CAA Consultation on CAP 1966

Coalition Response – DRAFT

5th November 2020

Introduction

This response to the CAA consultation on CAP 1966 is submitted on behalf of the No 3rd Runway Coalition.

Key Points

Heathrow is already the most expensive airport in the world and is more highly geared than any over comparable infrastructure asset. The debt to asset ratio is already at 95% and is simply not sustainable. In comparison, Thames Water the utility that services the entirety of London has a ratio of 81.5%, and is under pressure to reduce it.

The CAA is correct to conclude that Heathrow have not set out a clear case for why additional regulatory support is needed now. Many companies across the sector and wider economy will have to reduce investment because of the pandemic and Heathrow should not receive any preferential treatment.

Heathrow appear to only be seeking this request for an adjustment to the RAB, as it has become evident that there will be no direct financial assistance from Government.

Heathrow claim that the adjustment to RAB is for investment but have not made clear whether this is to recoup expenditure for their expansion plans, or to cover losses imposed by pandemic, or both.

Heathrow requests to add some £1.7 billion to its RAB and says that it stands to lose between £2.2 – £2.9 billion. Yet according to their most recent accounts, the net value of the assets of the group of companies after deduction of liabilities is just £1.162 billion. The £1.7 billion requested represents just 3 years dividends paid out to the shareholders. The attempt to renegotiate the current price agreement is a clearly an attempt to recoup the losses of the pandemic from the airlines and passengers and should be resisted.

The consultation paper rightly identifies that Heathrow's high level of gearing is a significant financial problem for the company. Currently the accounts of Heathrow's parent company, FGP Topco, show that by December 2019 the

proportion of liabilities to assets was a staggering 95.35%. It is clear that there is no case for an adjustment to the RAB, especially to address Heathrow's expansion aspirations. The ability of Heathrow to finance a third runway was always highly questionable and given the collapse in demand as a result of the pandemic it is certain that there will not be any justification for this for many years.

We agree with the CAA's iinitial overall assessment that Heathrow's request falls short of robustly demonstrating that its proposed solution is appropriately proportionate and targeted to in terms of a short-term or immediate regulatory intervention.

Heathrow recently told the Community Noise Forum that demand may not return until 2025, therefore any adjustment to RAB now will simply encourage Heathrow to come back again and seek further adjustments before the next review in 2022.

It is not the job of the regulator to ensure that Heathrow is an attractive investment for future debt and equity finance. This appears to be the principle incentive behind Heathrow's request. It is the responsibility of the management and shareholders of Heathrow's business to ensure their asset is an attractive investment. This is something that they have consistently failed to do.

We would assert that any amendments to the existing price control agreement have the effect of helping to lower the future cost of capital which will only help Heathrow rather than passengers and consumers.

The last point made by Heathrow in their submission reveals the true reason for their request for an adjustment, essentially to pay costs incurred by their expansion plans. This is something that they cannot afford to cover in normal times and reveals the lie that was told to Parliament that airport charges would be kept to present levels. As communities around the airport are well aware, this was another promise that Heathrow never had any intention of keeping.

The crucial question for future price control reviews is whether Heathrow are seeking to use their RAB to secure future debts.

The payment of dividends to shareholders in the past has been disproportionate and no further payments should be made until the level of debt is reduced. This is something that should be consider in the H7 price control review.

It remains unclear how Heathrow's debt structures work and what the implications of these are for its tax liability. Ahead of the H7 price control review, the CAA should seek answers to the following questions:

- What is the percentage of HAL's debt that is provided by shareholders and what are the key terms?
- Does the current RAB structure enable HAL's shareholders to secure favourable market terms on their debt?

- What are the consequences of sustained reduction of income for Heathrow?
- At what point can a robust case be made for Government providing financial support to Heathrow in the national interest?
- Does the RAB model encourage debt structures that have been used in the past to suppress taxable profit?