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22nd May 2020

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

Dear Rob,

Re: Economic regulation of Heathrow: Programme Update (CAP 1914)

Thank you for the opportunity to respond to the CAA's consultation, updating on the latest developments at Heathrow and seeking to respond accordingly for the next Price Control Period. This submission is made jointly by the LACC and AOC on behalf of the airline community at Heathrow.

This submission sets out agreed principles and outcomes that we believe the CAA's policy should aim to address. Individual airlines, groups and alliances may make their own submissions detailing their specific views on the CAA's proposals.

Overview Summary

The Airline Community are supportive of many aspects set out within the consultation, notably: (i) setting the next Price Control Period ("H7") from 2022, based on a two-runway environment; and (ii), the pragmatic approach and timetable given the current circumstances .

As described within, these are incredibly uncertain and challenging times which will require a dynamic approach with direct and active CAA engagement. For our part, despite the numerous challenges being faced, particularly with regards to resourcing, the Airline Community stands by ready to fully engage.

Notwithstanding the above, we do note a caution however that it will be more important than ever that a clear 'principles of engagement' are established and that HAL are held to account on appropriate engagement and the timely delivery of a Revised, and ultimately Final, Business Plan.

To that end the Airline Community also note the CAA references within to a possible "lighter touch commitments" framework as seen at Gatwick and encouraging "HAL and airlines to engage and seek agreement on commercial matters." For the avoidance of doubt the Airline Community fully expect

the CAA to run a full and robust review process and to set H7 within the parameters of the current regulatory arrangements. We are concerned that such messaging towards a ‘commercial approach’ may set undue expectations and drive certain behaviours from HAL that would undermine this process. We would encourage therefore the CAA to keep efforts focused towards the Constructive Engagement (“CE”) process as set out within the consultation.

It is also worth highlighting our agreement with the CAA’s assessment under 1.7 with regards to airlines’ views on airport charges. We have long highlighted and challenged how HAL’s have become the highest in the world and, now more than ever, we should be seeking to address this.

A 2022 Price Control Period, based on a Two Runway Airport

Given the passage of time since the last review in 2012 – early 2014, we think it is both necessary and within the interest of consumers to undertake a full review and reset the building blocks within the settlement. We are therefore supportive of the CAA’s proposal to undertake a full price control review and start H7 in 2022. We also note the current iH7 arrangements are due to end in 2021 and its component parts are not acceptable to just roll over without review which further reinforces this timetable.

Whilst HAL have recently been successful in their bid to appeal the Court of Appeal’s decision on the Airports National Policy Statement, efforts to align with the regulatory and expansion delivery timetable have proven challenging to date. We know that any potential success (or otherwise) on expansion will be subject to a lengthy legal, and possibly political, process; and there is still significant uncertainty on future demand at this point in time and overlapping with the proposed timetable as set out within the consultation document. Given such uncertainty surrounding an expanded Heathrow, we agree that the focus of H7 and the CE process should be on a two-runway scenario.

The Development and Use of ‘Scenarios’

Given the challenges in predicting a credible forward look at this moment in time, we agree that the development and use of a number of meaningful scenarios is a pragmatic and flexible approach that gives the best chance of settling on a holistic, balanced price path that does not place undue risk or burden on either one party.

Given the scenarios are likely to have a significant bearing on the process, and the insight airlines will be able to bring, we are fully supportive of these being developed in collaboration with the Airline Community. Furthermore, we would propose that not only should these scenarios be developed with the Airline Community but would add that their application to delivering a robust output (price per pax) have significant Airline Community input too. We would therefore build on the statement within the consultation to read *“To achieve this aim, the scenarios will need to be developed carefully so that they assist **JOINT** analysis and decision making, rather than simply create a large number of possible scenarios”*(1.13) (Airline Community **BOLD** insertion)

At this stage we would suggest it most relevant that the scenarios are based on a number of passenger volumes. These should be used to understand where such levels would likely have a

material, or step change within the overall strategy of the business plan and / or the building blocks themselves.

We fully agree that the scenarios should take a holistic approach and be an output of the CE process, incorporated in a Revised Business Plan(s) (“RBP”). The Airline Community have provided a proposal to HAL and the CAA with regards to scenarios and RBP in our recent feedback on CE Next Steps¹ for your consideration and where further details can be found

Form and Duration of the Control Period incl Air Traffic Volume Uncertainty

With regards to the form, it is first worth noting that we are not open to a ‘Gatwick style’ arrangement as suggested within but would look to build on the existing regulatory framework already in place.

In terms of the duration, we believe a ‘traditional’ 5-year timeframe should form the basis of H7. We would however be open for that to vary where: (i) there is a clear case and benefit for doing so; and (ii) a suitable framework is in place.

We note the CAA’s references to possible ‘risk sharing’ given the potential levels of uncertainty that might still exist at the time of setting H7.

Firstly, any such consideration must be based on a true ‘risk sharing’ proposition and not seek to de-risk HAL completely. The CAA will be aware from the Airline Community’s feedback on HAL’s Initial Business Plan (“IBP”)² that there was a considerable level of one sided ‘risk protection’ that had been baked in across the building blocks (for example applying a risk premium to the WACC, but uplifting a significant capital risk contingency or proposing ‘re-openers’ for every building block bar the cost of capital). Such an approach again, particularly given the timetable, would not be acceptable. Any ‘risk sharing’ consideration cannot be looked at in isolation but across the entire proposition.

Secondly, building on the ‘scenarios’ principle, we see their merit in helping to inform a possible ‘trigger-based mechanism’ that could help mitigate some of the risk and uncertainty during H7.

It is important to note that views and positions will continue to evolve and develop as we go through the CE process and we would suggest this remains a key area for ongoing review and feedback.

CAA Approach to Engaging with Stakeholders

Whilst supportive in principle to the approach and timetable set out in the consultation, in order to have full confidence in the proposed process the Airline Community believe it is important that a clear ‘principles of engagement’ is established so that all parties are aware of the expectations and requirements upon them. In particular this should include:

- A clear set of ‘ground rules’ or protocols so that all parties are aware of the expectations on them;

¹ “Airline Community Feedback to HAL / CAA – H7 and Constructive Engagement Presentation, 15th May 2020” and submitted 18th May 2020

² Airline Community letter to CAA re Feedback on HAL’s IBP, dated 24th March 2020

- The requirements for a ‘high quality business plan’ (2.12), that would form the basis of the RBP and the on-going engagement; and
- In order to help prioritise and ensure timely delivery, the questions we are collectively seeking to address, by when, and the associated information provision and engagement required to do so. To that end it is worth noting the Airline Community have submitted a proposal³ to HAL and the CAA on areas of prioritisation for consideration and discussion.

In order to meet the timetable as set out, including the CAA’s proposal for a RBP in ‘autumn’ we believe that there will be a number of areas that will continue to be developed post RBP and time needs to be afforded in order that this important work can be completed. Again, it will be important to set expectations on the longer-term engagement as well so parties can be confident that unaddressed matters will be resolved in a Final Business Plan and the H7 settlement itself.

Given the nature of the situation we also agree that having the CAA directly and actively involved in the CE process, and more use of ongoing feedback and ‘workshop’ sessions would be beneficial. We would highlight this consultation as a good example of that approach.

Notwithstanding the above comments, the Airline Community do have a number of concerns and points to note that we would wish the CAA to consider further.

Firstly, and as mentioned in our opening summary, we are particularly concerned on some of the comments within that allude to aspects that might be settled via some commercial arrangement, or under some looser ‘Gatwick’ type model. As set out previously, the arrangements for iH7 was a *“unique response to a unique set of circumstances”*⁴ and was for an interim period only. Continued references to such are likely to only undermine the process being proposed within the consultation.

It is worth noting that since those agreements were entered into, HAL has failed to show any ‘commercial behaviour’ as one could only expect from a monopoly provider. We would point to our letter⁵ to the CAA regarding HAL’s response to airlines regarding Covid-19 and our ongoing feedback since as to evidence of such. We also strongly believe the issues raised within, including HAL’s incentives and subsequent unilateral actions, is something that needs to be addressed for H7.

We do fully support the CAA’s position set out within re HAL’s substantial market power and believe the findings still very much applies. Furthermore, we would not see either the impacts of the expansion decision nor the current Covid-19 crisis as diminishing that position. In fact, we would highlight to both HAL’s rate of recovery post the financial crisis, and recent airline decisions to re-trench to Heathrow as examples of why this is still very much applicable.

³ “Airline Community Feedback to HAL / CAA – H7 and Constructive Engagement Presentation, 15th May 2020” and submitted 18th May 2020

⁴ Section “Comments on the Deal and Future Regulatory Arrangements”; Airline Community response to CAP1769, 30th April 2019

⁵ Airline Community letter to CAA re HAL’s approach to Covid-19, dated 6th April 2020

Secondly, whilst noting and supporting the need for flexibility, given the level of coordination across ultimately competing organisations, it will be important that timings agreed with the airline community are protected in so far as reasonably can be. It would not be fair nor reasonable for airlines to bear the brunt of any changes to the timetable, particularly if such changes were required as a result of any failings by HAL.

Furthermore, it is also worth reminding that the weight of resource during this process will still reside strongly with HAL. Given such, it will be important that the CAA does not allow HAL to be the only participant that will be able to draw on significant expertise, particularly where the CAA have advised they would be seeking “*views on different scenarios for conditions in the financial markets.*”(1.15). HAL previously agreed to allocate £300k in the capital budget to assist the Airline Community with external consultant support. The need and support for it from the Airline Community remains.

Finally, we note the CAA’s comments regarding HAL drawing on work from its IBP (1.15) and the Consumer Challenge Board as well (2.6). We are supportive of this approach but believe it is also important to recognise in doing so the significant shift from work that had been undertaken through the lens of expansion, compared to where we find ourselves today, and to take into account feedback the Airline Community have provided⁶ on such matters. We believe this will be an area for ongoing development between HAL, the CAA and the Airline Community and look forward to doing so.

Timings and Scope of Future Consultations

We note the CAA’s statements on its intention to publish a consultation in June that will cover in depth a number of topics we have been engaging on to date. Given the outcome of this consultation is likely to have a bearing on H7 (views on WACC, capital efficiency and governance for example), it will be important that these are progressed in a timely manner to keep within the proposed timetable and have a real bearing to this process.

With regards to the consulting during the rest of the CE process and before the H7 determination, we agree that the RBP should set out a number of credible scenarios (as described earlier in this response) and to formally revisit them in early 2021 as further work is undertaken and greater understanding established.

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

Yours sincerely,



Simon Laver
London (Heathrow) Airline Consultative Committee



Nigel Wicking
Chief Executive
Heathrow AOC Limited

⁶ Airline Community letter to CAA re Feedback on HAL’s IBP, dated 24th March 2020