NO 3RD RUNWAY COALITION

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Response of the No 3rd Runway Coalition to the CAA CAP2265 Economic Regulation of Heathrow Airport Limited: H7 initial proposals

December 2021

Introduction

The No 3rd Runway Coalition is the largest organisation campaigning against the expansion of Heathrow. Our membership includes local communities, parliamentarians, local authorities, trade unions and environmental NGOs. This submission constitutes our response to the Civil Aviation Authority's (CAA) consultation document CAP 2265.

Airport Charges for 2022.

We agree with the proposed action by the CAA to put in place a licence condition to prevent Heathrow Airport Limited (HAL) unduly increasing prices for 2022 to the detriment of consumers.

New condition C1 will effectively sets the maximum passenger charges for 2022 at £29.50, an increase of some 34% on current levels. However, there does not appear to be any limitation on HAL's ability to charge the maximum throughout the period.

Strengthening price control arrangements.

We support the introduction of Outcome Based Regulation to place greater incentives on HAL to deliver efficiently. However, concerns remain about the acceptance of HAL's proposed outcomes without sufficiently robust targets. The proposed working paper from Arcadis is a welcome step in the right direction.

Initial Proposals for capital expenditure efficiency incentives.

We are not surprised that the estimates provided in HAL's plan is unclear nor that the outputs and benefits of their expenditure have not been properly described. This is a similar issue campaigners have faced with regard to HAL's expansion plans.

We note the Arcadis paper concludes that HAL's "Optimal Plan" represents an increase in spend when compared to historic spend, which is surprising given the impacts of the pandemic and the regular complaints of HAL about their continued loss of revenue. Interestingly, ARCADIS suggest that this is not in line with the rest of the market.

Projections of passenger traffic for H7.

There is a significant range in HAL's update Revised Business Plan (RBP) passenger forecasts between the high and low range. The use of mid-case forecasts in the RBP appears far closer to the high-case and thus does not seem to be an appropriate basis for full analysis.

We agree with the CAA view that use of demand shock factor should not be included in passenger forecasting.

The Department for Transport should commit to update *Aviation Forecasts 2017* by the end of 2022 as all plans for expansion and airspace change at Heathrow are based on these now out of date figures.

Projections of HAL's costs and revenues.

We note that it is quite remarkable that Over the five years of the H7 period, CEPA/Taylor Airey project that HAL's operating expense (opex) would be £801m lower than HAL's forecast, a difference of around 13%. This overestimation appears designed to increase the size of the Regulated Asset Base (RAB) and, in turn, HAL's ability to raise and finance debt, at the expense of its customers.

Approach to estimating HAL's weighted average cost of capital & assessing financeability.

The proposed approach for annual updates of HAL's RAB makes sense given the levels of uncertainty around traffic volumes.

Initial Proposals for range of charges.

Whilst the initial proposals are not as generous as Heathrow would like it seems that the range of price increases proposed for H7 are based on an expectation that traffic levels take time to recover to 2019 levels.

However, it is not clear from the analysis provided by Skylark that the recovery will be as long as HAL assert. We are concerned that should traffic return more rapidly than HAL predict that these higher prices will be baked in, enabling them to make higher profits than is justifiable.

The size of the proposed increases appears not be to in the interests of consumers. HAL claimed that even the costs of its expansion would not result in an increasing in charges so it is not evident why such significant increases should be permitted to enable to them to recover revenue lost due to the pandemic.

Costs of Heathrow Expansion

We broadly agree with the CAA approach to Heathrow's early expansion costs. In particular, we support the decision to confirm the targeted RAB adjustment of £300 million but not to make further changes in response to HAL's request of a covid-19 related RAB adjustment.

We recognise the decision not to formally adopt the Demonstrably or Wasteful Expenditure Framework. But this leaves a question mark around the efficiency of Heathrow's expenditure on expansion in the Q6 price control arrangements. What would the impact have been in terms of assessment, and would this have an impact on future capital expenditure?

We agree with the CAA view that, "*We consider that it would not be sensible or efficient, or in the interests of consumers, for HAL to be actively pursuing expansion at this time, given the ongoing impact of the covid-19 pandemic.*"

We do not agree that HAL should be able to add the wind down costs to the RAB, especially when it is not clearly detailed what these costs involve.

We note the Taylor Airey conclusion that, *"It is difficult to assess whether Expansion costs have been fully removed without a detailed deep-dive review of the capitalisation treatment of these costs and the resultant impact on opex. This would require more detailed disclosure from HAL than is currently available."*

Further, we note their concern that a lack of clarity in the treatment of capitalised staff costs in the Statutory and Regulated accounts may disguise inconsistencies or double counting.

HAL's complex and permitted financial structure, allows them to finance projects mostly by debt, which in turn is serviced by charges to the public and airport users. The RAB structure provides no incentive for HAL to keep costs under control and should be examined as to whether this is a suitable model for a nationally significant piece of infrastructure.