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Infranews Infrastructure Investors Forum
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Introduction

Thank you very much for having me here today.

It was no surprise to see that the two key themes in the brief for my speech today were Brexit and Heathrow's third runway. Two issues never far from the headlines, or it seems, my speaking notes.

I will come on to both of those issues shortly, but before I do, I wanted to briefly touch on who the CAA is and what we're here to do.

Most of you will know us as the body that regulates Heathrow's charges.

But there are many other facets to our role including: safety, security, airspace, design, and running the ATOL holiday protection scheme.

In all of this, one thing cuts across our work: our duty to protect consumers.

My brief for today asked how the CAA can help protect investors, but I want to be clear right up front here: our primary aim is to protect the consumer. It is why we exist and we constantly challenge ourselves to consider *what is best for the consumer?*

But clearly, we must also recognise the needs of investors (both equity shareholders and those within the debt market) when it comes to infrastructure development.

Brexit

Before we get to infrastructure and Heathrow specifically, I wanted to touch briefly on Brexit – an issue of many questions, but still relatively few answers.

There are of course questions on what impact Brexit might have on aviation – a truly global sector reliant on international connectivity and relationships.

The Government, not the CAA as the regulator is the decision-maker here, but we are engaging and influencing so the interests of consumers are fully considered.

With this in mind we have set out four key principles for UK aviation post-Brexit:

- The UK must continue to punch its weight in the global aviation sector – *more on the scale of the UK market shortly.*
- The UK must be able to continue to influence beyond its borders – recognising that nearly half of all flights in UK airspace are flown by non-UK airlines.
- There should be fewer barriers to competition, not more – could Brexit create opportunities for UK airlines on things like slots and ownership?
- Consumers and the communities affected by aviation should continue to enjoy equivalent levels of protection – such as compensation for disruption.

Developing these principles means we are focused on the outcome we want to see, rather than the mechanism for getting there.

The UK aviation sector

Throughout history the UK has been a major player in international aviation and that remains true to this day:

1. London is the world’s best connected destination.
2. The UK has the second largest aerospace sector in the world, generating a turnover of £65 billion a year and supplying markets across the world.
3. We have the world’s third best developed aviation network behind the USA and China.

While we know demand for air travel fluctuates, particularly around summer peaks and more than it does for a utility such as water, demand for air travel remains strong.

Over 250 million passengers flew in and out of the UK last year, with airports across the country opening up new routes in emerging markets.

The aviation sector as a whole has generally shown strong profitability and returns in recent years. For example, the largest 11 UK airports are reporting operating margins of 25%, on average, over the last 5 years.

There is a breadth of business models, making aviation a dynamic and fiercely competitive sector – combining international hub and regional airports, for example.

There is more diversity in ownership models too. Since the break-up of BAA, all three airports sold by the group have seen an increase in passenger numbers. The CMA has estimated the economic benefits to this will be in the region of £870 million by 2020.

And of course, the sector continues to evolve and grow. There is the third runway project at Heathrow, but other airports are also looking to make major improvements to their infrastructure such as London Luton and City.

All of this brings competition and increased choice for the consumer.

Regulating aviation infrastructure in the interests of consumers

As I set out at the start, our primary role is to protect consumers. And that is very much the case for our work around regulating airport charges.

We believe effective competition in the market is the best way to drive value for money and high service standards for consumers.

But we do use our regulatory powers where there isn't sufficient competition to protect airport users from rising costs and falling service standards. This is the case at both Heathrow and Gatwick, two airports that have substantial market power and without regulation, could potentially abuse that power to the detriment of their users.

The way we regulate has evolved. In years gone by it was a rigid price control approach, but now we have the powers to be much more flexible. For example, the economic regulation in place at Gatwick involves the airport making a number of commitments to its customers on prices and service levels. The CAA monitors performance against the commitments, with the power to intervene if necessary – helping to protect the airport's users and investors alike.

Regulation can be seen by some as stifling competition. We don't believe that is true for aviation. We only regulate where there isn't sufficient competition to drive value and service.

Where we have seen the market evolve and competition emerge, we have taken airports out of regulation – such as Manchester and Stansted in recent years.

Regulation needn't be a barrier to growth or investment either. Heathrow has invested around £11 billion in infrastructure such as T5 since 2004 and is now moving forward with plans to develop its third runway. And Gatwick has continued to invest £1.5 billion since its sale in 2009, all the while increasing passenger numbers to record levels.

Heathrow third runway – priorities and next steps to making new capacity a reality

Which brings me to the second of the key themes for today: Heathrow's third runway.

The debate over how and where to increase the UK's aviation capacity is one we've been having for over 40 years now.

But the Government's confirmation of Heathrow as its preferred option for expansion brings new capacity a step closer to coming to fruition.

And while it is not for us as the regulator to determine where additional capacity should be built, we have been consistently clear that more capacity is needed to avoid consumers facing higher fares, less choice and more disruption.

Heathrow's third runway is a truly unique and unprecedented project: the largest privately financed airport expansion project anywhere in the world.

We are currently developing the regulatory framework for the project and are clear that as new capacity is in the interests of consumers, our framework must incentivise the necessary investment to make this much-needed capacity a reality.

Our approach to regulation will be responsive to the specific circumstances of this project – it will not be a one-size-fits-all approach. This includes learning lessons from previous regulatory reviews in terms of the risks and costs of unfruitful investment. We have, for example, set out risk-sharing agreements for the recovery of planning costs should Heathrow's third runway *not* be developed. Total abortive spending at Stansted over the period 2003-2010 was around £220 million (equivalent to 15% of Stansted's 10/11 RAB), before its runway scheme was halted.

But as always, we will have the interests of the consumer at heart of our decision-making and we have already made it clear to Heathrow that cost efficiency and value for money are vital.

This week we have published our priorities for the development of the regulatory framework that will guide our work over the coming months and years.

The two key priorities for you I imagine will be:

1. That the CAA develops a regulatory framework, including incentives for Heathrow, in a way that is consistent with efficient financing, affordability and financeability.
2. That Heathrow engages with airlines and other stakeholders on costing options to design a scheme that furthers the interests of consumers.

On the first priority, when looking at developing the regulatory framework in a way consistent with efficient financing, affordability and financeability, we will be:

1. Considering whether there are other long-term regulatory commitments we should make alongside the RAB model that will support long-term investor and stakeholder confidence in the regulatory framework;
2. Estimating an efficient cost of capital and making sure at the same time that we test the impact on Heathrow's financeability of this cost of capital;
3. Ensuring that regulatory incentives and particularly cost efficiency incentives provide for an appropriate balance of risk and reward; and

4. Reviewing the proposed price path profiles and whether it reflects our view of the consumer interests over both the short and longer term *[the prefunding issue]*.

Part of our work to develop the framework will involve working closely with other regulators, via UK Regulators Network working groups, in areas where we will be looking at similar issues, such as cost of capital and inflation issues.

We will be seeking views on the proposed architecture for regulation of the third runway this summer, along with consulting on the treatment of costs for compensating affected communities – with the Government already highlighting the need for a world class compensation and noise mitigation package to be made available to those communities. Something we also think is a crucial factor if this scheme is to succeed where others have failed.

On the second priority, we are monitoring and assessing Heathrow's engagement with airlines and other stakeholders on costs and costing options.

But our role is much more proactive than reactive. We are actively involved in the engagement, observing and advising on the format and quality of engagement in real-time.

We will be providing our conclusions to the Secretary of State for Transport throughout 2017 on how well Heathrow's engagement with the airline community has gone.

Crucially, this will also include assessing whether Heathrow has done all it can to meet the aspiration that airport charges do not increase in real terms (over the short and longer term), while delivering robust and resilient infrastructure consistent with the needs of consumers. This is something Heathrow committed to publicly and the Government has also made it clear it expects to see this happen.

So we will be seeking views from industry and the investor community alike as we develop our thinking on this crucial project.

Closing

So we are clear that new capacity is needed in the interests of consumers and we are committed to playing our part in helping to make that happen.

We have made it clear to Heathrow that cost efficiency and value for money are absolutely crucial and that they must engage fully with their airline community.

And we recognise that our regulatory framework must incentivise long-term investment – remembering that this is an unprecedented project, but in a dynamic industry where there is huge demand from consumers.

But it is those consumers whose interests we will have at the heart of all our decision-making and we stand ready to play our part in helping ensure the additional capacity consumers need moves from plans on paper to reality.

Thank you for your time today.

Questions