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

Re: Economic regulation of Heathrow Airport Limited (HAL): policy update and consultation on the early costs of capacity expansion (CAP 1871)

Dear Rob,

Thank you for the opportunity to respond to the CAA's consultation on Expansion early costs. This submission is made jointly by the LACC and AOC on behalf of the airline community at Heathrow.

The airline community has a number of comments relating to the CAA's proposed approach as to how both the Category B planning costs and early (pre-DCO) Category C construction costs should be treated. This submission sets out agreed principles and outcomes that we think the CAA's policy should aim to deliver. Individual airlines, groups and alliances will make their own submissions detailing their specific views on the CAA's proposals.

Appeal Court decision

We note the decision of the Appeal Court last week relating to the Airports National Policy Statement. In light of HAL's likely intention to appeal the decision the airline community believes that HAL should:

- Stop any early Category C cost spend for the duration of the appeal / ANPS re-work; and
- Minimise any Category B planning cost spend.

The CAA's support for £1.6bn of early Category C costs assumed a DCO decision by the end of 2021. HAL had already delayed this to Q2 2022 with additional delay now anticipated HAL should take the above actions as soon as possible.

Context

The ability of the airline community to respond fully to the consultation is challenging, bearing in mind that HAL have yet to share the full details of their revised plan. This includes elements relating to the 'early costs' associated with this consultation that HAL argues are required prior to the Development Consent Order decision in Q2 2022. This submission is therefore made in the context of that lack of

information which we had anticipated to be have been made available to us, and assured by the IFS, before making this submission.

One of the key assumptions informing the CAA's decision to allow early costs is the balance of risk between HAL progressing the scheme and the potential for consumers and airlines to bear those costs if the scheme is not progressed and the CAA should therefore bear this in mind when making its policy decisions.

Policy Aims

It is well documented both with HAL and the CAA that the airline community has continually raised concerns about the lack of transparency from HAL with regard to Category B costs incurred to date. The CAA's policy must ensure that HAL is required to behave appropriately on early costs for expansion.

HAL should therefore:

- Manage Category B and early Category C costs within the CAA's proposed caps;
- Minimise Category B and early Category C costs where possible;
- Be able to clearly demonstrate the need and efficiency of such costs with independent assurance, and
- Avoid the need to adjust the delivery caps prior to the DCO decision.

The airline community recognises that there must be a balance between affordability and financeability and supports an approach that sees the regulatory treatment of early costs aligning returns for HAL's investors with the benefits of expansion becoming available to consumers and airlines.

Regulatory Return

The CAA's proposal to use a 4.83% Weighted Average Cost of Capital (WACC) figure for the interim H7 period when Category B and early Category C costs are being incurred clearly over-rewards HAL's investors.

The airline community does not believe that the CAA's proposed WACC figure is representative of the actual WACC that HAL has today, being an adjusted figure derived from the Q6 WACC that is itself over 7 years old. We note that the CAA's latest WACC determination in relation to NATS was set at 2.91% and that this figure itself was in part a product of initial CAA work on the WACC for the Heathrow H7 period that PwC advised the CAA on. The CAA is also defending this WACC position as part of the NATS appeal to the Competition & Markets Authority on the RP3 price control decision. The airline community believes the 4.83% WACC is too generous and at the very least should be closer to the latest CAA position for NATS.

Licence Condition

The airline community supports the CAA's proposals for a modification to HAL's licence that requires it to deliver early costs that: (i) support delivery of runway capacity in line with the ANPS deadline of 2030; and (ii) are within the proposed delivery caps. The CAA should ensure that for early Category C costs the scope that will be delivered by the spend within the proposed delivery cap is made clear to

both the CAA and airline community, and that appropriate governance structures are in place, before being incurred. Ensuring that all parties have a common understanding of what the early Category C costs are delivering at the outset will allow for effective oversight of these costs. Our experience of HAL's lack of management of Category B costs and our concerns around initial early Category C cost management in 2019 and early 2020 inform our position on this.

Early Costs Remuneration

The CAA's proposed trigger point for remuneration of HAL's early costs is the outcome of the DCO process. During the initial stages of Constructive Engagement HAL has clearly stated to the airline community that even with the DCO being granted it will make a decision on whether or not to proceed with expansion in consultation with its investors. Effectively HAL is saying that it is not a given that it will continue with expansion on the basis of the DCO decision alone.

On this basis, the airline community believes that the CAA's policy on early costs should explicitly take account of this position with the remuneration of early costs linked to:

- Approval of the DCO decision by the Secretary of State (i.e. the final decision-maker on Heathrow expansion proceeding); and
- HAL and HAL's investors deciding to proceed with Expansion following that approval.

Without prejudice to airlines' own on-going assessment of the overall costs and case for expansion (both pre DCO submission and post DCO approval), only when both of the above points have been completed should consumers and airlines pay for early costs which are incurred in line with the comments set out above under 'License Condition'. If HAL and its investors decide not to proceed with expansion even having secured the DCO then this should be treated in the same manner as failing to secure the DCO.

The airline community strongly encourages the CAA to be clear about what the trigger is for early costs remuneration.

If you have any questions on this airline community response please do not hesitate to contact us.

Yours sincerely,



Simon Laver
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