

## **Response to the Civil Aviation Authority**

### **CAP2618 Setting Future Price Controls, Review of Approach**

#### **Introduction**

Arora is the provider of hotels at each of the main London airports. As the CAA is aware, Arora has significant concerns about the approach of HAL in the setting of charges to which Arora has no alternative other than to pay. Our concerns are then exacerbated when comparing charges at Heathrow to other airports, and the market in general. We hope that the review of H7, and the start of the H8 process, will seek to address our concerns.

#### **CAA statutory duties**

The Civil Aviation Act 2012 (CAA12) gives the CAA a general (“primary”) duty, to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services (AOS). The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS. The CAA says that CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners).

However, the services provided to airlines on behalf of passengers are also provided to non-airlines. The regulation of air transport services is therefore directly relevant to non-airlines. As such, there are a number of services provided by HAL to Arora (and other non-airlines) which are regulated as part of Other Regulated Charges (ORCs).

The CAA explains that the revenue from ORCs is included as part of the single till. Simply put, the higher the revenue expected from ORCs, the less revenue is needed to be collected from airport charges. Arora’s concern is that the CAA does not strike the right balance between its duties with respect to AOS and its regulation of ORCs. There seems to be no review by the CAA, when setting ORCs, that it is considering its primary or subsidiary functions, or its wider Competition Act duties.

Arora’s concern, which has been the subject of extensive correspondence between the CAA and Arora, is that that HAL, via the process of setting ORCs, and CAA’s lack of oversight of such ORCs, is being allowed to set charges for monopoly services that are wildly different to similar charges seen by Arora in the competitive market, and at our other airport locations. Combined with a lack of transparency over the costs purported to justify ORCs, Arora is forced to pay charges that are significantly above market levels, without appropriate justification by HAL. Given HAL’s status of significant market power,

this amounts, we contend, to an abuse of market power by HAL. CAA has taken very few steps to provide the transparency necessary to allow Arora to challenge the charges being levied by HAL.

In summary, Arora considers that CAA's duties with respect to the Competition Act are being subsumed by its interpretation of its price control duties. Airport charges should not be set in a way that allows users or ORCs to be subject to HAL's abuse of its market dominance.

Most of the issues raised by the CAA, while important to airport charges, are not directly relevant to Arora. We have therefore limited our comments to matters of direct interest to us. The paragraph references are to the CAA's document.

***Is our initial view on HAL's market power assessment reasonable and are there any other factors that you consider would have a material impact on the outcome of a market power determination for HAL?***

***(Paragraph 2.17)***

We agree with the CAA's assessment that HAL has, and will continue to have, significant market power. Having made this finding, the CAA relies on the finding to impose a licence-based price control on airport charges. We agree that this is an appropriate response to the market power finding.

However, the CAA does not rely on this finding when considering Arora's repeated complaints about the setting of ORCs. As we have demonstrated, HAL's charges are volatile, opaque and significantly above market rates. This seems to us to be *prima facie* evidence that HAL is abusing the significant market power that has been determined by the CAA. We do not consider that the CAA has in any way challenged the market power of HAL with respect to the provision of ORCs.

***Are there areas of the H8 and NR28 frameworks that should be simplified or where the current approach is not transparent or proportionate?***

***(Paragraph 2.23)***

It does not appear to Arora that the setting of ORCs is transparent or proportionate. The charges now being faced by Arora have been set with no direct consultation with Arora. Further, the CAA's intervention to move costs from airlines to non-airlines seems to further exacerbate the lack of engagement by the CAA, or HAL, in the setting of ORCs for H7. We would hope that the H8 process is able to provide more direct consultation and transparency in the setting of ORCs for H8.

***How should the CAA secure the provision of timely and high quality information to support the H8 and NR28 reviews?***

***(Paragraph 2.33)***

During H7, the CAA seemed at times to be frustrated by HAL's provision of information. It seemed that information was provided late or was incomplete. We therefore recommend that CAA uses its formal information gathering powers when collecting

information from HAL. Such information should be required to be signed off by the Board of HAL as true, fair and complete.

***Is the approach of waiting to see the impact of changes to governance arrangements and the results of the independent review (of ORCs) a reasonable and proportionate way forward?  
(Paragraph 2.55)***

The fact that the CAA is carrying out an independent review of ORCs after H7 has been set indicates that the process of setting the H7 price control did not scrutinise the costs underpinning the ORCs with sufficient rigour. Nevertheless, we welcome the independent review and confirmation by the CAA that the review will cover the level of ORCs as well as the allocation of costs between airlines and non-airlines.

The CAA will be aware of our long-standing concerns over the lack of regulation of ORCs. Most recently, our letter of 28 November 2023 made the following points (which remain our position):

*Cost allocation methodology: costs to be considered*

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.

*Allocation of costs to each Specified Facility*

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.

*Allocation of fixed costs and annuities*

HAL has provided ORC users with very little transparency regarding the allocation of fixed costs and annuities. There should be 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.

In today's monthly meeting with HAL with respect to non-airline ORCs, HAL confirmed that it has provided the fixed asset register to the independent auditor, Grant Thornton. We can see no reason why this cannot be made available to those parties, such as Arora, that are funding the recovery of the fixed asset register.

*ORC charging principles*

Historically, the ORC regime has resulted in significant price volatility. Arora considers that the reasons for this volatility should be identified, whether this is compatible with the

ORC charging principles, and consider whether a mechanism can be introduced to provide greater stability.

*Obligations under competition law*

As Arora has noted in previous CAA consultations, we consider that HAL's approach to ORCs may be discriminatory and therefore distorts competition in a number of related markets. It is unclear to us how HAL, and the CAA, are able to assess the compliance of ORCs with Competition Law.

In summary, we consider that the CAA has been passive and reactive with respect to ORCs. Given where we now are, the independent review is to be welcomed.

***Our most recent involvement with expansion plans at Heathrow also involved an early consideration of the potential issues arising from a third party proposal to provide and operate part of the infrastructure at the expanded airport. We will consider how we might approach similar issues in future, including assessing whether a continuation of our largely reactive approach (dealing with the issues associated with a specific proposal) remains appropriate.***

***(Paragraph 3.9)***

On the broader strategic issues in chapter 3, we note the CAA's reference to the competitively provided infrastructure at Heathrow. While expansion seems to be paused (although it is not clear that a dominant party should be withholding capacity given Government policy in favour of expansion), the case for competitive provision of a new terminal is less pressing.

Nevertheless, much of Arora's involvement in the Heathrow West project – the competitive provision of a Terminal 6 at Heathrow Airport – was spent trying to convince the CAA that competitive provision of infrastructure at Heathrow Airport would be in the interests of passengers and airlines. Indeed, the CAA's duties require it to promote the provision of Airport Operation Services, a duty that was seemingly ignored when considering Arora's proposals.

Going forward, there may be a case for competitive provision of infrastructure even without an expansion case. We note that the Ofgem is promoting competitive provision of infrastructure in the development of the National Grid while Ofwat promoted the competitive provision of the Thames "super sewer". We see no reason why the CAA cannot take the same pro-active approach with respect to the provision of competitive infrastructure at Heathrow Airport.

**Conclusion**

As the CAA is aware, Arora has long standing and significant concerns about the regulation of HAL. Nevertheless, we welcome the CAA's consultation and a direct request for input by the CAA from Arora. This represents a step forward in engagement by the CAA compared to previous price controls.

As always, we remain ready to meet with the CAA, or elaborate on our views, should that be of value to the CAA. We are happy for this response to be published.

Arora Holdings Limited

27 March 2024