

Economic Regulation of Heathrow: Programme Update, CAP 1914
Response from Richmond Heathrow Campaign
22 May 2020

INTRODUCTION

1. This is a written response of the Richmond Heathrow Campaign (RHC) to the CAA's consultation titled '*Economic Regulation of Heathrow: Programme Update, CAP 1914, April 2020*'.
2. CAP 1914 updates the CAA's programme for the development of the Economic Regulation of Heathrow Airport Limited (HAL) in the light of the very significant changes and uncertainties brought about by:
 - the severe impact of the Covid-19 pandemic on the aviation sector as a whole and passenger numbers at Heathrow airport;
 - the Court of Appeal's decision setting aside the Airports National Policy Statement; and
 - HAL's subsequent decision to pause its programme for expanding Heathrow airport in the light of these developments (although it is appealing the Court of Appeal's decision).It outlines the CAA's proposals for changing its overall approach to developing the regulatory regime for HAL in the light of these developments.
3. RHC represents three amenity groups in the London Borough of Richmond upon Thames: The Richmond Society, The Friends of Richmond Green, and the Kew Society, which together have over 2000 members. The members of our amenity groups are adversely affected by noise from Heathrow Airport's flight paths, poor air quality and road and rail congestion in west London. We acknowledge Heathrow's contribution to the UK economy and seek constructive engagement in pursuit of a better Heathrow. We are an active participant in the Heathrow Community Noise Forum.
4. Our premise is that it would be preferable to aim for a better Heathrow rather than bigger Heathrow and to capitalise on the world beating advantage of London's five airports, in particular by improving surface accessibility to all five airports, which would be a major benefit to users. Our approach is to continue supporting the case for no new runways in the UK and we believe this is well supported by the evidence produced by the Airports Commission and the DfT in relation to the Airports National Policy Statement.
5. Over recent years we have undertaken extensive research on Heathrow and submitted a large number of papers to the Airports Commission, the DfT, CAA and others - all of which can be found at www.richmondheathrowcampaign.org
6. RHC has responded to ten CAA consultations on Economic Regulation - CAPs 1510 and 1541 in 2017; CAPs 1610 and 1658 in 2018; CAPs 1722, 1769, 1782, 1812 and 1832 in 2019; and Caps 1871 and 1876 in 2020. The responses and other material are on the RHC website.
7. On 27 February 2020 the Appeal Court handed down its decision that the Airports National Policy Statement (APNS) approved by parliament in June 2018 is unlawful because it does not adequately take into account the UK's commitment to the Paris Agreement on Climate Change that requires signatories to demonstrate how they will reduce carbon emissions. The Supreme Court has granted HAL permission to appeal and the dates scheduled are 7 and 8 October. The Government has said it will not appeal the decision.

8. We can only speculate at this time on the legal outcome for Heathrow expansion and on the impact of the corona virus pandemic on the UK economy and airport expansion. The political direction of travel on expansion is also unclear, notwithstanding the APNS. **We support the CAA's monitoring of the situation as it develops and the steps being taken to draw the pieces together and reset the Economic Regulation of Heathrow from 2022.**
9. **It may even be the case that the current regime as contracted between Heathrow and the airlines will need to be reset. It will be necessary for the regime starting in 2022 to recognise the commercial and financial fragility of the starting position.**
10. This response is not the time to re-assess the merits or otherwise of Heathrow expansion. But we have repeatedly sought to demonstrate that the abandonment of Heathrow expansion would be beneficial for UK aviation and economy, as well as Heathrow's finances. The legal hurdles and now the additional impact of the pandemic undoubtedly delay Heathrow expansion into the 2030s. RHC believes the absence of need, unviable financials and the lowering climate change ceiling will prevent the project entirely. **We therefore support the CAA's approach of excluding a Heathrow third runway from Economic Regulation for the foreseeable future.**
11. **RHC's rejection of a third runway extends to our rejection of any expansion of Heathrow's capacity beyond the existing planning limit of 480,000 flights a year, whether by mixed mode, extension of night flights or any other means.** This needs to be confirmed by the CAA at the earliest moment possible.
12. UK air travel has reduced by over 85% as a result of the corona virus pandemic and will undoubtedly take time to recover. It is too early to predict what the aviation industry will be like as it recovers and how it will develop thereafter. Predictions to 2050 of overall demand and its composition and of airline and airport capacities and use will undoubtedly have to be changed - probably significantly.
13. In the more immediate future the recovery period is likely to raise substantial challenges for Economic Regulation and we encourage the CAA to start including parameters that historically have not been relevant or need emphasis going forward. For example:
 - a. The airlines and airports, including Heathrow, will take a substantial hit financially. This may be so severe that the Government decides to provide support in one form or another - loans, grants, tax holidays, guarantees, etc. in order to preserve a basic level of activity from which the industry can recover (it has already provided some support). We argue that the shareholders should be the first to bear the burden of losses and scarring and the consumers should be the next. The tax payer should be the last and any government support should be on commercial terms. Going forward the over-indebted Heathrow should have its debt capped and the industry should be subject to stress tests as the banks have been subjected to since the 2008 financial crisis. **Economic Regulation may need to include Government support in the economic projections.**
 - b. RHC's response in October 2019 to CAP 1832 on Financial Resilience concerned a three runway Heathrow but the concepts of resilience and sharing of risk and mitigation of residual risk are relevant to Economic Regulation going forward with a two runway Heathrow. We referred above to the stakeholders - shareholders, lenders, consumers and government. To these should be added employees. **The Economic Regulation will need**

- to recognise how the historic losses are shared but also who might fund the recovery.
- c. **A balance will need to be struck between today's expenditure and investment for the longer term. Heathrow has a substantial capital expenditure requirement even without expansion.** As we have often said we believe it would be far better for Heathrow to invest in surface access than runway expansion. **Future Economic Regulation could usefully give greater emphasis to surface access than it has done in the past.**
 - d. The purpose behind Economic Regulation is to avoid an airport exploiting a monopoly or near monopoly position and benefiting from inflated consumer prices. We believe the economic crisis could weaken the weak and enable Heathrow to advance its market power. **We have made the case previously that in recent years Heathrow has been making excess profits and that future Economic Regulation should ensure Heathrow does not enhance its anti-competitive market position.** This might require referral to the Competition and Markets Authority but we note the comment in CAP 1914 that there would be insufficient time before 2022.
 - e. CAP 1914 makes no reference to the environment, other than briefly in Appendix A, where it is stated that one of the primary duties of the CAA is to secure that the licensee is able to take reasonable measures to reduce, control and/or mitigate adverse environmental effects. We have said previously that the CAA's Economic Regulation should in our view put the environment on equal footing with the economics but it has not done so. **In times of financial distress the environment could easily be relegated further, so we urge the CAA to give greater consideration to noise, air pollution and climate change.** The Government is currently consulting on climate change and we urge the CAA to incorporate developments on this front in its Economic Regulation.
 - f. The CAA has been keen in developing its Economic Regulation to service and efficiency and this we commend. **The challenge going forward will be to sustain service and efficiency under the great pressures arising from financial stress.**
 - g. The aero charge is of course a key parameter and presumably with fewer passengers during recovery the per passenger charge will need to rise. Affordability at Heathrow and other airports presumably will have to give way to financial resilience during recovery. **We urge the CAA to extend its approach to Heathrow's regulation to assessing the prices and demand across the UK.** To focus on Heathrow in isolation we believe results in a potentially harmful outcome for other airports and the regional economic balance. It will be more important with greater variation in overall demand and its allocation to airports to assess **price elasticity**. We have often argued in our responses to the CAA that there is no or very little **scarcity rent** at Heathrow and we urge the CAA to review its position and the economic consequences.
14. We support CAA's approach to developing scenarios but it is important these are owned by Heathrow and that Heathrow retains responsibility and accountability for the outcomes.
 15. Regarding the length of the next regime, it might help to develop a five year plan within which a shorter regime could be rolled forward from year to year. The advantage of a longer plan might be that it allows the many distortions and anomalies of recovery to iron themselves out.
 16. Regarding the issue of CAA lighter regulation and airline/Heathrow agreements, our initial

thoughts are that it is important for the CAA to be closely involved in these times of great uncertainty and potential market power imbalances.

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