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British Airway's ("BA") Response to CAP2488
Economic regulation of Heathrow Airport ("Heathrow") : setting an interim price cap for 2023

Thank you for the opportunity to respond to your latest consultation on the Economic Regulation of Heathrow; we set out below our views on the Civil Aviation Authority's ("CAA") proposals and implications for the wider policy environment.

We recognise and support the need to set an interim price cap for 2023 as the alternative of Heathrow Airport Limited ("HAL") being free to set its charges at a level of its choosing would be an unacceptable outcome for consumers. However, it is BA's strongly held position that **the 2023 interim price cap as proposed by the CAA remains too high.**

We have several significant concerns about how the CAA has elected to implement the interim price cap, which will result in a number of significant consequences for consumers, our business and the overall credibility of the H7 process.

The CAA will not be in a position to reasonably consider our response

- We are concerned that the CAA will not have an opportunity to give due consideration to the submissions it receives given the ambitious timeline for review and implementation set out in CAP2488. This accelerated timeline is further hindered by the CAA setting a deadline that means responses will be received right before the Christmas holiday period and the requirement to provide a 6 week notice period to Heathrow of any impending license change. It therefore appears that this consultation is merely an exercise in process rather than a credible opportunity for BA and other interested parties to voice their concerns on behalf of consumers.

The CAA has elected to ignore available evidence when setting the interim price cap

- BA has provided the CAA with material and significant evidence in several forms, including but not limited to our responses to CAP2265 – Economic Regulation of Heathrow Airport: H7 Initial Proposals and CAP2365 Economic regulation of



Heathrow Airport Limited: H7 Final Proposals. We do not intend to repeat those arguments in this submission and refer the CAA to our previous consultation submission to be read in conjunction with this response.

- We have further shared at regular intervals since the publication of the CAA's Final Proposals detailed future booking data, market prognosis and assessment data and other relevant evidence with the CAA, none of which has been incorporated by the CAA into the interim price cap proposal.
- We would argue that it is not appropriate for the CAA to determine an interim price cap for 2023 that is not built on a foundation of the most relevant and up to date evidence. In fact, the CAA itself agrees with this position and section 2.6 of the consultation document acknowledges that, "[the CAA is] taking more time to assess the latest information on passenger numbers and changes in macroeconomic factors such as inflation and interest rates". Given that conclusion, it is an extraordinary decision to set the 2023 interim price cap at a level that does not consider the latest available and known information.
- More broadly, we are concerned that the CAA has not taken the opportunity to update core building block assumptions in its interim price cap proposal despite the clear and overwhelming factual evidence available.
- Significantly, the CAA's failure to incorporate the best available evidence and data into its interim price cap proposal for 2023 results in a charge being set that is too high. The consequence of this decision is that consumers, again, are being forced to overpay for services provided by Heathrow and further take on the burden of financing Heathrow's business in the short term.
- The CAA has elected to use its H7 Final Proposals as the basis for the proposed interim price cap for 2023. While we understand the rationale for such a decision, the CAA itself has noted in its Final Proposals publication that there were a number of issues with the evidence upon which its Final Proposals were based. It is therefore even more surprising and concerning to us that the CAA did not take this opportunity to incorporate the best available evidence into the interim price cap proposal.
- We believe that this is an unacceptable outcome for consumers and contrary to the CAA's primary duty. It is neither fair nor reasonable that consumers should pay a knowingly higher price for access to Heathrow because the regulator has elected not to update and incorporate the best available evidence that it has in hand.
- The interim price cap for 2023 being set too high is exacerbating a conflict that the CAA itself has already identified in its consultation document: as a direct result of CAA's proposal, the 2023 customers will overpay relative to later customers. The CAA is purposefully conflicting itself by proposing a situation where the 2023 consumer will (through the unnecessarily high 2023 interim price cap) fund future consumers' use of infrastructure at Heathrow Airport. The direct cause of this



outcome is the CAA's failure to reference the best evidence, and as such conflicts with the CAA's duty to protect consumers' interests.

- We reserve all of our rights to further assess and appeal the 2023 interim price cap decision on the grounds of this clear failure to consider relevant information known to the CAA at the time of publication and the CAA's decision to act contrary to its primary duty.
- We support the CAA's decision to not consider HAL's request to set the 2023 interim price cap at £36.00. Such a request is not supported by facts or based on the latest evidence available, and the CAA is correct to acknowledge the flawed arguments raised by HAL. HAL's proposed figure demonstrates Heathrow's prioritisation of the interest of its shareholders over the interests of its consumers.

The CAA continues to underestimate demand for 2023 and beyond

- The 2023 interim price cap is based upon passenger forecasts that remain generally too low for the H7 period and are specifically contrary to the latest forecasts for 2023.
- We consider that the CAA remains too reliant on unnecessarily conservative passenger forecasts, has ignored the significant recovery of the industry in 2022, has failed to consider new information available to the CAA since Final Proposals and is unduly influenced by Heathrow's flawed forecasting model.
- We reiterate the points we have previously made about our inability to assess or consider the assumptions and conclusions drawn from the Heathrow forecasting model. HAL has rejected BA and other airlines' reasonable requests (on numerous occasions) to access its model, referring to unevidenced and groundless arguments regarding commercial sensitivity. BA's concerns about access to the modelling have been raised directly with the CAA on a number of occasions, yet our concerns have not been adequately addressed. For example, these concerns were raised to the CAA and HAL in:
 - **A letter from BA to HAL 2022 rate consultation dated 1 October 2021: [9.4]** "Lastly, as we have not been provided access to Heathrow's passenger forecasting models as part of this consultation process, we have been unable to provide a detailed response on the assumptions contained therein."
 - **BA's Response to the Initial Proposal dated 17 December 2021:** The information asymmetry is addressed throughout the response, especially at paragraphs [4.6] – [14.11]
 - **BA's Response to the Final Proposal dated 9 August 2022:** The information asymmetry is addressed throughout the response, especially at paragraphs [14.11] – [14.13]
 - **A letter from the airlines to the CAA dated 12 October 2022:** "It is clearly in the interests of all parties to resolve any procedural disputes prior to the CAA



issuing its Final Decision. The CAA will appreciate that in the circumstances all of the airlines' rights are reserved."

- BA, like all other airlines affected by the 2023 interim price cap, remains at a procedural disadvantage as a result of not having access to Heathrow's modelling. The procedure is unfair when the CAA's has extensively relied on a model which is inaccessible and cannot be commented upon by British Airways or other interested parties. This procedural unfairness is extremely concerning. This is because the credibility of the modelling prepared is undercut by:
 - (i) HAL's financial interests in the outcome;
 - (ii) the lack of involvement of the airlines who have unique perspectives and insights that could better develop the price cap (e.g. real world passenger forecast data); and
 - (iii) the availability of third-party data which has not been considered.
- HAL itself has updated its 2023 passenger forecast to 67.3 million, which exceeds the level upon which the 2023 interim price cap has been proposed. This is a non-sensical outcome given Heathrow's demonstrated and proven track record of underestimating passenger volumes.
- In the last six months of 2022, the evidence is clear that passenger numbers have recovered to just under 90% of 2019 volumes and we see no reason for that trend not to continue, and indeed improve, in 2023. Therefore, we believe that the CAA is significantly under estimating passenger demand in its forecasts for 2023 upon which the 2023 interim price cap has been established.
- Our forward-looking booking data, as provided by British Airways to CAA, supports this conclusion and we would refer CAA to this evidence as submitted.
- BA repeats its position from previous submissions that it has third party data that is in greater alignment with the airlines' forecasts than HAL's forecasts.
- We would also point out that Heathrow's inaccurate and conservative passenger forecasts, as reinforced by the CAA's refusal to incorporate the latest evidence on forward looking demand, will undoubtedly result in a repeat of the appalling experience consumers faced in Summer 2022 that was caused by inadequate resource planning by Heathrow. Heathrow uses these forecasts as the basis for its operational planning and consciously allowing Heathrow to not prepare for the actual passenger demand in 2023 is not in the best interest of consumers.
- For the reasons outlined above, BA once again asks the CAA to require Heathrow to provide immediate and unrestricted access to its models. We reserve our rights to appeal the 2023 interim price cap on the grounds of a failure to properly consult on the Heathrow forecasting model.



The CAA has failed to reflect the current macro-economic environment in its 2023 interim price cap proposal

- Further, the CAA has elected to not revise and incorporate the most current assumptions reflecting the materially changed **macro-economic** conditions since publication of its Final Proposals.
- The cost of capital remains inflated by an asset beta that fails to recognise the significant transfer of risk identified above and over-estimates its starting point in the market
- We remain concerned with the CAA's approach in a number of specific areas, including:
 - a) The inclusion of an uplift for relative risk changes, which is not supported by evidence and is inconsistent with other assumptions
 - b) The use of an enduring pandemic effect that is contrary to the evidence and upwardly biased as a result of the estimation methodology, which differs from regulatory precedent
 - c) An adjustment for the TRS mechanism that could reasonably be greater given the comparison to the risk profile at other utilities
 - d) The use of a 31st March cut-off that excludes significant new information on inflation
 - e) The application of a halo effect that is not supported by the evidence and undermines other incentive properties.

The 2023 interim price cap must be replaced by the Final Decisions once published

- While we recognise the need for an interim price cap in 2023, the CAA's decision will exacerbate the trend of Heathrow meaningfully over collecting revenues in the period 2020-2022 as a direct result of delays to the H7 process. This is exacerbated by the CAA's unwillingness to require Heathrow to return the over collected revenues.
- The CAA has proposed that the interim price cap be in place for the entirety of 2023, but gives no proper basis in support of that proposal. We believe that this is a flawed decision as the interim price cap will be replaced and superseded by the CAA's H7 Final Decision in early 2023.
- We can assume that the Final Decision will incorporate the CAA's most complete and up-to-date consideration of all factors, so it is absurd that implementation of this determination should be delayed for so long while an outdated calculation is enforced. In light of this we reasonably conclude that the 2023 price as set in H7 Final Decisions will be lower than as proposed in the 2023 interim price cap once CAA incorporates all available evidence - and therefore it would be non-sensical for consumers to face



the unnecessary burden of higher charges for the entirety of 2023 when the CAA will have likely decided on a lower charge in H7 Final Decisions.

- The effect of a decision to retain the interim holding cap for the whole of 2023 is that Heathrow could charge a figure different to the Final Decision for the duration of 2023 regardless of the fact that the Decision will be published early in 2023.
- As such, the CAA must ensure that the 2023 interim price cap is withdrawn in an expedited manner upon publication of its H7 Final Decision, issue a revised license condition reflective of such H7 Final Decision, and require Heathrow to immediately adjust its charges to reflect such decision.
- We further reserve our right to appeal for the prompt implementation of the Final Determination if, as expected, the Final Determination produces a lower cap than the proposed 2023 holding cap.

K Factor Adjustment must be used for any new or outstanding reconciliations

- Any currently identified, or to be identified in the future, true ups or reconciliations outstanding from the Q6 settlement or caused by the delay to implement a final H7 settlement – and specifically by the imposition of an interim price cap – must be solved through the pre-existing and precedential K Factor Adjustment methodology as set forth in both the Q6 settlement and CAA's Final Proposals for H7.
- Given that the Q6 and proposed H7 settlements provide a technical framework to deal with true ups or reconciliations, we believe that there is no reason that this technical structure should not be followed in the future.

Concluding comments

While we support the need for an interim price cap for 2023, we do not believe that the CAA has acted rationally in its proposals as set forth in CAP2499 and in doing so is failing in its primary duty to act in the interest of consumers.



The CAA must consider, and implement, the suggestions we have outlined in this response to ensure fair treatment of consumers in 2023.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Gavin Molloy".

Gavin Molloy
Director of Aviation Infrastructure
British Airways