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Response to Economic Regulation of Heathrow – CAP2980: H7 Final Issues

Thank you for the opportunity to respond to the above consultation, addressing matters related to the H7 Final Determination that were: (i) remitted to the CAA by the Competition and Markets Authority ("CMA") as part of the H7 appeal process; (ii) not concluded at the time of the Final Determination; and (iii) have been raised by parties since the Final Determination, (the "Consultation").

This submission is made jointly by the London (Heathrow) Airline Consultative Committee ("LACC") and Heathrow Airline Operators Committee ("AOC"), collectively referred as (the "Airline Community") and sets out agreed principles and outcomes that we believe the CAA's policy should aim to address. It addresses each Chapter of the Consultation in turn where we have comments. It also addresses points raised by Heathrow Airport Limited ("HAL") to airline members of the Joint Steering Board ("JSB")¹, which we understand HAL will be raising with the CAA in their response to this Consultation.

Please note individual airlines, groups and alliances may make their own submissions detailing their specific views on the CAA's proposals.

1. Remittals following the Appeals to the CMA (Chapters 1 – 3)

The Airline Community note the three matters upon which the CAA has opined on relating to: the Ak factor; the "index-linked premium" used to calculate the cost of debt; and (iii) verification of the passenger forecast 'shock factor, and for a number of these matters, the CAA is proposing to follow the approaches set out by the CMA.

The Airline Community note a number of its Members, notably those directly involved in the CMA process, will be providing further arguments and evidence in relation to the matters raised here to which we strongly encourage the CAA to consider further.

Notwithstanding the above, the Airline Community make the further following comments in relation to aspects of the CAA's approach in addressing the CMA Remittals:

1.1 Ak Factor: Passenger Mix

Whilst the CAA have reflected the approach set out by the CMA for addressing the business rates and development capex elements of the Ak factor, the CAA's approach to passenger mix is of its own design.

¹ Letter from HAL to JSB Members "CAA consultation on H7 Final Issues (CAP2980): Other Outstanding Issues", dated 19th April 2024

Given the approach already reflects HAL's actual over-recovery, as the amount of additional revenue made by HAL was pure over-recovery against the regulated settlement based on actual traffic volumes/mix; it is unclear as to why HAL should not repay the 100% over-recovery (as opposed to only 50% under the CAA's proposal).

The approach proposed in the Consultation unjustly benefits HAL at the expense of airlines and, ultimately, consumers. We would strongly encourage the CAA to address this.

1.2 Ak Factor: Return

The Airline Community welcomes both the commitment and establishing a mechanism that ensures the return of the over-recoveries from consumers that HAL has unduly benefited from for the past several years.

Having raised concerns at the time on the incentive for HAL to return in a timely manner², we also welcome the CAA now being explicit on the timing of its return.

Notwithstanding the above, given the issue has been re-visited, we would encourage the CAA to return the full amount within 2025, given these over-recoveries would have historically already have been returned by now.

1.3 Shock Factor

The Airline Community continue to disagree with the application of a 'shock factor', particularly given the low starting base of H7 and forward projections for the remainder of the price control period. Notwithstanding this we would highlight that, without access to HAL's model, we are unable to validate and therefore comment on the CAA's assessment.

This issue further highlights the need for a review on the approach to passenger forecasting for H8, as set out further in our response to CAA CAP2618³.

2. Outstanding Matters not addressed at the Final Determination (Chapters 4 – 6)

2.1 Pension Deficit Repair Costs (PDRC)

The Airline Community support the work undertaken by the CAA as set out in the Consultation, including the use of independent, expert advice. We concur that it would not be in the consumers interest for HAL to be granted an unnecessary allowance for costs that: (i) the CAA had already identified at the time of the Final Determination it would be revisiting⁴; and (ii) would result in further over-recoveries by HAL, with no guarantee that the amount ever would be required⁵.

2.2 Business Rates

The Airline Community are strongly opposed to the proposal of HAL retaining the £85m over-allocation for business rates, with a proposed 'true-up' at the end of H7. In particular it shows a lack of consistency with the findings and approach with a principally similar issue with addressing

² Airline Community responses to CAA H7 Initial Proposals and H7 Final Proposals

³ 5.1 of the Airline Community response to CAA CAP2618

⁴ Paragraph 4.8 of the Consultation

⁵ Paragraph 4.17 and 4.18 of the Consultation

PDRCs. Furthermore, it is not clear, nor explained, how this different approach would better serve consumer interests here.

The Airline Community note the comments within the Consultation that the CAA is expecting a revaluation of business rates that would take effect for the final nine (9) months of H7, which “*may*”⁶ have an impact over and above the current allocation. Furthermore, the CAA note that the new value “...*may, potentially, be subject to challenge and subsequent revision.*”⁷ which would further diminish any potential impacts within H7.

Given the lack of certainty on the outcome, and any impact on HAL would be for a relatively short period of time within H7, the Airline Community would suggest that addressing the business rates issue in a manner similar (or to the same effect) as PDRCs would be a more consistent and appropriate, consumer led mechanism to address this issue. Such an approach would also ensure regulatory certainty and predictability.

2.3 POD Parking Premium

The Airline Community do not accept that the Pod Parking product generates a premium over other Business parking products. The T5 Business car park generates a lower premium than the Pod Parking site as its location is further from T5.

The map below shows that not only is the T5 Business car park (marked Pbiz in red, with an Entrance marked E in red) further away, but there is also a set of traffic lights between the T5 Business Car park and the T5 Terminal (marked in a red T).



Map showing the location of Pod Parking and T5 Business parking in relation to T5 (source Google Maps)

⁶ References to “may” and “might” appear in Paragraph 5.12, 5.13, and 5.15 with *emphasis* added within this response.

⁷ Paragraph 5.13 of the Consultation

We therefore do not agree with the CAA's assessment of an 8.2% premium and would state that there should be no premium for the Pod Parking product.

Notwithstanding the position above, we believe that the CAA should conduct a fuller evaluation to identify the costs attributable to pod parking, including: whether a premium is still justified a decade after the product has been entered into service; whether operating costs should also be carrying out a premium; and how costs should be allocated (for instance in relation to shared infrastructure).

3. Matters raised since the Final Determination (Chapter 7)

3.1 Formula Error in Condition C1.6

Having raised this issue directly with the CAA, the Airline Community welcome the acknowledgement by the CAA and HAL that this is an error, and we agree it is clearly in the consumers' interest to correct⁸.

In terms of correcting, in order to avoid any ambiguity, the Airline Community would stress the importance of addressing this matter in advance of the HAL 2025 aeronautical charges consultation. The CAA should ensure that any approach it takes ensures this correction is not at risk, or unduly delayed, as a result of any potential appeals or delays to this Consultation.

The CAA's reluctance to issue an erratum notice due to the time elapsed since the Final Decision is inconsistent with the CAA's acknowledgement that the issue ought to be corrected promptly in line with good administrative practice.

3.2 Adjustments for HAL's Operating Costs and Commercial Revenues

The Airline Community strongly support the CAA's assessment as set out in 7.27 and the decision to not re-open the H7 price control.

As a principle, re-opening for specific matters already assessed and addressed within the Final Determination would undermine the regulatory framework and, as the Consultation states, the intended incentives and protections within. We would also highlight that HAL did not choose to appeal these matters to the CMA as further evidence of this as a spurious request.

4. Matters raised by HAL to the CAA outside the Consultation (N/A)

In addition to the points raised in the Consultation, we are aware via the letter from HAL to airline members of the JSB⁹ of several matters that HAL is raising with the CAA to which the Airline Community make the following initial observations:

4.1 Queuing Times for Vehicles

The Airline Community are not opposed to the proposed clarifying amendment of adding "...measured once every 15 minutes..."; the complete sentence reading as follows:

"Percentage of vehicles at each control post group measured once every 15 minutes which have a waiting time of less than 15 minutes."

⁸ Paragraph 7.12 of the Consultation

⁹ See Footnote 1

4.2 Application of Terminal Drop Off Charge (TDOC) Recovery Mechanism

HAL have raised an issue in relation to the recovery mechanism with a proposed license adjustment for years 2022 and 2023. In doing so they have also highlighted an under-recovery of actual revenues to the CAA's allocation.

The CAA will be aware through the engagement at the time, both in its engagement on H7 and through the capital governance process, that a primary concern raised by the Airline Community was in HAL significantly over-recovering on commercial revenues and any impact of passenger volumes. Indeed, the CAA set out a similar concern in the H7 Final Determination:

"However, we remain concerned about both the general uncertainty associated with this entirely new revenue stream and also the more specific risk that HAL could significantly increase the charge and retain the extra profits for the duration of H7.¹⁰"

These matters were sort to be addressed by both the introduction of a recovery mechanism, as well as a requirement on HAL to consult on future price changes.

The risk raised by HAL at the time was the potential change to legislation in 2024 which would have meant the revenue was not recoverable – to which the CAA have established a mechanism within the Licence to address (if that materialises).

In addition to the principle of what the recovery mechanism was seeking to address, there are a number of inter-dependencies related to the commercial incentives on HAL set by the CAA; for example, an aim of TDOC was to increase public transport use¹¹ to which we have seen an over-recovery in HEx revenues.

We therefore are not of the view the CAA's policy was designed for any under-recovery situation which the HAL proposal would have effect to.

As such, the Airline Community would firstly welcome clarity from the CAA on whether they agree with HAL that there is a matter to be resolved (or still requires to be if it would now serve no purpose due to the passage of time). This should include clarity on whether the risk sharing mechanism is intended to cover shortfalls to the extent that these are due to HAL's decision not to price to the CAA's H7 forecast for TDOC revenues or operational inefficiencies.

Should the CAA determine that there is, or might be, an issue to resolve, given both the uncertainty and potential 're-opening' of the price control – including a retrospective reopening for the 2022 k factor which has already been set and applied to the 2024 charges that are currently in effect – we would stress that this issue would require further engagement and appropriate consultation led by the CAA before any amendments are made (if at all). We would suggest this could be best addressed as part of the proposed 2024 TDOC review, as set out in the H7 Final Proposals¹².

¹⁰ Paragraph 5.73, H7 Final Determination

¹¹ Paragraph 5.72, H7 Final Determination

¹² Paragraph 5.78, H7 Final Determination



4.3 Operational Certificate of Adequate Resources

Based on the information contained within the letter we understand that, due to the separating of the financial and operational Adequacy of Resources certification this has created an issue in that HAL's auditors, PwC, are only able to provide certification in relation to the financial resources.

Whilst noting this separation has appeared to cause the issue, we disagree with HAL's proposal to self-assess and certify the adequacy.

A key function of an auditor is providing independent scrutiny. HAL's proposal not only lacks this independent assurance but could raise concerns around conflict of interests. Similarly, there is no clear consequences under this approach should HAL be found to have misjudged the adequacy of its resources.

Whilst the approach for 2024 may have been agreeable in addressing the issue identified at the time, given the criticality of HAL resource to the successful operation of Heathrow, we do not believe that is reasonable in the long-term. Instead, the CAA, and HAL, should consider how independent assurance can be undertaken by experienced independent third parties in order to fulfil the requirements of H7 license.