significant cost implications and would likely not serve the consumer interest. In addition, as the airport community would now be procuring a service with associated service levels, Heathrow, as with any supplier or customer relationship contracted on this basis, would have to add a risk premium to the cost of providing the service. To date, airlines have been unwilling to fund such a risk premium and have preferred to maintain a pure cost recovery model.
- 3.9. Heathrow does not support the principle of implementing a periodic review process to validate that ORC process is being conducted in line with the ORC principles. It is our view that the Licence obligations assure the CAA that Heathrow will adhere to ORC

¹ See paragraph 25 [CAP2524F](#)

principles and that an ill-defined periodic review requirement will do nothing other than add additional administrative burden and costs with no benefit for the consumer. In the event that the CAA does not agree with this, the objective of any periodic review requirement would need to be well defined to ensure that it was fit for purpose.

4. Principles for ORC dispute mechanism process

- 4.1. Heathrow supports the principle of creating a proportionate independent dispute resolution process, but we reiterate our position that its scope should be limited to procedural matters.
- 4.2. We note that formal disputes on ORCs are a rare occurrence, and we are committed to constructive engagement and the use of appropriate escalation to address issues and reduce the likelihood of a formal dispute arising. This has been successful for the vast majority of disputes through Q6, and indeed exceptions to this during the previous price control period arose out of exceptional circumstances, notably the Covid-19 pandemic.
- 4.3. We consider that extending the dispute resolution process to operational and commercial matters poses a significant risk to implementation and will result in costs which will be borne by airlines and service-users and may not serve the consumer interest. It assumes the existence of a standard 'commercial' customer / service provider relationship which, as explained in earlier sections, is not the case for ORCs.
- 4.4. In addition, we anticipate additional complexity and inefficiency would be imported into the management of ORCs if dispute resolution were extended beyond procedural related disputes.
- 4.5. It must be highlighted that it was only the extraordinary circumstances of the Covid-19 pandemic and the impact on Heathrow financing which required the exceptional mid-year reprice and led to the previous dispute. It remains Heathrow's view that such exceptional circumstances should be covered by the protocol and we would request that the CAA incorporate this into the guidance.
- 4.6. The scale and complexity of Heathrow's operations and the interplay with service provision would require significant external expertise to be able to both be accepted by all parties as an appropriately qualified 'expert' and to adjudicate across such a diverse range of potential dispute sources. For example, there are a number of factors that can impact punctuality which in turn impacts PRM service provision. To be able to accurately apportion blame in the event of a dispute would be challenging. We note the successful application of independent dispute resolution processes in other regulated sectors, such as the railways², which have a more specific focus, and do not extend to matters of operational performance or broader commercial decisions. Considering the broad scope of the intended dispute mechanism process, in order to successfully implement, we require clarity on how outcomes will be legally binding on all parties.
- 4.7. To support the creation of a dispute mechanism process, we request further guidance from the CAA, drawing on examples from other regulated sectors. Specifically, what

² [Access Disputes Committee \(Railways\)](#)

gateway criteria should be applied, including the boundaries of scope of disputes, materiality and time parameters for a dispute to be valid.

5. Next steps

- 5.1. We are committed to working with the airport community to deliver a set of principles on the ORC Protocol by 30 September 2023. In support of this goal, we require the publication of the final guidance document by the end of June to allow sufficient time to inform the development of the principles and request that the CAA commit to this timeframe.
- 5.2. We believe that regular and open communication between Heathrow and the CAA will be critical in ensuring the successful development and implementation of the final guidance once published.
- 5.3. We note the strong interplay between the ORC protocol and the H7 Final Decision and how this will inevitably impact on the creation and operation of the ORC protocol, such as in the allocation of non-airline fixed costs. We request engagement and clarification from the CAA on elements of the Final Determination relating to ORCs, since we consider these integral to the implementation of the protocol guidance. Such issues include the outcome of the CAA mandated independent review, the absence of an adjustment term in the price control and the definition of windfall loss and gains.
- 5.4. We look forward to continuing to engage positively with the airport community and the CAA to best implement the final guidance and deliver a successful and collaborative ORC protocol for H7.