

Mr Paul Smith
Group Director of Consumers and Markets
Civil Aviation Authority
45-59 Kingsway
London
WC2B 6TE
Sent by email: economicregulation@caa.co.uk

Star Alliance Services GmbH
Frankfurt Airport Center, Main Lobby
60546 Frankfurt am Main
Germany
Tel +49 (0)69 96375 0
Fax +49 (0)69 96375 500

Christian Draeger
VP Customer Experience & Loyalty
T: +49 151 55013 080
E: christian.draeger@staralliance.com

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Dear Paul,

CAP2265: H7 Initial Proposals

Thank you for the invitation to respond to the above consultation. Please find below Star Alliance's response. This is written on behalf of Star Alliance Services GmbH and its 23 member airlines operating to LHR.

We have worked closely with other airlines through the LACC and AOC forums and have given significant input to the detailed community response and its incorporated evidential analysis which is being submitted. Rather than repeat those details here, we hereby state our full support for this submission and simply highlight below some key points which are of most importance.

Price cap range

The range of price cap proposed is extraordinarily high, far above what airlines and their passengers should reasonably expect and must be reduced. Even at its lowest point, the price cap would enable HAL to raise its prices by 25% versus the current level. The top end of the proposed range would see the per passenger yield increase by 75%. This is unprecedented and incredible. A commercial, non-regulated business could not possibly expect to increase revenues by this amount, especially in a climate of its industry being decimated by the impact of COVID-19. On top of this, LHR is already the most expensive hub airport in the world. Benefitting from the combined global reach of our member airlines, we can see that no other airport (despite being **already** cheaper than LHR) is being reported as raising its charges by this proportion.

The airline community has spent considerable time in developing an alternative business plan, which demonstrates how the aeronautical charges could in fact be reduced slightly from today's levels. It reasonably and objectively uses information from HAL and from independent advisors to put together an achievable proposition that could be followed and still deliver an appropriate service to consumers. This plan has been sent previously to the CAA.

In reviewing the building blocks and calculations which have resulted in such a high price cap range, we have concluded that there are several key flaws in the Initial Proposals which have led to this. These are summarised below.

Passenger forecast

The passenger forecast used in the Initial Proposals is outdated and therefore unduly pessimistic. It is essential that this forecast is re-visited in developing the H7 Final Proposals. Much work has been done by the base carriers and IATA to objectively assess the passenger forecast. Feedback from a selection of our member airlines aligns with this assessment; that a realistic forecast for H7 shows higher volumes driven by a quicker recovery than the CAA's and HAL's forecasts predict. This overarching message is reinforced by Skylark's recommendations in this area to the CAA.

We therefore firmly concur with the CAA's suggestion in CAP2265B that the forecast should be updated to inform the Final Proposals "if there is significant change in the expected path of the recovery". Given our concerns with the forecast itself and the dynamic nature of the industry and market at this time, this update must be undertaken.

Finally, we note with incredulity that the regulator's work in this area relies on the regulated entity's forecasting model. Clearly, an independently constructed model would be far more appropriate.

OPEX and Commercial Revenues

The Initial Proposals do not fully take account of the results of independent analysis on the above aspects, carried out by the CAA's advisors, CEPA/Taylor Airey. The Airline Community welcome and agree with CEPA/TA's recommendations; they are sensible and logically presented with supporting evidence, developed by independent entities. Having also received similar conclusions from PA Consulting (referenced in the full LACC/AOC response), it is difficult to understand why the Initial Proposals set levels of OPEX and Commercial Revenues that take a mid-point between the CEPA/TA analysis and HAL's overly pessimistic projections. We urge the CAA to review this work in its Final Proposals and re-assess these building blocks accordingly.

WACC

Setting the level of WACC is a very technical subject and as such, Star Alliance relies on independent expert analysis. The report in this regard by CEPA is referenced in detail and attached to the LACC/AOC response.

Aligned closely with airline community experts in this area, the CEPA report concludes that the WACC range proposed in the Initial Proposals is very high. In simple terms, this unreasonably high WACC rewards HAL's shareholders to the detriment of consumers. The CEPA report sets out that rather than being an extremely low contradiction of HAL's WACC analysis, it can be evidentially demonstrated that CEPA's proposed WACC is more

appropriate than the CAA proposals. We urge the CAA to side with the consumer and determine a more equitable WACC.

There are two further aspects of the initial Proposals to which we offer a response here.

Capital Plan

The headline number of the airline-suggested capital plan is broadly similar to that proposed by the CAA (£2.2b vs £2.4b) and therefore, we concur with this at a high level. There is much detail still to work through with HAL, but there is no way we can support its proposal to spend >£4b. This would be unreasonably high even in circumstances of a full-to-capacity airport. Compared with previous quinquennia, this level of spend actually seems impractical to achieve, particularly in the absence of large-scale infrastructure projects.

An element of the capital plan which is of particular importance to Star Alliance airlines is the programme to maintain resilience of the ageing T1 baggage system and progress with the development of Future T2 Baggage. While the 'mid-point' plan included in the Initial Proposals recognises the former, it omits the latter (shown as £35m in both the HAL and airline capital plans). At the time of compilation of the airline plan, previous work showed that to avoid a huge incremental spend on the Future T2 programme in H8, it was essential to undertake a significant proportion of the survey and design work for the new system in H7, such that the construction programme could begin very early in H8 (hence the £35m project). There is currently an evolving discussion on this matter, with HAL recently informing the community that earlier work is needed to avoid serious failures of the T1/T2 baggage product in the latter half of H7. We understand that the forthcoming update to HAL's business plan will show the required additional capital spend on this programme to mitigate this risk and we look forward to working further with HAL to understand the details of its proposals.

Star Alliance airlines are operating today with a baggage system that is dangerously ageing and unfit for purpose. Even at the time of writing this response, our members are this week again seeing their passengers negatively impacted by baggage system failures. The Future T2 Baggage system is a significant programme, both in cost and duration. Given the highlighted risks to the T1 system, we urge the CAA to reflect inclusion of this key programme within its Final Proposals, mindful of alignment with affordability based on actual passenger growth during the period.

Outcome-Based Regulation

We intend to submit a full response to Chapter 14 of the Initial Proposals as part of a wider response to the OBR Working Paper (CAP2274). For now, we will simply comment that we are disappointed at the recommendations as they currently stand. Reasonable airline input seems to have been ignored in favour of HAL's proposals.

In conclusion, we look forward to the Final Proposals, which we hope will set out an approach taking account of the points made here and others as detailed in the LACC/AOC response to this consultation.



Yours sincerely

A handwritten signature in black ink, appearing to be 'S. Scoggins', written over a horizontal line. The signature is stylized with a large loop on the left and a sharp downward stroke on the right.

cc: Simon Scoggins, Consultant to Star Alliance Services GmbH, Heathrow Programme Director

cc: Star Alliance member airlines, LHR