

25<sup>th</sup> November 2013

**Virgin Atlantic comments on developments since the final proposals in relation to Heathrow and Gatwick price controls**

This short submission responds to the open letter published by the CAA on 18th November 2013 seeking responses to new information provided in the consultations to the Q6 final proposals or other new information that has arisen since the consultation.

Virgin Atlantic has worked with both the LACC and ACC to provide airline community responses and we fully support the evidence provided within those. This response from VAA complements those and focuses on the key areas where we believe the interests of our passengers are being overlooked.

We urge the CAA to use this final consultation period to urgently review its recommendations and fulfil its obligation to regulate in the best interest of present and future passengers.

**Heathrow**

Traffic: Since the LACC submitted its response to the CAA's final proposals, HAL have published their traffic numbers for October which we're 4.6 per cent higher than the same month last year. These therefore continue both to show strong year on year growth and significantly outperform the forecasts in the CAA's final decision.

As set out in the LACC's response, the base year of the forecast (2013/14) has a significant impact on the overall level of traffic over the quinquennium. If just an increase in the base year is built into the projections (with no change in the CAA's projected growth rates) this increases the projections for Q6 by 10m, as shown in the table below. The latest figures from HAL continue to prove that this type of adjustment is necessary.

The Airline Community continues to believe that in order to reach a fair settlement this growth needs to be captured in the base of the CAA's assessment. Failing to do so would mean the Q6 proposals start from an incorrect base and would therefore be a clear error of fact by the CAA in reaching its final decision.

WACC:

Since the CAA's final proposals, new information has been provided by the Competition Commission. VAA believes this points to the CAA having over-estimated the cost of capital, and in particular the cost of equity:

- This difference is over 110bps on the cost of equity when using the CC parameters on the risk free rate and equity risk premium for HAL and GAL.
- The CC note in their approach to the NIE case that the appropriate way to arrive at a cost of equity is to examine long-dated index linked gilt yields and forward data in establishing a risk free rate, then calculating an equity risk premium (ERP) based on the deduction of the risk free rate from a total equity market return (TMR). This shows that the TMR estimated by the CC is an entire 100bps below the CAA point estimate, and the effect of using the CC parameters with the CAA equity betas would lead to a cost of equity which is over 110bps lower.
- VAA notes that in selecting a point from a range, the CC also favour using the mid-point. This has been consistently raised by the Airline Community and is in contrast to the CA's approach.

Commercial Revenue: There needs to be a corresponding rise in commercial revenue for the additional passengers which we believe need to be built into the traffic forecast.

#### **Gatwick**

Traffic: Since VAA's 4<sup>th</sup> November response, GAL have published their traffic numbers for October 2013 which are 4.3 per cent higher than the same month last year. These numbers continue to show strong year-on-year growth that significantly outperforms the forecasts in the CAA's final decision.

As the ACC's response shows, and the CAA's document confirms, the base year of the forecast (2013/14) has a significant impact on the overall level of traffic over the regulatory period. Taking the higher base year into account (with no change in the CAA's projected growth rates) leads to an increase in the traffic projections for Q6 of 2.7m passengers. The latest figures from GAL continue to prove that this type of adjustment is necessary.

The Airline Community continues to believe that in order to reach a fair settlement this growth needs to be captured in the base of the CAA's assessment. Failing to do so would mean the Q6 proposals start from an incorrect base and would therefore be a clear error of fact by the CAA in reaching its final decision.

Commercial Revenue: There needs to be a corresponding rise in commercial revenue for the additional passengers which we believe need to be built into the traffic forecast.

WACC: VAA believes the CAA needs to take account of the Competition Commission's findings in relation to Northern Ireland Electricity as well as in the Heathrow section of this paper as well as the ACC response.