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Sent Via E-Mail
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RE: Airline Community Response to CAP2265 – Initial Proposals for H7

Dear Paul:

Thank you for the opportunity to respond to the CAA's Initial Proposals covering the H7 regulatory price control period from 2022 – 2026.

As the 3rd largest airline operating at Heathrow (LHR), paying HAL around £80m a year pre-COVID, American is greatly impacted by the max yield that HAL can collect. Despite the challenges presented by COVID and government-imposed travel restrictions, American has supported consumers by operating multiple flights every single day during the pandemic. We have had the most passenger and cargo traffic of any US airline during COVID and plan to increase our presence further with announced new service to BOS and SEA beginning in Summer IATA 2022.

Firstly, American supports the attached letter submitted on the Airline Community's behalf by IATA and the AOC. In summary, the CAA consultation indicating a range of £24.50 – £34.40 shows too much deference to HAL's wildly inflated max yield proposal of £37.64. Reasonable adjustments to correct errors in the Initial Proposals inputs suggest an H7 period max yield between £11.30 – £14.72, far below the CAA's range and even significantly lower than today's levels. We would note our particular focus on the following points in the Airline response:

1. *Overall level of charges is too high*: £24.50 – £34.40 per passenger represents between a 25 – 75% increase in charges vs today, which is an unacceptably steep increase at what is already one of the most expensive airports in the world. Other airports in Europe are keeping rates flat or only showing a slight increase; the increase proposed by the CAA would put LHR further out of step with other comparable hub airports and disadvantage LHR as a viable connecting airport. The max yield the CAA is proposing for HAL does not appear to be in the interest of consumers.
2. *Commercial revenue / Operating expense inputs need to be updated:* The CAA has employed independent advisors CEPA and Taylor Airey to project reasonable Commercial revenue and Operating expense inputs, but rather than use their analysis, the

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CAA is taking a midpoint between this independent analysis and HAL's forecasts. Recent real-world evidence, even from HAL themselves, shows commercial revenue stabilizing back around the 2019 revenue per passenger numbers. We would urge the CAA to trust your own advisors and use the robust analysis they have produced rather than give equal credence to the overly pessimistic numbers HAL use in their business case.

3. *Passenger forecast is outdated*: The proposal for a £24.50 – £34.40 max yield is based on passenger forecasts from April 2021 that reflect a very gloomy near-term view of travel. Much has changed since then, including significant vaccine uptake and the relaxation of government travel restrictions around the world. More recent forecasts indicate passengers returning to 2019 volumes as soon as 2023, and the industry consensus is that traffic will be over 50m passengers higher across the H7 period than the CAA's estimate. For American Airlines specifically, our published OAG seat count for beginning with the Summer 2022 IATA season is ~12% higher than 2019. We are expecting summer 2022 demand to match (if not exceed) summer 2019; despite recent Omicron news, bookings are stable through the summer. We believe it is appropriate for the CAA to substantially increase the H7 passenger forecast in light of the positive travel policy updates and general trend since April 2021 of greater consumer ability to travel.
4. *Cost of Capital is too high / Traffic Risk sharing (TRS) is flawed*: Work undertaken by CEPA on behalf of the airline community shows that the CAA's WACC proposal substantially over-estimates HAL's cost of capital. A cost of capital that is higher than necessary simply safe-guards HAL and their shareholders at the expense of consumers. The vanilla range presented in the CEPA analysis is just 1.3% - 2.8%, much lower than the CAA's range that goes up to 5.7%. Related, the proposed TRS mechanism substantially shifts the balance of risk away from HAL and towards consumers. The downside protection for HAL extends all the way to zero under this proposal, however there is no corresponding reduction in the Cost of Capital. This means that HAL shareholders can continue to reap a return as if there is risk, whereas the actual risk they bear is nil. The goals behind TRS are understandable, however the proposed implementation is very flawed. Further, we do not agree to any continuation of TRS beyond the H7 price period.
5. *Capital Plan proposal is broadly in line with Airline expectations:* While we continue to seek more details from HAL on the elements within the plan, the CAA's mid-point of £2.4bn is very close to our suggested cap of £2.2bn. We would continue to emphasize that we should only focus on projects that are absolutely necessary in H7, and we are supportive of the ex-ante proposal methodology for reconciling costs and benefits.
6. *RAB adjustment*: We remain opposed to the CAA's decision granting even modest RAB adjustment relief. The evidence supports the position that no relief is warranted.

Based on the points presented above, a significant reduction in charges vs the CAP2265 max yield range guidance is warranted in order to protect consumers from being overcharged and to protect LHR from becoming more uncompetitive vs other Europe hub airports. The CAA

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proposal would result in consumers overpaying by roughly £4bn over the H7 period. Instead, we urge the CAA to apply the findings from your own advisers for the Commercial revenue and Operating expense inputs and layer those over updated passenger forecasts for the H7 period – this will result in a much more reasonable max yield that is less than half of the Initial Proposals range. This is the right answer to protect consumers and is the right answer based on the evidence.

We appreciate your attention to the points we and the rest of the Airline Community raise and look forward to your response.

Respectfully,

Walter Weems
Senior Manager, Airport Affairs & Properties

cc: Robert Wirick – Managing Director, International Government Affairs
Rhett Workman – Managing Director, Europe & Asia Operations
Amanda Zhang – Managing Director, Airport Affairs & Properties
Philippe Serafino – Director of Operations, LHR Airport

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