

**Virgin Atlantic Airways response to the CAA's consultation  
Economic regulation at Heathrow airport from January 2020: proposals for  
interim arrangements (CAP1769)**

## **Introduction**

1. Virgin Atlantic Airways welcomes the opportunity to respond to the CAA's consultation CAP1769, Economic regulation at Heathrow airport from January 2020: proposals for interim arrangements, published in February 2019.

## **Summary**

2. We have consistently supported expansion at Heathrow provided it benefits consumers by enabling a significant increase in effective airline competition and that the required scope is delivered efficiently at an affordable cost.
3. As noted in our previous consultation responses, we have taken a pragmatic view on the efforts made by the CAA to align the next main price control period with the wider capacity expansion programme at Heathrow.
4. We recognise that those efforts have led to unique and unusual circumstances, namely two extensions to the Q6 price control, Q6+1 and iH7. It is against this background that we have reached a temporary agreement with HAL for a two year time-limited period (2020 and 2021).
5. Nevertheless, we still believe that the greatest protection for consumers from HAL's substantial market power comes from effective economic regulation by the CAA.

## **Assessment of the commercial arrangement – Chapter 1**

6. The temporary agreement with HAL is a compromise that we would have preferred not to have to make. But as we noted in our CAP1722 response, the CAA's proposal for the interim period, making returns via depreciation over a long period, was not acceptable to airlines or HAL.
7. We believe that the temporary agreement is better for consumers in the short term than the proposal made by the CAA in CAP1658. Of course, we will never know if a more complete price review may have offered greater benefits to consumers as the regulatory process was never completed.
8. The multiple extensions to the Q6 price control have created unique circumstances and correspondingly a unique agreement. That it is the first of its kind at Heathrow is merely a reflection of those circumstances and not something we would expect to repeat. Given the scale of investment required by expansion, the cost risks that may be placed on consumers and the increase in market power that HAL is likely to accrue as a result of expansion, the

case for the CAA continuing to provide strong, effective economic regulation of HAL into the future is stronger than ever.

9. The CAA has found that HAL holds substantial market power, which places airlines at a disadvantage when entering into commercial negotiations. An expanded Heathrow will have even more market power in relation to other London airports and this disadvantage to airlines is only likely to increase.
10. As we have noted previously, there is a big difference in scale between airlines at Heathrow. One airline group operates more than 50% of slots and no other group operates more than 5% of slots. This means there is also likely to be a large disparity in power between different airlines in their negotiations.
11. We recognise that we were directly involved in the creation of the temporary agreement, but the vast majority of airlines operating at Heathrow were not involved in any discussions with HAL. In our view this is a significant flaw in the process. Under the regulatory regime all airlines have the assurance that the CAA is acting to fulfil its primary duty in the interests of consumers.
12. Our experience of the process is that airlines had limited success in negotiating significant changes to HAL's proposal and HAL appeared to be most responsive to its largest customer.
13. We do not agree that the benefits of 'commercial arrangements' identified by the CAA are unique or outweigh the risks of HAL exercising its significant market power to the detriment of consumers. Where the CAA suggests that substantial benefits could be realised from 'stakeholders working together successfully on design, scope and cost of the capacity expansion programme', we would note that this is already an expectation on HAL as part of its expansion work. Additionally 'HAL and airlines working together more successfully to improve passenger experience' should be the outcome of a strong regulatory framework enforced by the CAA. A strong framework of economic regulation does not and should not prevent the airport and airlines working together in the interests of passengers.
14. In response to the suggestion that a Gatwick style commitments based regulatory framework could be developed at Heathrow, we would reiterate our view that the approach taken to economic regulation at Gatwick is simply not appropriate for Heathrow.

### **Service quality arrangements**

15. The CAA states the SQRB would remain fixed through 2020 and 2021 and that "it is important for HAL to demonstrate that it is acting in the consumer interest over the iH7 period and that it continues to deliver on service quality, including a resilient airport operation". We agree and would also suggest there are some areas within the retained SQRB scheme where HAL could achieve higher levels of performance over the period 2020 and 2021. Specifically, security queue standards and areas measured by the Quality of Service Monitor (QSM) where improved performance would be in the interests of consumers.
16. Throughout Q6 HAL has been funded by the CAA to deliver a security queue performance standard of 99% of passengers waiting less than 10 minutes. Significant progress has been

made towards a system of measuring security queues at Heathrow however the required performance standard has not yet been delivered. To ensure the interests of passengers we think it is appropriate for the CAA to re-instate the Q6 incentive, for delivery of the better performance standard, on HAL for the iH7 period.

17. HAL has made considerable improvements in the four areas of its performance measured through the QSM - wayfinding, flight information, cleanliness, and departure lounge seat availability - and is now consistently earning bonuses for the wayfinding element.
18. Given that the target standard established by the CAA in Q6 included a gap between just achieving the standard performance level and achieving a performance level at which HAL could earn bonuses, it would be appropriate and in the interests of consumers for the target performance standards in these areas to be increased.
19. We have some concerns about the suggestion that parts of the OBR framework could be 'shadow tracked' in iH7 to determine suitability and provide evidence to set performance levels. Firstly, it is unlikely that HAL and the airlines will have an agreed a list of possible outcomes by the start of 2020. Secondly, it may incentivise HAL to underperform in iH7 if it believes its target performance standards in H7 will be based on performance in iH7. This would not be in the consumers' interest.

#### **Relationship between iH7 and the next main H7 price review**

20. We agree with the CAA that 'it would not be in the interests of consumers for the regulatory regime to allow HAL to recover revenues more than once in relation to services it provides' and that any rebates to airlines that result from the temporary agreement should not be considered in setting the price control for H7.

#### **Changes to HAL's licence – Chapter 2**

21. It is appropriate that provision for the commercial arrangements be incorporated into the licence issued to HAL by the CAA. Accordingly the CAA can maintain regulatory oversight and the arrangements can be enforced by the CAA through existing regulatory tools.
22. The document includes a statement that a change to the licence may be required "including hold baggage screening to the list of other regulated charges, if HAL decides to charge for this through this mechanism". We do not believe that Hold Baggage Screening should be part of Other Regulatory Charges nor that it is for HAL to unilaterally decide how HBS is funded. We believe it should be funded through Airport charges.