Written evidence submitted by Virgin Atlantic (AAS0041)

About Virgin Atlantic

Headquartered in London, Virgin Atlantic is a long haul, full service airline employing c.5,700 people. Operating a global passenger network from its London Heathrow and Manchester hubs, as well as seasonal flying from regional airports including London Gatwick. In 2019, Virgin Atlantic carried 5.9 million passengers to 25 destinations in North America, the Middle East, Africa, and Asia.

Introduction

The Global Travel Taskforce published its report in April 2021, setting a pathway for the reopening of international travel. We have been disappointed by the slow progress in reopening international travel, particularly compared to other major European markets such as France, Italy and Germany that reopened more quickly and with fewer restrictions than the UK, despite the UK's advanced vaccination programme. This led to a significant recovery in US-EU demand, with US-UK demand remaining flat throughout the summer until the introduction of the vaccinated passenger exemption from quarantine for US arrivals from 2 August.

The recent announcement of significant reductions in the 'red list' and a substantial increase in those countries whose vaccination status is recognised by the UK, builds upon the simplification of the 'traffic light' system and expected reopening of the US in early November. Together, this should enable a recovery of the UK's international aviation market. It is important however that the removal of all testing for fully vaccinated travels is achieved as quickly as possible, bringing us in-line with other major EU markets with which the UK competes for inbound travellers, particularly from the US. The Government should also ensure that where border measures are still required – such as proof of vaccination status – this is streamlined as much as possible, including working with international partners to agree global standards and solutions. In time, when it is safe to do so, we hope all requirements developed in response to the pandemic will be removed to ensure a return to seamless international travel.

However, as an airline based at London Heathrow, Virgin Atlantic is very concerned that the CAA may allow Heathrow Airport Limited (HAL) to increase average passenger charges by 88% compared to today (within a Maximum Allowable Yield increase of 94%), from January 2022. In the midst of the worst crisis ever to hit the travel industry, HAL is trying to recoup all of its pandemic losses while increasing its profitability, prioritising its private shareholders at the expense of airlines and consumers.

This would be a devasting blow to the strength of competition, global connectivity, and air cargo at the UK’s only hub airport, at a time when the industry is just beginning its recovery from the Covid-19 pandemic. Heathrow has already slipped to 13th busiest airport in Europe.

Both the UK's only hub airport and its flag carrier airlines, are at risk of becoming less attractive compared to EU competitors as a result of HAL’s proposals. Scrutinising both HAL’s request and the CAA’s role in determining the proposed increase in passenger charges to ensure they are proportionate, and fair for consumers is a critical priority if UK aviation is to recover fully from the pandemic and should fall within the scope of the Committee’s inquiry.

The Committee should also give consideration to the Government’s role in creating a cross- departmental strategy to protect and grow the UKs global trade and connectivity, through the development of a world leading aviation sector. This should include policies to support decarbonisation (including creation a UK market and supply chain for sustainable aviation fuels), the role of air cargo, business travel, and inbound tourism in supporting the UK economy, the role of airspace change and airport expansion to support UK aviation capacity and resilience, supporting further development of the aerospace skills and manufacturing supply chain (including emerging technologies such as EVTOL), and specific aviation policies to encourage growth and competition. This must go beyond the more limited previous iterations of the Department for Transport Aviation Strategy and be co-authored by the other government departments who are key stakeholders in the success of UK aviation.

The H7 regulatory period

Heathrow Airport is a heavily constrained airport, where there is more demand from airlines wishing to use the airport that can be met by its capacity. More than 99% of available slots are already used by airlines. As a result, CAA is tasked with regulating the charges Heathrow can levy, to prevent excessive fees being charged to passengers and airlines to use the airport.

Each time a passenger flies from Heathrow, they pay for the privilege. The 'passenger service charge' is normally passed through to customers as part of their air fare. Heathrow is already the most expensive airport in the world for passenger charges, costing 20pp more than Newark, New Jersey, the second most expensive. Flying from Paris CDG is 40pp cheaper, while Amsterdam Schiphol is 50pp less expensive[1].

The CAA is responsible for the economic regulation of Heathrow, including granting a licence that includes a Maximum Allowable Yield (MAY), a not to exceed threshold of revenue per passenger based on expected traffic volumes. Within the envelope of the MAY, Heathrow sets the per passenger charge and any other additional charges that passengers and airlines must pay to use the airport, such as aircraft movement, parking or cargo fees. The new license (H7), beginning 1 January 2022 is currently being consulted on with HAL and Airlines.

Heathrow Airport Ltd (HAL) the owners of the airport, have published a 'Revised Business Plan' that sets out its expected costs and returns for 2022 and the remainder of the H7 period, including proposals for increases in the per passenger charge, and overall level of charging (including additional charges paid by airlines).

The CAA will publish an initial assessment based of the Revised Business Plan – expected w/c 18 October – to be followed by a consultation, before confirming the final charging structure, likely in Q2 2022 (backdated to 1 January 2022).

HAL's proposals: increased passenger and airline charges

Despite forecasting over 24% fewer passengers per year than in 2019, HAL is planning to:

- Increase revenues by 71%
- Increase operating profits by 48%
- Increase Profit before Tax by 134%
- Increase dividend payments by 143%
- Increasing profitability per passenger by 312% on average through H7[2].

HAL plans to increase the MAY by 94% and as result average airport charges per passenger by 88% versus 2019, up from an average of £22 to £42[3]. HAL recently announced specific 2022 charges, where for the long-haul passenger service charge alone, Heathrow proposes a 77% increase - from £38.33 to £67.86 per customer, with a 24% increase for European flights[4].

Passenger service charge: 2021 vs proposed 2022

	2021 charges	**Proposed 2022 charges**	**% increase**
Domestic	£10.98	£12.26	**12%**
European	£15.98	£19.76	**24%**
Long haul	£38.33	£67.86	**77%**

HAL already added a 'pandemic tax' charge of £8.90 per passenger on all outbound flights in April to recover some of its 2020 and 2021 costs and is introducing a £5 per vehicle drop-off charge from November.

Increasing airport charges on top would add to the already painful cost of flying from Heathrow, the most expensive airport in the world, unfairly hitting the pockets of families, consumers and businesses just as they can return to the skies again.

The increase in passenger charges would also be coupled with additional charges for airlines to use Heathrow airport. Each time an aircraft lands, takes off or parks a cost is incurred for the 'movement'. The fee for a Boeing 787-900 departure – one of the most fuel efficient and quiet aircrafts in its class – would increase 49%[5].

Heathrow proposes to introduce a cargo levy on all cargo tonnage flown (£88.63 per tonne) from the airport, which will be a tax on trade. It will largely only be passenger aircraft that will be affected by this new charge and a clear attempt to salvage revenues, hitting the cargo sector which has kept global supply chains running and transported vital supplies during the pandemic. The levy is completely at odds with Heathrow's plans "to supercharge the Government's Global Britain ambitions and deliver a post-lockdown, post-Brexit economic stimulus."

The HAL proposal for a WACC (weighted average cost of capital) of 10.4% (which includes an unjustified risk premium) over-rewards HAL and its shareholders and delivers a return above market expectations at the expense of the consumer. Independent analysis from CEPA and Flint as well as using data from HSBC analyst coverage suggests an appropriate WACC range of 2.9%-4.6% for the regulated entity.

HAL's proposals: increased shareholder returns

Heathrow's shareholders[6] have reaped the benefits of the good years yet not invested equity during the pandemic. Just as UK airlines have raised significant funds from shareholders to weather the pandemic – including Virgin Atlantic's private-only £1.5 billion solvent recapitalisation - it's only right that Heathrow turns to its equity owners first, rather than expecting the CAA, industry and consumers to effectively compensate them for its losses.

Heathrow's shareholders have favoured raising additional debt rather than injecting new, permanent equity into the business - expecting the CAA, industry and consumers to effectively bail it out. Heathrow's shareholders enjoyed returns of over £3.8bn in this regulatory period (H6).

However, over the course of the H7 period HAL plan to increase their total profits by 134%, returning an additional £700m per annum to shareholders[7], with the majority of dividends being redistributed outside of the UK economy

- including the Qatar Investment Authority and China Investment Corporation. This is in addition to recent dividends; Heathrow has been hugely profitable on an operating basis, and even in 2020 at the height of the pandemic reported adjusted EBITDA of £270m and paid a dividend of £106m[8]. This followed dividends of £421m in 2019 and £483m in 2018[9] – an average of £400m pre-pandemic.

Heathrow cite £2.7bn of Covid-19 related losses to July 2021[10] yet until formal accounts are published in 2022 the losses attributed to Covid-19 remain opaque and may include self- inflicted losses including the third runway campaign and write-downs that may well reverse and create exceptional profits going forward.

Our recommendation

The basis of HAL's request for a near 90% increase in overall charges is an unjustifiably pessimistic passenger forecast. As the airport is seeking to generate the same revenue regardless of passenger numbers, a more pessimistic forecast results in a higher charge. However, if passenger demand returns sooner than forecast, HAL would still benefit from very high charges.

HAL is pessimistically forecasting a drop in demand of 36% in 2022, compared to IATA which forecasts only a 5% reduction, versus 2019. HAL claims that 2019 levels of demand won't return until beyond 2026[11], an average reduction of 24% in passenger volumes over the next five years (versus 2019). Virgin Atlantic and IATA expect Heathrow is more likely to return to 2019 levels in 2024[12], due to its resilience as evidenced in previous crises. While the pandemic has been unprecedented, history has shown that LHR went into growth within months of previous economic shocks, including the global financial crisis in 2008.

The passenger outlook remains extremely dynamic and it is premature to use these forecasts, which may prove inaccurate, to determine irreversible Heathrow charges that will be in place for the next five years. This lack of certainty over demand is one of the reasons the CAA chose to roll over the

2020 passenger charge levels into 2021.

The CAA should also recognise that the process for setting 2022 charges has been severely delayed and will not be resolved before 1 January. With this level of continued uncertainty, the best approach is to roll the 2021 charges to 2022 so that full and informed assessment can be done to reach a fair settlement.

October 2021

Endnotes

[1] Jacobs Review of Airport Charges (Nov 2020)
[2] This is based upon a Virgin Atlantic assessment of the Revised Business Plan
[3] H7 Revised Business Plan - Update 1 here. Note: takes into account the overall envelope of charges not just passenger service charge (including, for example, the cargo levy)
[4] Airport Charges for 2022 Consultation document p.34 here
[5] Airport Charges for 2022 Consultation document p.33 here - Chapter 14 Low charges peak landings and departures and H7 Revised Business Plan - Update 1 here.
[6] Heathrow Airport Holdings Limited is owned by FGP Topco Limited, a consortium owned and led by Spain's Ferrovial S.A. (25.00%), Qatar Investment Authority (20.00%), Caisse de dépôt et placement du Québec (CDPQ) (12.62%), Singapore's GIC (11.20%), Alinda Capital Partners of the United States (11.18%), China Investment Corporation (10.00%) and Universities Superannuation Scheme (USS) (10.00%).
[7] This is based upon Virgin Atlantic assessment of H7 Revised Business Plan.
[8] Heathrow financial results available here here
[9] Heathrow 2019 investor report and presentation available here
[10] Airport Charges for 2022 Consultation document p.9
[11] H7 Revised Business Plan - Update 1 here
[12] IATA Tourism Economics Air Passenger Forecast, July 2021