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Sent by email to: economicregulation@caa.co.uk

October 2019

Re: Economic regulation of Heathrow Airport Limited: working paper on financial resilience and ring fencing CAP1832

Dear James,

Virgin Atlantic Airways welcomes the opportunity to respond to the CAA's CAP1832, Economic regulation of Heathrow Airport Limited: working paper on financial resilience and ring fencing.

In this letter we make general comments followed by specific comments on chapters 1 and 2 of the working paper.

General comments on financial resilience and ring fencing

The financial resilience of HAL is important to the delivery of Heathrow expansion and we agree with the CAA that financial distress for HAL is a 'low probability but potentially high impact event'. However, the 'low probability' aspect must be borne in mind. There is the risk of the CAA overregulating in an area where HAL is already under considerable scrutiny from bondholders where significant safeguards around financial resilience are already in place. HAL is a well-managed company with mature relationships with lenders and a strong financial platform.

The government's Better Regulation framework and its Regulators' Code includes the need to keep regulations simple and user-friendly and specifies that they should be focused on specific problems in such a way as to minimise side effects.

We are supportive of measures that protect consumers. However, should the CAA act to modify HAL's licence to promote financial resilience it must ensure such modifications genuinely improve protection for consumers, do not damage HAL's financing platform and do not have unintended consequences. In our view there is real risk of unintended consequences from actions taken in such a low probability area.

We believe that the interests of bondholders and consumers are more aligned than the CAA appears to suggest. In most situations, reductions in service or quality of service are not in the interests of either party. It is only in extremis that these interests are likely to diverge, and this should be reflected in a generally cautious and light touch approach to any action around financial resilience. We note the statement made by Gatwick Airport in response to the December 2017 consultation. Gatwick is the second largest airport in the UK and would be expected to clearly understand the operations and the financials of a large-scale airport. Gatwick stated: “Furthermore, even in the case of financial distress, a large airport is very likely to generate positive operational cashflows and therefore continue to operate and provide services to consumers.” The CAA may therefore be too pessimistic in assuming that HAL would sacrifice the quality of services to comply with bondholder covenants.

That said, we are also concerned that the CAA appears to be seeking to shift the burden of regulating HAL for compliance certification, onto HAL. This is not appropriate. Seeking to control HAL’s behaviour via self-certification or simple licence conditions that attempt to extract promises from them to behave in a certain way are not enough. The CAA needs to regulate.

The difference between financial distress and the financial stress that might be expected given the size and nature of the Heathrow expansion programme needs to be clearly defined and articulated.

Ensuring HAL has sufficient resources

With regard to the options laid out in chapter 2 we make the following comments,

We support the position on gearing caps and prohibition of asset disposals. Neither are suitable instruments and a prohibition on asset disposals would almost certainly damage HAL’s financing platform.

We are not convinced that a licence condition on HAL to maintain an investment grade credit rating is necessary. It could be burdensome, potentially expensive and we are not clear on the additional benefits it would provide over and above the conditions already put in place by HAL’s bondholders. The CAA should instead focus on scrutinising information from HAL and reaching its own views on financial resilience.

We note that HAL already has significant liquidity requirements in place through covenants with its bondholders. Although it seems reasonable to include a licence condition around sufficiency of resources that is more specific and more transparent, particularly as regards the maintenance of operations in the event of financial distress, we would like to understand how such a condition would be enforced.

Mitigating the impact of financial distress and providing information

With regard to the options laid out in chapter 3 we make the following comments,

While we understand the CAA’s intentions pertaining to compliance certification, we are not convinced that the process itself will provide added value. We believe it would be more appropriate for the CAA to simply define a requirement to provide certain information rather than require self- certification.

In general, we would support the inclusion of a curtailment of dividends and other payments condition into the licence subject to a precise definition of the condition. We would, however, note the need for careful design of such a condition to ensure that it does not damage HAL’s financing platform or act as a disincentive to deliver Heathrow expansion as soon as possible. We also note, again, that such covenants already exist with HAL's bondholders.

We support CAA's suggestions around clarification of the ultimate controller within HAL's licence and their position on requirements for additional information to enable monitoring of HAL's financial health, assuming such requirements are not unnecessarily burdensome on HAL.

We appreciate that the CAA is still developing its policy in this area and we would be pleased to discuss any aspect of this response in due course.

Yours sincerely,

Claire Lambert

Regulatory Affairs
Virgin Atlantic Airways