

# Draft guidance on ORC protocols and dispute resolution

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## About this document

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Our Final Decision for the price review (“H7”) of Heathrow Airport Limited (HAL) requires HAL and airlines to develop a new set of protocols for Other Regulated Charges (“ORCs”) including setting up an independent dispute resolution scheme for disputes on ORCs.

We decided to underpin ORC protocols in HAL’s licence but have left the detail of the ORC protocols to be developed by HAL in collaboration with the airline community and in consultation with other ORC users.

To facilitate this process, we committed to issue principles based guidance to help steer the development of the new ORC protocols and dispute resolution scheme. This consultation starts that process.

The draft principles set out in this document are based on the ORC framework and represents the necessary collaboration, consultation, and transparency that is required to ensure that ORCs continue to deliver in the best interest of consumers.

If you would like to discuss any aspect of this document, please contact [kalpesh.brahmbhatt@caa.co.uk](mailto:kalpesh.brahmbhatt@caa.co.uk)

## Introduction and background

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1. In our Final Decision on the H7 price review, we noted that weaknesses in the current governance processes and dispute resolution mechanisms for Other Regulated Charges (“ORCs”) needed to be addressed. The weaknesses, which had come to light following disputes between Heathrow Airport Ltd (HAL) and ORC users were largely the result of under-recovery of ORC costs as a direct result of the covid-19 pandemic between 2020 and 2021. A number of stakeholders had highlighted differences in interpretation of the current ORC protocol and expressed concerns about how HAL can be held to account for delivery of arrangements that are consistent with ORC principles.
2. In response, we said that we would require HAL, in consultation with ORC users to redesign and develop a new set of ORC protocols (the new protocols). The new protocols, underpinned in HAL’s licence, would be based on established ORC principles of:
  - costs pass through;
  - user pays;
  - transparency of costs and service provision; and
  - high quality and effective collaboration including on consultation and engagement.
3. We also said that the new protocols should include provisions for an effective and binding dispute resolution function.
4. Anchoring the new protocols in HAL’s licence was a necessary, targeted and proportionate approach to driving good governance, accountability and transparency in the provision of ORC services by HAL to ORC users. It is also in the interests of consumers of air passenger services to ensure that ORCs continue to deliver benefits to consumers and to avoid disputes between HAL and airlines (and other ORC users) ending in deadlock.
5. Condition F1 (consultation and governance) in HAL’s licence sets out the requirements for HAL to develop and agree the relevant arrangements for consultation and governance but leaves the content and structure of those arrangements largely up to HAL and airlines to work out, other than to follow any guidance from the CAA. Where agreement is not possible, there is a provision that will allow the CAA to step in to resolve these differences.

## Consultation

6. This consultation starts that process by inviting comments on the key principles that should frame the development of the new ORC protocols and dispute resolution mechanisms.
7. We welcome views on our proposed guidance. Please e-mail responses to [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk) by no later than **5pm on Friday 28<sup>th</sup> April 2023**.
8. We cannot commit to take into account representations received after these dates. We expect to publish the responses we receive on our website as soon as practicable after the period for representations expire. Any material that is regarded as confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to information under section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

## High level principles for the ORC protocols

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9. In our Final Decision on the H7 price control, we have decided to modify HAL's licence to strengthen ORC governance to give certainty to HAL and the airline community as they work together to develop a new ORC protocol.
10. Our view remains that there is a pressing need to ensure greater clarity, consultation and transparency across the ORC governance process. Underpinning the ORC protocols in HAL's licence creates a strong incentive on HAL to do this. However, it is in the interests of all parties to make the ORC governance process work to ensure that the right costs are allocated to the right parties, which is ultimately in the interests of consumers. To that end, we expect all ORC users to agree to a binding set of ORC conditions in the new ORC protocol.
11. In developing this consultation paper, we have reviewed the current ORC protocol ('existing protocols'), a document that was drafted in 2014 after the conclusion of the Q6 Price Control Review.
12. Although the existing protocols explain in detail the various committees and oversight groups set up in the ORC governance process, in our assessment they fall short on issues such as:
  - how ORC service requirements are established, procured, and agreed;
  - how ORC charges are (transparently) challenged, the level of independent assurance on cost allocation and how adjustment mechanisms are developed and implemented;
  - description of the appropriate consultation arrangements;
  - ORC users' rights of recourse when things go wrong in the provision of ORC services including payment of penalties and rebates; and
  - access to an independent dispute resolution process (see below for further discussion on this).

### Stakeholders' views

13. In the Autumn of 2022, we discussed our emerging principles for the new protocols<sup>1</sup> and the ORC dispute resolution<sup>2</sup> with HAL and the airline community

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<sup>1</sup> see paragraph 25 below

<sup>2</sup> see paragraphs 36 to 38 below

(represented by the AOC/LACC). We set out below the main points raised by both sides.

14. HAL agreed that it was important to outline some key principles which would help stakeholders to focus on the important areas and develop a common understanding on the objectives of the protocols. HAL did, however, highlight that the current governance process and information provision on ORCs has been in place since Q6 and should be the starting point for improvements.
15. HAL said that it had met the transparency requirement in its licence and was committed to review the current level of information provided to ORC users to ensure the breadth, quantity and level of information is targeted, proportionate and sufficient.
16. HAL did not agree with the principle that there should be service level equivalence and pointed to the regulatory framework that already incentivises performance through Outcomes Based Regulation. HAL added that the introduction of further service measures would lead to a double jeopardy. HAL said that penalties collected from suppliers when performance had not been met were passed back to users through the relevant ORCs. HAL also asked for further clarification on the CAA's independent assurance proposal and, in particular, what we meant by built in periodic reviews.
17. The airline community suggested a radical overhaul of ORC governance. They suggested that a new standalone ORC company should be set up with separate responsibilities for a governing Board and directors. The Board (whose membership would comprise of the ORC Governance Group) would be charged to hold the directors of the company to account in the interest of consumers.
18. The airline community put forward the following principles that would underpin the proposed standalone ORC company:
  - **Responsibility:** the directors of the new standalone company would be answerable to the Board, with the Board being responsible for ensuring that the directors drive efficiencies in the ORC procurement process. The directors would manage risks and challenges to the benefit of consumers.
  - **Accountability:** the Board would have to justify its decision making with reference to the consumer interest and would hold the directors to account.
  - **Awareness:** the Board would have relevant ORC experience so that it can identify risks and eliminate them as far as practically possible for the benefit of consumers.
  - **Impartiality:** the Board would have balanced responsibilities to shareholders and consumers.



- **Transparency:** the Board would take responsibility for documenting and reporting in a clear and thorough manner. Accounts would be drawn up on a standalone basis with financial controls in place to give independent assurance to stakeholders.

19. In addition to the above, the airline community proposed further supporting principles for the new ORC protocol and requested:

- **Establishing costs and services:** greater input in tendering and contract negotiations and direct ability for them to influence both costs and service levels.
- **Visibility of contracts:** contracts between HAL and suppliers of ORC services to be shared in an open and transparent manner.
- **Service level rebates:** clarity on how service level rebates flow back to ORC users as this was not at all clear how HAL accounts for this at present.
- **Audit assurance:** the right to an independent audit of all or specified costs.
- **Non-airline involvement:** proportionate weight given to non-airline users given that airlines account for 90% of ORC costs and that airlines act on behalf of consumers, hence avoiding the current scenario in which HAL has overridden airline views to overly influence consultation options for ORC charging in 2023 (including resisting CAA's Final Proposals).
- **Independent forecasts:** ORCs charges should be based on either the CAA's or an independent passenger forecast.

## Our response to stakeholders' views

20. We welcome feedback from both HAL and the airline community on the need for guidance in the development of new ORC protocols and we are encouraged by HAL's commitment to review the quality and breadth of information that it currently provides to ORC users.
21. We agree with HAL that we should take appropriate account of any broader legal (for example PRM standards) or regulatory service standards (such as the new OBR quality standards).
22. Given the disputes that have arisen on ORC charges over the last two years and those that continue to be raised by ORC users, it is in the interests of consumers that there is an independent assurance on ORC charges and cost allocation going forward. The timing and frequency should be subject of discussion between the airline community and HAL in the development of the new ORC protocols. The outcome of such assurance could usefully feed into the next H8 regulatory ORC forecasting process.

23. We are not convinced that a structural separation of HAL's ORC business, as suggested by the airline community, is a necessary or proportionate step at this stage of the H7 process. Furthermore, the ORC protocols are not the appropriate legal or regulatory mechanism to deliver such a complex and highly interventionist corporate change in HAL's business structure and, to that extent, is not one that the CAA supports. The ORC framework is built on the premise of collaboration and co-operation from all sides and we are firmly of the view that this is the right framework for ORCs.
24. We consider that many of the additional principles that the airlines have suggested are captured by the CAA's principles set out below. Although we agree with the airline community that there does need to be a sense of proportionality when considering views of affected parties, we do not agree that there should be a fixed rule that overrides the views of non-airline parties, especially when they are likely to be disproportionately affected by a proposed change.

## ORC Protocol Principles

25. Bearing the above discussion in mind we propose the following principles to help guide the development of the new ORC protocols<sup>3</sup>. The Principles have been developed from the ORC framework that is built on collaboration, consultation, transparency, governance and fairness:
- **Collaboration:** The new protocols are to be jointly developed and owned by HAL and airlines (and/or non-airline ORC users) and must be binding on both parties. This is particularly important for the dispute resolution function that we describe below.
  - **Consultation:** The new protocols should adopt best practice in consultation and engagement, where HAL demonstrably takes into account the views of both airlines and non-airline ORC users. Licence Condition F.1 (Consultation and Governance conditions) contains the consultation requirements that HAL is expected to follow.
  - **Governance:** Have clear frameworks for governance groups and terms of reference (including governance committees and their respective roles) for decision making and processes, and should contain:
    - relevant rules, principles and processes for decision making and charge setting including year-end adjustments; and
    - clear and unambiguous processes to support the above rules and principles for decision making.

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<sup>3</sup> The new protocols should be written to plain English, to bring clarity and avoid disputes over interpretation

- **Transparency:** Linked to governance above, the new ORC protocols should:
  - facilitate reasonable transparency of cost information so that ORC users understand the charges that they are asked to pay;
  - enable consultation of ORC service users on the scope of any ORC-related procurement so that they have clear visibility of what is being purchased, and that services are fit for purpose; and
  - drive transparency and accountability by HAL over ORC service and performance levels.
- **Equivalence:** Ensure that 'fit for purpose' ORC services are delivered to ORC users and that they are in the interest of all parties, in particular to consumers. ORC users, who pay for a particular service should benefit from an appropriate level of service, including compensation when services do not meet an existing contractual standard.<sup>4</sup>
- **Independent assurance:** Build in periodic reviews, which should:
  - ensure ORC pricing is done on a reasonable basis adhering to ORC principles; and
  - be timed to inform CAA regulatory price control review processes and decisions.

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<sup>4</sup> Different arrangements may apply to those services already covered under the OBR framework or where there are existing legal and regulatory standards (such as PRM services).

## Principles for ORC dispute mechanism process

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26. In the Final Proposals, we said that it was our preference for HAL and ORC users to agree how a dispute resolution function should work and to build that into the new governance arrangements. To that end, we set out some high-level principles around which an independent dispute resolution function should be based.
27. In the context of ORCs and the challenges that have been raised over the last two years, it has become increasingly apparent that there has been significant disagreement largely around costs and pricing. We remain of the view that there is a need to allow the CAA the opportunity to intervene where meaningful commercial negotiations between parties have broken down and where genuine disputes exist including in establishing the new ORC protocols themselves.
28. Timely resolution of disputes, in an agile and reasonable manner is in the interests of consumers and, in particular, settling disputes and removing any deadlock situations between HAL and ORC users on a fair and reasonable basis. We reiterate our views that we do not see the need to limit who may raise an issue with us for resolution, provided that they are currently a specified user of an ORC service.

### Stakeholders' views

29. HAL said that it understood the need to be flexible and agile in decision making but considers this must not come at the cost of strong and compelling evidence. HAL also said that the dispute resolution function should only be required to resolve disputes solely relating to procedural matters, (i.e whether HAL followed the ORC protocols).
30. HAL welcomed the concept of timelines for decision making as it strives to mitigate uncertainty and delays. However, it said that clear and transparent timescales should apply equally to the CAA when it is asked to resolve disputes.
31. HAL supported a 'gating process' to eliminate any frivolous escalations but also argued that any escalations must be targeted and only related to procedural matters. An assessment should be made on whether it has followed procedures, the protocol and that it has met its transparency condition.
32. The airline community expressed its support for a dispute resolution process where genuine disputes are raised. It also welcomed full transparency in the dispute resolution process and especially in terms avoiding unnecessary repetition.

## Our response to stakeholders' views

33. We agree with HAL that there should be clear timescales across the entire dispute resolution function, including timescales on the decision maker, whether this is the CAA or another independent person. As with all dispute resolution schemes, there will need to be an ability to extend timescales due to exceptional circumstances to allow some flexibility around matters completely beyond the influence of either parties or the dispute or the scheme operator.
34. A flexible and agile dispute resolution function relies heavily on:
- the standard of proof that it makes its decisions on; and
  - the availability of information sought from the parties to the dispute.
35. We do not agree with HAL that the dispute resolution function should solely be limited to procedural matters. To do so, risks leaving some significant issues in deadlock, remain unresolved and would run counter to the purpose of having a dispute resolution function. The dispute resolution function is intended to deal with disputes on ORC operational, commercial or procedural (whether the ORC protocols have been followed) matters. Complaints relating to matters concerning HAL's compliance with its licence will be dealt with by the CAA under the relevant investigation and enforcement procedures under the Civil Aviation Act 2012.
36. Bearing all of the above in mind the high-level principles for a dispute resolution function should:
- create a framework where the dispute resolution decision maker should be **independent** of either party raising a dispute;
  - allow the dispute resolution decision maker to **issue guidance** on the process that he/she will follow with the process being quick and relatively inexpensive when compared to regulatory investigation/determination;
  - facilitate **evidence-based decisions** (made to a 'fair and reasonable' standard of proof) which are **binding** on both parties;
  - ensure an **accessible, transparent, and proportionate** process from raising a dispute, right through an enquiry/investigation process and the final decision;
  - allow the dispute resolution decision maker (whether this is the CAA or another independent person) to **refuse to hear** certain disputes (for example, on the grounds of materiality and/or subject to certain de minimus levels);
  - facilitate **outcomes that are transparent** so that lessons can be learned and repeated disputes on the same issue(s) avoided where possible; and

- enable the **timely, efficient, and effective resolution** of disputes backed by appropriate time limits (for example, within which disputes should be raised and logged with the dispute resolution scheme).

37. We would also expect parties to have entered meaningful negotiations prior to raising a dispute and respond to information requests in a true and complete manner. There will be a need for the dispute resolution scheme to have rules on dismissing frivolous requests for disputes, and timelines within which to submit a dispute.
38. We expect all parties to have taken reasonable steps to avoid disputes including demonstrating the involvement of senior management in negotiations prior to referring any dispute for resolution.

## Next Steps

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39. This guidance is intended to be used by HAL and the airline community to develop the new ORC protocols and dispute resolution function. We expect HAL and airlines to work together constructively on the new protocols, however, we understand that disagreements may arise. Should HAL and airlines be unable to resolve any disagreements on the development of the new ORC guidance and dispute resolution function, then they may escalate the dispute to the CAA for resolution.
40. In the event that the CAA is asked to resolve a dispute, any decision(s) that we make will be informed by consideration of our duties. In this context, our proposed guidance as set out in this document should serve as an indicator of what we consider should constitute the forming principles for the new ORC protocols and dispute resolution function. It should, however, be noted that this guidance is not binding on the CAA. Our decision(s) on whether to intervene to resolve a dispute(s) will be made on a case by case basis and in accordance with our statutory duties.

## Consultation

41. We welcome views on our proposed high-level principles as set out in chapters 1 and 2 of this document. We will fully consider stakeholder responses before issuing the guidance in its final form. Please e-mail responses to [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk) by no later than **5pm on Friday 28<sup>th</sup> April 2023**.
42. We cannot commit to take into account representations received after this date. We expect to publish the responses we receive on our website as soon as practicable after the period for representations expire. Any material that is regarded as confidential should be clearly marked as such and included in a

separate annex. Please note that we have powers and duties with respect to information under section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

## **Timeline**

43. We will aim to issue our guidance document as soon as reasonably practical after receipt and review of stakeholder responses to this consultation.
44. Thereafter, we expect HAL and the airline community to work in collaboration on the high-level principles set out in our guidance document, with a view to tabling a clear set of proposals on the new ORC protocols and dispute resolution function to the CAA by 30 September 2023.