

## BA's alternative quality-incentive proposals

### Introduction

1. BA told us that the attractiveness of the CAA's Q-term proposals had been weakened by a number of decisions. First, the CAA had limited the impact of the Q term to a level that might be ignored by BAA. Second, any resulting price-cap adjustments would only take place after a long delay that would lessen the incentive effect. Third, the proposed measures involved the averaging of performance across a range of different elements of performance; despite an airport performing poorly on a factor critical to airlines, any resulting penalty could be diluted, or its incentive effect offset, by over-performance in other, possibly less important, areas. BA felt that customer service quality at airports was achieved by getting all aspects of a number of services right—to get only some of them right did not achieve the required result. BA regarded the CAA's proposals as a form of tokenism that would create the illusion of progress whilst leaving airlines in a worse position.

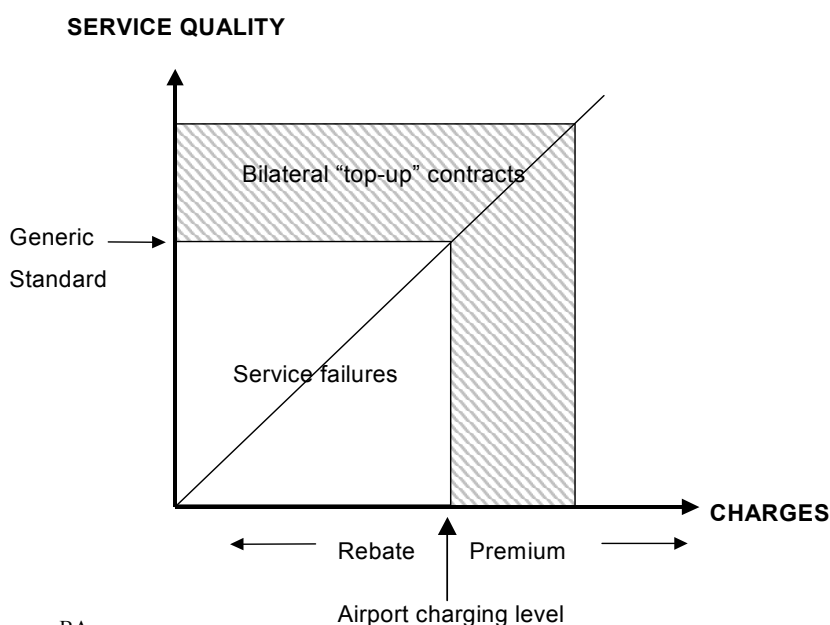
### Generic standards

2. BA considered that one of the most important issues for this inquiry was the need to create generic standards for the aspects of the airports' operation that are most critical to airlines and their passengers. Airlines should be entitled to receive a service, defined by generic standards, in return for the user charges paid under the price cap mechanism. Currently, without such standards, BA considered that complaining was difficult and often ineffective. It felt that airlines were unable to assess either whether value for money was being achieved or whether a service, subject to a 'top-up' bilateral agreement, was being paid for twice.

3. Figure 1 sets out BA's explanation of the role of generic standards. Service below the generic standard (that is in the unshaded area) would result in rebates for denied service, and compensation for additional costs incurred by the airlines, as a result of the airport not meeting the generic standard. If an airline wanted service above the generic standard (that is in the shaded area) it would make a top-up contract with the airport and pay a premium.

FIGURE 1

### Generic standards within BA's overall service quality regime



4. BA considered that its bilateral SLAs with BAA were, in effect, non-legally binding contracts. The essential difference between them and BA’s proposed generic standards was that, while the bilateral SLAs were rooted in contractual principles, generic standards would be a regulatory device. The regulatory regime should also permit bilateral top-up arrangements, but these would not be part of it. Such arrangements might be needed by any airline that decided that something needed to be added to a particular generic standard for competitive purposes.

5. Given its views on the inadequacy of the CAA’s proposals for the QA and QP components of the Q factor, BA chose to put forward the following alternative package of generic service standards, consisting of short-, medium- and long-term elements.

### BA’s short-term incentives

6. BA’s proposed system of short-term quality incentives was modelled on the existing remote stand rebate and jetty rebate.<sup>1</sup> BA told us that its idea was based on the commercial practice that anyone, who pays for goods or services that are not fully delivered, is entitled to receive the denied value in the form of a refund. It added that commercial practice afforded parties a right to receive compensation for damage caused by another party.

7. The generic service standards proposed by BA are set out in Table 1. They would cover the availability of serviceable runways, taxiways, stands, air bridges,<sup>2</sup> pier service, people movers, baggage systems and FEGP. A standard for waiting time at security queues would also be included.

TABLE 1 **Generic service quality standards proposed by BA**

<i>Element</i>	<i>Metric</i>	<i>Target</i>
Runways	Hours of closure of either runway	Published runways available. 24hrs (emergency closures exempt). 2230–0430 maintenance (1 runway still to be available at Heathrow).
Taxiways	Hours of closure of taxiway adjacent to runway	Available 24hrs (emergency closures exempt). 2230–0430 maintenance (alternative taxiway to be available).
Stands	Serviceability vs agreed target (including planned maintenance)	100% availability (including planned maintenance with > 7 days’ notice to users). Focus on 0430–2230.
Air bridges	Serviceability vs agreed target (including planned maintenance)	100% availability (including planned maintenance with > 7 days’ notice to users). Focus on 0430–2230
Pier Service	Pier-served aircraft movements	100% of aircraft movements to receive pier service within each terminal.
People movers	Serviceability vs agreed target (including planned maintenance)	100% availability (including planned maintenance with > 7 days’ notice to users). 97% target for inter-terminal transit at Gatwick. Focus on 0430–2230.
Security queuing (direct & transfer)	Waiting time < 4 mins international and domestic	100% achievement on sampled occasions that a 4-min standard for the international central search queue and for the domestic search queue are achieved. (Automatic method to capture data to be reviewed.)
Baggage Systems	Serviceability vs agreed target (including planned maintenance)	100% availability (including planned maintenance with > 7 days’ notice to users). Focus on 0430–2230.
FEGP	Serviceability vs agreed target (including planned maintenance)	100% availability of FEGP between 0430–2230 for each terminal.

Source: BAA.

<sup>1</sup>Under the remote stand rebate, all airlines receive a rebate of £1.50 for each passenger that has to arrive or depart on an aircraft that does not obtain pier service. Under the jetty rebate, £15.36 per movement is payable if an aircraft cannot use a jetty.

<sup>2</sup>BA prefers to use the term ‘air bridge’ and BAA prefers ‘jetty’.

8. The generic service standards would be set out in BAA's permission to levy charges (usually referred to as its licence). Airlines would be entitled to expect that BAA would always meet these service standards and any failure to do so would give the affected airline the right to receive a rebate for services denied and compensation for costs incurred as a result of the service failure. The rebate and compensation payments received would be open-ended, depending only on the number of service failures experienced, and set at a realistic level, ie rebates would reflect payments for the service denied, and compensation the actual extra costs incurred by the airline for the airport's failure to deliver.

9. BA said that the short-term generic service standards would provide a baseline, above which airlines could contract with the airport for any additional services on the basis of bilateral negotiations. BA would be likely to do this itself at Heathrow, given the importance of this airport to it.

### ***BAA's comments on BA's short-term proposal***

10. BAA told us that it did not agree with BA's assertion that the CAA had absolute discretion in choosing conditions to include in the licence. BA seemed to have overlooked the fact that the airport charges cap and any public interest conditions are licence conditions. Section 39(1) of the Airports Act made it clear that the licence conditions were in force by virtue of the following sections of the Airports Act. Accordingly, the only conditions that could be imposed were those specified in sections 40(1), 41(2) and 46(3), namely conditions concerned with:

- (a) accounts, as referred to in section 40(2);
- (b) airport charges, as covered by section 40(3);
- (c) abuses of a dominant position related to relevant activities; and
- (d) public interest issues.

11. BAA could not, therefore, see how BA's proposed condition could be framed, unless the service quality incentive was either incorporated into the formula in the airport charges condition, or resulted from the abuse of a dominant position or a public interest finding.

12. BAA foresaw a practical problem with BA's proposal, which negated the desire for 'immediacy'. A year's data would be required for many of the elements listed in BA's document, before it would be possible to judge whether a financial penalty was due. For example, BAA itself had proposed a financial adjustment for people mover performance that would be determined by the number of monthly targets achieved across the range of types of people mover over a year; it would be impossible to determine the scale of any financial adjustment until the end of that year.

13. An alternative approach would involve adjusting each month's airport charges invoices, using monthly service quality performance results. BAA felt that such a system would be very complex and administratively burdensome. Each month's invoice for every airline would need to be adjusted in line with the performance of ten or more individual indicators. This might cause confusion and would make it more difficult to predict monthly payments. BAA considered that the same financial incentive could be achieved, with a far smaller administrative burden, through an annual adjustment to airport charges.

14. BAA noted that BA was proposing targets of 100 per cent in some areas of performance. This was unreasonable, given the complexity of an airport's environment. It would also create poor management incentives. In particular, BA's suggestion of a 100 per cent pier service target was unrealistic, given that the current infrastructure made this unachievable—a large level of investment would be required.

15. In other areas, BA had proposed that the percentage targets from the existing SLAs should be retained, whilst changing the measurement definition to include planned maintenance. BAA considered that, if a definition were to be changed in this way, the corresponding target would need to be reduced.

16. BA had suggested two different targets for international security queuing times: six minutes and ten minutes. The existing SLA was based on a ten-minute queuing target. BAA considered that any change from this target would have significant resource implications.

17. BA wanted to include baggage systems and FEGP in the generic standards. BAA argued that these items should be excluded, as they were not covered by core airport charges. BA had suggested a single 'serviceability' target for baggage systems. BAA said that this ignored the successful joint work done by it and BA on the range of measures that were required to judge the effectiveness of a baggage system. If baggage system performance were to be incorporated into another incentive scheme, BAA would have to remove the financial incentives from the existing Heathrow baggage system SLAs to avoid 'double jeopardy'.

### **BA's medium-term incentives**

18. BA's proposal for medium-term incentives was based on BAA's planning standards (see paragraph 6.159). The intention was to provide an incentive to build adequate terminal capacity. The planning standards were already published and BA considered that BAA had accepted them as a contract with user airlines and the MMC in its 1997 planning standards document. It would only be necessary to develop a regular audit process to assess whether the existing terminals complied with the standards. BA considered that to be a relatively simple task. Where the standards were not met, possible remedies could include annual price adjustments, reopening the price cap, representations to the CAA under section 41 of the Airports Act, or a complaint under CA 98.

### ***BAA's comments on BA's medium-term proposal***

19. BAA did not consider that the regulatory regime should be linked to the achievement of planning standards. It already had an incentive to increase airport capacity: if the demand existed, meeting it would result in increased income. Nonetheless, BAA had to take a realistic view of the value of individual projects. For example, additional capacity in the CTA at Heathrow might only have any incremental value until T5 opened; it might therefore fail a cost-benefit test. BAA considered that it was necessary to balance the existing volume incentive with a service quality incentive, rather than to create a further capacity incentive.

### **BA's long-term incentives**

20. BA felt that BAA was in the privileged position of having a regulatory regime that forced its airline customers to act as banks to the airports. By contrast, the airlines had no guarantee that commitments to investment in the regulatory settlement would be honoured.

21. The Airports Act made the timely development of airport infrastructure a statutory duty. BA considered that this had never been achieved. The third element in its alternative proposals was, therefore, designed to encourage the timely development of airport infrastructure. To achieve this, BA proposed that future major projects should only be remunerated on a 'pay-for-what-you-get basis'. Any future increases in an airport's price cap that were needed to finance capital projects would be implemented only when the CIP was delivered as planned. If BAA failed to deliver major agreed projects, it would be penalized by adjustments to its price cap, until the projects in question were delivered—including adjustments in future quinquennia.

### ***BAA's comments on BA's long-term proposal***

22. BAA did not consider that it would be appropriate to have legally binding agreements for airport investment. Nevertheless, it told us that it was sympathetic to the view that charges should be linked to delivery. The regulatory structure should reflect a compromise between airlines that wanted to know

what would be delivered for any given level of charges, and BAA, which needed adequate charges to invest. BAA thought that it might be done in the following ways:

- (a) The airports could undertake to provide a given level of throughput (in terms of passenger numbers) at a certain standard of service. Incentives for the latter would be provided by BAA's Q-factor proposal. BAA considered that there were already strong incentives for it to maximize the number of passengers handled.
- (b) Charges could be linked to provision of certain predefined outputs. Examples were the increases that the CAA proposed to link to the early release stands and the ART on the T5 site.
- (c) Alternatively, increases in charges could be contingent on major projects throughout Q4. These projects would have to be well defined already, with a high probability that they would still match airline requirements.