

T. Martin Blaiklock
Consultant
Energy & Infrastructure Project Finance

February 22nd, 2018

The Civil Aviation Authority : Consultation

CAP1610: "Economic Regulation of Capacity Expansion at Heathrow"

Sirs,

I wish to contribute to the above Consultation.

1. It is now 2½ years since the Airports Commission finished their work. Heathrow NW Expansion was identified as the preferred option by Government at that time, yet to date LHR/HAL have been unable to provide "consumers" (see para 8, below) - who will have to pay for the Expansion in the end, - with their financial plans to support the investment, notwithstanding many requests.

2. The estimated cost for the Expansion is reportedly around £17bn (@ 2016 prices?) of which Government has stated that it will make no contribution (i.e. towards Expansion-related investment).

3. Meanwhile, HAL, in their current (Jan 2018) Consultation Document (p. 12) state:

"we are [also] committed to ensuring our plans can be delivered while keeping the airport charges, - the fee airlines pay to operate at the airport, - at close to current (i.e. in real, 2016 terms) levels".

4. Given that the Expansion will require a number of years for construction before it is operational, financiers will need to be paid during the construction period under the RAB Model, or finance costs need be capitalized under a "project finance" model. Whichever model is adopted, HAL's statement seems unrealistic in cash-flow terms, unless there is significant increase in traffic throughput using LHR's existing facilities.

"It does not stack up!" Yet, huge resources and costs are being incurred in planning, consultations, public time, etc., when, to me, there seems little likelihood that HAL can raise the funding needed, unless Government foots the bill.

5. CAP1610 reviews a number of scenarios as to the proportion of funds (debt & equity) needed to make up a "financeable" funding package, which, given an overall cost of, say, £17bn (@ 2016 prices) will require £3 - 4bn of additional equity capital to be committed at the outset.

There has been no indication to date as to where this money might come from or whether it is committed. It represents one of the largest equity investment in infrastructure undertaken anywhere to date. Even PwC stated it would be "unprecedented" (ref. p. 64, PwC Funding Report, Airports Commission, Nov 2014). Nevertheless, the Airports Commission recommended, - and the CAA supports, - the LHR NW Expansion, in the face of other, much cheaper alternatives.

The CAA (and Government) seem oblivious to these warning signals.

6. Chap. 3 of CAP 1610 appears to assume the use of the RAB Model for financing the Expansion, which places much of the financial risks on consumers. I have already opined in previous submissions the flawed nature of this mechanism for major capital projects, such as the proposed Expansion, as much of the financial costs relating to completion risks are passed onto airlines and customers. Even the energy sector does not adopt such an approach for private utility investment, viz. the CfD arrangement for Hinkley Point.

In the interests of airlines and customers, CAA needs to re-think its approach, not least as the RAB Model has been shown in recent times, viz. the UK water sector, to over-compensate shareholders as a result of its imperfect structure.

7. I am also concerned as to the continued potential in the development of The Expansion for undeclared conflicts of interest, and the corrupt practices that might lead to. A number of such conflicts are perceived, but in the context of CAP1610 the role of PwC to advise on the WACC stands out, in particular:-

- PwC were advisors and financial modellers for the Airports Commission;
- PwC have been auditors/advisors to the CAA for some years;
- PwC were auditors to BAA plc / HAL 2004-2009, when the current structure for HAL was set up and BAA/LHR was taken off the Stock Exchange; and
- The ex-Head of Global Infrastructure Advisory Services for PwC is a non-Executive Director of the Dept. for Transport.

In addition, (i) the ex-Sec. of State, HM Treasury, responsible for infrastructure investment, is now Chairman, Heathrow Holdings, and (ii) the Chief Executive of the National Infrastructure Commission was Head of Secretariat for the Airports Commission.

Such relationships, historic or not, need to be publicly disclosed to avoid any suspicion of impartiality.

8. Finally, I note a conflict of definitions between the CAA and the H7 Consumer Challenge Board, set up in early 2017 for the Expansion.

Appendix A of CAP1610, Item 3, states: quote: *"CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of "consumers", end-quote.*

However, "The principles of good consumer engagement" guide, published on the CCB website, first bullet point, states:-

"Be clear what you mean by a "consumer", i.e. a person who purchases or uses a good or a service - this is not the same as a citizen (tax payer), or a community (a geographical or interest based collective), or a stakeholder (wider group of interests)".

The above two definitions of "consumer" seem incompatible, yet they appear on the same website. Perhaps you may wish to reflect and adjust?