

RESPONSE TO THE CIVIL AVIATION AUTHORITY ON THE DRAFT TERMS OF REFERENCE FOR THE INDEPENDENT REVIEW OF HEATHROW AIRPORT LIMITED'S COST ALLOCATION METHODOLOGY FOR OTHER REGULATED CHARGES

This is Arora Group's (**Arora**) response to the Civil Aviation Authority (**CAA**) in relation to the Draft Terms of Reference for the Independent Review of Heathrow Airport Limited's (**HAL**) cost allocation methodology for Other Regulated Charges (**ORCs**) dated 1 November 2023 (referred to throughout as the **Draft ToR**).

As the CAA is aware, Arora has had significant concerns about the way in which ORCs are calculated and charged for by HAL for some time. Arora was encouraged by the CAA's recognition of flaws in HAL's approach to ORCs as part of H7, and the subsequent licence condition (Condition C2.4) requiring an independent review. However, Arora is concerned the scope of the Draft ToR is inappropriately narrow. Accordingly, Arora is taking this opportunity to complement its various letters to the CAA and its responses to previous consultations by setting out its main concerns in relation to the Draft ToR below.

1. Cost allocation methodology: costs to be considered

Arora remains concerned that the independent review will not include a comprehensive review of the costs used to calculate ORCs. As the CAA is aware, Arora is concerned that these costs have never been fully reviewed (by the CAA nor any independent third party reviewer). Arora considers it critical that the independent review includes a full review of all underlying costs making up ORCs to ensure that HAL has, in accordance with the CAA's directions in CAP2524, devised an ORC pricing structure that allocates and recovers ORC charges on a fair and reasonable manner adhering to ORC charging principles,¹ and in a way which facilitates reasonable transparency of cost information so that ORC users understand the charges that they are asked to pay.²

A review of whether the costs (i) have been sufficiently clearly and robustly identified; (ii) are appropriate; and (iii) have been assessed at a reasonable level of detail to support a robust cost allocation methodology, cannot take place without reviewing and demonstrating that the underlying costs themselves have been calculated on a fair and reasonable basis.

Arora also considers that the independent review should compare ORCs set by HAL against those being applied at comparable UK airports. Such comparison will assist in reaching a view on the whether ORCs are being charged on a fair and reasonable basis.

¹ CAP2524C, para 8.15

² CAP2524F, para 25

2. Allocation of costs to each Specified Facility

As the CAA is aware, Arora considers that HAL has historically not provided ORC users with sufficiently detailed information to demonstrate how it allocates costs. Arora considers that HAL's fixed asset register, and movements over time, must be shared and reviewed in order to determine whether the right costs are allocated to each Specified Facility.

3. Allocation of fixed costs and annuities

HAL has provided ORC users with very little transparency regarding the allocation of fixed costs and annuities. The independent review should include and provide a detailed explanation of how annuities are calculated, in particular specifying which assets are RAB related; details of asset life; depreciation profiles; discount rates; and specifying any other non-asset based fixed costs. HAL has from time to time claimed commercial confidentiality with respect to this information. However, as a dominant or even monopoly supplier, Arora can see no reason as to why commercial confidentiality should be permitted to justify a lack of transparency.

4. ORC Charging Principles

Historically, the ORC regime has resulted in significant price volatility. Arora considers that the independent reviewer should identify the reasons for this volatility, whether this is compatible with the ORC charging principles, and consider whether a mechanism can be introduced to provide greater stability.

5. Obligations under competition law

As Arora has noted in previous CAA consultations, it considers that HAL's approach to ORCs may be discriminatory and therefore distort competition in a number of related markets. It is unclear to Arora how an independent reviewer will be capable, or indeed appropriately placed, to review whether HAL's cost allocation methodology is informed by its competition law obligations. This is for HAL to assess and for the CAA to oversee given its statutory duty under section 1 of the Civil Aviation Act 2012 to promote competition in the provision of airport operation services.

6. Timeframe for review

The Draft ToR provide that the independent review will be carried out between March and May 2024, with the review finalised and submitted to the CAA and ORC users by the end of May. However, Arora considers that this timeframe will not provide the independent reviewer with sufficient time to carry out a comprehensive review, especially if the expanded remit suggested in this response is adopted. Arora is concerned that such a timeframe could risk only a superficial analysis of the ORCs, which will thereafter not result in any meaningful recommendations for changes being made. Arora therefore recommends that the period of review is extended by at least two months to allow for a more comprehensive analysis, but still completed prior to the next ORC pricing consultation in September 2024.

Arora Holdings Limited
28 November 2023