

Delta Air Lines, Inc.  
H7 Final Proposal – Consultation response  
Supplement to letter dated 9 August 2022

1. **PASSENGER FORECASTING**

- 1.1 This section provides additional information in response to Chapter 1 of the CAA's Final Proposals, which concerns passenger forecasts.
- 1.2 Delta incorporates by reference its prior submissions in the Initial Proposals stage, both as part of VAA's consultation response as well as Delta's separate, supplemental letter. Delta also endorses the material included in the joint VAA/Delta Consultation Response in this Final Proposals stage.
- 1.3 As VAA and Delta noted at the Initial Proposals stage, accurate passenger forecasting is pivotal in achieving the ultimate proper pricing calculation, and the effect of that pricing calculation on consumers. Delta agrees with the CAA's observation in its Final Proposals that "*developing appropriate forecasts of passenger numbers is a fundamental step in allowing us to properly discharge our statutory duties, including furthering the interests of consumers*".<sup>1</sup>
- 1.4 Delta also agrees with the CAA that the passenger forecast "*remains at the core for setting an appropriate price control*",<sup>2</sup> notwithstanding the risk sharing mechanisms which the CAA proposes to put in place.
- 1.5 Delta recognises that (i) the Final Proposals provide for higher passenger forecasts than those set out at the Initial Proposals stage, and (ii) the CAA has said that it has placed materially less reliance on the forecast and model provided by HAL than at the Initial Proposals stage, instead drawing on a range of other sources. Delta welcomes these developments but, as explained below, remains concerned that the passenger forecasts used by the CAA are both insufficiently robust and unduly pessimistic.
- 1.6 Delta is presenting its perspective as both a major international carrier at LHR as well as a Joint Venture partner of VAA. Although Delta and VAA participate in joint network planning with respect to LHR-North America flying, the data and forecasts here were developed independently from VAA. Delta hopes that this additional perspective will be helpful to the CAA in considering the appropriate H7 passenger fees. Delta also endorses VAA's LHR-wide forecast.
- 1.7 This Annex contains information which is confidential (marked in red). Delta therefore considers that an unredacted version of this Annex should not be disclosed publicly on the CAA website or in the event of any request made under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004, or otherwise. In the event that the CAA does receive such a disclosure request, Delta would expect to be informed in good time before any decision is made on disclosure and to be provided with an opportunity to make representations.
- 1.8 By way of overview, this supplement includes:
- Delta's perspective on HAL's recent actions;
  - Delta's forecast for 2022 and Q1 2023; and
  - Passenger forecasts from 2023 onwards.

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<sup>1</sup> CAA's Final Proposals Section 1, Chapter 1, page 5, paragraph 1.2.

<sup>2</sup> CAA's Final Proposals Section 1, Chapter 1, page 5, paragraph 1.4.

### HAL's recent actions

- 1.9 The CAA must address recent actions taken by HAL which have had the effect of unilaterally reducing capacity to an artificially low level in view of passenger demand (and the ability of airlines such as Delta to service that demand) as well as take note of its impact on future forecasts. On 11 July 2022, HAL took the unilateral decision to enforce capacity restrictions on airlines flying out of LHR under Local Rule A ("**LRA**"), effective 25 July 2022. HAL notified carriers serving LHR, including Delta, that it would require all airlines to comply with the capacity reductions under LRA, and HAL would enforce the capacity reductions by application to court if necessary. As set out in the Consultation Response, HAL has also indicated that it is minded to further extend capacity restrictions.
- 1.10 These capacity reductions imposed by HAL have significant effects on actual passenger number data. The effect of HAL's actions is to limit daily seat capacity to 100,000 seats per day, a material decrease from a capacity of more than 120,000 seats. This decrease artificially and dramatically decreases the number of actual passengers the airline industry was able to serve. The CAA must act to ensure that the H7 passenger forecast is reflective of the potential traffic flow through the airport as opposed to the current actuals which reflect the artificially constrained capacity as a result of HAL's actions.
- 1.11 Delta and other airlines have repeatedly expressed to HAL the concern that HAL's plans to resource LHR in line with a pessimistic passenger forecast could be detrimental to consumers. The data and flying schedule underpinning the VAA/Delta IP Response<sup>3</sup> was shared with HAL at a similar time as it was shared with the CAA (as part of the VAA/Delta IP Response) in December 2021. HAL responded to VAA that its 2022 passenger forecast was overly optimistic and has otherwise failed to engage with airlines' concerns about its resourcing plans. In calculating the overall passenger forecast for H7, the CAA should prevent HAL from benefitting from its own self-interested actions (which are not aligned with the interests of consumers) in this way, i.e. limiting the available capacity at the airport in order to skew passenger data downward for its own financial benefit.
- 1.12 John Holland-Kaye, HAL's Chief Executive Officer, has made public statements as recently as 26 July 2022 which portray the airlines as taking a counterproductive approach to passenger forecasting. Delta is further concerned that Mr Holland-Kaye's public statements indicate that, without intervention from the CAA, HAL may seek to keep a cap in place for at least a further year.<sup>4</sup> It is clear that HAL has every incentive to extend such capacity restrictions through to the end of the current season (and beyond). It is vital that the CAA should not reward HAL for this behaviour when finalising the passenger forecast data for H7.
- 1.13 Overall, Delta urges the CAA to:
- 1.13.1 Take decisive action in influencing HAL to ensure that enforced capacity restrictions are lifted at the earliest opportunity. Delta shares VAA's concerns that Mr Holland-Kaye's comments might have the effect of discouraging customers against travelling from LHR in 2022 and 2023 and serve only to further dampen the already-restricted demand. Indeed, Delta is seeing LHR bookings down 40% for travel in the first quarter of 2023, compared to where bookings were in August 2018 for travel in the first quarter of 2019.
  - 1.13.2 Consider the extent to which HAL is able to use its dominant market position in such a way. HAL's actions adversely affect the use of the airport, which in turn cascades into a detrimental effect to consumers.
  - 1.13.3 Ensure that, in calculating the overall passenger forecast for H7, it prevents HAL from benefitting from its own self-interested actions (which are not aligned with the

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<sup>3</sup> VAA Submission - Economic regulation of Heathrow Airport Limited: H7 Initial Proposals – 2022 Charges Consultation.

<sup>4</sup> Oliver Gill, The Daily Telegraph, "*Heathrow Chief ignored airline warnings about summer travel surge*" (15 July 2022); Oliver Gill, The Daily Telegraph, "*Holidaymakers face another summer of disruption, Heathrow chief admits*" (26 July 2022).

interest of consumers), i.e. by limiting the available capacity at the airport in order to skew passenger data downward. Delta shares VAA's concern in this regard that throughout the H7 process, HAL has repeatedly projected a pessimistic passenger forecast which has the ultimate effect of keeping the maximum allowable yield high, and in HAL's favour.

### **Delta's forecast for 2022 and Q1 2023**

- 1.14 The following section summarises Delta's approach to its LHR traffic forecasting in the period from 2022 to 2023, whilst also highlighting concerns around the current methodologies and assumptions used by the CAA and HAL in their own annual passenger forecasts ahead of price setting for the H7 travel period.

#### **Table A – [CONFIDENTIAL INFORMATION REMOVED]**

- 1.15 Delta's approach to passenger forecasting is based on [CONFIDENTIAL INFORMATION REMOVED].
- 1.16 In its own 2022 "mid" passenger forecast, the CAA concluded that an upper bound of 74% of 2019 levels was to be used based on selecting a cap of 84% of 2019 in its 2023 forecast.<sup>5</sup> Even amongst staffing difficulties and other operational challenges, the load factor for June 2022 was 81% across all airlines serving LHR.
- 1.17 LHR's average load factor since 2005 stands at [CONFIDENTIAL INFORMATION REMOVED] and typically follows the same peak pattern throughout the calendar year. Q2 2022 (an average load factor of [CONFIDENTIAL INFORMATION REMOVED]<sup>6 7</sup>) has been used as a baseline to forecast load factors for the remainder of 2022, applying a monthly weighting to map to historic patterns and a recovery rate factor based on 2022 vs 2021. As such, in Delta's forecast, the load factor across all LHR flights for 2022 is expected to be between [CONFIDENTIAL INFORMATION REMOVED] and [CONFIDENTIAL INFORMATION REMOVED] with the base case expected to be at [CONFIDENTIAL INFORMATION REMOVED].

#### **Table B – [CONFIDENTIAL INFORMATION REMOVED]**

- 1.18 In order to meet HAL's initial "mid" passenger forecast for 2022 of 43.2 million passengers the load factor across all remaining flights would need to be 30.3%. Load factors as low as this were only seen in April and May 2020 and are highly unlikely to be seen again. It is also highly likely that passenger numbers will far exceed HAL's "high" case of 52 million passengers. HAL's excessively pessimistic forecast demonstrates that assumptions being made are not congruent with the market and underlines the need for complete rebasing of the forecast. Similarly, a load factor of 43.2% is required across the remainder of the year to meet the CAA's initial forecast of 45.6 million passengers for 2022.<sup>8</sup> Even HAL's revised forecast in Q1 2022 of 52.8 million passengers for the year appears to be unduly pessimistic based on data available as of July 2022.
- 1.19 On-sale capacity for the remainder of 2022 has changed markedly over Q2 2022. This is owing to various market caps and external pressures. Applying forecasted load factors to

<sup>5</sup> Economic Regulation of Heathrow Airport: H7 Final Proposals Section 1: Regulatory Framework 1.67.

<sup>6</sup> HAL reports/traffic statistics June 2022, <https://www.heathrow.com/company/investor-centre/reports/traffic-statistics>.

<sup>7</sup> DIIO Capacity Data July 2022.

<sup>8</sup> HAL reports/traffic statistics June 2022, <https://www.heathrow.com/company/investor-centre/reports/traffic-statistics>; DIIO Capacity Data July 2022.

on-sale capacity as of May 2022 leads to forecasted annual passenger figures of 65.1 million for 2022. Reductions in capacity as of July 2022 now equate to forecasted annual passenger figures of 61.9 million. Had Delta been allowed to fly its full schedule, it alone would have carried an estimated **[CONFIDENTIAL INFORMATION REMOVED]** additional passengers in the third quarter.

- 1.20 Delta's on-sale capacity for Q1 2023 currently stands **[CONFIDENTIAL INFORMATION REMOVED]** higher than for Q1 2019.<sup>9</sup> We have seen in the case of the United States that demand recovers quickly after the lifting of travel restrictions. As of May 2022, ticketed data shows passenger levels on flights to the US are at **[CONFIDENTIAL INFORMATION REMOVED]**<sup>10</sup> of pre-pandemic levels month-on-month, **[CONFIDENTIAL INFORMATION REMOVED]**. In addition, on flows to the United States via LHR over 30%<sup>11</sup> are "behind" connections, meaning that passengers start their journey in a different airport than the gateway they use to reach LHR. Consequently, a greater number of itineraries will be available as more countries continue to ease restrictions, which will further drive passenger demand.
- 1.21 Delta urges the CAA to take on-sale capacities into account and look at likely seat load factor scenarios rather than relying on external forecasts for time periods when these data sources are available.
- 1.22 Delta's own independent forecasting sees passenger restoration and growth beyond 2019 levels by April of 2023 and sustained for the foreseeable future.

**Table C – [CONFIDENTIAL INFORMATION REMOVED]**

**Passenger forecasts from 2023 onwards**

*Recovery prospects*

- 1.23 Despite the amendments to the forecast for LHR issued in the CAA's Final Proposals, the recovery profile projected by the CAA over the regulatory period still looks very slow in comparison to other industry forecasts and given the developments in key drivers of passenger traffic for the UK generally. The IATA / Tourism Economics forecast for the UK O-D market updated in May 2022 points to a recovery of passenger volumes to pre-pandemic levels in 2023. The recovery profile of ACI Europe's forecast for the region was brought forward by one year to 2024 in their May 2022 update.<sup>12</sup> As shown in Figure 1 below, Delta's own internal forecasting shows growth beyond 2019 levels next year, and steady growth thereafter.

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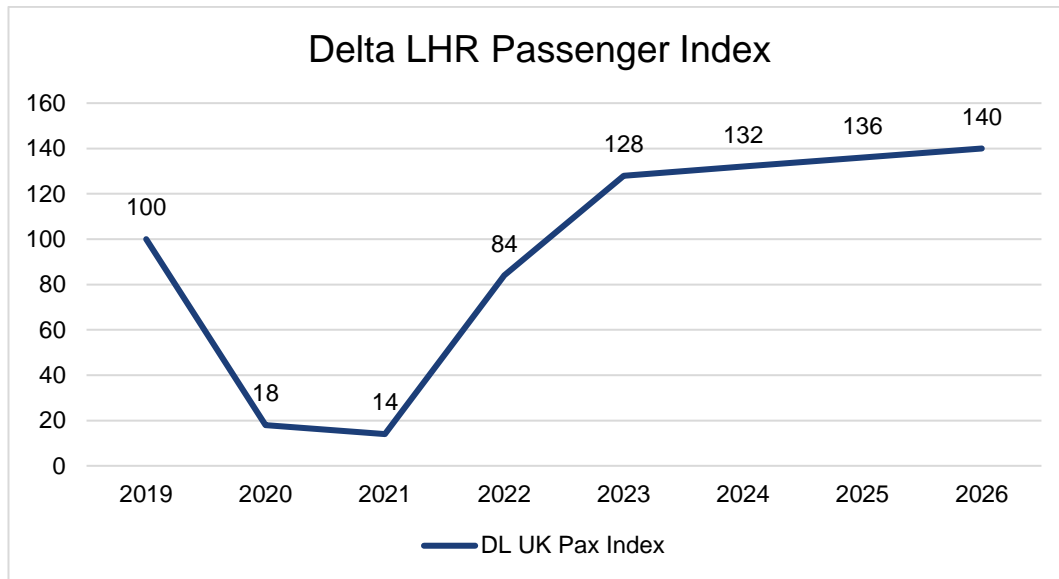
<sup>9</sup> DIIO Capacity Data July 2022.

<sup>10</sup> DDS Ticketed Data LHR-USA Jan 18 - May 2022.

<sup>11</sup> DDS Ticketed Data LHR-USA Jan 18 - May 2022.

<sup>12</sup> <https://www.aci-europe.org/downloads/resources/Airport%20Traffic%20Forecast%202022%20Scenarios%20%202022-2026%20Outlook%20-%20May%202022.pdf>.

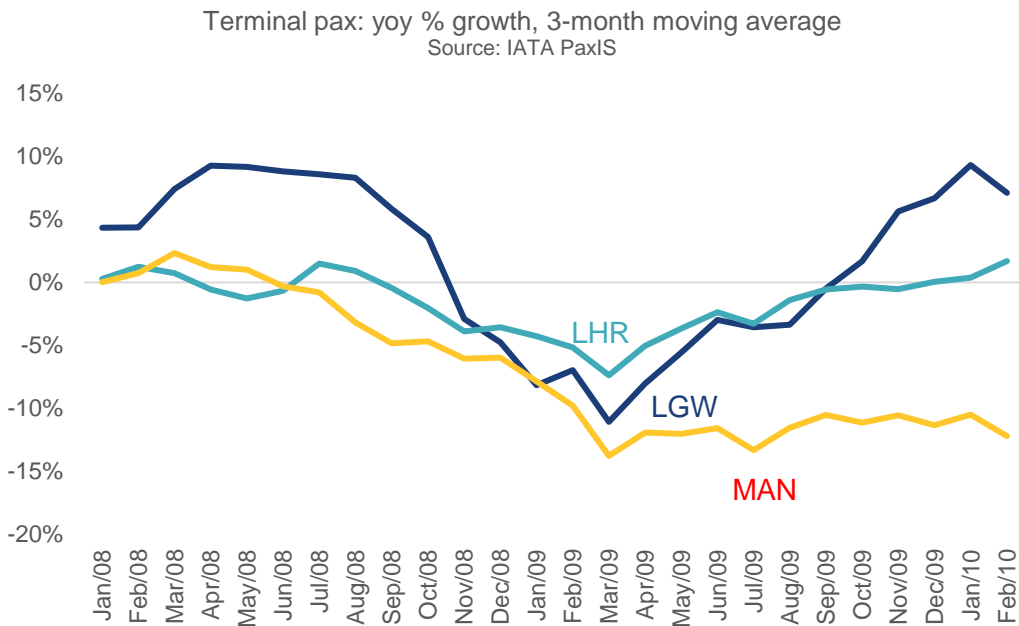
Figure 1



- 1.24 It is evident that the various forecasts, predict a return to 2019 traffic levels much earlier than the current CAA and HAL forecasts, which indicate that a recovery to pre-pandemic levels for LHR will only occur by 2025, which is one/two years slower than the IATA and ACI comparators. As outlined above, Delta expects 2023 will exceed 2019 levels – a much higher forecast than the CAA sets out in its Final Proposals. The absolute difference in the forecasts for years 2024, 2025 and 2026 as compared to the CAA forecast will be smaller. This is at odds with the developments in key drivers of traffic for the UK and the evidence of LHR's relative resilience, as outlined below.
- 1.25 Notwithstanding the massive impact of Covid-19, according to the IMF:<sup>13</sup>
- 1.25.1 the UK economy is expected to be around 2.3% larger in 2023 compared with 2019 measured by real (constant price) GDP;
  - 1.25.2 per capita incomes are expected to be 0.3% higher measured by real GDP per capita;
  - 1.25.3 the unemployment rate is forecast to remain relatively low at 4.6% compared with 3.8% in 2019; and
  - 1.25.4 population is likely to be 1.3 million persons higher, moving above 68 million.
- 1.26 All of these factors indicate that it would be more realistic to assume recovery in air passenger demand approaching pre-pandemic levels in 2023 rather than the gradual and protracted recovery indicated by the “mid” scenario in the CAA's Final Proposals, only reaching 2019 levels in 2025.
- 1.27 Moreover, as documented in Figure 9 of the Airline Community Response to the H7 Initial Proposals (reproduced as Figure 2 below), LHR has proven to be relatively resilient to shocks in the past. During the Great Financial Crisis of 2008-9, the impact on traffic at LHR was less pronounced than for other large UK airports.

<sup>13</sup> World Economic Outlook database, April 2022.

Figure 2 (reproduced from Airline Community Response to H7 Initial Proposals)



- 1.28 Evidence of this resilience is also apparent when looking at the relative pace of recovery out of the Covid-19 pandemic. It is worthwhile to review the performance of LHR against other airports in the UK. VAA agrees with the CAA's view that 'demand at Heathrow has historically been more robust in the face of economic headwinds than that at the rest of the UK airports, helped by the pressure on airlines to protect valuable Heathrow slots.'<sup>14</sup> According to CAA data for the 12-month period from June 2021 to May 2022, LHR handled 45% of 2019 passenger volumes, well ahead of the 33% for London Gatwick ("LGW") and above a number of other large UK airports.
- 1.29 This supports the industry expectation of a recovery for LHR that is in advance of, not lagging behind, the UK market on average.
- 1.30 However, overall economic risks should not be pre-factored into a forecast and should instead be part of a low-case scenario. Such a low case scenario should not be considered as part of any forecast, but a mere reflection of the risk for the industry, including airlines and airports. Such a business risk needs to be mitigated by the business and should not be overlaid onto the passengers.
- 1.31 The AP Report considers it would be possible to provide a complete approach by combining perspectives, as shown at paragraphs 3.6.28 through 3.6.30.

**Conclusion**

- 1.32 Delta appreciates the opportunity to supply this input to the CAA. As described above, ensuring maximal accuracy in forecasting passenger numbers will be critical to protecting consumers from unnecessarily high passenger fees at LHR. In this matter, the CAA should take into consideration the available evidence and revise the passenger forecasts that underpin its Final Proposals, and consequently arrive at materially higher forecast figures. HAL's recent conduct should serve as a sharp reminder that, as a monopolist, it has every incentive to protect its own interests, and is not incentivized to serve the traveling public. The CAA must act to prevent HAL from simply lining its pockets and, instead, further the interests of customers. A crucial step that the CAA must take in this regard is to stop putting

<sup>14</sup> CAA Final Proposals, Section 1, Chapter 1, page 26, paragraph 1.74.

weight on HAL's forecasting model, which has not even been allowed to be examined by the airlines or public at large. The CAA has sufficient data in the form of independent forecasts and, therefore, it does not have to rely on the HAL model. Further, independent forecast data is more robust, and is supported by Delta's own experience and forecasting, which sees passenger restoration and growth beyond 2019 levels by April of 2023 and sustained for the foreseeable future. These points indicate that the CAA has materially underestimated passenger numbers for H7 in the Final Proposals and must, therefore, adjust its forecast upward, and the passenger charges downward, to prevent consumer detriment.