



Economic Regulation of Heathrow Airport Ltd: response to its request for a covid-19 related RAB adjustment (CAP 1966)

CILT Response to the CAA Consultation

November 2020

Introduction

- 1 The Chartered Institute of Logistics and Transport (CILT) is a professional institution embracing all transport modes whose members are engaged in the provision of transport services for both passengers and freight, the management of logistics and the supply chain, transport planning, government and administration. Our principal concern is that transport policies and procedures should be effective and efficient, based on objective analysis of the issues and practical experience, and that good practice should be widely disseminated and adopted. The Institute has a number of specialist forums, a nationwide structure of locally based groups and a Public Policies Committee which considers the broad canvass of transport policy. This submission draws on contributions principally by the Aviation Policy Group.
- 2 This the response of the CILT to the CAA's consultation on Economic Regulation of Heathrow Airport Limited: response to its request for a covid-19 related RAB adjustment (CAP 1966) opened on 9 October 2020. This response is structured to match the paragraphs headed 'Views invited' in Chapters 1, 2 and 3 of the consultation document. We also comment on CAP 1966A.

HAL's request and our approach to assessment

- 3 It must be recognised that the present situation and the impact on passenger's willingness and even ability to travel is on a different level than even the impact of the Twin Towers in September 2001 and before that the impact of the price rise in kerosene caused by the first Gulf War. However, going forward it would seem better to have a 'ratchet clause' in each settlement to allow for adjustment during a regulatory period. This would create a mechanism for adjusting charges without reopening the discussion around the RAB.

Our initial assessment of HAL's request

- 4 The assumption in the current settlement that HAL would bear the volume risk assumed the normal business risk of perhaps a 5% drop in volume due to changing travel patterns or more competition from the large UK regional airports or the European and Mid East hubs.
- 5 ACI Europe suggests that some 200 European airports will be insolvent over the next few months and, where there has been government financial support for airports, it has taken a range of forms. Indeed, as the CAA reports, a number of European airports have received funds either through loans

and grants or direct investment. This has also been true for the numerous airlines in Europe where government support has been provided. Notwithstanding an early suggestion of a sector specific package, the UK Treasury has taken a more indirect approach through the job retention scheme and the Covid Corporate Finance Loan Scheme which were and are available to companies in all sectors. In the case of the airlines the stated need was for existing shareholders to invest before the government would consider providing new equity.

- 6 In the case not only of Heathrow but also the majority of airports in the UK the shareholders are predominantly pension and sovereign wealth funds all capable of withstanding some business shock. The particular issue around Heathrow and indeed one which was flagged up when considering its ability to support the proposed expansion was its capital structure and in particular its relative lack of equity and beyond this the quantum of dividend payments that it has made to its shareholders. There is also the issue of the Heathrow Board member representing the QIA being the CEO of Qatar Airways which is a 25% shareholder in IAG and where British Airways, even after Covid-19, will be the largest operator at the airport.
- 7 The consensus by HAL, the airlines and DfT is that traffic is unlikely to fully recover until summer season 2024 but the timing of the move from the restart phase into recovery is unclear. What is however more certain is that the traffic structure at Heathrow is likely to be materially different from that pre-Covid, with a structural reduction in transfer traffic not least as a direct result of the fleet changes already made and signalled by British Airways. Furthermore at least in the near and into the medium term it is reasonable to conclude that not only will short haul traffic be relatively more important than in the past but also that a perhaps materially greater share of this will be low yield VFR and leisure traffic, all of which has implications for levels on non-aeronautical revenue. Furthermore, against the background of changes that will last well into H7, attention needs to focus on the actions that LHR needs to take to “right size” itself for this period. Whilst we recognise by its very nature an airport has significant fixed costs not only does Heathrow management need ensure that it is not hoarding labour or any other resource but also that it moves as much cost as possible from fixed to variable.

Next steps and timetable

- 8 A possible way forward using the Constructive Engagement process would be to plan on the basis noted above. This would mean a two terminal, two runway operation until Summer 2024 regardless of whether the traffic has a rapid bounce back once a vaccine has been given to all senior citizens and other vulnerable people. If the flu vaccine programme were followed this could be completed within three months of the vaccine being made available. This could be as early as Summer 2021. Indeed the introduction of an acceptable testing programme could also result in an earlier and more material recovery in traffic reinforcing the need for “revisiting”.
- 9 This plan would enable HAL to establish the base line of its customer service levels for security and airfield operations and present a cost plan on this basis. The parties should agree which scenarios and their associated forecasts should be used to test this plan. It is then up to HAL to decide how to deal with any shortfall, but previous decisions by HAL should be taken into account when the CAA rules on the extent to which any shortfall is covered by changes to regulated charges.
- 10 Unless some agreement is reached mutually between HAL and the Airlines, the CAA as regulator will need to intervene directly and act as adjudicator.

CAP 1966A

- 11 We note that the mention of Railtrack in Appendix F has been given particular attention in the media. We note the CAA's caution in drawing direct comparisons but suggest that the situations are so different that the then Secretary of State's remarks can not be applied to the current situation and Railtrack is therefore not a relevant example. Railtrack failed because of its own failings, whereas HAL's situation (and indeed that of the whole of the aviation sector) is because of external factors.

Submitted by:

Daniel Parker-Klein
Director of Policy and Communications
The Chartered Institute of Logistics and Transport
Daniel.parker-klein@ciltuk.org.uk
07894 620655

5 November 2020