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## **Vueling response to CAA H8 Initial Proposals at Heathrow airport (CAP3232)**

Vueling welcomes the opportunity to respond to the Civil Aviation Authority's ("CAA") Initial Proposals for the H8 price control for Heathrow Airport Limited ("HAL"), covering the period 2027-2031.

Vueling supports the responses submitted by Aer Lingus, British Airways and Iberia, and by our parent company, International Airlines Group ("IAG"). This submission complements those responses by setting out Vueling's perspective as a low-fare airline serving short-haul, point-to point routes, for which airport charges are a critical determinant of route viability, frequency and affordability.

This response should be read alongside submissions made by other airlines, including British Airways and by our parent company, IAG, which Vueling fully supports. This submission focuses on the implications of the Initial Proposals for consumers, affordability, competition and the appropriate allocation of risk.

### **Overall position**

Vueling recognises and supports the CAA's objective of strengthening the regulatory framework relative to previous price controls, including more structured analytical approaches to operating costs, capital expenditure and commercial revenues. However, Vueling is concerned that the overall H8 package remains insufficiently challenging and risks locking in outcomes that are not aligned with consumer interests. The combined effect of materially higher airport charges, conservative traffic and commercial revenue assumptions, and an overstated allowed return, would place disproportionate pressure on short-haul and price-sensitive services, reducing connectivity and ultimately increasing fares for passengers.

In Vueling's view, the Initial Proposals do not yet represent a balanced "fair bet" settlement.



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Jordi Pla Pintre  
Chief Network Planning and Strategy Officer

## 1. Charges and connectivity

The CAA presents the H8 Initial Proposals as implying only a modest increase in charges relative to H7. Vueling believes that this comparison is misleading.

The average H7 price cap is inflated by years of depressed traffic during the post-pandemic recovery. A more appropriate comparison would be with later H7 years, when demand had substantially recovered. On a like-for-like basis, the H8 proposals imply a material real-terms increase in charges of around 7%, not the marginal uplift cited by the CAA.

For Vueling, higher Heathrow charges directly affect route economics. Short-haul services operate on thin margins and have limited ability to absorb cost increases without adjusting capacity or fares. Sustained increases in airport charges therefore risk:

- reducing frequency on marginal routes,
- weakening competition on short-haul markets, and
- undermining Heathrow's role as a competitive hub for price-sensitive passengers.

These effects ultimately reduce choice and increase costs for consumers.

## 2. Customer outcomes and service incentives

Vueling supports the CAA's objective of strengthening service quality and improving outcomes for passengers. However, Vueling shares concerns expressed by the airline community that the proposed incentive framework remains imbalanced.

Despite theoretical exposure to rebates being significantly higher than bonuses, HAL has earned around 50% more in bonuses than it has paid in rebates over 2023-2025, even as service issues have persisted. This outcome shows that there's any imbalance in the framework, and consumers are essentially paying extra for service quality at Heathrow despite the airport failing to recover to pre-covid standards of quality of service.

For passengers, service failures such as baggage system outages have a disproportionate impact on overall journey experience. Vueling therefore considers that rebates should be strengthened and more tightly linked to material service failures and resilience issues; and bonuses (which Vueling opposes), if retained at all, should be limited to genuinely exceptional performance.

A framework that rewards average performance while failing to penalise disruption risks normalising poor outcomes rather than preventing them.

## 3. Traffic Forecast

Vueling welcomes the CAA's decision to commission an independent traffic forecast and agrees that robust forecasting is central to setting efficient charges. However, experience from previous price controls shows

a pattern of systematic under-forecasting, which in a capacity-constrained airport inflates allowed charges without exposing the airport to commensurate risk.

Skylark's independent analysis commissioned by the airline community indicates that key assumptions in the CAA's forecast remain conservative. Adjustments relating to aircraft size, seat factors and recovery assumptions suggest that total H8 passengers could be around 447.6 million, compared to the CAA base case of 442.0 million; and 2031 passenger volumes could be around 92.2 million, compared to 90.2 million in the CAA's base case.

Vueling is particularly concerned about the continued use of the shock factor, which widens historical under-forecasting and overlaps with the Traffic Risk Sharing (TRS) mechanism. Vueling therefore supports removal of the shock factor for H8 or, at a minimum, significant recalibration to avoid systematic bias against consumers.

#### **Vueling proposal on traffic forecast**

*Based on Skylark's independent analysis commissioned by the airline community, Vueling proposes that the H8 traffic forecast be set at 447.6 million passengers, compared to the CAA's base case estimate of 442.0 million.*

#### **4. Operating expenditure**

Vueling welcomes the CAA's methodological improvements in its H8 Initial Proposals for operating expenditure, particularly the adoption of a clearer base-step-trend framework and a more disciplined assessment of overlays through need, additionality and efficiency tests. Vueling supports the rejection of poorly evidenced cost additions, which represents an important improvement relative to earlier price controls.

However, Vueling remains concerned that the overall opex allowance is insufficiently challenging, with the cumulative effect that allowed costs risk being materially above efficient levels. As opex feeds directly into airport charges, this has a disproportionate impact on short-haul and price-sensitive services, making robust cost discipline essential to protect consumers.

A key constraint on effective scrutiny has been the quality and transparency of HAL's information. Where data gaps persist, assumptions have tended to be resolved conservatively, increasing the risk that inefficiencies are funded by users. Vueling considers that where evidence is incomplete, the burden should rest with HAL to demonstrate efficiency, rather than higher allowances being granted by default.

Vueling supports the CAA's position that the baseline year cannot be assumed to be efficient. Heathrow's performance in benchmarking exercises remains weak, with the CAA's own analysis placing Heathrow close to the bottom of the comparator set (39<sup>th</sup> out of 43 airports in 2019 and 40<sup>th</sup> out of 43 in 2022). Despite this, the Initial Proposals apply only a 4% catch-up adjustment. Vueling shares the airline community's concern that this adjustment understates the true efficiency gap, particularly as it is expressed in log terms, which materially compresses the implied gap when translated back into cost levels. Vueling considers that

benchmarking should be updated using the latest data and presented transparently in cost levels in Final Proposals.

Within individual cost categories, Vueling considers security opex to be a priority area for stronger challenge. Analysis based on HAL's own Security Programme indicates a material disconnect between the efficiencies implied by the programme and those reflected in the Initial Proposals, quantified by the airline community as a minimum of £114.7 million over H8. There is also concern that transitional CT implementation costs may be embedded in the baseline, while productivity gains are excluded on timing grounds, despite the use of 2024 as the H8 baseline year. Vueling supports a focused reassessment of security opex to ensure consumers receive the full benefit of major capital investment.

Vueling also notes that several material operating cost lines have not been subject to detailed bottom-up review. Given Heathrow's poor performance in assessed categories, it is not credible to assume that unassessed categories are fully efficient. Vueling therefore supports applying a proportionate efficiency challenge to such costs to avoid implicitly endorsing inefficiency.

Finally, Vueling emphasises that one-off and service-failure-related costs should not be rolled into the baseline and carried forward into H8, and that strict discipline should continue to apply to overlays and late submissions. Consumers should not fund recurring allowances for exceptional or avoidable costs.

Vueling therefore urges the CAA to strengthen the overall efficiency challenge, reassess security opex to reflect programme-implied efficiencies, apply proportionate challenge to material unassessed cost lines, and maintain firm discipline on overlays and baseline composition. These steps are necessary to ensure the H8 opex allowance reflects efficient costs and does not place unnecessary upward pressure on charges.

#### **Vueling proposal on OPEX**

*Based on CEPA's independent analysis commissioned by the airline community, Vueling proposes that the H8 opex allowance be set at £7,480m, compared to the CAA's base case estimate of £7,790m. A reduction of £310m reflects a stronger efficiency challenge, the removal of one-off costs from the baseline, and a 5% challenge applied to unassessed cost lines.*

## **5. Commercial revenues**

Vueling supports retention of the single-till framework, which remains a critical protection for consumers at a monopoly airport. However, Vueling is concerned that the commercial revenue baseline adopted in the Initial Proposals remains conservative and understates Heathrow's revenue-raising potential relative to comparable hub airports.

Underperformance in retail, catering and advertising should not be treated as structural. Where Heathrow lags peers, the regulatory settlement should reflect realistic scope for improvement, with benefits shared with passengers through lower aeronautical charges.

Vueling also emphasises the need for safeguards where Heathrow can raise tariffs during H8 (for example through Terminal Drop-Off Charges or premium services). Any tariff-driven upside should be returned to users rather than retained by HAL.

### **Vueling proposal on Commercial Revenues**

*Based on CEPA's independent analysis commissioned by the airline community, Vueling proposes that the H8 commercial revenue forecast be set at £5,905m, compared to the CAA's base case estimate of £5,493m; an increase of £412m reflecting a stronger challenge on retail, catering and advertising revenues, a corrected POD revenue scope adjustment, and the pass-through of business rates increases into commercial rents.*

## **6. Other regulated charges (ORCs)**

Vueling shares concerns that the ORC framework has evolved into a low-powered cost pass-through mechanism with weak efficiency incentives. Specifically, Vueling supports:

- reclassification of baggage-related costs out of ORCs and into aeronautical charges (c. £123.4m), where stronger incentives apply;
- treatment of PRM as a bespoke cost line, reflecting its materiality and distinct cost drivers;
- exclusion of Business Rates from ORCs, given their scale and limited controllability by airlines; and
- application of a clear efficiency challenge to residual ORC costs.

Without reform, ORCs risk undermining cost discipline and increasing charges without commensurate passenger benefit.

## **7. Capital expenditure**

Vueling supports the CAA's proposed H8 capex envelope of approximately £5.9 billion (2024 CPIH) and the emphasis on deliverability, needs assessment and independent benchmarking. Constraining the overall scale of capital investment is an important consumer protection, particularly given Heathrow's live, capacity-constrained environment.

However, Vueling stresses that consumer outcomes will depend critically on governance and prioritisation. Capital spend should focus on reliability, resilience and passenger experience rather than discretionary enhancements with weak consumer cases.

Late submissions or scope expansion that increase costs without clear benefits should be resisted.

## **8. Cost of capital**

Vueling considers that the CAA's proposed weighted average cost of capital ("WACC") for H8 is materially overstated and not aligned with Heathrow's risk profile as a regulated, capacity-constrained monopoly airport. The proposed WACC of 5.87% pre-tax CPIH-real would result in charges that are significantly higher than necessary to finance efficient operations and investment, to the detriment of consumers and connectivity.

Independent analysis commissioned by the airline community and undertaken by CEPA estimates an efficient WACC for Heathrow of 4.68% pre-tax CPIH-real, around 120 basis points below the CAA's proposal. Applying this lower WACC would reduce Heathrow's financing cost allowance by more than £1.2 billion over H8 and reduce airport charges by approximately £3 per passenger. For short-haul and price-sensitive airlines such as Vueling, this difference is material and directly affects route viability and fares. Vueling fully supports the CEPA analysis and the independent academic advice provided to the airline community by Professors Mason and Robertson, and considers that the weight of evidence supports a materially lower allowed return.

### **Heathrow's risk profile and the fair bet principle**

Vueling strongly supports the application of the fair bet principle, under which the allowed return should be sufficient to finance efficient investment but should not systematically over-reward the regulated entity. In Vueling's view, the CAA's Initial Proposals do not meet this test. Heathrow is a single, capacity-constrained hub airport operating under a single-till regulatory framework, with a stable demand base and extensive regulatory protections. The single-till framework materially reduces Heathrow's exposure to systematic risk.

### **Equity beta and relative risk adjustment**

Vueling is concerned that the CAA has overstated Heathrow's systematic risk by adopting an equity beta that implies Heathrow is riskier than the average listed company. This conclusion is not credible for a regulated, capacity-constrained monopoly airport. Independent analysis shows that the CAA's beta estimate is inflated by two compounding issues:

- **Methodological instability**, driven by the use of long-window regression estimates that give disproportionate weight to Covid-period outliers; and
- **Failure to apply a relative risk adjustment**, despite Heathrow's materially lower risk characteristics compared to its comparator airports.

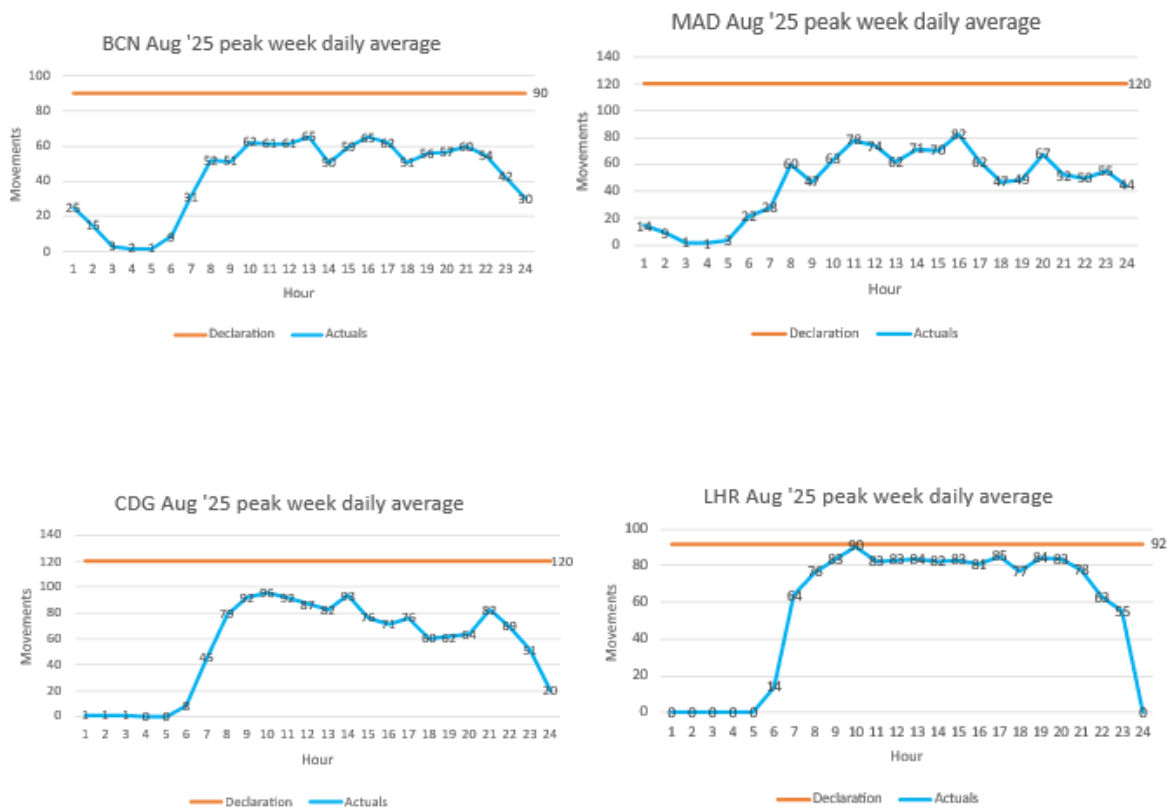
The airline community's evidence demonstrates that Heathrow's comparators (including AENA, AdP, Fraport and Zurich) are diversified airport groups operating across multiple unconstrained airports and jurisdictions. These characteristics expose them to risks that Heathrow does not face. In previous price controls (Q6 and H7), the CAA recognised this and applied relative risk adjustments. Vueling sees no justification for departing from that precedent in H8.

Vueling also notes that the French transport regulator (ART), using the same comparator airports, reached the opposite conclusion to the CAA and identified an upward bias in beta estimates driven by comparator diversification. The CAA has not provided a clear explanation for why Heathrow should be treated differently.

### **Capacity constraints and factual inaccuracies**

Vueling shares concerns raised by the airline community regarding factual inaccuracies in the CAA's assessment of comparator airport capacity constraints. Heathrow operates at or close to its declared runway capacity throughout much of the operating day. By contrast, major European comparators such as Paris CDG, Madrid and Barcelona operate well below their declared limits. This distinction is critical: capacity constraints materially reduce demand risk and volatility. Failure to reflect this properly in the beta

assessment results in an upward bias in the allowed return and is inconsistent with both economic logic and regulatory precedent.



Source: IAG analysis, OAG schedule data. Declared capacities: COHOR (CDG), DORA II (MAD/BCN), CAA (LHR).

### Cost of debt and notional capital structure

Vueling is concerned by the CAA’s decision to move away from a notional cost of debt and instead rely on Heathrow’s actual debt costs. This approach creates pass-through risks for consumers and weakens incentives for efficient financing, particularly given Heathrow’s highly leveraged capital structure. Airlines and passengers should not be exposed to the consequences of HAL’s specific financing choices. Vueling therefore supports reverting to a notional cost of debt, consistent with previous CAA practice and the notional company framework. Independent analysis suggests that a notional approach would result in a materially lower and more appropriate cost of debt allowance. Vueling also supports reducing the notional gearing assumption from 60% to a level more consistent with comparator airport evidence and peer practice. Maintaining a high gearing assumption while simultaneously adopting an actual debt approach is internally inconsistent and shifts risk onto users.

### Vueling recommendation on WACC

Based on the independent evidence and the considerations set out above, Vueling recommends that the CAA:

- Adopts a materially lower WACC, anchored to CEPA’s estimate of 4.68% pre-tax CPIH-real;
- Applies a relative risk adjustment to the asset beta to reflect Heathrow’s capacity constraint, single-till regulation and traffic risk sharing, consistent with Q6 and H7 precedent and the approach taken by the French ART;
- Corrects factual inaccuracies in its assessment of comparator airport capacity constraints;

- Uses shorter-window beta estimates that avoid Covid-period distortions;
- Reverts to a notional cost of debt, removing pass-through risks associated with the actual debt approach;
- Reduces the notional gearing assumption to a level consistent with comparator evidence;
- Adopts a later and consistently applied data cut-off date in Final Proposals;
- Ensures the H8 WACC reflects a two-runway operation, without embedding expansion-related premia; and
- Ensures internal consistency between the risk-mitigating features of the wider regulatory package and the allowed return.

Vueling considers that a recalibrated cost of capital, aligned with these principles, is essential to delivering a balanced and credible H8 settlement that protects consumers, supports connectivity and preserves Heathrow's long-term competitiveness.

### **Vueling proposal on WACC**

*Based on CEPA's independent analysis commissioned by the airline community, Vueling proposes that the H8 WACC be set at 4.68% pre-tax CPIH-real, compared to the CAA's proposal of 5.87%. This would reduce the financing cost allowance by more than £1.2 billion and reduce charges by around £3.02 per passenger over the H8 period.*

## **9. Vueling recommendation on the price cap**

Based on the above proposals across the cost of capital, operating expenditure, commercial revenues and traffic forecast, Vueling advises an average price cap of £24.48 in 2024 CPIH terms over H8, 15% lower than the CAA's proposed average of £28.80 per passenger.

Vueling considers that a price cap at this level is both financeable and consistent with the weight of evidence assembled by the CAA itself, and that the CAA's proposed £28.80 represents a material overstatement that would deliver excess profits to HAL and undermine the affordability and competitiveness of Heathrow as a global hub.