



Economic Regulation of Heathrow Airport (CAP 1940)

CILT Response to the CAA Consultation

August 2020

Introduction

- 1 The Chartered Institute of Logistics and Transport (CILT) is a professional institution embracing all transport modes whose members are engaged in the provision of transport services for both passengers and freight, the management of logistics and the supply chain, transport planning, government and administration. Our principal concern is that transport policies and procedures should be effective and efficient, based on objective analysis of the issues and practical experience, and that good practice should be widely disseminated and adopted. The Institute has a number of specialist forums, a nationwide structure of locally based groups and a Public Policies Committee which considers the broad canvass of transport policy. This submission draws on contributions principally by the Aviation Policy Group.
- 2 This the response of the CILT to the CAA's consultation on Economic regulation of Heathrow Airport Limited opened on 23 June 2020, which noted responses received to an April 2020 Update and asked for views on HAL's Revised Business Plan (RBP) and other related issues. This response is structured to match the six bullet points at paragraph 24 of the consultation document.

Developing the H7 Programme

- 3 The Appeal Court ruling of February 2020 is that the ANSP would need to be revised to reflect the Paris climate change agreement and resubmitted. An appeal by HAL to the Supreme Court on this judgement is scheduled for October 2020. Then in March 2020 it became clear that most of the growth anticipated for 2020 would not occur because of the Covid-19 impact. The date by which traffic levels will return to 2019 levels remains uncertain but most estimates assume a two to three-year recovery time. This will inevitably delay the point as which a third runway will be needed to meet the forecast demand, but HAL have indicated that they intend to pursue a third runway plan.
- 4 Until more is known about the impact on travel patterns this Summer with 'airbridges' in place it is difficult to know the level and speed of recovery. For Summer 2021 it will depend on how prevalent Covid-19 is in each country and particularly the UK and of the confidence of passengers in any system of controls, cleaning and testing. However, if the plan to have a vaccine in use by early 2021 is realised there could be a stronger recovery as older passengers would have confidence to travel.
- 5 The use of scenarios and trigger points can be the only way forward with a mechanism agreed by

the CAA with HAL and the airlines to allow adjustment perhaps on a bi-annual basis without the need to review the outline capital plan or the RAB. The aim would be to ensure equity so that neither party gains unduly from rapid changes to the traffic pattern. This would also give the flexibility to put back in elements of work on R3 should that project re-start in H7.

- 6 The CAA proposal that the RAB should be based on the existing terminals and runways seems to be the best way to proceed. The planned expenditure would include refurbishment of the terminals and upgrades to existing infrastructure. Any expenditure related to the appeal could be agreed subject to the Constructive Engagement Process.

Constructive Engagement

- 7 This process has worked well in H6 and should be continued and enhanced by giving the airlines the ability to input to any changes of plan. Heathrow is a very constrained site for any kind of construction work (although rail access to a construction logistics centre is well established) and entry of goods and vehicles to airside needs tight security control. Also, the ground conditions despite early investigation cannot be completely known. This sometimes give rise to a delay and increased cost to the project and disruption to the airlines that eventually benefit from the project. It is recommended that a mechanism of an 'early delay warning' be given by HAL to the airlines and mitigation agreed jointly. Also, construction triggers should be part of the control mechanism and perhaps further consideration given as to how and delay that causes direct and identifiable cost to the airlines could be compensated.
- 8 The CAA should remain a part of the CE process to help resolve any issues that arise. The comparison with Gatwick does not equate the two quite different situations. At LGW the RAB is much smaller and the airline operating in mainly short-haul low cost and so the demand for infrastructure is less and the engagement process easier. At LHR long-haul is around 50% of the operation and requires greater terminal and gate space. Also, the alliances (oneworld has around 55% of the traffic the STAR Alliance is 11%) ask to be treated as a group as well as the individual airlines.

Capex Incentives, Governance and Cost of Capital

- 9 Cost benchmarking is as much an art as a science as there is never an absolute fit. The proposed approach to efficiency and the econometric model is too generalised and, while a type of trend approach over the 2022-2036 period would be appropriate, the focus is now on 2022-2026 which needs a bottom up approach. The proposed approach is rather like a DCF but where all the value is in the broadly unexplained terminal value. However, efficient airports in Europe can provide a good comparator on OPEX as labour and other input costs are similar. It is more complex with CAPEX as Heathrow is a unique site. However perhaps as part of CE HAL and the airlines could agree development parameters that would link design objectives to cost. The airlines sometimes complain of 'gold plating' by HAL but the airlines should state what their 'plain vanilla' design option would include or exclude. It is a matter of judgement how far down the low cost/low quality path any part of the UK's major hub airport and international entry point should go. Passengers expect

relatively low quality from airports where low cost carriers predominate but providing low quality within Heathrow may contaminate the brand (of both Heathrow and the UK). The comparison between the iconic Saarinen terminal at Washington Dulles with the low cost/low quality Z gates at the same airport illustrates the point, as do the long snaking queues and inadequate seats in the low cost boarding area in Copenhagen Kastrup. This may require consultancy input but that could be part of the CE process. Benchmarks of construction cost could include other recent projects at airports in the UK and high-end shopping malls as the framework rates should be similar.

Other matters: Arora Western Terminal Proposal

10 The consultation does not ask for views on this, but we comment as follows. The Arcadis tests are comprehensive as shown in their report but in addition to the documents being created by Arora it would be useful to have the following factors included:

- A clear process for stand allocation, which from the Arora plan is assumed to be a HAL function, would integrate with their terminal operations plan so that gates which were out of service or in active were known to the HAL stand allocators. Also, which entity would be responsible for stand cleaning and snow clearance?
- Heathrow now has a fully automated integrated baggage handling system operated by HAL for both connecting and originating baggage. How would the Arora construction and operating plan integrate with that system and how would cost sharing with HAL be agreed as part of the CE process?
- What would be the mechanism by which airlines or alliances could switch terminals bearing in mind alliances count for 70% of LHR passengers? Existing terminals are close to capacity being at flow levels of between 85% to 90% in peak hours so the flexibility to move is limited. JFK is the only airport with entirely airline-owned terminals and moves are very limited and usually occasioned by an airline going into administration.
- Would new entrants be automatically allocated to the Western terminal? This might happen before R3 if airspace changes and new automated cockpit landing systems enable ATM capacity to be increased. One new US entrant has applied for slots at LHR should they become available.

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