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Sent via e-mail to: economicregulation@caa.co.uk

Date: 6th December 2016

Dear Abigail,

Virgin Atlantic's response to the CAA consultation on the notice of proposed modification to Heathrow Airport Limited's economic licence to allow for an annual recovery of £10 million of Category B costs for a new north-west runway

Summary

Virgin Atlantic (VAA) welcomes this opportunity to respond to the consultation on the notice of the proposed modification to the Heathrow Airport Limited (HAL) economic licence to allow for an annual recovery of £10 million of Category B costs.

As we have stated previously, and in agreement with the wider airline community at Heathrow via the LACC, we do not believe that there should be the ability for an annual recovery of £10 million of Category B costs as indicated in this proposed notice. In our view, this constitutes a form of pre-funding, a principle which we are wholly against. Additionally, this proposed notice brings with it intertemporal issues, where passengers today will be apportioned a cost for which they may not reap any benefits from.

Notwithstanding the above, it is important that any costs passed through to the passenger are robustly scrutinised and fully evaluated that it is in their best interest. Therefore, it is important that the Independent Fund Surveyor (IFS) has the ability to intervene where costs are deemed inefficient.

Main Points

The CAA indicates that this proposed modification to the licence is necessary to incentivise the start of work on securing planning permission immediately after a Government announcement of its preferred location, and before a risk-sharing mechanism is put in place. In our view, HAL is already highly incentivised to do so (as it leads to the expansion of HAL's business), even before this proposed licence modification and therefore such a change is superfluous and brings no further benefit to the passenger.

While the CAA has highlighted that this licence change is necessary to ensure the consistent treatment between HAL and GAL on the recovery of costs, it is important to note that both airports are under differing economic regulatory regimes. Therefore, the treatment of such costs at one airport should not necessarily be directly replicated at the other, without clearly being evidenced that this should be the case. Additionally, the determination of the inclusion of the clause in the GAL licence is not in itself justification for replication in the Heathrow licence.

The annual recovery of £10 million in this consultation is in our view an arbitrary figure. It does not meet the CAA's primary objective to further the interest of current and future passengers, as it does not add any further incentive for HAL to press ahead with obtaining planning consent. However, it does result in an increase in the maximum revenue yield per passenger for current passengers, who may not reap the future benefit. Greater in-depth analysis and evidence as to why the CAA is of the view that £10 million is an appropriate figure in our view would be welcomed.

Additionally, the implementation of this proposed modification to the licence in itself raises intertemporal issues and is ultimately a form of pre-funding. As the CAA is aware, we are strongly of the view that passengers should only pay for additional capacity when the asset comes into operation and not beforehand.

We welcome the further clarity around the use of the term "automatic" and note that all Category B costs will need to be clearly justifiable and subject to an efficiency test. It is important that the Independent Fund Surveyor (IFS) during this process acts clearly in the interest of the passenger and has the appropriate information to identify any expenditure that is inefficient to both the airlines and CAA during this process. We also note that no details have been provided as to how the IFS efficiency test will work in practice, and whether such scrutiny will be ex-post or ex-ante. Furthermore, great clarity on what the repercussions will be if the IFS judges that any costs are not efficient, along with how the governance and dispute resolution mechanism will work is necessary.

It is proposed that the recovery of costs should commence from 25th October

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2016, when the Government announced it has identified the Heathrow North-West runway as the preferred scheme. We believe that the automatic recovery during the 2016 period from 25th October 2016 – 31st December 2016 should, therefore, be pro-rata. HAL should not be allowed to recover the full £10 million allowance during this period, and we estimate that this would equate to the maximum allowable recovery cost being approximately £1.8 million.

Finally, we reserve the right to comment further on the aspects associated with planning costs above £10 million under consultation separately. We strongly reject a model where current passengers pay for future capacity, and where current operators are competitively hampered vis-à-vis operators from competing airports as a result of this. We also have considerable concerns with the risk-sharing arrangement being proposed and are of the view that the CAA misinterpreted the comments we previously made in its summary in CAP1469 para. 5.8 stating that we welcomed the risk allocation mechanism. We will provide further comments on this along with an evaluation of HAL's proposed reward structure, the incorrect treatment of planning consent as an asset, alongside other points in a separate response to CAP1469 in due course.

I trust that you find the above comments helpful. Please do not hesitate to contact me if you have any questions in relation to the points made.

Kind regards,

David Joseph
Regulatory Affairs
Virgin Atlantic Airways