



London (Heathrow) Airline Consultative Committee

Response to CAA Consultation on the Future of Service Quality Regulation for Heathrow Airport Limited

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Executive Summary

The Heathrow Airline Operators Committee (AOC) and the London Airline Consultative Committee (LACC) welcome the opportunity to respond to the CAA's consultation on the future of service quality regulation for Heathrow Airport Limited.

Since the services and facilities provided by Heathrow Airport Limited are provided on a monopoly basis it is important that the CAA retains the regulatory focus on the performance of the airport company. Therefore, we welcome the CAA indicating that its consultation is about the regulation of the quality of airport services by Heathrow Airport Limited.

The Airline Community welcomes the focus of the CAA on the interests of passengers. This aligns with the perspective of the airlines who have the most direct relationship with passengers. We also support the CAA's policy of wanting to put the interests of passengers at the heart of the regulation of Heathrow Airport Limited. The regulation of the service quality provided by the airport operator is an opportunity to do this.

In considering the CAA proposals for a more outcomes based form of regulation we are conscious of the significant contribution the Service Quality Rebate and Bonus (SQRB) Scheme has made to protecting the interests of passengers from the potential abuse of the monopoly position held by Heathrow Airport Limited. Establishing the SQRB scheme in 2003 put the CAA at the international forefront of airport service quality regulation. A key benefits of the SQRB is that it sets a baseline of quality that each and every passenger should expect to receive from Heathrow Airport Limited in return for the airport charges paid by the airlines.

The SQRB was innovative at the time, and it is still at the leading edge of service level regulation. Notwithstanding the success of the SQRB we welcome the CAA's intention to pursue the development of a range of outcomes that are in the interest of passengers and which build on the SQRB.

We think the CAA can build on the success of the SQRB by retaining it and adding a layer of anticipated outcomes above the SQRB outputs.

We believe this is a 'belt and braces' and 'best of both worlds' (outcomes and the SQRB) proposal which:

- is manifestly in the interests of passengers
- puts the passenger at the heart and purpose of regulation
- simulates what would happen in a competitive environment, and
- provides the benefits of both financial and, to a lesser extent, reputational incentives for Heathrow Airport Limited. Although we wonder if reputational incentives are actually meaningful given the substantial market power of the airport.

We believe our proposal is aligned completely with the CAA's objective of seeing real benefits for passengers and cargo owners established through the H7 review. Therefore, we would commend our proposal to CAA, Heathrow Airport Limited, the Consumer Challenge Board, the Consumer Panel and the Passenger Services Sub-Committee of the Heathrow Airport Consultative Committee and we look forward to engaging with all stakeholders in the development of this work.

Introduction

The Heathrow Airline Operators Committee (AOC) and the London Airline Consultative Committee (LACC) welcome the opportunity to submit this joint response to the Civil Aviation Authority (CAA) consultation on the future of service quality regulation for Heathrow Airport Limited.

For ease of reference this response seeks to follow the headings, structure and chronology of the CAA consultation. In addition to this it contains a specific proposal from the airlines operating at Heathrow Airport which brings together the high-level information benefits of a number of outcomes whilst not losing the proven benefits of the Service Quality Rebate and Bonus (SQRB) scheme established by the CAA. The questions from the CAA, set out in Appendix 1 of its consultation, are specifically addressed at the end of this response.

Context

Without economic regulation companies with substantial market power are able to leverage their monopoly positions, to the detriment of consumers, through 2 principal abuses of their market power. These are:

1. Increasing prices to consumers above that which would exist in a competitive market, and,
2. Reducing service levels to consumers in a manner that would not occur in a competitive market.

We welcome the recognition by the CAA, and the Consumer Panel, that Heathrow Airport Limited will continue to hold substantial market power for a number of years after 2019. Therefore, it will be important for consumer (passengers, cargo operators and airlines) protection that the CAA continues to establish policies that address the two potential abuses of market power above.

The likelihood of Heathrow Airport Limited to raise prices above that which would exist in a competitive market is addressed through the CAA RPI+/-X price cap set by the CAA as part of the H7 settlement. We look forward to working with the CAA and Heathrow Airport Limited

over the course of the H7 review in considering what level of airport charges are justified for Heathrow Airport Limited and are in the interests of passengers for H7.

The likelihood of Heathrow Airport Limited delivering levels of service below what would be expected in a competitive environment has been addressed since 2003 through the SQRB scheme established by the CAA as a remedy to a Public Interest Finding by the Competition Commission (CC) regarding the service levels provided by the airport operator.¹

The level of service provided by Heathrow Airport Limited to passengers and airlines is key to the overall experience of passengers; the efficient operation of the airport; and it supports the resilience of the airport. Therefore, it is fundamental to the H7 settlement.

With regard to service levels it is worth noting that in a competitive market customers are able to:

1. make a choice between the cost of goods/services and the level of quality expected in return for the prices paid, and
2. benefit from compensation from suppliers if the goods/services are not as promised or are defective

These two benefits are often not available from suppliers with substantial market power and economic regulation is required to establish mechanisms and incentives which simulate these competitive market characteristics.

This is the case with respect to the services and facilities provided by Heathrow Airport Limited, where passengers have benefitted from the proven capacity of the SQRB introduced by the CAA to address points 1 & 2 above in Q4, Q5 and now also in Q6.

¹ The absence of a link between the quality and cost of the services and facilities provided by the airport operator was against the public interest.

Developing new arrangements

In addition to working with the CAA and Heathrow Airport Limited the airline community at Heathrow welcomes the opportunity to work with the new Consumer Challenge Board and the already functioning Consumer Panel.

Consumer Challenge Board

We welcome the establishment of the Consumer Challenge Board (CCB) by the CAA and very much look forward to working with this Board to ensure that the interests of passengers are considered and reflected in the Business Plans to be developed by HAL.

As the CCB has just been established, and indeed has yet to be fully populated, we think it would be prudent for the CAA provide an opportunity for the CCB and stakeholders to consider the emerging CAA proposals for regulating service quality before any policy update is provided by the CAA. This is because it will be important for the CCB to be able to take a view on both the aspects of quality that are in the interests of passengers and the method of regulating these aspects of service provided by the airport.

Consumer Panel

In addition to working with the CCB and the CAA, we think it will also be important to gain the perspective of the Consumer Panel regarding the interests of passengers and how these can be best protected and promoted.

CAA duties

We welcome the CAA setting out that the scope of its primary duties concerns the range, availability, continuity, cost and quality of airport operations services. In addition to this, we would highlight the comments of the Consumer Panel that the CAA needs to be effective in ‘monitoring, regulating, enforcing and producing guidance in the consumer interest.’²

We note that the CAA states that it should, where appropriate, undertake its duties in a way which promotes competition in the provision of airport operation services. However, since

² Page 3 of CAP 1445

the substantial market power of Heathrow Airport Limited insulates it from the incentives it would face in a competitive environment it is critical to the interests of consumers that the CAA establishes policies which simulate what would happen in a competitive environment.

Existing Service Quality Rebate and Bonus Scheme

The SQRB established by the CAA has a proven track record of benefits to passengers since 2003. The reasons for its existence, purpose, the dimension of market failure that the SQRB is remedying on behalf of passengers and how it does this have previously been set out clearly by the CAA.³ The relevant paragraphs from the CAA are below:

10. “Prior to considering individually the issues raised during the review, we consider that it would be helpful to examine the purpose of the Service Quality Rebates and Bonuses (SQRB) scheme and SQRB exclusion requests (SERs).
11. The service quality regime was first introduced in Q4, after a public interest finding by the Competition Commission (CC). The CC found that prices did not reflect the quality of service provided to the extent that would occur in a competitive market and, consequently, that there was an absence of the financial incentive to provide the combination of price and quality of service that would be obtained in a competitive market.⁴ The CC proposed that HAL (and Gatwick Airport Limited) pay specific rebates to the airlines when service quality fails to meet the performance standards for which the airlines have paid. The regime was subsequently developed by the CAA and has been a feature of the price control since 2004.
12. Ultimately, this finding is about benefiting passengers. The overarching purpose of the SQRB scheme is to improve service quality at the airport, and thus to improve the passenger experience. Furthermore, this purpose explicitly aligns with the CAA's primary duty, which is to carry out our functions in the interests of passengers and cargo-owners.⁵ It is with this objective in mind that we have considered the issues which were raised during the review.
13. We have considered from a first principles approach why we regulate service quality at HAL. The core issue is that HAL possesses substantial market power (SMP).⁶ A company that has the ability to exploit its SMP may set prices above the competitive level, lack investment incentives and efficiency, offer poor

³ Heathrow Airport Limited Q6 service quality protocol – CAA review final decision paper

⁴ Competition Commission finding, <http://www.caa.co.uk/default.aspx?catid=5&pageid=1322>

⁵ As outlined in the Civil Aviation Act 2012, <http://www.legislation.gov.uk/ukpga/2012/19/section/1/enacted>.

⁶ CAP 1133, Market power determination in relation to Heathrow Airport – statement of reasons, <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=15717>

services and impose unfair trading conditions. There is a risk that airlines operating at Heathrow Airport might not receive sufficient levels of service quality, and hence regulation of service quality is required.

14. The service quality regime is put in place to incentivise HAL to achieve certain levels of service quality and even to exceed standards, similar to what would be expected to occur in a competitive market. As indicated by the name of the regime, if HAL fails to deliver service standards set in a price review, the airlines should receive a rebate as they have not received the service for which they have paid, and passengers lose out as a result. Similarly, if HAL outperforms standards, it may receive a bonus for delivering higher quality.”

The essence of this public interest finding by the Competition Commission is still relevant today and the SQRB established by the CAA has a tried and tested track record of providing the following benefits to passengers and airlines at Heathrow Airport:

- Providing an exclusive focus on the goods/services provided by Heathrow Airport Limited - the company with substantial market power that is regulated by the CAA
- The establishment of a baseline of service quality that all parties (CAA, Passengers, Cargo Operators & Airlines) can expect for the funds Heathrow Airport Limited is allowed to earn through the regulated settlement
- The elements⁷ and metrics⁸ have been tested with passenger representative groups (e.g. the Passenger Services Sub Group of the Heathrow Airport Consultative Committee) in the Q5 and Q6 reviews to ensure that the areas of service quality measured are those which are of most interest passengers.
- Providing a suite of financial and reputational incentives on Heathrow Airport Limited to deliver the level of service set by the CAA
- Visibility for all parties on the service delivery performance of the airport.
- Simulating what would happen in a competitive environment

We note the CAA consultation makes a distinction between service quality elements that are passenger focussed and airline focussed. We are not sure why this distinction is made as all the elements in the SQRB are focussed on ensuring that passengers receive the level of quality

⁷ **Elements** are the actual dimensions of quality e.g. security queue lengths, level of pier service etc

⁸ **Metrics** are the form of measurement for each element e.g. time based or % of availability

from the airport for which they are paying through the airport charges paid by airlines. It is simply that some of the services provided by the airport impact passengers directly and some, as highlighted by the Consumer Panel⁹, impact passengers through an impact on the ability of airlines to deliver services to passengers.

Taken together, the effective working of the elements and metrics of the SQRB have led to significant improvements in the overall service quality experienced by passengers at Heathrow Airport.

Is there a case for change?

It is important for all aspects of a regulatory regime to be periodically reviewed to ensure that the mechanisms established are still fit for purpose, are focussed on a specific dimension of market failure and are still able to remedy that market failure. Therefore, we agree with the CAA that there is a need to review the SQRB and it would be diligent for such a review to be undertaken as part of the H7 process. In the interests of passengers, the review of the regulation of quality should be about whether the market failure identified by the Competition Commission is still relevant; the capacity of the SQRB to remedy this market failure on behalf of passengers and if this can be improved.

Over the course of the Q5 and Q6 regulatory reviews the airlines at Heathrow have reviewed both the relevance of the public interests finding by the Competition Commission and the extent to which the SQRB serves the interests of passengers. In order to do this the airlines and the airport jointly sought input from passenger representative groups about the services provided by Heathrow Airport Limited. Taking into account the views from passenger groups, the view of the airlines is that nothing has changed at Heathrow Airport that would reduce the relevance of the public interest finding by the Competition Commission and that the SQRB is still the most appropriate method of regulating the service quality provided by Heathrow Airport Limited to passengers.

⁹ Page 4 of CAP 1445

CAA already at the leading edge for regulating service quality

We note that one of the reasons cited by the CAA for considering an outcome based approach to regulating the service quality provided by Heathrow Airport Limited is the emerging use of outcome based frameworks in other regulated sectors. However, it is the CAA, through the SQRB, that has already been at the forefront of innovation with the regard to the regulation of service levels since 2003. The extent of the improvement in the levels of service provided by Heathrow Airport since 2004 is testament to this.

Therefore, since the SQRB has proven its benefits to passengers, any review of the framework should be about how it can be improved for passengers rather than change for changes sake or the pursuit of alignment with regulation in other (and different) industries. This is particularly the case since the regulation of Heathrow Airport Limited is different to the regulation of others sectors at a fundamental level. This difference is that there is only one Heathrow Airport. In other sectors (such as water regulation) there are a number of privatised companies whose performance the regulator can compare and incentivise according the performance of the companies in their comparison.

Quality provided by Heathrow Airport Limited

Since the services and facilities provided by Heathrow Airport are provided on a monopoly basis it is important that the CAA retains the regulatory focus on the performance of the airport. Therefore, we welcome the CAA indicating that its consultation is about the regulation of the quality of airport operation services by Heathrow Airport.

We also welcome the CAA indicating that¹⁰:

...we [the CAA] are not attempting to bring other parties operating at the airport into service quality regulation.

Therefore, we suggest that one of the Principles for the design of a service quality regulation framework should be an explicit reference that it only covers the airport operations services provided by Heathrow Airport Limited.

¹⁰ CAP 1476 page 23

Heathrow Airport Limited is the company, with substantial market power, that is being regulated. Therefore, we are surprised that the CAA would suggest that HAL leads the work on the development of the outcomes. This for two main reasons. Firstly, if Heathrow Airport Limited was to lead the work it would be leading the development of the framework by which it was itself regulated. Secondly, the passengers are the direct customers of the airlines who compete for the business of each passenger. Therefore, the airlines have the most direct relationship with the passenger and the most interest in ensuring passengers are well served by the services and facilities provided by the airport.

In contrast to Heathrow Airport Limited being asked to lead the development of outcomes we would have anticipated that all parties would have an equal role in the design of a framework under the auspices of the CAA. This is particularly the case when the CCB is being introduced into the process for the first time.

CAA description of outcome based regulation

We agree that the elements of quality to be included in a mechanism for the regulation of quality should be those which are recognised to be in the interests of passengers. It is also very important that the agreed dimensions of quality are able to be measured objectively. Therefore, any outcomes that are proposed should be SMART. That is to say they should be:

- Specific (unambiguous dimension of quality provided by the airport operator)
- Measurable (able to have defined and trackable performance standards)
- Achievable (recognised to be deliverable by the airport operator)
- Reasonable (able to be delivered, and for accountability to be held by the airport)
- Targeted (aimed at delivering defined benefits to passengers)

A number of possible outcomes have been listed by the CAA (e.g. reasonable charges, safe and secure service, reliable infrastructure, satisfied passengers). We recognise that these are initial suggestions and that the CAA has also proposed that these outcomes are supported by performance indicators. Nevertheless, we are concerned that the example outcomes do not

have SMART characteristics. In contrast to this the Elements of quality in the SQRB are SMART.

Outcomes and Outputs

Our understanding of the objective of the CAA in the 'Outcomes' proposal is to promote a capacity of tracking the impact of the level of service delivered by Heathrow Airport Limited at a level above that of the individual elements of quality in the SQRB. The Airline Community at Heathrow is extremely concerned by the CAA proposal for two main reasons:

1. The responsibility for delivery of the outcomes proposed by the CAA cannot be attributed exclusively to the regulated company with substantial market power – Heathrow Airport Limited. The outcomes would be the result of the activities of the airport operator, National Air Traffic Services (NATS), the Airlines, Government Agencies, Handlers and Cargo operators. Of these parties, only Heathrow Airport Limited and NATS are regulated monopolies [both by the CAA]; the other parties either operate in competitive markets or are services delivered by the government. Therefore, the outcomes proposed by the CAA could either:
 - distort already competitive markets; with the risk of the CAA being responsible for unintended and unquantifiable consequences in those markets, or
 - attempt to impose service standards on government bodies which set their own parameters of service delivery

2. The inability of the proposed outcomes framework of regulation to replicate the benefits to passengers of the SQRB for the following reasons:
 - Complexities of defining the outcomes, the form of measurement, the performance index and performance standard
 - Lack of a baseline of performance
 - Loss of a direct link between charges paid and service delivered
 - The subjective nature of the outcomes leading to protracted responsibility debates amongst stakeholders.
 - Differing levels of outcome importance for various passenger segments
 - Difficulties in linking revenues to Heathrow Airport Limited with outcome performance standards

- The differing incentive properties for *perceived* satisfaction surveys between competitive markets and captive markets

Distinguishing between Outputs and Outcomes

In our view, it is important to note the difference between Outputs and Outcomes when considering the service levels delivered by any company.

Outputs are the specific and measurable (SMART) dimensions of airport service quality the performance of which can be objectively tested against a specific service target. In the normal course of events, it could be expected that achieving the output standards would result in the delivery of a range of outcomes predicated on the outputs. Importantly, outputs can be tested empirically.

Outcomes are the anticipated experiences for consumers that could reasonably be expected to result from a specific set of achieved outputs. However, outcomes cannot be objectively measured given the complexities around:

- a) Defining an outcome
- b) Determining an objective outcome standard which reflects a level of service important to all passengers

Due to their highly subjective nature, outcomes would be difficult to measure empirically.

In the airline proposal below the proven elements in the current SQRB scheme provide the outputs for a number of possible passenger focused outcomes.

Airline Proposal for regulation of the quality provided by Heathrow Airport Limited

In considering the more outcomes based regulation proposal from the CAA we recognise that the elements of quality in the SQRB should (when delivered effectively by Heathrow Airport Limited) combine to deliver a number of high-level outcomes. Such outcomes could be; Punctual Operations, Efficient Processes and a Full Service Passenger Experience.

In order to build on the proposal from the CAA and promote the delivery of these possible outcomes would require a suite of SMART dimensions of quality outputs provided by the airport operator in return for the charges paid by airlines on behalf of passengers.

Therefore, in order to build on the benefits to passengers of both a service quality framework which measures the delivery of specific service levels from the airport and which also tracks the holistic experience of passengers at the airport the airline community would propose a system of quality regulation which is based on outputs and outcomes.

The proposal from the airline community is that the current SQRB, be retained and that a layer of anticipated outcomes be added above the SQRB outputs.

This proposal is manifestly in the interests of passengers and puts their benefit right at the heart of the purpose of regulation. It is a 'belt and braces' and a 'best of both worlds' approach that builds on the benefits of tracking outcomes with the proven airport service performance measurement for passengers of the SQRB. The proposal from the airline community is set in diagram form in Appendix 1.

The benefits of this proposal from the Airline Community are:

- Retains transparency on the baseline of quality for all passengers at Heathrow regardless of their terminal, airline or class of travel.
- Retains the tried and tested SQRB scheme with objective and quantifiable measures
- Provides transparency on the underlying service quality elements which then impact the delivery of the anticipated outcomes

- Retains the familiarity, simplicity and objectivity of the SQRB whilst adding the opportunity to review the extent to which these promote multiple agreed outcomes.
- The ability to track the impact of outputs on a number of outcomes for a greater understanding of the drivers of passenger satisfaction.
- Focuses on the performance of the regulated company, with substantial market power, and retains the regulatory incentive of the airport operator facing consequences for not delivering the expected quality which has been paid for by passengers
- The ability of the SQRB to simulate what would happen in a competitive environment is retained.

A specific benefit we would commend to the CAA, Consumer Challenge Board, Consumer Panel and the Passenger Services Sub-Committee is the ability to identify any emerging sources of passenger dissatisfaction. This could be achieved through the airline proposal tracking the extent of the delivery of outcomes. If outcomes are not achieving the anticipated levels the CAA and Consumer representative bodies could look at the performance of the SQRB outputs. If the SQRB outputs are not at the standard set by the CAA, the service failures of the airport operator could be addressed by the CAA.

However, if the outcomes are not being achieved even when the SQRB outputs are at the required standard then it will become evident that the source of dissatisfaction is based on alternative factors. These factors could be the design of infrastructure, the nature of the service proposition, airline activities or even the activities and service levels provided by government agencies. The desire of the CAA to be able to identify areas of possible improvement beyond the role of the airport has been highlighted by them in the consultation¹¹:

...we [the CAA] consider one potential benefit of OBR is the opportunity to shine a light on the whole consumer experience at the airport.

Such knowledge of the source of dissatisfaction would empower the CAA and consumer bodies to pursue improvements in the passenger experience through other means at their

¹¹ CAP 1476 Page 23

disposal. But this would be done only if it was evident that the passenger dissatisfaction was due to services and facilities not provided by the airport as opposed to a tracking of the performance of other parties. This would enable the CAA to promote the interests of passengers without blurring their capacity to regulate the services provided specifically by the monopoly airport operator and risk the unintended consequences of distorting already competitive markets.

Stakeholder views

In this section, the views of the airline community and Heathrow Airport Limited are reviewed.

Airline position

We can confirm that the CAA has accurately reflected the input of the airline community to the CAA in the period leading up to this consultation.

Heathrow airport position

We note Heathrow Airport Limited considers that there may potentially be some elements of the passenger journey not covered by the SQRB. We would agree that at least one specific area of airport performance is not yet included in the SQRB. This is the performance of Heathrow Airport Limited with respect to passenger's baggage.

Heathrow Airport Limited states that the current SQRB does not provide opportunities for stakeholders to consider services for specific types of passengers. This is not the case. The opportunity to provide specific services to passengers has always been available and continues to exist within the SQRB.

The airline community does not concur that the SQRB has limited the ability of stakeholders to collaborate. The airline community has frequently attempted to work with Heathrow Airport Limited. If the CAA is able to incentivise the airport operator to collaborate more with its airline customers we would welcome this.

We agree that any high-level outcomes should emerge from robust consumer research.

Heathrow Airport Limited appears to indicate that any high-level outcomes should be

supported by lower level outcomes that 'could be more easily linked to measure, targets and incentives'. The airline proposal does this through high-level outcomes being supported by the SQRB elements and we look forward to discussing this with Heathrow Airport Limited in order to build on this in a way which brings real benefits to passengers.

It is surprising to us that the airport operator would suggest that actual output based measures (such as 'queuing time' and 'asset availability') of its performance should be outside of any outcome based system. The queuing time of passengers and the availability of the assets provided by Heathrow Airport Limited are fundamental to the experience of passengers. However, the airport operator suggests that its performance in these areas should no longer have any financial incentives. This proposal from Heathrow Airport Limited runs contrary to the interests of passengers since charges paid by passengers specifically fund the security queue performance of the airport and the construction of the assets required to process passengers. Therefore, the interests of passengers are served by the airport operator continuing to be financially incentivised to provide the expected levels of service in these areas.

We are concerned by Heathrow Airport Limited's proposal that more passenger perception based surveys be used to measure service levels. Perception based surveys can provide a directional indication of service levels but are weakened through subjectivity in their ability to measure the actual performance of services and facilities within a regulated context.

It is worth highlighting again that within the SQRB the financial incentives on the airport operator are not 'penalties'. The SQRB scheme is not punitive. The monies paid by Heathrow Airport Limited on any occasions of service failure are 'rebates'. This is to say the airport pays back money to consumers in recognition that it has not provided the level of service for which consumers have paid. In this way, the SQRB simulates what would happen in a competitive environment where consumers receive rebates when suppliers do not deliver the services that have been purchased. We do not understand why a company with substantial market power would suggest it should be rewarded for the provision of a high level of service to a captive market. The important task is for the CAA to set a baseline at the level of standard

that is in the interests of passengers and ensure that a framework is established which ensures that **all** passengers receive the standard set.

At this point the airline community would also note that the level of rebates paid by the airport do not actually cover the costs the airlines incur in compensating for the service failure of the airport. Therefore, the rebates provide an incentive to the airport to avoid payment rather than the level of financial compensation that could be expected to occur in a competitive market. We would highlight the following two points from this fact:

- The airlines would much rather have the service provided by the airport for our passengers than receive rebate payments, and
- Rebate payments should be set at levels that incentivise the airport to provide the service rather than pay rebates.

In such a world we do not see there being a role for the airport operator to be rewarded for delivering what it should naturally be expected to provide for passengers within a captive market.

Answers to CAA Questions

The CAA has set out a number of questions in appendix A of its consultation. These have been helpful and we welcome such questions in the CAA consultations since they help us to structure our thoughts when responding. In this case we have sought to answer the questions in the course of our response. However, for completeness to we set out brief responses below to each of the CAA questions.

1. Do you agree with the case for change in service quality regulation at Heathrow airport, as outlined in Chapter 3?

We agree that it is prudent to review aspects of regulatory mechanisms at each review to ensure they still achieve the purpose for which they were intended. Such a review could result in no changes or some changes which can be demonstrated to improve the incentive properties of the regulatory mechanism. However, we don't think change for changes sake or amendments which are aimed at alignment with our regulators should be pursued for that

purpose . It should also be remembered that the CAA has been at the leading edge of airport service quality regulation. Indeed, it has set the international standard for airport quality regulation. Therefore, any changes should only be those which would improve the experience of passengers; not risk losing the passenger benefits that the CAA has delivered so far through its SQRB.

2. **Have we accurately reflected stakeholder views, as outlined in Chapter4? Do you have any comments on our proposals regarding the level of stakeholder engagement we require of HAL in developing an outcomes framework?**

We can confirm that the CAA has accurately reflected the views so far of the airline community. Since the airport operator has not engaged directly with the airline community on this issue we are not able to comment on the extent to which the CAA has reflected the views of Heathrow Airport Limited.

Turning to the level stakeholder engagement the CAA expects from Heathrow Airport Limited. We note that the CAA has proposed that Heathrow Airport lead the work and engagement process on service quality. We do not think it is appropriate for the regulated company to lead this work. In our view the CAA should require all stakeholders to engage meaningfully with each other and be able to demonstrate that they have done so. We anticipate that the Consumer Challenge Board, the Consumer Panel, the Passenger Services Sub-Committee of the HACC as well as the airlines and Heathrow Airport Limited will have meaningful input to make. It would be useful, therefore, if the CAA was to require stakeholders to meet and work out how they will engage to take this work forward under the auspices of the CAA.

3. **Do you have any comments on the proposed principles?**

The 5 principles proposed by the CAA are discussed below:

A) OBR should be informed by robust consumer research.

We agree with this principle. In addition to the research being robust, all stakeholders should have to demonstrate that their research is objective and evidenced based.

B) The structure of OBR should include ‘outcomes’, ‘measures’, ‘targets’ and ‘incentives’.

We agree that the terms set out by the CAA should be included in the framework for regulating the quality of services and facilities provide by Heathrow Airport Limited.

C) CCB and airlines play a key role in the development of OBR.

We agree the CCB and airlines play a key role in the development of OBR and we look forward to working on with all stakeholders in putting the interests of passengers at the heart and purpose of the regulation of Heathrow Airport Limited.

D) OBR should build upon the SQRB scheme.

We agree with this and have set out above a proposal which builds on the SQRB and introduces outcomes into the framework for regulating the quality provided by Heathrow Airport Limited.

E) Performance reporting should be targeted at consumers.

The performance reporting should be set out in a way which is easy to use and understand by all stakeholders.

4. Do you consider there are further principles that should be included, or principles that should be removed?

Yes, we think another principle should be added by the CAA. This is that the OBR will be about measuring the performance of Heathrow Airport Limited through a series of outputs. As set out above, the delivery of these outputs should result in a number of outcomes for passengers. If the outcomes are not being delivered but the outputs are being delivered, the CAA can then consider the use of other mechanisms to pursue the delivery of the outcomes. However, anything which introduces ambiguity in delivery responsibility between the airport and other parties will simply create a ‘cottage industry’ dedicated to deciphering responsibility. This would not promote the interests of passengers in any way – rather quite the opposite.

5. Do you have any comments in terms of the proposed structure of the OBR framework, specifically:

a. outcomes

Our comments on outcomes and their role in the structure of the regulation of quality are set out above.

b. measures

Measures are needed to define the form of (as well as measurement of) the quality provided by Heathrow Airport Limited.

c. targets

Targets are needed to provide the level of quality that is expected to be delivered by Heathrow Airport Limited in return for the charges levied on passengers and airlines. Another possible definition could be Standards; this has been the term used in the SQRB and has served the interests of passengers well.

d. incentives

It will be important for the OBR to contain meaningful financial incentives for Heathrow Airport Limited. This because it is rational for companies to respond to financial incentives and because passengers and airlines deserve rebates of the charges paid for the delivery of the quality for which they are paying. We wonder if there is a role for reputational incentives when Heathrow Airport Limited does not have competitors. Its substantial market power means it can provide services to airlines with its reputation bearing only a minimal impact on its business. Therefore, reputational incentives are not an equivalent replacement for financial incentives.

We are not convinced that there is a role for rewarding Heathrow Airport Limited for delivery of quality that is above the level set by the CAA as being in the interests of passengers. This could have perverse incentives for the airport operator and increase costs to passengers without being of any extra benefit to them. The most important factor is to set the level of the baseline standard at the correct level for passengers in the first instance.

6. Do you agree that consumers would benefit from increased transparency on the performance of other parties providing services who play a major role in their experience at the airport?

We recognise there is a benefit to passengers from the transparency proposed by the CAA. However, it should be noted that some service providers are government agencies with their own perspectives on the publishing of their performance. Also, the airlines operate in a competitive market in which passengers already have access to performance information. We think careful consideration should be given to any unforeseen and unintended consequences which might arise from the CAA publishing the performance of companies operating in a competitive market.

ends

Appendix 1 : Airline Proposal Diagram

