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29 May 2026

Iberia response to CAA H8 Initial Proposals at Heathrow airport (CAP3232)

Iberia 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.

Iberia supports the responses submitted by our sister airlines Aer Lingus, British Airways and Vueling, and by our parent company, International Airlines Group ("IAG"). This submission provides Iberia's perspective as a network carrier operating short-haul services between Heathrow and our hub Madrid airport, which plays a critical feeder role into Iberia's long-haul network.

This response should be read alongside submissions made by other airlines and by our parent company, IAG. Iberia supports those submissions and does not repeat all arguments made therein. Iberia's comments focus on the implications of the Initial Proposals for consumer outcomes, connectivity, and the appropriate allocation of risk within the regulatory framework.

Iberia would welcome the opportunity to engage further with the CAA on these issues.

Overall position

Iberia 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 revenues. However, Iberia remains concerned that the overall H8 package remains insufficiently stretching and risks embedding outcomes that are not aligned with consumer interests.

The combined effect of higher airport charges, conservative traffic and commercial revenue assumptions, and an overstated allowed return would place upward pressure on airline costs at Heathrow. For a hub airport, these pressures ultimately feed through to reduced network flexibility, weaker feeder connectivity and higher fares for passengers, particularly on routes that depend on efficient short-haul feed to sustain long-haul services.

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

A handwritten signature in black ink, appearing to be "Jaime García Blázquez".

Jaime García Blázquez
Manager Aeropolitical Affairs, Iberia

1. Charges and connectivity

The CAA presents the H8 Initial Proposals as implying only a modest increase in charges relative to H7, which Iberia considers to be a misleading comparison.

The average H7 price cap is distorted by years of suppressed demand during the post-pandemic recovery. A more relevant benchmark is the later years of H7, when traffic had substantially recovered. On a like-for-like basis, the H8 proposals imply a material real-terms increase in charges of around 7%, rather than the marginal uplift suggested by the CAA.

For Iberia, higher Heathrow charges directly affect network economics. Heathrow plays a critical role in supporting connectivity between the UK, Spain and Iberia's long-haul network. Sustained increases in airport charges therefore risk:

- reducing feeder frequencies that support long-haul connectivity,
- weakening competition on both short- and long-haul markets, and
- undermining Heathrow's effectiveness as a competitive European hub.

These impacts ultimately reduce choice and increase costs for consumers.

2. Customer outcomes and service incentives

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

Despite headline exposure to penalties exceeding bonuses, HAL has earned significantly more in bonuses than it has paid in rebates over recent years, even while material service issues have persisted. This outcome suggests that the framework does not adequately protect consumers and risks allowing passengers to pay more without commensurate improvements in service quality.

For network airlines, service failures, including baggage system outages and terminal disruption, have amplified effects across connecting journeys. Iberia therefore considers that rebates should be strengthened and more directly linked to material service failures and resilience issues. Any retention of bonuses should be limited strictly to genuinely exceptional performance.

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

3. Traffic Forecast

Iberia 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 demonstrates a persistent tendency toward under-forecasting traffic at Heathrow.

At a regulated hub airport, systematic under-forecasting inflates allowed charges without exposing the airport to commensurate risk. Independent analysis commissioned by the airline community indicates that key assumptions in the CAA's forecast remain conservative, with plausible adjustments implying higher passenger volumes over H8 than assumed in the base case.

Iberia is particularly concerned by the continued application of the shock factor. This mechanism compounds historical under-forecasting, overlaps with the Traffic Risk Sharing (TRS) mechanism and materially increases charges. Iberia therefore encourages the CAA to remove the shock factor for H8 or, at a minimum, substantial recalibration to avoid systematic bias against consumers.

Iberia proposal on traffic forecast

Based on Skylark's independent analysis commissioned by the airline community, Iberia 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

Iberia welcomes the CAA's methodological improvements in its assessment of operating expenditure, including the clearer base-step-trend framework and more structured testing of overlays. The rejection of poorly evidenced cost additions represents a positive development relative to earlier price controls. However, Iberia remains concerned that the overall opex allowance is insufficiently challenging. As opex feeds directly into airport charges, any over-allowance disproportionately affects airlines and passengers, making robust cost discipline essential.

A recurring constraint has been the quality and transparency of HAL's information. Where evidence gaps remain, assumptions have tended to be resolved conservatively in HAL's favour. Iberia considers that where data is incomplete, the burden of proof should rest with HAL to demonstrate efficiency.

Iberia supports the CAA's position that the baseline year cannot be assumed to be efficient. Heathrow's performance in benchmarking exercises remains weak, yet the catch-up adjustment applied in the Initial Proposals appears modest relative to the implied efficiency gap. Iberia considers that benchmarking should be updated using the latest data and presented transparently in cost levels in Final Proposals.

Security opex remains a particular concern. Analysis based on HAL's own programmes suggests a material disconnect between implied efficiencies and those reflected in the Initial Proposals. Iberia supports a focused reassessment of security opex to ensure passengers receive the full benefit of major capital investment.

Iberia proposal on OPEX

Based on CEPA's independent analysis commissioned by the airline community, Iberia 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

Iberia supports retention of the single-till framework, which remains a vital protection for consumers at a monopoly hub airport. However, Iberia is concerned that the commercial revenue baseline remains conservative and understates Heathrow's revenue-raising potential relative to comparable hubs.

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 users through lower aeronautical charges.

Iberia also emphasises the need for safeguards where Heathrow can raise tariffs during H8. Any tariff-driven upside should be returned to users rather than retained by HAL.

Iberia proposal on Commercial Revenues

Based on CEPA's independent analysis commissioned by the airline community, Iberia 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 efficiency 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)

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

- i. reclassification of baggage-related costs into aeronautical charges,
- ii. bespoke treatment of PRM costs reflecting their distinct drivers,
- iii. exclusion of Business Rates from ORCs, and
- iv. application of a clear efficiency challenge to residual ORC costs.

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

7. Capital Expenditure and Governance

Iberia supports the CAA's proposed H8 capital expenditure envelope of approximately £5.9 billion (2024 CPIH) and the increased emphasis on deliverability, needs assessment and independent benchmarking. In principle, a more disciplined approach to the scale and timing of investment is an important consumer protection at a live, capacity-constrained hub airport. Constraining overall capex helps to mitigate the risk that passengers and airlines are required to fund investment that is either premature, inefficient or weakly linked to tangible improvements in service quality.

However, Iberia considers that the effectiveness of the H8 settlement will depend critically on the robustness of capex governance arrangements, rather than the headline envelope alone. Heathrow has a long history of scope expansion, late submissions and re-prioritisation during control periods, which has diluted accountability and increased costs without clear evidence of commensurate consumer benefit. Iberia therefore considers it essential that the CAA applies strong ex-ante controls and resists retrospective approval of cost increases where the original needs case has not been clearly demonstrated.

From a network airline perspective, capital investment should be clearly prioritised toward reliability, resilience and operational performance, particularly where failures have system-wide consequences for connecting passengers. Investments that improve baggage performance, asset resilience, airfield reliability and terminal operability deliver far greater consumer value than discretionary enhancements or aesthetic upgrades with limited operational impact. Iberia is concerned that, without clear prioritisation criteria, scarce capital may be diverted toward projects with weak consumer cases while persistent operational vulnerabilities remain insufficiently addressed.

Iberia also emphasises the importance of maintaining firm discipline around change control, scope creep and late submissions during H8. Where additional or accelerated investment is proposed, Heathrow should be required to demonstrate a clear and quantified consumer benefit, robust cost efficiency and genuine urgency. Projects that increase costs without demonstrable improvements in resilience or passenger experience should not be accommodated within the regulatory settlement. Strong capex governance is therefore essential to ensure that the H8 programme delivers efficient,

targeted investment that improves outcomes for passengers while avoiding unnecessary upward pressure on charges.

8. Cost of Capital

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

Independent analysis commissioned by the airline community, undertaken by CEPA, estimates an efficient WACC for Heathrow of approximately 4.68% pre-tax CPIH-real, around 120 basis points below the CAA's proposal. Applying a WACC at this level would reduce Heathrow's financing cost allowance by more than £1.2 billion over H8 and lower airport charges by around £3 per passenger. For a hub-dependent network airline such as Iberia, this difference is material and directly affects the viability of feeder services and the sustainability of long-haul connectivity. Iberia therefore 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

Iberia 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 Iberia's view, the CAA's Initial Proposals do not meet this test.

Heathrow is a single, capacity-constrained hub airport benefiting from a stable and diversified demand base, extensive regulatory protections and a single-till framework that materially reduces exposure to systematic risk. Demand volatility is constrained by physical capacity limits, while the single-till framework provides a further stabilising effect by offsetting aeronautical risk with commercial revenues. Taken together, these features imply a risk profile that is significantly lower than that assumed in the Initial Proposals.

Equity beta and relative risk adjustment

Iberia is concerned that the CAA has materially 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 monopoly hub airport operating under a single-till framework.

Independent evidence demonstrates that the CAA's beta estimate is inflated by two compounding issues. First, the use of long-window regression estimates gives disproportionate weight to Covid-period outliers, introducing instability and upward bias. Second, the CAA has failed to apply an appropriate relative risk adjustment, despite Heathrow having materially lower risk characteristics than its comparator airports.

The airline community's evidence shows that the principal comparators relied upon by the CAA, including AENA, Groupe ADP, Fraport and Zurich Airport, are diversified airport groups operating across multiple unconstrained airports and jurisdictions. These characteristics expose comparators to demand and regulatory risks that Heathrow does not face. In previous price controls, including Q6 and H7, the CAA explicitly recognised this distinction and applied a relative risk adjustment. Iberia sees no convincing justification for departing from this established precedent in H8.

Cost of debt and notional capital structure

Iberia 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 weakens incentives for efficient financing and exposes consumers to pass-through risks arising from HAL's specific capital structure and financing choices.

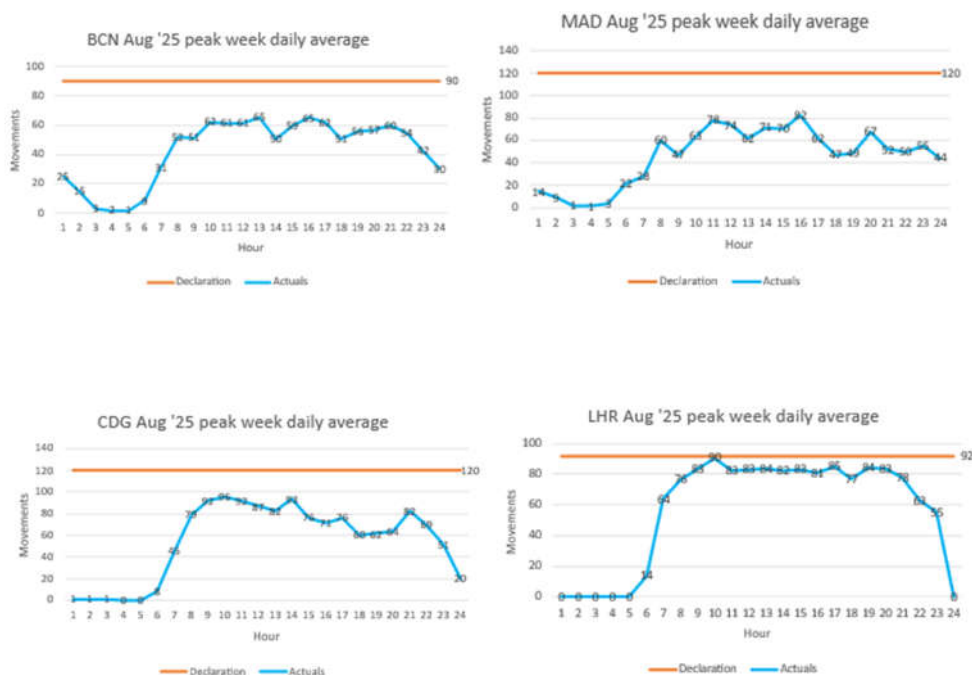
Given Heathrow’s highly leveraged balance sheet, Iberia considers that airlines and passengers should not bear the consequences of financing decisions that go beyond what would be assumed for a notional efficient operator. Iberia therefore supports reverting to a notional cost of debt, consistent with previous CAA practice. Independent analysis indicates that a notional approach would result in a materially lower and more appropriate cost of debt allowance.

Iberia 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.

Capacity constraints and factual inaccuracies

Iberia shares concerns raised by the airline community regarding factual inaccuracies in the CAA’s assessment of capacity constraints across comparator airports. Heathrow operates at or close to its declared runway capacity for much of the operating day, materially limiting demand volatility and downside risk.

By contrast, as displayed in the graph below, major European comparators such as Paris CDG, Madrid and Barcelona operate well below their declared capacities, retaining significant headroom to absorb demand shocks. This distinction is fundamental to assessing systematic risk. Failure to reflect Heathrow’s uniquely binding capacity constraint leads to an upward bias in the estimated beta and, consequently, the allowed return. Iberia considers that this 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).

Iberia’s recommendations on WACC

Based on the independent evidence and the considerations set out above, Iberia 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;
- 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; and
- ensures internal consistency between the risk-mitigating features of the wider regulatory package and the allowed return.

Iberia 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.

Iberia proposal on WACC

Based on CEPA's independent analysis commissioned by the airline community, Iberia 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. Iberia recommendations on the price cap

Based on the above proposals across the cost of capital, operating expenditure, commercial revenues and traffic forecast, Iberia 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.

Iberia 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.