

## Heathrow Airport Limited

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Dear Colleague

### Heathrow Airport Limited - Airport Charges from 1 April 2013

#### Introduction

I would like to thank you for your participation in the 2013/14 Heathrow Airport Charges Consultation process. The 2013/14 Airport Charges Consultation process began on the 26<sup>th</sup> October 2012. Heathrow Airport Limited (HAL) held a formal consultation meeting on 29<sup>th</sup> November 2012 and also received fifteen formal written responses to its proposal. This letter announces HAL's decision, rationale for its decision and how airline community responses have been taken into account in making our final decision.

#### Decision

We have carefully considered all airline and airline representative body responses on our price proposals, which include all the comments expressed at the consultation meeting and written responses. HAL has come to a decision that it will recover the forecast maximum allowable yield of £21.664. The following sets out HAL's rationale.

#### Rationale for Decision

The economic outlook remains uncertain and HAL has faced a significant shortfall in passenger numbers throughout the Q5 regulatory period compared to the Regulator's assumed traffic volumes. This has resulted in significant shortfall in cash flow than the Regulator allowed, which funds the agreed £5 billion Q5 capital investment programme.

This capital programme is essential to deliver HAL's vision to become "Europe's hub of choice and UK's direct connection to the world by making every journey better". The capital programme is delivering significantly improved facilities, better experience for passengers and airlines, which are seen through passenger satisfaction scores.

In addition, HAL believes that the overall price elasticity for all passengers at Heathrow is such that recovering the maximum allowable yield generates the optimal total revenue for the airport as allowed under the Q5 decision.

The final 2013/14 airport charges tariffs for HAL is shown in **Annex A**.

## Heathrow Airport Responses to Airline questions

I would now like to respond to each of the main themes from the airline community responses to our price proposals and how HAL has considered these comments in coming to our final decision:

**(1) Airline Question:** The increase in yield is unacceptable, HAL must price below the cap as we are in one of the most difficult operating climates where all suppliers are holding or reducing prices.

**HAL Response:** HAL has carefully considered this request, but in light of HAL's £5 billion capital programme, HAL must continue to fund its agreed committed programme of spend. This capital programme is essential to deliver HAL's vision to become "Europe's hub of choice and UK's direct connection to the world by making every journey better". The capital spend is delivering significantly improved facilities for passengers and airlines. In addition, current market conditions have had a negative impact on HAL, as a result of shortfall in traffic volumes for Q5 resulting in a far lower return for HAL than allowed by the regulator.

This passenger volume shortfall is expected to continue for the remainder of Q5. HAL is anticipating a shortfall in the region of 33 million passengers against the Regulator's assumed traffic volumes by the end of Q5, which will result in a shortfall in aeronautical revenues of £646m.

**(2) Airline Question:** This level of price increase is making HAL less competitive to other hub airports and is now the most expensive airport, which is unsustainable and unaffordable.

**HAL Response:** HAL is aware of its relative position against other airports however the primary reason for the level of price increase is to fund the substantial capital programme, which has been agreed with the airline community. This capital spend is delivering significantly improved facilities for passengers and airlines, which will also help to attract new customers.

Current market conditions have had a negative impact on HAL, as a result of shortfall in traffic volumes for Q5 resulting in a far lower return for HAL than allowed by the Regulator. This passenger volume shortfall is expected to continue for the remainder of Q5. HAL is anticipating a shortfall in the region of 33 million passengers against the Regulator's assumed traffic volumes by the end of Q5, which creates the shortfall in aeronautical revenues of £646m.

In addition, HAL believes that its charges remain competitive and affordable relative to comparator airports. Moreover, HAL believes that airport charges should not be considered in isolation, but in the wider context such as the passenger mix at HAL and total airline ticket fares.

- (3) **Airline Question:** The proposed price increase will impact passenger demand in 2013/14.

**HAL Response:** HAL has considered the impact of pricing to cap on passenger demand in putting together its passenger traffic forecasts and retains its view that the price increase in 2013/14 will not materially impact overall total passenger demand. In addition, HAL believes that the overall price elasticity for all passengers at Heathrow is such that recovering the maximum allowable yield generates the optimal total revenue for the airport as allowed under the Q5 decision.

- (4) **Airline Question:** The proposed price increase disregards the interests of passengers and airlines, and HAL is obliged to reduce its costs and become more efficient.

**HAL Response:** The Q5 capital programme is transforming the airport by improving facilities and services provided to passengers and airlines. The benefits of the capital programme can be seen through the significantly improved passenger satisfaction scores, which highlights the value this spend is providing. We strongly believe this capital spend is acting in the interests of passengers and airline customers. However, in many cases, this capital expenditure also results in additional fixed operating costs such as rates, utilities and maintenance.

The airline community has been actively involved in the Q6 constructive engagement process in particular in the “Opex, Opex Efficiency & NRC Q6 Working Group”. Through this working group a number of detailed discussions have taken place where HAL has highlighted both the initiatives that it has implemented in Q5 and those that are planned for Q6 to reduce its costs and improve its efficiency. For example, passenger security process change and automation, fixed post automation, outsourcing of IT services, management organisational change programmes and procurement/contract savings. HAL has reduced its underlying cost base and will continue to target savings at every opportunity whilst maintaining high standards of service.

- (5) **Airline Question:** HAL must not include the £80m opex that was disallowed by the Regulator in its price proposal.

**HAL Response:** The £80m of disallowed operating costs are not included in the 2013/14 airport charges. The context of the £80m is to help explain HAL’s actual opex performance by adjusting the Regulatory settlement to include disallowed items to ensure a comparable set of data is used.

HAL’s price decision to recover the maximum allowable yield is set according to the Regulator’s Q5 formula to set the maximum allowable yield, namely RPI+7.5%, which was explained in detail at the consultation meeting. The maximum allowable yield does not include any additional opex over and above the Regulatory settlement allowance.

**(6) Airline Question:** The proposed price increase is being used to maximise revenues for HAL and acting in its shareholders interests.

**HAL Response:** HAL is continuing to fund its agreed committed capital programme, the cost of which is allowed to be recovered through the aeronautical charges by pricing up to the maximum allowable yield. However current market conditions have had a negative impact on HAL by a shortfall in traffic volumes for Q5, resulting in lower cash flow to fund the capital programme and a far lower return for HAL than allowed by the Regulator.

**(7) Airline Question:** HAL should not make its pricing decisions based on a single two hour meeting. An opportunity exists to have more multilateral dialogue throughout the year.

**HAL Response:** HAL commenced a three month period consultation which started on 26<sup>th</sup> October 2012 with a consultation meeting on the 29<sup>th</sup> November 2012. HAL also offered to hold bilateral meetings with any interested parties to discuss the price proposals and a number of these have taken place. HAL appreciates the desire for more multilateral dialogue on aeronautical charges and we will discuss this with you further to gain a fuller understanding of the proposed objectives and aims of such dialogue.

**(8) Airline Question:** HAL must conduct a review of its structure of charges.

**HAL Response:** Airline responses to the consultation had differing views on how the structure of charges should be changed. As you are aware through the 2010 structural review this is a lengthy and detailed process that requires careful consideration. We understand the desire from airlines for HAL to review its future structure of charges and we will consider this request.

The responses include two actions for HAL to consider: (1) understand further the request for greater multilateral dialogue and (2) again review of structure of airport charges. We will examine these requests in more detail and Chris Butler (Airline Business Development Director) will coordinate this and engage with airlines in due course.

Finally, I would like to thank you again for your participation in this consultation process and I value your feedback throughout this process. Heathrow recognises its increase in charges will not be welcome but remains committed to working with the airline community and all other airport stakeholders to make Heathrow "Europe's hub of choice and UK's direct connection to the world by making every journey better".

Yours sincerely



Fidel Lopez  
**Commercial Director**

## Annex A

	<b>2013/14 £ GBP</b>
<b>Charges on Landing</b>	
Peak	
Chapter 2	7,817.88
Chapter 3 high	7,817.88
Chapter 3 base	2,605.96
Chapter 4 high	1,563.58
Chapter 4 base (equivalent)	1,302.98
Chapter 4 minus	781.79
Super Night Peak	
Chapter 2	19,544.70
Chapter 3 high	19,544.70
Chapter 3 base	6,514.90
Chapter 4 high	3,908.95
Chapter 4 base (equivalent)	3,257.45
Chapter 4 minus	1,954.48
Emissions charge (per kg)	7.76
ANS charge	
per ATM	78.58
Per Metric tonne	1.06
<b>Charge on departing passengers</b>	
Europe - Destination	28.30
Other - Destination	39.75
Europe - Transfer	21.23
Other - Transfer	29.82
Europe - Transit	21.23
Other - Transit	29.82
Remote Stand Rebate (All paxs)	-5.15
Minimum charge	1,263.00
<b>Charges on aircraft parking</b>	
Narrow bodied	22.68
Wide bodied	54.45