

Virgin Atlantic Airways response: CAA Consultation on Guidance for Heathrow Airport Limited in preparing its business plans for the H7 price control

Summary

Virgin Atlantic Airways (VAA) welcomes this opportunity to respond to the CAA on its guidance for Heathrow Airport Limited (HAL) in preparing its business plans for the H7 price control period.

We supported the extension of the Q6 period given the uncertainties associated with expansion at Heathrow Airport and welcomed further discussion on how best to align the current regulatory periods, resulting in Q6+1. Given the on-going engagement on expanding capacity at the airport and the work that will be required for the development of the DCO application, there is a clear need for further discussion on how the capacity timetable and development of the initial business plan (IBP) and final business plan (FBP) for H7 can be better aligned.

We believe that a flexible approach to a further extension of Q6+1 should be utilised to ensure that there is true alignment between the two processes. However, a mechanism should be introduced to ensure that any variances in outputs compared to the original Q6 settlement during a further extension period is addressed.

In this response, we have provided high-level comments on guidance and incentives for a high-quality business plan, outcome-based regulation (OBR), consumer engagement and the Consumer Challenge Board (CCB) and how best to align the regulatory and business planning timetable. We want to work further with the CAA to develop these proposals over the coming months, particularly on aligning the timetables.

Guidance and incentive for high-quality business plans

We welcome the CAA's intention to increase transparency with respect to its expectations from HAL and assistance in producing more useful business planning information and a higher quality IBP and FBP. Such a move, also recently made by other regulators, should help to improve the quality of discussion that takes place between HAL and the airline community. However, this is dependent on the definition and transparency as to how "high-quality" is defined. Over recent regulatory reviews, it has been proven that airline assumptions, particularly traffic forecast numbers, are closest to actual outcomes, and therefore such analysis needs to be robustly taken into consideration when considering the quality of the business plans.

It is important to note that HAL is a monopoly in this market and therefore a regulated entity. We should be clear that it is airline operators at Heathrow that provide the best proxy for passengers' interests and such views need to be given full consideration in both the IBP and FBP. Airlines need to have the ability to sign-off both business plans and this should be one of the metrics which underpins whether the business plan is deemed high-quality.

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Additionally, there needs to be a greater emphasis in the business plan criteria on affordability. Passengers will only gain the benefit of flying from Heathrow if airlines can afford to operate from the airport.

We note that the CAA is choosing to focus on both reputational and financial incentives for improving the business plan. We are opposed to the proposal that HAL should receive a financial reward for producing a high-quality business plan. Producing a high-quality plan should be an essential given, not an outcome requiring a reward. We note there is no proposal for a financial penalty for producing a 'bad/sub-par' plan. If the CAA is minded to proceed with this unnecessary and unprecedented (in terms of UK airport regulation) proposal, it must be balanced and not tilted in favour of the airport operator.

We acknowledge that there is precedent in other regulated sectors. However, in this case, HAL is the only regulated entity producing a business plan, with no ability to compare plans across a number of regulated companies concurrently as seen in other regulated sectors. This makes it even more difficult to consider why HAL should receive a financial reward. In other regulated industries where there are multiple regulated companies, with the energy sector being a key example, their ability to compete to produce a business plan that furthers the interest of the consumer is possible because clear comparisons can be made. This is not the case for Heathrow.

Regarding the parameters for what constitutes a good business plan, we would expect the use of 'SMART' objectives, so that the plan can be judged against clear and measurable outputs.

We welcome the decision to rule out administrative and procedural incentives. Both approaches in our view are inappropriate in this context.

Outcome-based regulation (OBR)

We have consistently and repeatedly stated that the existing service quality regime has worked well over previous regulatory reviews and that any changes made to it need to be demonstrably in the passengers' interest. We welcome that the CAA recognises that airlines have a vital role to play in helping to deliver an appropriate quality of service, with a firm onus on HAL in this process as the regulated entity. The successful implementation of OBR will require close work between both HAL and the airlines, whilst not forgoing the key strengths of the current service quality regime.

We support the retention of the current SQRB regime and believe a move towards OBR should be an evolution rather than a radical overhaul. Any movement to OBR needs to ensure that the changes result in clear outcomes and measurable targets based on sound evidence. With this in mind we support the five principles set out by the CAA and would stress the weighting on:

- Principle 2: the structure of OBR should include outcomes, measures, targets and incentives; and

- Principle 3: CCB and airlines play a key role in the development of OBR

which in our view are vital in delivering OBR in an effective way for passengers.

Consumer engagement

We have welcomed the establishment of the CCB in providing independent scrutiny and challenge to HAL on the development of its business plan. Given the important nature of the role that airlines play in representing passengers' views in the H7 process, it is important that there is close engagement between the CCB and the airline community in achieving the best outcomes for passengers.

Options for aligning timetables

We agree that the work on expansion requires us to think differently about how best we go on to align the regulatory process with capacity. Our view is there is still a significant amount of uncertainty around expansion and on the timetable that needs to be addressed and therefore we support the CAA's proposal to extend Q6 beyond the current Q6+1 period. However, a fixed alignment period of one year may not necessarily result in full alignment with expansion, therefore we would support flexibility on the length of this further extension.

While the CAA has put forward two broad options for dealing with these challenges, we do not believe either of these options would be fit for purpose and would propose an additional option of a flexible alignment period. This could be anywhere from 6 months to 18+ months, to ensure that this extension results in true alignment.

Given the inadequacy of the traffic forecasts during the Q6 period so far we would need to ensure that this is addressed. We support the LACC/IATA proposals for introducing a total revenue cap for this additional period rather than a per passenger charge. The details of this would need to be agreed across stakeholders, but this would involve rolling over the current regulatory building blocks, incorporating the same efficiencies as the Q6 period, but also incorporating some form of truing-up mechanism to ensure passengers are protected from such variances. This would be particularly aimed at addressing the current disparity in traffic performance.

Such a mechanism could also be applied to the current Q6+1 period, given when the CAA took the decision to extend Q6 for an additional year this was under the assumption that only one extension will take place.

We are open to exploring this idea further; however, we would need to be sure of the detail that would sit behind such a mechanism. We would suggest a deep-dive workshop between the CAA/airlines/HAL to bottom this out as soon as possible.

We look forward to engaging with the CAA on this matter in particular over the coming months.

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