

RESPONSE TO CAA'S DRAFT GUIDANCE ON ORC PROTOCOLS AND DISPUTE RESOLUTION

This is the Arora Group's (Arora) response to the consultation issued by the CAA as CAP2524F. Arora welcomes the opportunity to contribute to this consultation, but we consider that the CAA has ignored all our previously submitted evidence showing that the Other Regulated Charges (ORCs) are volatile, unpredictable, opaque and not cost-related. In our view the CAA has therefore not addressed these issues, either in its decision on ORCs nor in the consultation document CAP2524F.

Issues with the regulation of ORCs previously flagged

As a hotel owner and operator both in and around London Heathrow Airport, Arora is required for certain of our properties to use and pay for a number of services included in ORCs, in particular utility services (including gas, electricity and water / sewerage services). As the CAA is aware, Arora has very material concerns about the way in which ORCs are set and charged for by HAL. In our response to CAP2275¹, we supported our views with the following evidence as to why the regulatory framework for ORCs is not working effectively:

- Published gas and electricity charges at Heathrow are significantly higher than published charges at Gatwick and Manchester airports;
- On-airport water charges are multiples higher than off airport water charges (and are higher than other airports);
- HAL's response to requests for clarity fails to provide any clarification beyond highlighting that these are regulated charges; and
- HAL refuses to respond meaningfully to bilateral requests for transparency over charges.

The CAA's Decision shows that the CAA has made little meaningful progress in addressing our evidenced concerns.

Arora previously proposed 4 areas for development in the licence conditions put forward for consultation:

- HAL should be required to demonstrate that where it is procuring services in a competitive market (such as electricity, gas or water), that such procurement has resulted in costs to HAL that can be competitively benchmarked;
- This demonstration of competitive sourcing would then be subject to an independent value for money audit. This would be in line with other regulated companies, whereby

¹ Licence conditions implementing the Initial Proposals contained in CAP2256.

services have to be demonstrably procured in an efficient way and are subject to independent audit accordingly;

- That ORCs are only able to come into force once the CAA has confirmed that the charges are in compliance with the ORC methodology statements; and
- That the licence conditions not only require a greater element of transparency in the level of detail provided about the ORCs, but also provide stronger controls on HAL's ability to make unilateral changes to costs and charges.

Arora continues to consider that these proposals would enhance the regulation of ORCs and would be more effective than enhancing the protocol framework. We now turn to the consultation on the protocol framework.

Principles for development of a new protocol

It is hard to disagree with the tenor of the principles. However, without effective regulation – which has not existed to date – the principles can become irrelevant. We are surprised, and disappointed, that the principles do not include the requirement that charges are cost related, and that that those costs should be market tested. As the CAA is aware, some of the charges levied by HAL are many multiples of market rates. HAL must be required to demonstrate why its costs are so different from the market.

Collaboration

The consultation states that the protocols are to be developed by HAL and airlines and / or non airline ORC users. The terminology used throughout the consultation is inconsistent as to which parties should be involved in the development of the protocols. It must be made clear that the development of the protocols has to include non-airlines ORC users.

Consultation

The CAA needs to ensure that consultation is effective and actions delivered and HAL properly takes into account views of both airlines and non-airline ORC users. The principles should make that clearer.

Governance

The CAA needs to ensure that all users are involved in the governance procedure. This means non airlines as well as airlines. All consumers of the ORC services should have a place at the table.

Transparency

This requirement is weak. As the CAA knows, Arora has been concerned about the lack of transparency over the costs that are recovered through the ORCs. Requiring “reasonable transparency” is too vague. We do not comprehend how a business with a dominant position – HAL – should be allowed to determine the level of transparency.

We note that the airlines want to have a degree of oversight of tendering of contracts. We agree. As we have commented before, HAL should be required to demonstrate that it has market tested its services. From our experience with HAL, it seems to have little interest as to whether its services are market-related.

Equivalence

We do not understand what “fit for purpose” ORC services actually means. We agree that the services should include compensation when not properly delivered.

Independent assurance

We agree with periodic reviews. These should be independent of HAL and involve airlines and non-airlines in setting out the terms of reference.

ORC dispute mechanism

Again, there is little to disagree over the dispute mechanism high-level principles. Although we welcome the CAA's position regarding the scope of this process not being limited to procedural matters, this should be reflected in the high-level principles the CAA has set.

Dispute resolution should be independent of both parties

We agree with this proposal. We do not consider that the CAA should be that independent party given that it has shown limited (or no) interest in addressing Arora's and other non-airline users concerns to date.

Guidance

We agree that the dispute resolution decision maker should be able to issue guidance.

Evidence based decisions

We agree that the decision maker should be able to request and rely on evidence. The CAA should ensure that information gathering powers are available since we expect that most information will be required from HAL.

Accessible, transparent and proportionate process

We agree. We also consider that the mechanism should include the possibility of requesting a review of the decision-maker's decision.

Refusal to hear disputes

We do not agree with this proposal, unless the carve-outs are defined very narrowly. Parties will not go to the expense of an appeal unless an issue was substantive.

Transparent outcomes

We agree. Consideration will need to be given to confidentiality of parties' information.

Timely, efficient and effective resolution

We agree and this is one reason why we do not support the CAA being the decision maker. ORCs have been a significant issue for a number of years with no tangible progress on costs levied by HAL.

Next steps

The CAA is requesting new protocols by the end of September. The CAA therefore needs to issue final guidance in good time to allow negotiations over the protocols. The CAA also needs to make clear that the negotiations must involve non airlines as well as airlines. The consultation document varies between airlines and ORC users. The CAA must be clearer and confirm that non-airlines must also be involved.

The ORC decision

As part of CAP2542C, the CAA determined the levels of ORCs that should be included in the single till calculation. Arora fundamentally disagrees with the CAA's decision:

- The allocation of fixed costs from airlines to non-airlines will lead to differential pricing for the same services, which is *prima facie* discriminatory pricing, in this case introduced by a regulator, rather than a dominant player;

- We are not persuaded by the CAA's statement that it is not advocating differential pricing – it is the CAA's policy that is causing differential pricing;
- HAL has indicated that it intends to recover the re-allocation of costs from 2022 and 2023 through the remainder of H7 – this will exacerbate the price differential between airlines and non-airlines;
- As noted above, the CAA has ignored the evidence provided by Arora that HAL's charges are not market related;
- The CAA has ignored the price volatility that the ORC regime enables;
- The CAA's decision to ignore Arora's submissions, evidence and the effects of its decision previously highlighted to it is particularly concerning given that ORC users like Arora are materially affected by the CAA's decision but have very limited options for redress;
- Charging different prices for the same services provided by a dominant player may generally be regarded as price discrimination activity susceptible of distorting competition, and the CAA can and should intervene to achieve its aims in less distortive ways (starting, as we say below with an independent review and scrutiny of these costs); and
- The indicative prices resulting from the CAA's decision take the absurdity of ORCs to a whole new level:
 - A staff ID for an airline employee would cost £35.70 while a staff ID for a retail employee would cost £51.92 – for exactly the same security process;
 - Electricity (low voltage) for airlines would cost 31.6p/kWh while the same electricity for non-airlines would cost 72.5p/kWh, where such electricity is bought for the same price in the market and uses the same infrastructure; and
 - Water and sewerage for airlines would cost £4.42/m³ while the same services for non-airlines would be £33.34/m³, a differential of over 7 times!

In conclusion, we strongly object to the proposals contained in the CAA's Final Decision.

Independent audit

We note that the CAA is proposing that there should be a one-off review of HAL's allocation of costs between airline and non-airlines, undertaken by an independent reviewer appointed by HAL. While we understand that this is a matter for the CAA and not HAL, we would add the following comments:

- Given our concerns outlined above, we strongly consider that some form of independent review is required, in the absence of any proper oversight by the CAA of any aspect of ORCs. The appointment of an independent reviewer provides the ideal opportunity for an independent assessment of these charges and their allocation;
- We consider that this review should cover all aspects of ORCs which, as far as we are aware, have never been subject to the rigour of a full regulatory investigation. We have repeatedly sought, and failed, to obtain from HAL clarity as to the detail of charges and calculations justifying the multiple differentials between its charges and off-airport charges, for the same service;
- It is also axiomatic that a review cannot be independent if the reviewer is appointed by HAL. For a review to be meaningful, the reviewer should be appointed directly by the CAA and/or ORC users in consultation with HAL;

- Terms of reference for a fully independent review will be central to ensuring that the review is meaningful. Such terms of reference should be published in draft, and agreed with the airlines and other ORC users, prior to finalisation;
- Such an independent review should seek to replicate the regulatory oversight of the rest of HAL's H7 costs, which would imply a number of evidence sessions and working groups fully to understand HAL's proposals; and
- We also think there would be merit in an independent review considering whether airlines and other users of ORC services should carry the volume risk associated with ORCs. HAL carries, and is compensated for, the volume risk associated with passenger volumes (albeit it is proposed that there should be a degree of traffic risk sharing for H7). We see no reason why airlines and other users of ORCs should carry the entire volume risk for ORCs.