

Heathrow West's request for cost recovery: decision

CAP2524H

Published by the Civil Aviation Authority, 2023

Civil Aviation Authority
Aviation House
Beehive Ring Road
Crawley
West Sussex
RH6 0YR

You can copy and use this text but please ensure you always use the most up to date version and use it in context so as not to be misleading, and credit the CAA.

First published 2023

Enquiries regarding the content of this publication should be addressed to: economicregulation@caa.co.uk

The latest version of this document is available in electronic format at: www.caa.co.uk

Contents

Contents	3
Introduction	4
Stakeholders' views	4
Our views	7
Our Decision	9
Regulatory arrangements	12

Introduction

1. In response to our June 2020 document “Economic regulation of Heathrow: policy update and consultation”,¹ Heathrow West wrote to us requesting² that it be allowed to recover the costs that it had incurred in developing the “Heathrow West” project.³ Heathrow West considered that the CAA should adopt this approach because it was the only approach compliant with:
 - “fairness principles”, since the CAA was consulting on allowing Heathrow Airport Limited (“HAL”) to recover its costs of seeking a development consent order (“DCO”);
 - the CAA’s duties and powers; and
 - Government policy.
2. We consulted stakeholders on Heathrow West’s request in our April 2021 document Consultation on the Way Forward for HAL’s “H7” price control (the “Way Forward” document).⁴ Several of the responses to that consultation addressed these issues. We considered these responses and issued a draft decision in the light of them in August 2022 (the “Draft Decision”).⁵ We received two responses to that Draft Decision which we have now considered before issuing this final decision.
3. This document sets out more of this background, together with a summary of stakeholders’ responses and our views on them. It then sets out our final decision on these matters, together with the reasons for it.

Stakeholders’ views

4. Of the responses to the Way Forward document:
 - Heathrow West reiterated the views it set out in its original request;
 - airlines considered that it was not in consumers’ interests to pass on the costs of what they saw as speculative proposals as there is little prospect of capacity expansion proceeding;
 - an airline welcomed the prospect of terminal competition in future, encouraging the CAA to consider further how to capture its benefits, but did not support recovery of Heathrow West’s costs;
 - the AOC/LACC considered Heathrow West should seek to recover its costs from the Government; and

¹ Available online: <https://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=9669>

² Available online: <https://www.caa.co.uk/media/q2vfyyoh/cap1940-heathrow-west.pdf>

³ The costs in question are those incurred in developing an application for planning consent under the Planning Act 2008 for its proposal to deliver a terminal as part of the expansion of Heathrow Airport in response to the Airports National Policy Statement (“NPS”).

⁴ Available online: <https://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=10401>

⁵ Available online: <https://publicapps.caa.co.uk/docs/33/Heathrow%20West%20cost%20recovery.pdf>

- HAL said that CAA does not have the power to grant Heathrow West's request, that recovery would not be in the consumer interest, and that Heathrow West was attempting to "free ride" on HAL's efforts having entered the expansion process at its own risk. It reiterated its view that inter terminal competition was unlikely to be in the interests of consumers.

5. The Draft Decision set out our position that:

- it would not be in the interests of consumers to allow Heathrow West to recover its costs at this stage;
- Heathrow West had not provided sufficient evidence that its work has delivered benefits to consumers that are proportionate to the size of its request. It is not clear that cost recovery is needed to further the interests of consumers by promoting competition, given that Heathrow West brought forward its proposals without prior agreement with the CAA on funding mechanisms;
- we were not convinced that it would be a proportionate approach, or targeted at the circumstances we now find ourselves in, where the focus is on the operation of a two runway airport, not expansion, to set a regulatory precedent allowing Heathrow West to recover its costs;
- there would be the potential for significant consumer detriment if the regulatory regime developed in such a way that it provided a means of underwriting the costs of commercial proposals developed outside the established regulatory framework as there would be a risk of consumers funding wasteful or duplicative spending. It is not clear that to allow Heathrow West to recover £30 million of costs would be proportionate to any benefit consumers might have received from that expenditure; and
- the position of Heathrow West was distinct from that of HAL, where the recovery of costs is subject to the terms of its economic licence and the price control process: given that Heathrow West is not a regulated airport operator, it is consistent with the overall scheme of regulation under Civil Aviation Act 2012 ("CAA12") that the position in relation to cost recovery by HAL and Heathrow West may be different and that "fairness principles" are not part of the matters that the CAA must consider under CAA12 save to the extent that similar notions are relevant under its duties.

6. We also noted that:

- Government policy in the NPS was designed not to exclude alternative developers, but that did not imply that they should benefit from the same treatment as HAL;
- comments made by the Competition Commission in a report in 2009 in a different context do not provide direct or strong support for Heathrow West's request;

- Heathrow West had proceeded with its project without agreement from the CAA that its costs should be borne by consumers irrespective of whether it was successful; and
 - Heathrow West's proposals were paused at a relatively early stage and before unambiguous benefits to consumers from its project could be evidenced, so it is not possible for the CAA to conclude now that the proposals were in the interests of, and should be borne by, consumers.
7. Nonetheless, we made clear that the Draft Decision did not set a precedent for how the CAA might act in the future, nor should it be taken as the CAA expressing a view that the Heathrow West project would not have been credible or that its promoter would not have been capable of delivering it.
8. In response, we had two submissions.
9. Heathrow Hub made no comment on the specific issue of Heathrow West's "claim", other than to state that it was a "positive and timely contribution to the fundamental question of competition in the provision of airport infrastructure at Heathrow". Its response focussed on the need for competition to be introduced at Heathrow, calling on the CAA to conduct a review, and set out processes and evidence requirements for how an alternative promoter could: (i) seek prior agreement with the CAA on funding mechanisms, (ii) demonstrate consumer benefit, (iii) be considered in a consistent way to an existing regulated promoter, and (iv) be considered for cost recovery. As such, Heathrow Hub's response was forward-looking in encouraging the CAA to look further at how competition might best be promoted, rather than giving a view that Heathrow West's costs should be recoverable in this case.
10. Heathrow West's response was provided by the Arora Group,⁶ its parent. It disagreed with the CAA's approach on the grounds that the CAA had made a number of errors, namely that:
- the CAA is fettering its discretion and setting an unreasonably high bar to cost recovery by imposing a test that Heathrow West must provide "unambiguous", "tangible and quantifiable" benefits to consumers with "specific and/or quantified evidence of a clear benefit" to consumers, and that this test stifles competition contrary to the CAA's duties;
 - the CAA has unreasonably taken a retrospective approach, ignoring both benefits that Heathrow West considered that it was set to deliver had the third runway not been paused by HAL in circumstances beyond Heathrow West's control, and that the CAA considered that expansion was in the interests of consumers at the time that Heathrow West was incurring costs; and

⁶ We refer to Heathrow West and the Arora Group collectively in this decision as "Heathrow West".

- the CAA's approach is inconsistent with its approach in relation to HAL as well as its approach to surface access costs, earlier decisions on the regulation of Stansted and wider regulatory framework and the approach taken by other regulators to promoting competition as well as being inconsistent with Government policy, represented by the NPS.

Our views

11. We note that Heathrow Hub's submission was more general and forward looking in nature and made no comment on the specific issue of Heathrow West's claim. While we note its contents, we do not consider that this submission sheds significant light on the question of whether the costs of the Heathrow West project should be borne by consumers.
12. Our views on the main issues raised by Heathrow West's response are addressed in the following paragraphs.

Fettering discretion

13. Our decision on whether Heathrow West being able to recover its costs will further the interests of consumers relates solely to that request and is based on the submissions made to the CAA in relation to that project alone. As such, the decision is specific to the facts of the present case. As we said in the Draft Decision, our decision on the recoverability of the costs of the Heathrow West project sets no precedent for how we will act in relation to competing projects to develop infrastructure at regulated airports in the future and, so, does not fetter the CAA's discretion in relation to such projects in any way.

Unreasonable test/too high a threshold for recovery, retrospective approach

14. The Draft Decision made clear that, as a matter of fact, the CAA considered that the evidence Heathrow West has provided was not sufficient to justify a decision that its costs should be recoverable. The use of the words "tangible and quantifiable benefits" were used in the Draft Decision only to describe the evidence that Heathrow West had (not) provided, rather than set any test or threshold that should be met to justify the recovery of the costs requested. As such, the CAA does not consider that it has set either an unreasonable or a retrospective test.

15. In this context, we note that Heathrow West's response to the Draft Decision, as with previous submissions on this matter, continued to rely on general arguments "from principle" about the benefits of competition and the benefits for consumers that Heathrow West itself expected the project to bring, rather than more specific evidence that it would be proportionate for the CAA to exercise its discretion to allow Heathrow West to recover its costs. The CAA's Draft Decision made clear that the evidence it had seen at the time it published the Draft Decision was not sufficient to make an intervention of the size requested in the interests of consumers. We do not consider that the submission provided in response to the Draft Decision provided arguments or evidence that were significantly more robust or persuasive than those provided by Heathrow West previously.

Stifling competition

16. We note that Heathrow West's response asserted that "the CAA must, when exercising its power to ensure recovery of costs, do so in a manner that promotes competition", but that this line of argument did not address the use of the clear wording of section 1(2) of the CAA12, that the CAA

must carry out its functions in a manner which it considers will promote competition “where appropriate”.

17. Having considered the CAA’s duties as a whole, our view is that the evidence and arguments provided by Heathrow West is not sufficient to make it “appropriate” to promote competition in the way Heathrow West advocates as it would not be proportionate for the CAA to impose significant costs of around £30 million on consumers without further justification.

Inconsistency with other CAA decisions and Government Policy

18. Heathrow West decided to proceed with the Heathrow West project without agreement on cost recovery and so did so on the basis of being “at risk”. This was Heathrow West’s commercial decision. One of the risks Heathrow West therefore exposed itself to was that the project would end before it had reached a stage where the CAA had taken a decision on how Heathrow West’s costs should be dealt with. In practice, this risk crystallised because the project ended at a relatively early stage when the CAA had not conducted significant work on this matter or made such a decision at the point the project ended. While Heathrow West did argue⁷ that:

- the CAA’s approach to the recovery of HAL’s expansion costs should be replicated for it; and
- a charge should be added to HAL’s airport charges to recover the planning costs of the Heathrow West project, even if it were unsuccessful in planning consent

this request was made when the project was already “paused”. At that stage, the work that the CAA (and its consultants, Arcadis) had undertaken at that point was expressly limited to a prioritisation exercise as to whether the CAA should conduct more detailed work on the proposals.^{8, 9}

19. We maintain our position that Heathrow West’s position is distinct from that of HAL’s position because HAL is a regulated airport operator subject to the long-standing approach of UK economic regulators (as expressed in relation to the recovery of abortive costs in relation to Stansted) that efficient costs incurred are recoverable, while Heathrow West is not regulated. As a result, it is not obvious that their treatment should be the same. In any event, the level of HAL’s costs was not “agreed” by the CAA, but assessed for inclusion in its RAB as part of the development of HAL’s price control arrangements.

⁷ In its response to CAP1871 (“Economic regulation of Heathrow Airport Limited: policy update and consultation on the early costs of capacity expansion”), available online at <https://www.caa.co.uk/media/40qkn4gd/heathrow-west-2.pdf>

⁸ See “Economic regulation of capacity expansion at Heathrow: policy update and consultation” (CAP1782) at paragraphs 4.20 ff. See: www.caa.co.uk/CAP1782

⁹ See “Economic regulation of Heathrow: policy update and consultation” (CAP1940) (www.caa.co.uk/CAP1940) in which the CAA gave an update on the “initial tests” that the CAA was using to prioritise its resources in the light of a report by the CAA’s consultants, Arcadis. That report found that Heathrow West had provided evidence of sufficient progress against the initial tests and the CAA’s assessment was that Heathrow West’s proposals were likely sufficient for the CAA to commence more detailed work on them. However, given the circumstances of the Court of Appeal’s decision on the lawfulness of the NPS and the covid-19 pandemic, the CAA confirmed that it would not be undertaking further work unless circumstances changed sufficiently to justify it.

20. As for Government policy, it should be noted that this was expressed in terms of planning policy in the form of the NPS. The approach taken to alternative developers in the NPS was facilitative rather than prescriptive and the CAA's approach has been consistent with it (for example in developing the Technical Information Note (see footnote 11). Similarly, if the Parliamentary materials on the CAA12 facilitating competition quoted by Heathrow West were relevant (which the CAA considers they are not) the CAA's approach is consistent with them as these materials only addressed the possibility of competition, rather than it being a specific goal of CAA12.
21. As for the approach taken by other regulators in promoting competition, this is not directly relevant and some of those arrangements (such as competition in offshore electricity transmission) benefit from specific statutory underpinnings which are not relevant to the matters under consideration here. While CAA12 requires the CAA to have regard to ensuring consistency, this does not relieve the CAA of its primary duty to carry out its functions in a manner it considers will further the interests of consumers or provide a clear answer as to whether promoting competition is "appropriate" in the specific of the current matter.

Other comments

22. While we note Heathrow West's comments on s21(1)(b) CAA12 in relation to what licence conditions may contain, we consider that this provision would be relevant only if the CAA had decided that Heathrow West's costs should be recoverable. Given that the CAA has decided that this is not proportionate to further the interests of consumers, this section is not engaged.

Our Decision

23. Having considered stakeholders' views carefully alongside our powers, duties and assessment of the interests of consumers and, in particular, the submissions made in response to the Draft Decision, the CAA has now reached its final decision on whether Heathrow West should be able to recover its costs in relation to the Heathrow West project. For the reasons set out in this decision, we do not consider that it is appropriate for the CAA to allow the recovery of Heathrow West's costs, even if such recovery might promote competition in the provision of airport operation services at Heathrow airport.
24. Having considered these matters in detail we do not consider that it follows from the CAA having the *discretion* to exercise its powers to allow Heathrow West to recover its costs, that the CAA *should* carry out its functions in this manner in the present case because it would not be in the interests of consumers for the reasons set out below.
25. As we set out in our April 2021 Consultation on the Way Forward for the H7 price control¹⁰, Heathrow West's proposals formed part of a standalone commercial project that it chose to commence at its own risk and without prior agreement with the CAA on how it should be funded. We note the suggestions by Heathrow West that there may be advantages in setting a regulatory precedent in the form of allowing Heathrow West to recover its costs, but are not convinced that this a proportionate approach or targeted on the circumstances that we now find, where the focus is on the operation of a two runway airport rather than capacity expansion.

¹⁰ See CAP2139A "Appendices to Economic regulation on Heathrow Airport Limited: Consultation on the Way Forward" at Appendix O which sets out in more detail issues we have considered in relation to Heathrow West's request.

26. We note Heathrow West's observations that its approach was supported by airlines, but also observe, as noted in paragraph 4 above, that such support does not extend to supporting recovery of the costs in the circumstances where capacity expansion is no longer being taken forward. In this context, we consider that there would be the potential for significant consumer detriment were the regulatory regime to be developed in such a way that it provided a means of underwriting the costs of commercial proposals that were being developed outside the established regulatory framework, as there would be a risk of consumers funding wasteful or duplicative spending. We also note the different position of HAL, where the recovery of its costs is subject to the conditions of an economic licence and its rates of return are determined by a price review process. As such, and despite the progress made by Heathrow West, its proposal remains distinct from that developed by HAL.
27. While we note the arguments made by Heathrow West that its approach was in accordance with Government policy, we also note that the statements in the NPS about not specifying the promoter to deliver expansion at Heathrow were designed to ensure that alternative developers were not excluded, rather than implying that any such developer should necessarily benefit from the same treatment as HAL. The treatment that HAL has received in relation to the costs of expansion recognises the arrangements in the price control, including how it recovers its capital investments.
28. We are also not persuaded by Heathrow West's arguments based on comments made by the Competition Commission in 2009 in relation to terminal competition. The comments referred to were made in the context of a market investigation that did not consider inter-terminal competition in detail and were supported by an Appendix that was relatively equivocal about the benefits and downsides that such competition might bring. As such, we do not consider that that report provides either direct or strong support for Heathrow West's request.
29. Overall, having considered Heathrow West's arguments about the potential and possible benefits that it perceives that it brought to the expansion programme, we consider that Heathrow West has not provided sufficient evidence that its work has delivered benefits to consumers that would justify the CAA taking a decision to allow it to recover the costs it is seeking. Much of Heathrow West's submission is based on the general arguments about the benefits of competition, rather than the delivery of tangible and quantifiable benefits to consumers that are proportionate to the size of the request that it is making. In that context, we note that Heathrow West was free to, and did, proceed with its project without having sought or obtained agreement from the CAA that the early costs of its proposal should be borne by consumers irrespective of whether the project was a success.
30. We also note that the expansion programme, and Heathrow West's proposals for a new terminal, were paused at a relatively early stage and before unambiguous benefits to consumers of the competition to HAL's proposals it would provide could be clearly evidenced. Indeed, our reviews of Heathrow West's proposals had only reached the stage of determining that they were worthy of more detailed work. As a result, the CAA had not reached any conclusion on whether Heathrow West's proposals were:
- in fact, in the interests of consumers; or
 - likely to deliver specific benefits to them.

31. Given this, we do not have a strong basis for concluding that Heathrow West's proposals were in the interests of consumers, or that it would now be proportionate for consumers to bear the costs of developing its project.
32. In coming to this decision, we have considered the requirements under the CAA12 for us to act transparently, consistently, proportionately and in a way that is targeted at cases where action is needed. As such, we consider:
 - a. it is not clear that cost recovery is needed to further the interests of consumers by promoting competition in the manner contemplated by sections 1(1) and 1(2) CAA12, given Heathrow West brought forward its proposals without prior agreement with the CAA on funding mechanisms;
 - b. there has been little specific and/or quantified evidence of a clear benefit for consumers from Heathrow West's proposals, thus it is not clear that to allow Heathrow West to recover the costs of around £30 million referred to by Heathrow West would be proportionate to any benefit that consumers might have received from that expenditure; and
 - c. given that Heathrow West is not a regulated airport operator and thus is not restricted in how it can fund its activities, it is consistent with the overall scheme of regulation of the operators of dominant airports under CAA12 that the regulatory position in relation to cost recovery by each of HAL and Heathrow West may be different at this time. In this context, we note that perceived notions of "fairness" do not form part of the matters that the CAA is required to consider under CAA12, save to the extent that similar notions are relevant under its duties, such as those in relation to proportionality and consistency.¹¹
33. While we do not consider that it would be reasonable for us to decide that consumers should be exposed to Heathrow West's costs at this stage, we are clear that this decision does not set, and should not be seen as setting, a precedent for future decisions. We do not want to set a precedent against cost recovery for potential new providers if that would stifle the emergence of appropriate competition in future.
34. Similarly, this decision should not be taken as the CAA expressing a view that the Heathrow West project would not be credible, nor that its promoter is not capable of delivering the project. However, given the wide range of potential developments that could occur, it is not possible for the CAA to provide more certainty on its approach to dealing with the issues raised by alternative terminal operators at this stage, beyond that given in the "Technical Information Note" published by the CAA in August 2018.¹²

¹¹ We also note Heathrow West's assertion in its response to CAP2139 that the CAA's policy proposals in 2016 gave Heathrow West "every indication" that its costs would be recoverable. This statement appeared to be a reference to CAP1469 (footnoted in the same paragraph). However, it is clear that CAP1469 (and CAP1513 which is the CAA's decision on the matters raised in it) relates only HAL's costs. As such, it gave no indication as to how the costs of an alternative developer might be addressed.

¹² See: <https://www.caa.co.uk/media/xyhdcu4b/technicalinformationnote-heathrowcapacityexpansion.pdf>

Regulatory arrangements

35. In respect of HAL's comments that it would not be within the CAA's powers to ensure that Heathrow West could recover its costs, we note that section 21(1)(b) of the CAA12 allows a licence to include provisions:

"requiring the holder of the licence to enter into a contract or other arrangement for a purpose specified in a condition and on terms specified in, or determined in accordance with, a condition".

We consider that this provision appears to be broad enough to support the development of a mechanism for the recovery of the costs of other projects in the future, should it be in the interests of consumers for those costs to be recovered.

36. Nonetheless, recognising the position that Heathrow West has taken and the efforts that it has devoted to its project, we consider that this process has identified some challenges with the current regulatory arrangements with regard to introducing competition to the provision of airport infrastructure. For instance, it is not clear that the current statutory framework provides sufficient support for third party proposals for airport infrastructure at dominant airports. If evidence were to emerge in the future (and taking account of evolving circumstances) that these difficulties would likely create significant consumer detriment, then we would consider how they might be reasonably addressed.