

Virgin Atlantic Response: Economic regulation of the new runway and capacity expansion at Heathrow airport: consultation on CAA priorities and timetable

Summary

Virgin Atlantic (VAA) welcomes this opportunity to respond to the CAA consultation on the priorities and timetable for the economic regulation of the new runway and capacity expansion at Heathrow Airport. We continue to support Heathrow expansion provided that it delivers for the consumer a transformative increase in airline competition and genuine value for money. As such, affordability is a top priority. Given the importance of the decisions being taken during this process to consumers (passengers and cargo customers) and our business, we will continue to engage robustly to ensure the best possible outcome.

We welcome the CAA's enhanced role in this process. We expect the CAA to keep its primary duty to further users' interests at the heart of all its decisions. It is also important that this process is as clear, focused and transparent as possible for all stakeholders to remain engaged and for the optimal outcome to be achieved.

With passenger charges at Heathrow already the highest in the world, it is simply untenable to increase them further to fund expansion. There should be no increase in today's charges in real terms over the life of the runway. Furthermore, as tens of millions more passengers start using the airport when the runway opens, our customers would expect charges to fall over time to levels comparable with other European hubs.

While we have welcomed HAL's early indications on affordability, we are somewhat disappointed by the lack of progress that has been made on this to date, particularly with the lack of development of a robust 'affordability protocol'. Such a protocol needs to underpin every aspect of this process from scheme design to surface access arrangements, and it is vitally important that this is developed and jointly agreed as soon as possible. We are concerned that design work and optioneering is underway without any agreed affordability parameters in place.

We welcome the four priority areas that the CAA has presented in this consultation. The CAA must monitor progress against these objectives and ensure that HAL is being held to account against all of these measures as the timetable progresses.

We will work with the CAA to ensure that the package of regulatory measures that apply to expansion at Heathrow are acceptable to the customers we represent. With this in mind, it is important that sufficient time is allowed for the robust

scrutiny of proposals in a similar vein to the time which is currently being worked into the schedule for HAL to review other stakeholder inputs.

Priority issue 1: HAL must develop a scheme design to further the interests of consumers by engaging in a transparent and effective way with airlines and other stakeholders on the potential options, costs and value for money.

It is welcome that HAL's starting position is for engagement during this process to remain open, transparent and constructive. We hope that this is an aim which will continue to be met throughout in order for it to be of true benefit to the consumer. This includes accessibility to relevant documents and tools in a timely manner to allow for the appropriate scrutiny and input from airlines and other relevant stakeholders.

We would also like to see demonstrable evidence that HAL is taking onboard all input that is being received from airlines and relevant stakeholders in its assessment process. This includes justifying how such input is dealt with in any final measures that are adopted by HAL.

Objective criteria and evidence must, of course, be used to ensure that the appropriate outcome is achieved for consumers. These are areas which airlines have aimed to uphold throughout this and previous reviews and will continue to engage in good faith. The CAA must maintain a robust role in monitoring and assessing the outcomes from this process. It should also guarantee that all outcomes are fully aligned with any affordability objectives that are established.

We welcome the Consumer Challenge Board (CCB) having a role in this process, alongside airlines, in scrutinising the cost and affordability components on the consumers' behalf. We would like further clarity as to what this will mean in practice for the CCB given its current terms of reference are focused on the H7 process.

Securing the best possible outcome for consumers is a fundamental priority and we are resourcing accordingly. In order to assist with this, we would expect both HAL and the CAA to allow for time in the timetable and where possible necessary resource to aid us in this.

Priority issue 2: HAL must develop robust cost estimates and we need to develop regulatory arrangements to incentivise HAL to deliver the project in a timely and efficient way.

Our primary objective is to ensure that expansion at Heathrow is affordable for the consumer and to prevent any increase in charges. As such, we believe our interests are fully aligned with the customer. The development of robust cost

estimates is essential in meeting this objective and will only be achieved with close engagement with airlines. The CAA is also vital to ensure that HAL is being held to account. So far we have seen a lack of clarity on costs and affordability which needs to be rectified as urgently as possible if we are to meet the pressed timetable which has been presented.

While we welcome the CAA pressing for HAL's proposals and evidence to clearly demonstrate that all costs are reasonable and efficient in this process, it is also important that such estimates are made available in due time and are presented in a transparent manner. This is necessary if we are able to give such evidence due scrutiny.

When looking at cost estimates during this process we require the following to be taken into account:

- The use of benchmarking studies will be vital in this process to ensure that costs are within an appropriate range and are in the customers' interests. The CAA also needs to take a proactive approach to benchmarking, and not just rely on the benchmarking studies being presented by HAL
- Clear lessons can be learned from previous quinquennial reviews, particularly Q5 and Q6 on cost estimates which should be taken into consideration. Constructive engagement has also delivered better outcomes and should be a key component of the regulatory process, particularly when scrutinising HAL's business plan and proposed design concept
- Capital expenditure triggers for the delivery of meeting certain milestones will need to be explicitly clear in order to drive the appropriate behaviours during this process
- An affordable core and development approach to budgeting which has been nurtured over Q6 should be adopted
- The inclusion of the Independent Fund Surveyor (IFS) in this process will be invaluable to ensuring that the consumer's needs are met and the scheme design is being developed within the parameters of affordability
- We have highlighted the procurement practices by HAL over previous regulatory reviews being out of line with the actions of a company operating in a commercial environment. This is an area that we would welcome exploring further, particularly any implementation of safeguards and bolstering of competition in the supply chain
- Assurance that a robust co-developed affordability protocol underpins all cost estimates

We have highlighted in our feedback to the Q6 review process that ex-post incentives have not always resulted in the best outcome for the consumer. We would like to work more closely with both the CAA and HAL on the type of incentives of both ex-ante and ex-post variety to ensure that the right balance is secured for consumers given the complexities that sit behind such mechanisms. In order to aid such discussions, we would welcome sight of HAL's initial

proposals on such matters as soon as possible, to enable scrutiny by ourselves and the rest of the airline community.

Finally, it is important that the CAA is reviewing how HAL has engaged and independently assessing the evidence being put forward by HAL. The CAA also needs to ensure that there is a robust mechanism in place to follow up where this is not the case. We would welcome further clarity from the CAA on how it would address any failings that it identifies.

Priority issue 3: HAL must develop proposals for efficient financing and we need to develop the regulatory framework in a way consistent with efficient financing, affordability and financeability.

The allocation of risk in this process will be key to ensuring the right outcome for consumers. We would welcome the CAA elaborating further on their thinking in this area. The CAA highlights in this consultation the potential for individual investments; while this is an interesting concept it requires further development in thinking. As do areas such as volume risk, gearing and the applicable weighted average cost of capital.

We agree that a regime where charges are set purely through bilateral commercial agreements between HAL and airlines is unlikely to be sufficient to underpin the key risks associated with new capacity. Given HAL's market dominance such bilateral contracts would be highly unlikely to be in the consumer's interest given the asymmetric balance of power in negotiations.

We would be happy to look at whether there are evolutions to the RAB model that would better serve consumer interests. However, we would be concerned with any suggestions that a complete move away from this approach is necessary given that it is a tried and tested model over previous regulatory reviews.

Underpinning all efforts on efficient financing should be affordability and at the very least maintaining flat charges while aiming to drive towards a reduction in charges over the longer term.

It is worth highlighting that there may at some point be tensions between financeability and affordability. We would welcome further insight from the CAA as to how it plans to balance these factors in taking a final decision.

Priority issue 4: HAL must develop coordinated proposals for existing operations (i.e. for the H7 price control) alongside its proposals for the new

runway and capacity expansion so that its overall business plan is affordable and financeable.

As we have noted throughout this consultation response affordability is of paramount concern for us and should underpin all aspects of this project.

It is now clear that Q6+1, H7 and capacity expansion are all intrinsically linked and sufficient information is required for all to make informed decisions, particularly the information which will be presented in HAL's initial business plan which will form a baseline for this ongoing process.

Given that HAL's business plan will be published in December 2017, there are a number of decisions which will have to be made over the course of this year with a significant amount of uncertainty remaining from our perspective. This is why it is vitally important that the balance of risk is apportioned appropriately so that consumers and airlines do not become the insurer of last resort. We are also pressing for clear ongoing engagement, coinciding with a collaborative decision-making process, particularly at key development milestones.

Finally, to reiterate, there is a clear imbalance in the resources available to HAL and airlines during this process. Allowances need to be made in the timetable to address this and allow for appropriate scrutiny to take place in the consumers' best interest.