IAG INTERNATIONAL AIRLINES GROUP

Stewart Carter
Civil Aviation Authority
Sent by email to: economicregulation@caa.co.uk & stewart.carter@caa.co.uk

26th September 2025

Dear Stewart,

**Subject: Update on the regulatory treatment of the early costs of capacity expansion at Heathrow airport**

Thank you for recent correspondence and follow up call on Early Costs yesterday.

Having reviewed the CAA's position, we must express our surprise and disappointment at the decision to permit early cost recovery. This approach sits at the opposite end of what regulatory reform and competition are intended to achieve — namely, efficiency, neutrality, and consumer protection. Competition brings costs down as investors chase profits by making their businesses more efficient and better for consumers. Instead, the CAA's proposed approach risks furthering the current regulatory incentives of spending without consequences, shifting speculative risks from the promoter to consumers.

The CAA appears to believe HAL when they say the prospect of billions of future profits underwritten by the regulator isn't enough incentive to make them compete. We are also concerned that CAA has taken the view that Heathrow expansion is not a private sector project given the U.K. Government's support of expansion itself. We caution CAA to continue to act independently of Government in its role as regulator of HAL.

We respectfully submit six key reasons why we believe the current approach is misguided:

1. **Consumers Paying Twice** – Passengers have already funded over £0.5bn of sunk expansion costs. Allowing reimbursement now risks double-charging and eroding trust in the regulatory process. HAL has been earning a return on expansion related costs since 2017 and will continue to do so for decades to come.

2. **Weak Efficiency Incentives** – HAL's proposed costs are vastly higher than those of competing promoters. Reimbursement removes commercial discipline and encourages inefficient, inflated spending. Under the current update paper, there are no guardrails to limit the level of early costs.

3. **Moral Hazard** – Applying the "fair bet" principle prematurely fosters a culture where HAL can incur costs with confidence of recovery, even encouraging overspending without accountability. A 75% guaranteed recovery is concerning, especially if HAL were granted a full WACC (i.e. a return on equity). Furthermore, allowing a bonus on early costs in the case of DCO approval seems entirely illogical (105% incentive). HAL would gain a guaranteed return for decades to come through a successful expansion and the substantial premium paid by investors over the RAB in 2024 clearly demonstrates that investors are comfortable they can gain upside vs. the regulated returns (upside resulting from higher gearing, lower tax, etc.). There is absolutely no evidence that would suggest HAL, or another promoter, would not proceed with expansion without this incentive.

4. **Distorted Competition** – Reimbursing HAL with no cap and no meaningful jeopardy for excessive spending entrenches its monopoly position, disadvantaging alternative promoters and undermining the level playing field envisaged by Government.

5. **Contrary to Consumer Interests** – The Civil Aviation Act 2012 obliges the CAA to further consumer interests, not insulate a monopoly operator from normal commercial risks. Funding speculative costs fails this test. We see absolutely no reason to disconnect the decision on early costs from CAA's work to review the regulatory approach to capacity expansion at Heathrow. Early costs are inherently capacity expansion costs.

6. **Airlines, and IAG in particular, will be incurring significant costs** in engaging with promoters. Our costs will not be covered, nor we will earn an equity return on these costs

Beyond aviation, we note that in **other regulated sectors** — energy (Ofgem), water (Ofwat), rail (ORR) — early and bidding costs are **borne at risk by promoters**. Only successful projects may recover efficient costs once approved. Likewise, the **Airports Commission precedent** required Heathrow, Gatwick, and others to fund their bids without consumer reimbursement. The CAA's current stance diverges from these well-established principles of regulatory practice.

For these reasons, we are deeply concerned that the decision risks undermining the credibility of both the regulatory framework and the Government's objectives for competition in airport expansion.

We remain committed to engaging constructively with the CAA on this important matter. We would welcome the opportunity to meet and discuss how the regulatory approach can be better aligned with the objectives of efficiency, fairness, and consumer protection.

Best regards,

Yann Cambier
Head of Strategic Programmes – Corporate Development
International Airlines Group