



London (Heathrow) Airline Consultative Committee

LACC & AOC Response to CAA's Market Power Assessment of Heathrow Airport Limited

July 2013

Introduction

The LACC and AOC welcome the opportunity to respond to the CAA's assessment of market power of Heathrow Airport Limited (HAL) at Heathrow airport. We agree with the CAA's assessment that HAL continues to hold significant market power. As the UK's only hub airport Heathrow is a unique and essential facility. Continued strong ex-ante economic regulation, by the CAA, therefore remains extremely important in order to protect passengers from the market power held by HAL at the airport.

The LACC and AOC believe HAL clearly passes Tests A, B and C and therefore continued RAB based regulation and strong governance controls are required. In particular, evidence on the behaviour of HAL and its propensity to act independently of its customers evidences its substantial market power are also included below.

Test A

The LACC and AOC agree with the CAA's assessment that HAL has significant market power. We think the benchmarking carried out by the CAA's consultants has been helpful in identifying and benchmarking pricing trends across hub airports. This shows Heathrow airport has become increasingly expensive and out of line with comparable hub airports and has therefore been able to use its market power to sustain prices above an efficient level.

Since the CAA published its market power assessment, HAL have responded to the CAA's initial proposals by unilaterally disengaging in the Q6 review and reducing their proposed capital plan for Q6. We found it surprising that they have managed to both revise-down and prioritise a £2 billion capital plan with no input from their key customers, who are best placed to judge and promote passenger interests at the airport.

Further behavioural evidence of market power has also been demonstrated. Behavioural evidence for market power can be manifested in two ways. Firstly, when the airport leverages its market power by undertaking actions which it can do so because it has substantial market power. Secondly, when the airport does not undertake actions because its substantial market power allows it to avoid the competitive pressures which would normally ensure that a company seeks to supply what its customers need. Both of these behaviours are evident on the part of HAL and evidence the substantial market power of the airport. Below are examples of HAL leveraging its substantial market power:

- The approach adopted by HAL in establishing its annual Conditions of Use (CoU) and the nature of some of the clauses in the CoU evidence proactive leverage of its market power. In particular, the position taken by the airport on its ability to impose the CoU each year and also use the CoU to insulate itself from liability evidences that HAL proactively leverages its substantial market power when engaging with its customers.
- The track record of HAL in delivering infrastructure evidences the extent to which it manifests behaviour that would not be expected from an infrastructure supplier operating in a competitive environment. For example, the Terminal 3 Integrated Baggage system is a project which should have been complete and operational by the end of 2011. It has instead been a project which has suffered from extreme delays and cost overruns. Current estimates from HAL are for it to be operational in 2 years. In addition to this HAL is again seeking an additional £60m to complete the project - this is even though the Airline Community had been assured by HAL that the previous request for additional funds and project extension would ensure the completion of the project. This is a key element of airport infrastructure required in the interests of passengers. If it was being supplied in a competitive environment it is unlikely to have suffered from the level of delays and increased cost being proposed by the airport.
- In addition, the recent evidence of financial reporting where the overall Q5 capex budget cap, went from an under budget to an over budget together with a substantial increase in the Q6 rollover, emphasises a need to strengthen financial governance and ensure that all spend remains within affordable targets.

This shows further evidence of the dominant position HAL holds and the need for continued robust regulatory controls.

Test B

The LACC and AOC agrees with the CAA's assessment that competition law on its own would not provide sufficient protection from the market power held by the airport. Ex-ante regulation has a number of advantages that outweigh competition law and some

form of robust licence based regulation should be applicable at the airport during the Q6 period.

Test C

The LACC and AOC also agree with the CAA's assessment that the benefits of a robust licence based approach outweighs the costs of regulation. The Airport Charges Regulations 2011 and Airports (Groundhandling) Regulations 1997 will not provide sufficient protection to air transport users.

The airline community at Heathrow is working with HAL to create a more efficient and effective consultation and governance process for Q6. It is essential that the CAA uses its new powers to ensure that clear and robust frameworks are in place to make sure these processes improve the effectiveness of economic regulation going forward and take full account of passenger needs. The airlines have engaged with HAL over recent months on a governance proposal which the airlines consider is required in Q6. This engagement was interrupted by HAL as a consequence of HAL's disengagement from the Airline Community. We welcome the CAA's indication that this engagement should recommence and a meeting has been scheduled with HAL to discuss the governance proposals of both HAL and the Airline Community. The output of this meeting will be submitted to the CAA. In the interests of the passenger we believe that Airlines must have the opportunity to influence project approval and prioritisation processes within the licence or regulated framework in order to ensure a more balanced focus of both opex and capex and to ensure value for money.

In summary the evidence in Tests A-C and the behavioural evidence examples above demonstrate both HAL's substantial market power and its ready propensity to leverage this market power to its commercial advantage. We believe this market power needs to continue to be address through robust, independent and object economic regulation by the CAA.