

## Response to CAP2139, Economic regulation of Heathrow Airport Limited: Consultation on the Way Forward

### Executive Summary

**The CAA has a duty to promote competition and has been positive in its support for the concept of competition for infrastructure**

It can be seen that, in various forms, the CAA has been supportive of the concept of competition in the provision of infrastructure at Heathrow.

**CAA12 (following the break up of BAA) ensured that terminal competition would be possible**

We see a “golden thread” of Government objectives and action and CAA views that clearly support the concept of terminal competition. From the Competition Commission (CC)<sup>1</sup> report in 2009, through the introduction of the Civil Aviation Act in 2012 (CAA12) and repeated CAA comments starting in 2017, Arora and then Heathrow West, is justified in considering that terminal competition was a proposal that would be considered appropriately and seriously by the CAA.

**CAA’s duties are consistent with the promotion of terminal competition**

HW’s proposal was consistent with the CAA’s primary statutory duty to promote competition and failure to adequately consider HW’s request for recovery of DCO-related costs would seem to represent a mis-direction by CAA with respect to its duties.

**Airlines strongly supported Arora’s proposals and were keen to understand the possible benefits in terms of terminal competition**

There were many comments from Heathrow airlines expressing their interest in exploring the issues of terminal competition ... *“The consumer interest in the Arora Group scheme going forward is clear.”*

**The Heathrow West proposal would have allowed the expansion to meet the affordability challenge; HAL’s development would not**

It would only have been possible to meet the Government’s affordability challenge (interpreted as charges not increasing) with a combination of HW and HAL. None of the HAL-only options would have met the Government and CAA’s affordability challenge.

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<sup>1</sup> The predecessor to the Competition & Markets Authority

**The HW proposal would have been more efficient (both in terms of cost and environmental impact) than HAL's proposals**

HW's earlier provision of capacity would also have provided the opportunity for lower airline fares and allowed the potential for new airlines and new airline models to be introduced into Heathrow. The ability to rescue the business case, as well as meeting the affordability challenge, would have been another benefit of a successful delivery of the HW proposals.

**Other sectoral regulators are continuing to push for competition in infrastructure**

Competition in the provision of infrastructure is a common feature in other regulated sectors. We consider the case for competition for the provision of infrastructure at Heathrow is consistent with this trend, and fully in line with the CAA's statutory duties.

**HW proposals have already been beneficial for passengers**

Given the range of reports that support the benefits of terminal competition, it is incumbent on the CAA to properly examine the points put by such experts.

**Heathrow West should be treated equitably to HAL and STAL**

Given the nature of the costs that were incurred by HW – directly associated with expansion and related to the DCO process – it is our view that the CAA is obliged to seriously consider HW's requests for cost recovery.

We are happy for this submission to be published.

## **Introduction**

We welcome the CAA's consultation, CAP2139, *Economic regulation of Heathrow Airport Limited: Consultation on the Way Forward*. We discuss each of the points above before we address the CAA's issues as set out in Appendix O of CAP2139. We are very disappointed in the lack of engagement by the CAA with Heathrow West over its request for cost recovery. The CAA has had many consultations on the recovery of HAL's costs. In contrast, the only reference to Heathrow West's proposal is contained in Appendix O of CAP2139.

**The CAA has a duty to promote competition and has been positive in its support for the concept of competition for infrastructure**

The best demonstration of this can be found in the following statement:

*"We act to encourage choice and value to consumers. In doing this, our approach is guided by our statutory duty to promote competition as far as appropriate. Experience has demonstrated that with only a few exceptions, a market based approach, where providers compete with each other on the merits of their offering, across the aviation value chain, has delivered major benefits to consumers."*

This is taken from the second paragraph of the CAA's "Guidance on the Application of the CAA's Competition Powers"<sup>2</sup>. While this statement is provided in the context of guiding stakeholders as to how the CAA approaches the application of competition law, the statement reflects and is consistent with the CAA's general duty applicable to its regulation of dominant airports in section 1(2) of the CAA 2012 which states that the CAA "must" carry out its functions in a manner which it considers "will promote competition in the provision of airport operation services".

The CAA has issued a variety of recent statements in support of the concept of competition within Heathrow Airport made in the context of its consultation on Heathrow expansion. Thus,

- *January 2017 "We remain open to the idea that certain parts of the programme could be subject to commercial agreements between HAL and the airlines (or other parties)...This may include projects such as car parks and possibly the construction of terminal buildings" CAP1510*
- *June 2017: "We are open to the development of such commercial approaches, and proposals to incentivise such developments" CAP1541*
- *April 2018 "We have consistently supported the exploration of alternative commercial and delivery arrangements with a view to establishing whether they could be integrated into the overall plans for capacity expansion in a way that would help protect the interests of consumers." CAP1658*
- *October 2018: "In previous consultations, we have explained the advantages of HAL exploring alternative commercial and delivery arrangements for capacity expansion at Heathrow airport." CAP 1722*

It can be seen that, in various forms, the CAA has been supportive of the concept of competition in the provision of infrastructure at Heathrow.
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**CAA12 (following the CC's break up of BAA) ensured that terminal competition would be possible**

The concept of terminal competition was the subject the Q5<sup>3</sup> review, as well as a focus of the CC when it considered the break-up of BAA. In fact, terminal competition was also assessed by the CAA during the Q4<sup>4</sup> price control process.

The conclusions of the CC's investigation were that powers should be given to the CAA to allow the concept of terminal competition to be considered and, if felt to be in the interests of passengers, to be introduced, with consideration focused on a new sixth terminal at Heathrow.

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<sup>2</sup> CAP 1235

<sup>3</sup> Q5 was 2008 to 2014

<sup>4</sup> Q4 was 2003 to 2008

This is clear from the ancillary documents issued at the time the CAA 2012 was introduced. In the Decision Document<sup>5</sup> issued by the DfT when deciding to develop the Civil Aviation Bill, the Government says:

*“Although there are some risks associated with terminal competition, there are also a number of potential benefits. Firstly, it might represent one way of delivering more timely and appropriate investments as development of terminals is a lot less ‘lumpy’ than the development of new runways. Secondly, it would allow airlines to tailor the services offered at the terminals to their needs which could improve the passenger experience as terminals would better reflect the needs of consumers. Thirdly, this approach may reduce on-going regulatory costs, since where effective terminal competition develops the CAA would only need to regulate runway facilities.*

*To summarise, we do not believe that consultation responses have identified any issues which convince us that the new regulatory regime should explicitly preclude the development of terminal competition in the future. As the CAA, in assessing whether terminal competition at a particular airport would be in the interests of passengers, would need to ensure that any potential risks are addressed, we believe the new regulatory regime should not prohibit the development and operation of competing terminals.”*

Once CAA12 was enacted, the Guidance Notes<sup>6</sup> explained:

*“This section introduces the concept of an ‘airport area’ (and therefore a ‘dominant airport area’) to allow for the possibility of there being more than one operator at an individual airport. This could be the case, for example, if an airline acquired or leased a terminal building. As there can be more than one ‘airport area’ at an airport, it follows that there can be more than one ‘operator of an airport area’ at an airport.”*

We therefore see a “golden thread” of Government objectives and action and CAA views that clearly support the concept of terminal competition. From the CC report in 2009, through the introduction of the CAA12 and repeated CAA comments starting in 2017, Arora and then HW, is justified in considering that terminal competition was a proposal that would be considered appropriately and seriously by the CAA.

### **The CAA’s duties are consistent with the promotion of terminal competition**

The objective of introducing CAA12 was to reform the framework for airport economic regulation to “benefit passengers and support investment in better facilities”<sup>7</sup>. It was also to promote competition; “Effective competition is a crucial enabler of growth. Competitive markets are the best way in the long run to deliver the goods and services that consumers want at minimum cost. Effective competition also incentivises firms to invest and improve

<sup>5</sup> Reforming the Framework for the Economic Regulation of Airports: Decision [Document](#), DfT, 2009

<sup>6</sup> <https://www.legislation.gov.uk/ukpga/2012/19/notes/division/4/1/1/3/1>, paragraph 45

<sup>7</sup> Para 2.1, Policy Paper of Secretary of State for Transport when Civil Aviation Bill was presented to Parliament

*efficiency, choice and service quality*<sup>8</sup>. The Government went on to explain when introducing the Civil Aviation Bill:

*“It is essential that the CAA’s priorities are clear. The Government therefore proposes to replace the four duties with a single primary duty to further the interest of consumers (that is passengers and owners of cargo both present and future), wherever appropriate by promoting competition. This is consistent with the Government’s Principles for Economic Regulation which state that the role of economic regulators should be focused on protecting the interests of end users.”*

This duty was enacted at section 1(2) of the CAA12 which places a general duty on the CAA when conducting its economic regulatory activities (i) to carry out its functions in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, costs and quality of Airport Operation Services<sup>9</sup>, and (ii) that the CAA must [our emphasis] carry out its functions, where appropriate, in a manner that will promote competition in the provision of Airport Operation Services. In discharging this primary duty, the CAA has a number of other matters to which it should have regard, including:

- The need to promote economy and efficiency on the part of licensees in the provision of Airport Operation Services, and
- The need to secure that the licensee is able to take reasonable measures to reduce, control and/or mitigate adverse environmental effects.

As we have outlined in previous submissions, we consider that the CAA should be promoting the type of competition envisaged by CAA12, and before that the CC. HW’s proposals for terminal development would have reduced the price of Heathrow’s expansion, reduced its environmental impact and driven efficiencies across Heathrow’s proposals. Thus, in our view, HW’s proposal is consistent with the CAA’s primary and other duties.

HW’s proposal was consistent with the CAA’s primary and other duties and failure to adequately consider HW’s request for recovery of DCO-related costs would seem to represent a mis-direction by CAA with respect to its duties.

### **Airlines strongly supported Arora’s proposals and were keen to understand the possible benefits in terms of terminal competition**

In our previous submission to the CAA, the response to CAP1940, we noted the many comments from Heathrow airlines expressing their interest in exploring the issues of terminal competition. Indeed, Arora undertook significant engagement with airlines and would not have proceeded with its proposals without airlines being supportive. While not repeating the comments here, the following IAG extract<sup>10</sup> summarises its views:

<sup>8</sup> Para 2.5, Civil Aviation Bill Policy Paper

<sup>9</sup> Airport Operation Services include services provided by terminals such as “the arrival or departure of passengers and their baggage”

<sup>10</sup> Extract from IAG response to CAP1722.



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*“The Arora Group scheme offers a genuine alternative to HAL’s proposal that could be built, delivered and operated and has brought competitive pressure to bear on HAL. This is of huge importance to the Expansion process as a whole highlighting that there are alternatives to the continued HAL monopoly of airport services and the design and build of Expansion at Heathrow. The consumer interest in the Arora Group scheme going forward is clear.”*

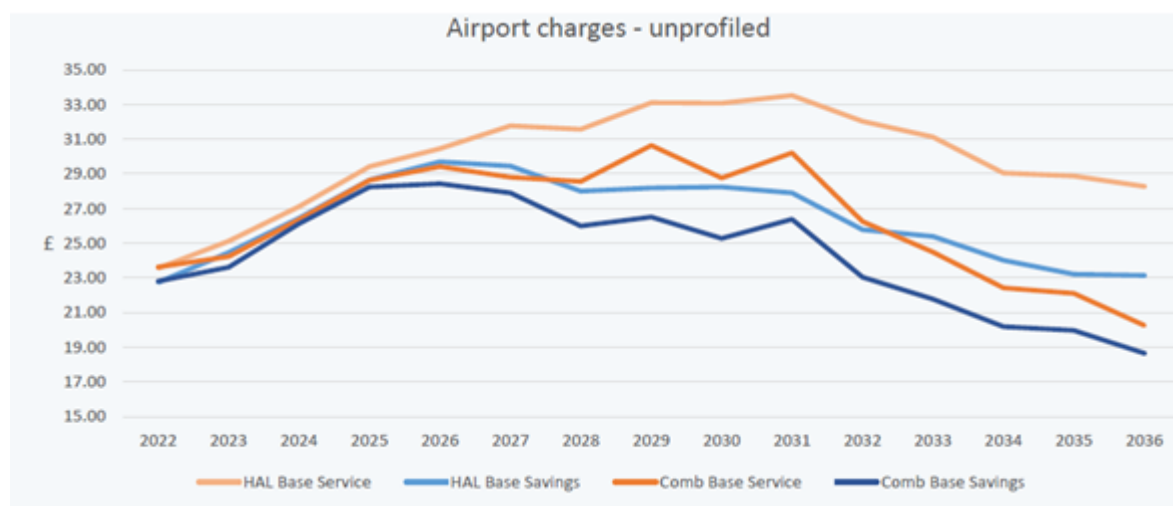
There were many comments from Heathrow airlines expressing their interest in exploring the issues of terminal competition ... *“The consumer interest in the Arora Group scheme going forward is clear.”*

### **The Heathrow West proposal would have allowed the expansion to meet the affordability challenge; HAL’s development would not**

In approving the selection of Heathrow as the Government’s choice for runway expansion, the Government set HAL (and the CAA) an “affordability challenge”. This is defined as keeping airport charges flat in real terms when compared to 2016. It was never clear whether HAL had ever agreed that its proposals would meet the affordability challenge, with vague references to charges being “close to” 2016 levels.

In our response to CAP1812, “Working paper Heathrow expansion – affordability and financeability update”, we had a detailed discussion of the challenges facing HAL and the CAA in meeting the Government’s “affordability challenge”. The comments here should be read in conjunction with that submission. Both the IAG response and that of Heathrow Hub cast doubt over the ability of HAL, and therefore the CAA, to deliver the affordability challenge.

HW had started modelling the implications of the HW scheme upon the overall costs of the Heathrow expansion. We compared the costs set out in the Heathrow business plan and a combination of Heathrow and HW. While this work was at an early stage, early indicative analysis is shown the graph below illustrating the potential cost per passenger in real prices over time:



To develop this analysis<sup>11</sup>, we sought to replace elements of the HAL expansion programmes<sup>12</sup> with the equivalent elements of the HW terminal and terminal-related expansion. As can be seen from the graph, our early views were that it would only have been possible to meet the Government's affordability challenge with a combination of HW and HAL. None of the HAL-only options would have met the affordability challenge.

It would only have been possible to meet the Government's affordability challenge (interpreted as charges not increasing) with a combination of HW and HAL. None of the HAL-only options would have met the Government and CAA's affordability challenge.

**The HW proposal would have been more efficient (both in terms of cost and environmental impact) than HAL's proposals**

The benefits of the HW development are summarised below:

- The introduction of competition in development, ownership and operation;
- Delivery of additional terminal capacity efficiently and affordably;
- Significantly lower construction costs;
- Flexibility to enable a phased increase in terminal capacity in a timely manner and in line with demand;
- Reduced costs for consumers and improved passenger experience;
- Greater design quality and operational efficiency, brought about by the Arora Group's extensive experience in airport based developments;
- Integration of existing and new public transport interchanges in a single location to support key modal shift;
- Reduced land take and impacts with a positive focus on communities; and
- Fully sustainable approach to development and operation.

The other aspect that we had addressed before the project was put on hold was the impact on airline fares of bringing terminal capacity on earlier than the HAL proposals. HAL was proposing an incremental expansion of terminal capacity, matching forecast demand for the runway with supply of terminal capacity. HW had assessed that it would be more efficient to deliver capacity in 2 phases, possibly 2028 followed by 2030. Much of the efficiency and environmental benefit of the HW scheme derived from this enhanced construction schedule.

Moreover, HW considers that earlier provision of terminal capacity would have facilitated greater competition between airlines and would have delivered this earlier than would have been allowed under the HAL scheme. This earlier provision of capacity would therefore have led to lower airline fares than under the HAL scheme. HW's earlier provision of capacity would also have allowed the potential for new airlines and new airline models to be introduced into Heathrow.

In passing, we note that the incremental traffic forecast that had been issued by HAL was at odds with the very dramatic take-up of capacity that was assumed by the Airports

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<sup>11</sup> HAL base service and HAL base savings taken from the HAL business plan and "comb" refers to HW's assessment of the project combining HAL runway costs and HW terminal costs.

<sup>12</sup> HAL at the time was proposing 2 programmes, a "service" programme and a "savings" programme

Commission and the Government when designating Heathrow as the location of the next runway in the South East. We consider that this undermined the business case for expansion and that this would have been revealed during the Planning Enquiry (and the inevitable legal challenges that would follow any approval for expansion). The ability to rescue the business case, as well as meeting the affordability challenge, would have been another benefit of a successful delivery of the HW proposals.

HW's earlier provision of capacity would also have provided the opportunity for lower airline fares and allowed the potential for new airlines and new airline models to be introduced into Heathrow. The ability to rescue the business case, as well as meeting the affordability challenge, would have been another benefit of a successful delivery of the HW proposals.

### **Other sectoral regulators are continuing to push for competition in infrastructure**

From its encouraging comments with respect to the possible benefits of terminal competition, the recent CAA consultation (CAP2139) is almost silent on the issues associated with terminal competition. While we see the concept of terminal competition has most relevance in the context of runway expansion, we still expect the CAA properly to consider HW's request to have its costs allowed, in line with CAA's approach to HAL with respect to HAL's Category B costs.

In contrast to the CAA's relatively benign view currently, other sectoral regulators – who also have duties to promote competition – are pushing forward with the concept of competition for the provision of infrastructure:

- Ofgem has introduced competition for the provision of offshore transmission capacity;
  - *Our key objectives of the OFTO regime in running competitive tenders for offshore transmission licences are to:*
    - ....
    - *Provide certainty and best value to consumers through the competitive process*<sup>13</sup>
- Ofgem is now proceeding to introduce competition for the provision of onshore transmission capacity (despite the legal complications that are arising in the absence of primary legislation):
  - *Competition in the design and delivery of energy networks is a central aspect of the RIIO-2 price controls. It has a key role to play in driving innovative solutions and efficient delivery that can help us meet our decarbonisation targets at the lowest possible cost to consumers*<sup>14</sup>
- Ofgem has also introduced competitions where market solutions (via a series of tenders) are intended to substitute for the provision of transmission capacity entirely:
  - *To exceed our expectations the ESO would have to deliver tangible new markets and product developments within 2020-21. These markets and*

<sup>13</sup> [Decision](#) on developments to the tender process within the current OFTO regime, Ofgem, April 2021

<sup>14</sup> RIIO-2 Final [Determinations](#) – Core Document, Ofgem, December 2020



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*products should be implemented in a manner that ensures fair competition and a level playing field for market participants through competitive, close to real time procurement and standardised requirements<sup>15</sup>.*

- Ofwat introduced competition for the provision of the “super sewer” that is now being constructed beneath London:
  - *“Cathryn Ross, Ofwat’s Chief Executive, said: “Once the tunnel had been confirmed as the best solution to the problem of sewage in the Thames, our job at Ofwat was to work with government and the project to make sure that Thames Water’s customers got a fair deal. Going out for competition on the construction and financing costs of the tunnel has resulted in significant savings”<sup>16</sup>*
- Ofcom has always supported infrastructure competition, with the arrival of companies such as CityFibre complementing the competition between Virgin and Openreach;
  - *Investment in new fibre networks will create an alternative means of delivering world-class connections to people and businesses, in addition to the innovations in copper-based technologies currently being planned by BT, and advanced improvements to Virgin Media’s cable network. Together, new investments will help secure the UK’s position as a world leader in the availability and capability of its digital networks.<sup>17</sup> and*
- Ofcom sought to encourage competition in end-to-end letter delivery:
  - *In developing the March 2012 regulatory framework, we considered that access competition was beneficial and should be retained. We considered it would help to incentivise the financially sustainable and efficient provision of the universal service, without threatening its sustainability (provided access prices reflect Royal Mail’s costs).*
  - *We also considered that access was likely to be an important component in facilitating the development of end-to-end letter competition, as it allowed potential end-to-end entrants to develop a customer base and offer a national delivery service without the prohibitive expense of delivering to all addresses. This was likely to be particularly important as delivery operators enter the market and gradually roll-out to additional geographic areas.<sup>18</sup>*

As can be seen, the encouragement of infrastructure competition is well advanced in other sectors.

As a final point, we remain ready to deliver the benefit to passengers that would arise from terminal competition, regardless of whether there is a new runway. That is, we recognise the economic and policy uncertainty over the future of the third runway. Nevertheless, the

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<sup>15</sup> Ofgem formal opinion on the Electricity System Operator’s Forward [Plan](#) for 2020/21, May 2020

<sup>16</sup> The [Guardian](#), August 2015

<sup>17</sup> Making Communications work for everyone, [Ofcom](#), 2016

<sup>18</sup> [Review](#) of the Regulation of Royal Mail, Ofcom, 2016

need for extra terminal capacity at Heathrow remains strong as we would expect passenger throughput to return to previous levels in due course, and then continue to grow as runway and airspace technology improves runway utilisation. Therefore, we consider that this new terminal capacity – perhaps 20mppa – could and should be delivered by a competitor to HAL. This would bring genuine choice to airlines and passengers and move away from the “one size fits all” approach that has to date been adopted by HAL.

Competition in the provision of infrastructure is a common feature in other regulated sectors. We consider the case for competition for the provision of infrastructure at Heathrow is consistent with this trend, and fully in line with the CAA’s statutory duties.

### **HW proposals have already been beneficial for passengers**

We imagine that the HW proposals were beneficial by putting downward pressure on HAL’s costs. We consider it no coincidence that when Arora announced its plans for expansion in June 2017, that HAL rapidly produced a scheme that purported to be £2.5bn cheaper than the plan approved by the Government. This figure also happened to be slightly lower than the figure that had been issued by Arora. In reality, this was not a like-for-like comparison since HAL was only proposing to deliver part of the project approved by the Government. As notified to the CAA at the time, we consider that the overall cost of the HAL expansion was at least £32.5bn, to be compared to the c. £17.5bn assumed by the Airports Commission.

To support this view, there have been a number of independent and / or commissioned reports that conclude terminal competition is in the interests of passengers. These were summarised in HW’s response to CAP1812 and include:

- The Walbrook Report: *“By opening different terminals up to competition from different operators, this will quickly drive improved efficiency, increased choice and drive down prices”*
- The Adam Smith Institute: *“The existence of competition between airport terminals would diminish, if not alleviate, the need for other airport regulations and price controls. It would encourage investment in terminal capacity consistent with market demand, ensure terminal facilities are provided in an efficient manner, lower regulatory costs in the longer run, and reduce the need for price controls.”*
- Frontier for easyJet: *“Involving players other than the existing airport operator, in the provision of terminal facilities could be expected to result in a more efficient delivery of required additional terminal capacity.”*
- Alix Partners for Heathrow West: *“We conclude that there are substantial benefits of competition at the various stages in passenger terminal provision.”*  
*“The benefits of competition at the operations stage will expand beyond operational cost savings and an increased use of commercial deals between terminal operators and airlines. Entry by airlines with different business models (i.e. LCCs) could stimulate competition between airlines and thus drive further benefits for passengers and the UK economy as a whole.”*

The CAA's own consultants, Arcadis, came to the following *conclusion* with respect to the HW proposals:

- *“prima facie, this provides some evidence that such competition is in the interests of passengers and that it was clear the interest of the consumer was considered a core objective in the delivery of Heathrow West's proposals”*

Given the range of reports that support the benefits of terminal competition, it is incumbent on the CAA to properly examine the points put by such experts.

### **Heathrow West should be treated equitably to HAL and STAL**

Through a number of consultations, the CAA has concluded that HAL should be entitled to recover the vast majority of its expenditure to date in pursuance of the DCO. The most recent document<sup>19</sup> proposed that over £500m should be added to RAB and recovered from airlines.

Following extensive consultation, the CAA's policy position was set out in 2017<sup>20</sup>, *“The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement”*:

*“Our final policy decision is that Category B costs should be defined as costs which are directly associated with, and solely for the purposes of, seeking planning consent for the delivery of new runway capacity, including through the Development Consent Order (DCO) process.”*

*“Category B costs incurred, including those recovered through the licence modification that we made on 21 December 2016, will be subject to ongoing governance and efficiency tests”<sup>21</sup>*

We draw several conclusions from the CAA's final policy position.

First, the policy applies to costs incurred in pursuance of a DCO seeking planning consent with respect to the costs associated with the delivery of new runway capacity. Clearly, costs associated with the provision of terminal capacity are accordingly “associated costs”.

Second, and following on from the first point, HW's costs are direct costs associated with the delivery of new runway capacity. The proposal would have fitted seamlessly into the provision of the third runway and associated airfield infrastructure by HAL. The costs were solely incurred in pursuance of a DCO. As such, HW's costs fall directly into the definition set out by the CAA.

Third, HW expects to follow the same process that has been put in place by the CAA for HAL. This would include transparency of HW's costs, an efficiency review and engagement with the airlines. HW can confirm that it is content to follow this process.

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<sup>19</sup> CAP1996

<sup>20</sup> CAP1513, paragraph 1.11

<sup>21</sup> CAP1513, Paragraph 1.14

Fourth, we note that this policy – first promulgated in 2016<sup>22</sup> – appears to relate only to HAL’s costs. This policy was therefore set prior to HW’s proposals being made public in 2017. Nevertheless, given the nature of the costs that were incurred by HW – directly associated with expansion and related to the DCO process – it is our view that the CAA is obliged to seriously consider HW’s requests for cost recovery. Indeed, the CAA’s policy proposals in 2016 gave HW every indication that such costs would, in due course, be recoverable. We would expect this cost recovery to be via the HAL RAB, in the way that has been proposed by the CAA.

Finally, we note that the CAA’s policy position for costs associated with runway development at Heathrow is consistent with its views with respect to the abortive second runway at Stansted (STAL), when it was considering setting a price control for Stansted Airport<sup>23</sup>:

*“STAL, consistent with government policy at the time, started to develop a second runway to ensure sufficient capacity going forward. Some of these costs were included in STAL’s RAB. While this long-term project has been abandoned, these costs are being recovered through current users of the airport.”<sup>24</sup>*

Given the nature of the costs that were incurred by HW – directly associated with expansion and related to the DCO process – it is our view that the CAA is obliged to seriously consider HW’s requests for cost recovery.

## **The CAA’s issues**

We now turn to the CAA’s issues as contained in Appendix O of CAP2139. We have reproduced each of the 3 CAA statements and comment accordingly, drawing on the material set out above.

***“Heathrow West’s proposals formed part of a standalone commercial project that it chose to commence without prior agreement on how it should be funded. We are mindful of this context when considering whether or not to allow Heathrow West to recover its costs”***

HW agrees that its work commenced without CAA prior approval as to how it should be funded. However, this was also the case with respect to HAL. That is, HAL spent over £500m of costs before indicative CAA approval to recover all of these costs was received by HAL. Indeed, the CAA is still consulting on elements of these costs, such as the wind-down costs and the costs of the Supreme Court action.

Having seen the direction of travel as outlined in the main CAA consultations on the subject of HAL’s Early Costs, it seems reasonable that HW should have been entitled to expect similar treatment with respect to costs, associated with runway development and related to seeking a DCO. Or, put simply, there was no need for the pre-approval given the

<sup>22</sup> CAP1469, November 2016

<sup>23</sup> In fact, Stansted was subsequently found not to have met the Market Power Test in January 2014, and is no longer subject to direct economic regulation.

<sup>24</sup> CAP1030, Paragraph 3.25, April 2013

regulations. Furthermore, any suggestion of pre-approval of such costs would immediately eliminate any potential competition, which would contravene the CAA's own policies.

HW's expectations in this regard are consistent with the proposed regulatory framework that HW put to CAA during 2019. In that submission, HW proposed a Heathrow West Regulatory Asset Base. This was intended to allow the direct regulation of Heathrow West by the CAA, should it choose to regulate in this way. Clearly, the establishment of a RAB would have allowed the recovery of HW's Early Costs.

However, and more fundamentally, it is remarkable (particularly in light of the CC report and the objectives of the CAA 2012) that for such a major infrastructure project, the CAA had not considered incorporating a competitive process into the expansion process. HW should not be penalised for seeking to challenge the presumption that only HAL could take forward some or all of Heathrow expansion.

***“regarding our duty to promote competition where appropriate, we consider that Heathrow West emerged as a new potential terminal provider without the CAA having a policy that allowed such parties to recover their costs. So, it is not clear that such a policy is required to promote appropriate competition in the future. That said, we would not want to set a precedent against cost recovery for new potential providers, if that would stifle the emergence of appropriate competition in future”***

As explained above, the CAA has made 2 decisions regarding Early Costs. The first related to the second runway at Stansted, and the second related to the third runway at Heathrow. We also note that CAA's consultations on Early Costs included the possibility that Gatwick would have been able to recover Early Costs, had it been selected for runway expansion. The conclusion that must be drawn is that Early Costs are recoverable by parties pursuing a DCO application.

The CAA comments that given that HW emerged as a competitor to HAL without having a policy in place to allow HW to recover its costs, a cost recovery policy is clearly not required. First, as explained above, HAL proceeded to incur costs, which in fact doubled over the course of 1 year, before confirmation from the CAA that this higher level of costs would be recoverable. Second, we struggle to see how the CAA's duties to promote competition can be reconciled with a regulatory approach which allows a regime where the incumbent is reimbursed for its costs, whereas a new entrant – expecting to be regulated – does not. This clearly does not sit with the CAA's duties to promote competition or to act proportionately and consistently.

The evidence above shows that:

- CAA12 was drafted to allow terminal competition;
- This competition was encouraged by the CAA (recognising that a final policy position was some way off);
- The possibility of terminal competition was attractive to the airlines; and
- HW was entitled to expect fair treatment by the CAA with respect to its project to deliver Government policy.



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***“we should consider Heathrow West’s request in the light of the requirements under CAA12 for us to act transparently, consistently, proportionately and in a way that is targeted at cases where action is needed. Given that it is not clear that cost recovery is required to encourage appropriate competition and there has been little specific and quantified evidence of a clear benefit for consumers from Heathrow West’s proposals, it may not be necessary or proportionate to allow cost recovery.”***

It is difficult to see the case for HW to take forward a competing terminal project if the signal from the CAA is that HAL will be recompensed (even when its costs exceed £500m, including a doubling of costs in one year) while a competitor is not duly recompensed.

We recognise that an alternative approach would be to disallow both company’s costs. We have confirmed to the CAA that if HAL withdraws its request for Early Costs, then HW will also withdraw its application for Early Costs.

We have outlined above extensively why HW and numerous others consider that terminal competition will benefit consumers and accordingly this should not be a barrier for HW to recover its costs.

The policy imperative to have some competitive constraint over HAL is only reinforced when we consider HAL’s request to have £2.5bn added to its RAB due to traffic under-performance as a result of the Covid-19 pandemic. Other large airports such as Gatwick, Manchester and Stansted are not, as far as we are aware, seeking to avoid the traffic consequences of the pandemic. HAL’s apparent belief that it is entitled to transfer traffic risk to the airlines, is directly at odds with the Q6 settlement (where traffic risk is borne by the airport), and aptly demonstrates why competitive pressure must be brought to bear on HAL’s operations.

**In conclusion, failure to recompense HW for its costs, incurred efficiently, in line with the CAA’s policies, would represent a failure by the CAA to properly understand its statutory duties. Equally as important is that it would send a clear signal that competition is not welcome at Heathrow Airport.**