

# FUNDAMENTAL REFORM OF HEATHROW



To comprehensively address the failings  
with the current model of economic  
regulation at Heathrow

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REDACTED VERSION FOR PUBLICATION

Submission to the Civil Aviation Authority, made jointly by Heathrow AOC, Arora Group,  
International Airlines Group and Virgin Atlantic.

2 June 2025

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# A. EXECUTIVE SUMMARY

## **A fundamental review of the economic regulation of Heathrow is required urgently**

1. In February 2025, the Heathrow Airport Operators Committee (AOC), Arora Group, IAG and Virgin Atlantic (together ‘the Parties’ and ‘Heathrow Reimagined’) made a submission to the CAA (the ‘February Submission’) requesting that the CAA undertakes an urgent and fundamental review of the model of economic regulation at Heathrow.
2. In response, the CAA set out in a letter to stakeholders dated 26 March 2025 (‘the Stakeholders Letter’) that it intends to review the framework for economic regulation for capacity expansion at Heathrow, and that this “*review will look at options to ensure the regulatory model provides strong incentives for the efficient delivery of the substantial costs involved in expansion*”.
3. This submission, which is made jointly by the Parties, explains that, while **the CAA’s announcement is a welcome step forward, the review scope must be broadened to properly address the existing incentives giving rise to consumer harm today**. A narrowly scoped review focused on capacity expansion only will not address the full range of sources of consumer harm under the current regime and, therefore, will not be consistent with the CAA’s statutory duties.
4. Any review needs to be completed on a timetable that does not delay the process of capacity expansion at Heathrow. However, there is no reason why, with appropriate priority and resources, a broadly-scoped review should take longer to complete than that currently set out in the Stakeholders Letter.

## **While capacity expansion incentives are important, current incentives and outcomes result in material consumer harm today, irrespective of whether Heathrow is expanded**

5. Ensuring that the regulatory regime provides strong incentives for efficient expenditure on capacity expansion should be a key focus of the CAA’s review. Such expansion must provide value for money for users, maximise its contribution to economic growth, and deliver sustainable charges over time. Absent fundamental reform, capacity expansion will result in substantial increases in charges, which are already the highest among Heathrow’s peers and have been for the past decade, risking the viability and economic benefits of any expansion.
6. Heathrow is the UK’s primary gateway to the world and its only hub airport. The unique and critical role Heathrow plays in underpinning vital aspects of the UK economy means it is essential for the country to derive the maximum value possible from its only hub airport. This requires Heathrow to be an attractive and efficient option for connecting passengers who are choosing which hub to connect through. However, as connecting passengers and airlines choose more efficient or better-value hubs, the viability of marginal routes from Heathrow is reduced. Airlines operating at Heathrow already serve fewer direct destinations (217) compared to key European hub competitors like Frankfurt (284), Paris Charles de Gaulle (278), and Amsterdam (268). Further ‘dehubbing’ of Heathrow, driven by a failure to provide value and efficiency, will inevitably harm the UK economy (from reduced cargo and trade, business investment and activity, and tourism owing to the loss of specific routes and connectivity).
7. However, **a review focused solely on capacity expansion expenditure, as set out in the Stakeholders Letter, will fail to address the full set of problems stemming from the existing**

**regulatory model.** Such a review would only consider one aspect of HAL's harmful incentives and in a way that goes against the grain of the cross-cutting nature of the issues. It will lock in higher costs, leading to consumer and economic harm for the long-term, which is contrary to the CAA's duties. Incentives, outcomes and harm today cannot be decoupled from future capacity expansion related capital expenditure.

8. **The deep-rooted issues with the current model extend far beyond capital expenditure for capacity expansion,** pervading Heathrow's entire operation. As is clear from the current Constructive Engagement process, **HAL is developing plans for double-digit billions of capital expenditure beyond that related to capacity expansion over H8.** Failing to address HAL's harmful incentives in relation to such capital expenditure will result in significant harm to consumers, contrary to the CAA's duties. This must not be allowed to happen.

### **Focusing on capacity expansion expenditure only is overly complex and impractical**

9. Implementing a 'twin-track' approach to regulation, which is implied by reviewing the approach to economic regulation for capacity expansion only, is also overly complex and impractical. For example:
  - There is unlikely to be a clear division between capital expenditure required for capacity expansion and that required for the maintenance of existing airport activities and facilities. Capacity expansion will, for a material part, take place on the existing site and alongside (or in replacement of) existing infrastructure. For example, it is unclear how costs would be allocated if investment is needed in existing terminals to realise the passenger throughput needed to support an expansion in runway capacity.
  - Some of the projects started in H8, including those related to capacity expansion, will not be completed in a single price control period as they are longer-term projects. It is unclear how such projects would be treated under a new framework for capacity expansion, and whether they could be reclassified and moved to the new regulatory framework or be locked into the flawed legacy regime.
  - The twin-track approach risks exacerbating existing perverse incentives, encouraging HAL to promote capital projects as 'H8' rather than expansion given their ability to grow the regulatory asset base (RAB) today. The ability of the Parties to challenge this approach will remain limited as a consequence of information asymmetries and lack of involvement in project scoping and development.
10. Depending on the reforms adopted by the CAA, it may also raise practical difficulties associated with allocating commercial activities and their revenues to capacity expansion and existing activities.
11. Dealing with such issues will increase the administrative complexity of the regulatory regime and risks creating incentives for HAL to pursue allocations across the two processes that are to its own benefit (i.e. 'game the system') by taking advantage of its considerable information asymmetries.

### **The CAA must not miss the opportunity to establish the right comprehensive long-term regulatory framework and structure for Heathrow**

12. The CAA's review must not miss the opportunity to establish the right comprehensive long-term regulatory framework and structure for Heathrow as a whole. In order for the CAA to meet its primary duty to consumers, it must capture both capacity expansion and Heathrow's

broader ongoing activities. Such reform, which must be put in place before HAL embarks on any new programme of major capital expenditure, will result in better outcomes for consumers and airlines, but also enable stronger economic growth across the UK economy.

13. By comprehensively addressing the full range of incentive problems in one overarching review and establishing the right long-term model, the CAA will not only further the interests of consumers and other users of Heathrow, consistent with its statutory duties, but will also promote greater long-term regulatory certainty for all stakeholders.
14. Consistent with the CAA's duties, the review should establish a regulatory model and structure that:
  - secures an efficient airport delivering improved value for money for UK consumers, businesses, and other users, while effectively supporting Britain's growth ambitions; and
  - ensures Heathrow is an attractive destination for much-needed investment and provides appropriate protection to investors.
15. The reforms needed to meet these objectives cannot be achieved by incremental changes to the current regulatory regime, including as part of H8. Attempting only incremental adjustments within a framework facing such inherent application failings risks perpetuating, rather than resolving, the issues. Rather, they require a review that is broad enough to establish the fundamental reforms necessary to resolve all the deep-rooted and interdependent incentive issues with the current regime.
16. Such a review should draw on the findings of prior reviews (both the Competition Commission in 2009 and the Competition and Markets Authority in 2016) as well as lessons from other jurisdictions and sectors. The current regulatory model and structure of Heathrow, including the CAA's current RAB-based model, are not the norm for airports internationally; other models and structures are used successfully. However, it is highly unlikely that there is a single model or approach from other jurisdictions and sectors that could be applied directly to Heathrow. The review and reform must be tailored to reflect the specific combination of features and circumstances at Heathrow, to ensure that harmful incentives are fully addressed.

### **Examples of the types of reform the CAA's review needs to be broad enough to consider**

17. A package of effective reforms tailored to Heathrow needs to combine several key features, each designed to address specific failings of the current regime, including:
  - **Unlocking the benefits of competition to the fullest possible extent:** Exposing as much of the value chain at Heathrow as possible to effective competition would help put in place the right incentives for the airport operator(s) to deliver higher quality and value for money services. As well as being consistent with the CAA's duty to "*promote competition in the provision of airport operation services*", it could also help to directly improve the ability of the CAA and stakeholders to constrain HAL's ability to act on residual harmful incentives.
  - **Materially enhancing the effectiveness of regulation to police against harmful incentives:** Where effective and sustainable competition cannot be implemented in the Heathrow value chain, regulation will continue to be needed to minimise the risk that substantial market power (SMP) activities are undertaken in a harmful way. This means that other changes are also required to materially enhance the effectiveness of regulation, including: providing full, ongoing transparency over HAL's costs and RAB; reinforcing the CAA's

expertise and capacity; and providing a stronger role for stakeholders in governance and decision making.

18. This submission sets out illustrative and non-exhaustive examples of the types of reform that the CAA should consider to deliver aspects of these key features:

- **Options for exposing terminal development and operations to greater competition** – allowing competing third parties to invest in and operate terminals is an example of how competition could play a greater role at Heathrow. It offers the potential to improve the efficiency of both terminal capital expenditure and operations, ultimately enhancing the overall consumer experience and driving better value for money. Such reforms could be implemented in a number of different ways, each requiring careful assessment as part of a broad review by the CAA, including:
  - **Independent management of terminals.** This model would introduce competitive tendering for fixed-term management contracts for the operation of major infrastructure, such as terminals, while HAL retains asset ownership.
  - **Long-term leases for terminal operations.** Awarding longer-duration leases (e.g. 50 years) for terminal operations through a competitive process could create stronger incentives for leaseholders to undertake a broader range of capital expenditure, including potentially significant terminal redevelopment, and drive operational efficiencies and value for money through the creation of direct, facility-based competition between terminals.
  - **Structural separation of airfields and individual terminals.** A more fundamental reform could involve the structural separation of airfield and terminal ownership, requiring HAL to divest terminal assets (freeholds) to independent owners/operators. This would introduce direct, facility-based competition between individual terminals seeking to attract airline customers, potentially driving significant improvements in efficiency, innovation, and passenger experience.
- **Capital investment committee models designed to strengthen the effectiveness of regulation** – such models would involve establishing a new structure dedicated to developing and managing major capital expenditure schemes. The committee(s), which would include representatives from HAL, the airline community, CAA and potentially other relevant stakeholders, could be implemented in different forms, including creating a new HAL subsidiary or a joint venture with the airline community.

The aim would be to significantly enhance stakeholder scrutiny and control over investment proposals (including scoping of requirements, setting budgets, and tendering) and improve alignment with the needs of airport users, thereby directly targeting HAL's ability to act on its incentive to inflate capital spend. The committee would also be responsible for the ongoing monitoring of invested capital to ensure that the anticipated benefits are delivered as fully as possible.

The model would be critically dependent on complementary reforms, including measures to significantly improve transparency, bolstering the CAA's capacity and technical expertise, and more effective use of benchmarking. Further, to be effective, the CAA must have a key leadership and oversight role. This role would involve the CAA playing a stronger, more active, and more decisive role in defining appropriate capital expenditure envelopes, monitoring the prioritisation of specific schemes, and ensuring efficiency is rigorously pursued and maintained during development, delivery and operation.

19. These illustrative examples are not intended to be exhaustive of the full range of potential reform options the CAA should consider as part of a comprehensive and fundamental review.

### **Fundamental reform of the entire regulatory model is needed urgently**

20. The regulatory model at Heathrow needs to be fundamentally reformed. Despite being the world's most expensive major international airport, HAL's experience and service continue to decline in the eyes of passengers and users – the recently announced 2025 Skytrax awards show Heathrow has slipped yet further from 21<sup>st</sup> to 22<sup>nd</sup> globally. In addition, its ACI ASQ score for 2024 continues to be below the averages for airports globally, European airports, and large airports. Heathrow's inadequate response to recent power supply issues is further evidence, if needed, of a serious lack of fundamental resilience and inadequate processes to enable proper stakeholder engagement and influence on key decisions such as Heathrow's operational resilience.
21. Fundamental reform is needed urgently before HAL's plans for very high levels of capital expenditure are baked into the regulatory settlement and lock-in higher charges and harm for decades to come. Alongside developing very expensive capacity expansion plans, HAL is also planning very substantial non-expansion capital expenditure for H8 – running to double-digit billions of pounds. While these plans are still subject to the regulatory review process, they provide a live demonstration of the nature and scale of the problems with the current model, even without expansion, proving the critical importance of urgent regulatory reform. Should a sufficiently broad regulatory review not be undertaken urgently, the current HAL masterplan (with or without expansion) will soon become *de facto* locked in – expanding and entrenching all the current problems.
22. The Parties recognise that the CAA review must be completed in a timely manner. There is no reason an urgent review applicable to the whole campus and range of issues need take longer than one for expansion only, nor need it wait until all the scheme proposals have been submitted (for final scheme agreed in principle) – the substantive work is the same, and the dynamics at play are the same. The difference lies in the scale of benefits to consumers and the UK economy. Consumers and other users continue to be harmed by poor and declining value for money. The review's reforms must be implemented as rapidly as possible.

### **The CAA should act quickly**

23. The proposed capital plans for H8 would embed substantial long-term increases in costs and, therefore, charges for decades. HAL must not be permitted to embark on a programme of major new capital expenditure, including the plans it is developing for H8 non-expansion capital expenditure, without a fundamentally reformed regulatory regime.
24. In light of this, the Parties continue to consider that the right approach in this case would be to adopt a time-limited rollover of the H7 price control arrangements. This would provide protection to consumers, provide clarity and certainty to stakeholders in the short-term, and allow time for the outcomes of the regulatory review to be put in place before HAL embarks on the major capital plans, including those it has been developing for H8. While it may result in a short delay to some capital projects planned for H8, such delay is outweighed by the benefits of ensuring such projects are undertaken efficiently under a reformed regime.
25. However, should the CAA continue to progress H8 alongside the review, it must send a clear signal to all stakeholders that it does not intend to wait until H9 (or later) to implement any reforms identified through the review. Delaying much-needed reforms will only prolong the

harm to consumers and the economy from the current model, which is contrary to the CAA's duties.

26. The CAA applies a high bar to change aspects of the regulatory framework midway through a price control period, given the potential for increased regulatory uncertainty. The threshold is clearly met in this case: the CAA can manage any risks of increased regulatory uncertainty by clearly signalling in advance its intentions, and doing so would outweigh the very significant harm arising from the current regime. This harm necessitates reform to be put in place at the earliest opportunity. The CAA would not be fulfilling its duty to further the interests of consumers by prioritising short-term regulatory certainty over reforms that will deliver very substantial consumer benefits over the long-term.
27. To ensure the review is robust, credible, and commands confidence, it must be conducted in a transparent manner, founded on robust evidence, and incorporates meaningful and inclusive stakeholder engagement throughout. The Parties stand ready to support the CAA in undertaking such a review in an effective and timely manner. There is no reason why the review should not be completed within 12 months of being launched.



**B. ECONOMIC REGULATION  
AT HEATHROW IS FAILING  
CONSUMERS, OTHER USERS  
AND THE UK ECONOMY**

## Introduction

28. In February 2025, the Parties made a submission to the CAA requesting an urgent and fundamental review of the model of economic regulation at Heathrow as the current model is not fit for purpose.
29. This submission builds on the detailed evidence and arguments presented in our February Submission<sup>1</sup> which explained how, as a result of HAL's enduring SMP and an ineffective regulatory regime, it has harmful incentives, and it is not adequately constrained from acting on those incentives. As a result, Heathrow is the world's most expensive major airport, yet the service and infrastructure it provides are inadequate, resulting in poor and declining value for money. Significant consumer harm – estimated to exceed £1.1 billion annually<sup>2</sup> – is a direct consequence of these failings.
30. Detailed below are the fundamental problems with the current model of economic regulation at Heathrow, building on the arguments and extensive evidence presented in our February Submission. Understanding the full range and depth of these failings, and the risk consumers could be subject to the harm they cause for a further full regulatory period (H8), provides crucial context for determining the right scope for the CAA's review.

## Regulation has failed to remedy the adverse effects on competition and harm to consumers from HAL's SMP

31. HAL enjoys enduring SMP in the provision of Airport Operation Services (AOS) at Heathrow.<sup>3</sup> This SMP stems from a unique combination of structural advantages: Heathrow's status as the UK's only hub airport generating significant network effects not replicated elsewhere in the UK; its size as the largest airport in the world's largest aviation centre (London); its premium passenger catchment area; and its strong surface access options. Consequently, airlines operating at Heathrow and their passengers are captive customers, affording HAL considerable market power, as recognised by the CAA in its 2014 market power determination and re-affirmed by the CAA in August 2024<sup>4</sup>.
32. The Civil Aviation Act 2012 (CAA12) provides the CAA with powers to impose ex-ante economic regulation on dominant operators like HAL to remedy the potential harm arising from SMP. The CAA's primary statutory duty under CAA12 is to further the interests of users of air transport services regarding the range, availability, continuity, cost, and quality of AOS, promoting economy, efficiency, and competition where appropriate. To fulfil this duty at Heathrow, the CAA currently determines and implements licence conditions in respect of HAL, including a price control calculated using a RAB-based building blocks model, and a service

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<sup>1</sup> Heathrow Reimagined, *Fundamental reform of Heathrow: Securing the right long-term model for passengers, airlines and the UK economy*, shared with the CAA on 5 February 2025. We refer to this as the 'February Submission' throughout this document.

<sup>2</sup> An illustrative calculation combining data on the 2024 passenger volume at Heathrow (from Heathrow's website, [link](#)); average per passenger charges (i.e. £25.43 for 2024), and the Jacobs charges index data to calculate the change in Heathrow's total charges revenue if charges were in line with the average (mean) of European airports in the top 50 (excluding Heathrow) and taking the difference between the two figures. Calculation part of the February Submission.

<sup>3</sup> Heathrow Reimagined, *Fundamental reform of Heathrow: Securing the right long-term model for passengers, airlines and the UK economy*, shared with the CAA on 5 February 2025.

<sup>4</sup> CAA, *Setting future price controls – lessons learnt from the review of approach*, August 2024, paragraph 2.9. [link](#).

quality regime. The use of the RAB model is the CAA's chosen approach, not a statutory requirement.

### **The current regulatory model at Heathrow is ineffective at remedying the adverse effects of HAL's SMP and actively creates its own harmful incentives**

33. The current framework for economic regulation, including the RAB-based model as applied at Heathrow, is fundamentally failing. It not only fails to adequately remedy the adverse effects of HAL's SMP, but it also actively creates and reinforces harmful incentives for HAL while simultaneously failing to constrain HAL's ability to act upon them.
34. As detailed in our February Submission, these harmful incentives include:
- **An incentive to spend capital inefficiently to grow the RAB:** HAL is incentivised to maximise capital spend to grow its RAB, the key driver of passenger charges and regulated returns, irrespective of whether the expenditure is efficient and delivers value for users. Once included in the RAB, recovery of this expenditure is effectively guaranteed. This risk, explicitly recognised by the Competition Commission (CC) in 2009, remains inadequately addressed.<sup>5</sup> The regulatory structure can also create incentives to underspend on the maintenance of existing assets, potentially leading to the need for larger, more costly capital expenditure later. Also, HAL is incentivised to sequence and prioritise investments in a manner that maximises the total amount of capital expenditure signed off over time, rather than maximising the benefits to users.
  - **No incentive to ensure commercial activities are NPV positive:** The Parties strongly support the use of the single-till approach at Heathrow. In principle, the approach shares the financial benefits of commercial activities with consumers and other users through lower charges. However, the current regulatory model does not ensure that the benefits of the single-till are realised by contributing to lowering charges. HAL receives a return on capital employed on commercial facilities via the RAB, and any cost shortfall is recovered through regulated charges. This removes the incentive to maximise the contribution of commercial activities to lowering charges under the single-till, encouraging capital deployment primarily for RAB growth even if that capital spend is unlikely to be NPV positive.
  - **Weak incentives to drive operational efficiencies:** Lacking effective competitive pressure, and with regulatory processes often focusing on short-term allowances, HAL faces insufficient incentives to pursue all available operational efficiencies, with costs often passed straight through to consumers.
  - **Weak incentives to innovate or be responsive to user needs:** HAL's market power reduces the commercial imperative to innovate or align investments and services closely with the evolving needs of airlines and passengers, particularly regarding service quality and timely infrastructure improvements. For example, HAL has no incentive to respond to repeated airline community requests to review and amend the Conditions of Use (CoU), which is the commercial contract framework between HAL and its airline customers. These CoU are, in practice, a one-sided set of obligations that are effectively imposed on airlines by HAL, rather than having been negotiated or agreed as would be the case in a

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<sup>5</sup> The CC commented in 2009: "[The RAB model] provides an incentive for BAA at each regulatory review to make the projected capital expenditure and operating expenditure as large as possible, and to understate the scope for efficiency savings, traffic growth and growth of other revenues, and subsequently to outperform its projections." Competition Commission, *BAA airports market investigation*, 2009, paragraphs 6.17 to 6.28.

competitive market. They seek to almost entirely exclude HAL's liabilities to airlines, place almost no obligations on HAL itself, and conversely grant HAL very significant and comprehensive rights and remedies against airline users.

### **HAL's harmful incentives are reinforced by a regulatory focus towards financeability**

35. The current regime fails to strike an appropriate balance between ensuring HAL's financeability and furthering the primary duty to protect consumer interests.<sup>6</sup> Although financeability considerations play a role in promoting the interests of consumers, they should not be prioritised to such an extent that they undermine the broader interests of consumers (and the CAA's primary duty) by promoting inefficiency and high charges.
36. Under the current regime, HAL's own financing choices have resulted in very high levels of gearing. In theory, HAL's choices and their consequences do not affect charges (which are based on the costs – including the cost of capital – for a notionally efficient and notionally geared company). As a matter of principle, consumers should not bear any adverse consequences of HAL's financing choices, particularly as they do not receive the benefits.
37. However, in practice, the very high levels of debt and the resulting importance to HAL of ensuring it meets its payment obligations linked to that debt and reissuing debt when required (on sufficiently attractive terms), is inevitably part of the broader context to the CAA's decisions in tackling (or not) inefficiency as part of the charge control process; they make it far more likely that HAL's *actual* financing and debt choices, rather than those of the *notional* company, drive the CAA's decisions.
38. A regulatory focus towards financeability, particularly in the context of HAL's chosen capital structure, reinforces the incentive to pursue inefficient capital expenditure to grow the RAB and build its debt burden to arbitrage the notional capital structure. Such reinforcement of HAL's already harmful capital expenditure incentives is clearly harmful to consumers' interests.

### **The regulatory regime is ineffective in preventing HAL from acting upon these harmful incentives**

39. Critically, the regulatory regime is ineffective in preventing HAL from acting upon these harmful incentives, most notably with respect to capital expenditure. Under the current model, the CAA's ability to effectively scrutinise and police HAL's capital plans, expenditure and delivery of benefits is severely hampered by significant information asymmetries which HAL is incentivised to maintain. This is exacerbated by the diverse array of complex and often bespoke infrastructure and services, including myriad consumer touchpoints – security screening, baggage systems, passenger mobility assistance, retail, parking, etc. The passenger experience is shaped by the quality, efficiency and interactions across all these facilities and touchpoints. It makes it particularly complex for the CAA to detect and demonstrate inefficient capital expenditure in the level of detail needed for the regulatory process.
40. Despite the involvement of supporting entities such as the Independent Fund Surveyor (IFS) in the CAA's process, a significant challenge persists: no stakeholder involved currently is able to adequately address the inherent information asymmetries, making it very difficult to effectively challenge Heathrow's multi-billion-pound expenditure plans. Information

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<sup>6</sup> The CAA set out in paragraph 4.32 of its [H8 method statement and business plan guidance](#) document that it expects to “carry out financeability analysis for H8 that is similar to our approach to H7”.

asymmetry reduces the IFS' current role to assess Heathrow's claims on what it will deliver as opposed to determining if the capital has been allocated efficiently, procured efficiently and executed efficiently. These plans, ultimately, materially contribute to the growth of the RAB and, as a consequence, charges for airport users.

41. The limited and incremental changes proposed by the CAA for the H8 price control period within the existing RAB-based model – such as looking to “*further sharpen the incentives for capital efficiency*”<sup>7</sup> – are insufficient to address these fundamental failings and incentive problems, or HAL's ability to act upon them. Attempting only incremental adjustments within a framework facing such inherent application failings risks perpetuating, rather than resolving, the issues.
42. HAL's pursuit of its own interests under the current regulatory model, while commercially rational given its incentives and historical policing of those incentives, ultimately ends up coming at the expense of consumer outcomes.

### **The challenges of effectively applying the RAB-based model at Heathrow are greater than in other sectors**

43. While the RAB-based model is applied in other regulated sectors, its application to Heathrow faces greater challenges. Other sectors, such as water, often benefit, for example, from greater standardisation in infrastructure and the ability of the regulator (Ofwat) to draw efficiency comparisons and benchmark across multiple comparator companies.
44. In contrast, Heathrow is the only UK airport fully regulated through the RAB-based model and airport infrastructures are diverse and complex, with myriad customer-facing activities. While other regulated sectors have their own complexities, the scale and nature of these challenges are more acute at Heathrow, increasing the complexity, and limiting the effectiveness, of the current regulatory tools.

### **Poor consumer outcomes at Heathrow demonstrate that the regulatory model is failing to deliver on its primary purpose**

45. By failing to effectively constrain HAL's SMP and address its harmful incentives, the current regulatory model is failing in its primary purpose. It allows, and even encourages, behaviour that directly leads to exceptionally high charges that far exceed international peers, coupled with services and infrastructure often perceived as inadequate and representing poor value for money. The regime is, therefore, failing to further the interests of consumers, other users of Heathrow, and the wider UK economy, and it falls short of the CAA's own stated objectives of protecting passengers and incentivising efficient investment.

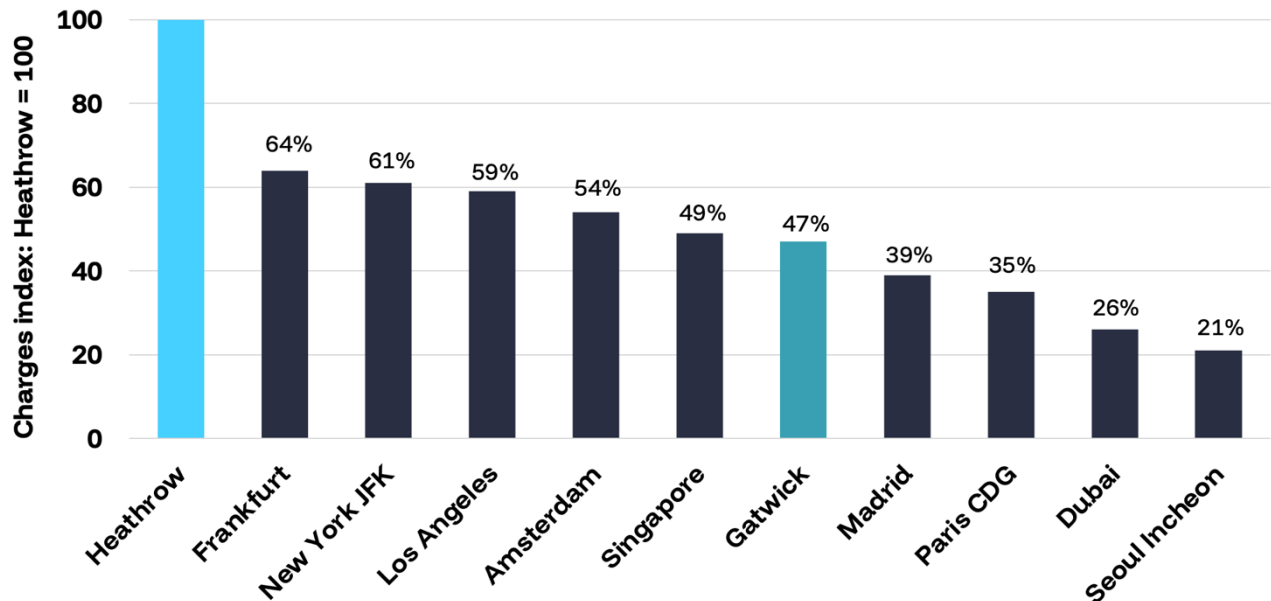
### **Heathrow's charges are the most expensive in the world**

46. A direct and harmful consequence of HAL not having the right incentives to pursue efficient capital spend and operations, is that **passengers and airlines using Heathrow face the highest airport charges in the world** and have done so for the past decade despite no major infrastructure investments.

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<sup>7</sup> CAA, *H8 method statement and business plan guidance*, 2025, [link](#).

Figure 1: Heathrow's charges are significantly higher than those of other major international airports, 2024



Source: Heathrow Reimagined analysis of Jacobs, *Review of Airport Charges, 2024*.<sup>8</sup> Reported as an index score with the world's most expensive airport set at 100. The sample includes the world's top-10 busiest international airports as included in Jacobs' study, plus LGW. Note: percentages above the bars represent each airport's charges as a percentage of Heathrow's charges.

47. HAL's airport charges are approximately twice as expensive as most other major hubs and Gatwick.<sup>9</sup> As we set out in the February Submission, **Heathrow's users are paying c.£1.1 billion more per year on average than if Heathrow's charges were in line with other European hubs.** Heathrow has held the unenviable position of the world's most expensive major airport for nearly all of the past decade, having rapidly climbed the rankings since the early 2000s and taking the top spot in 2013 (apart from 2021 during the pandemic).<sup>10</sup>

### HAL's lack of incentives to be innovative or respond to user needs means that Heathrow's service quality and value for money continue to decline

48. Heathrow's world-leading charges do not translate into commensurate value for passengers or airlines. **Heathrow's user experience falls far short of the significant premium it charges users** as a direct result of the lack of incentives to invest efficiently, innovate, improve efficiency, or be genuinely responsive to the needs and priorities of its users. Value for money is consequently poor and is in decline.
49. Further recent evidence further demonstrates the severity of the problems:
- **Heathrow's Skytrax ranking continues to decline.** Given Heathrow's high charges, you would expect it to be, at a minimum, in the top five of the global Skytrax airport rankings. However, Heathrow's standing falls far short of this and continues to decline, dropping from 8<sup>th</sup> globally in 2014 to 21<sup>st</sup> in 2024, and, most recently, to **22<sup>nd</sup> place in 2025**.<sup>11</sup> Despite

<sup>8</sup> Jacobs' index covers a sample of 50 airports across the world. It states that it does not intend to represent the fifty busiest or largest airports by any specific measure. Instead, it aims to cover a broad spectrum of different approaches to airport pricing across public and private sector operating environments under different regulatory regimes. However, it states that the sample includes "virtually all airports worldwide that normally handle in excess of 10 million international passengers per year".

<sup>9</sup> Jacobs, *Review of Airport Charges, 2024*.

<sup>10</sup> Jacobs, *Review of Airport Charges, 2024*.

<sup>11</sup> Skytrax, *World Airport Awards, 2014 – 2025*, [link](#).



nearly half of the world's top 20 airports being European peers, Heathrow no longer even features among them.

- **The latest data on Heathrow's ACI ASQ passenger satisfaction score again falls far short of its peers.** Data from ACI's Airport Service Quality (ASQ) Barometer reinforces this picture. Heathrow's passenger satisfaction score was **3.98 (out of 5)** for the full year 2024.<sup>12</sup> This is below average for airports globally (4.39), European airports (4.08), and large airports (those over 40 million passengers per year, 4.43).<sup>13</sup> Heathrow's ASQ score has declined from 4.16 in 2017<sup>14</sup>, indicating worsening passenger satisfaction over time despite sustained high charges.
  - **Heathrow continues to fare poorly when compared to other UK airports.** In a survey of UK airports by Which? Heathrow received only average scores in most categories (e.g. queues at check-in, bag drop, security and passport control), and poor scores in other areas (e.g. availability of seats).<sup>15</sup> The poor value offered by Heathrow compared to other UK airports is clearly shown by Heathrow having a lower score than Gatwick, despite having charges that are approximately double.
  - **Heathrow continues to perform badly on accessibility services** wholly-run and provided by HAL. The most expensive major airport in the world should be best-in-class in terms of accessibility. In a recent study<sup>16</sup> of international airports, Heathrow was found to be in the bottom five, while Manchester, Edinburgh and Bristol were all in the top ten. This is wholly unacceptable for the UK's primary gateway to the world and only hub airport.
50. **Heathrow continues to operate some of the oldest terminals among its international peers.** Despite HAL undertaking over £7 billion (in CPI 2024 real terms) of capital expenditure between 2014 and 2023,<sup>17</sup> and charging the world's highest fees for nearly all of the last decade, Heathrow still operates some of the oldest terminals amongst its international peers. Terminal 3 dates back to 1961, and Terminal 4 to 1986.<sup>18</sup> Under Heathrow's current plans, Terminal 4 will be at least 60 years old when it is replaced, and replacements for Terminal 3 will not open before the 2040s.
51. **HAL's lack of incentive to focus on the user experience means that not only are Heathrow's facilities expensive, but they also lack basic aspects of resilience.** This lack of resilience manifests in significant operational failures, causing disruption to passengers and airlines. Under the current one-sided CoU, the costs associated with compensating passengers for disruption are borne by airlines – HAL has no incentive to remedy the failures as it does not face their commercial consequences.
52. **HAL is also slow to adopt new technologies and innovations** compared to international peers, which can also harm operational resilience.<sup>19</sup>
53. The March 2025 airport-wide shutdown caused by power supply issues, which affected hundreds of thousands of passengers, starkly illustrates the ongoing lack of fundamental operational resilience despite the premium prices charged. This is not an isolated incident of inadequate resilience. In 2024 alone, HAL experienced 82 baggage system outages across all

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<sup>12</sup> Heathrow Airport Limited, *Annual Report*, 2024, [link](#).

<sup>13</sup> ACI, *ASQ Barometer*, 2024, [link](#); Heathrow (SP) Limited, *Results for the year ended 31 December 2024*, [link](#).

<sup>14</sup> Heathrow Airport Limited, *Annual Report*, 2017, [link](#).

<sup>15</sup> Which?, *Best and worst UK airports*, 2024, [link](#).

<sup>16</sup> Timeout, *Three British airports have been named the most accessible in the world*, [link](#).

<sup>17</sup> Heathrow (SP) Limited, *Regulatory Accounts*, 2014 – 2023, [link](#). Measured by RAB 'additions in year', adjusted for CPI inflation. Does not include RAB indexation nor non-capex additions to the RAB (e.g. the 2021 Covid RAB adjustment).

<sup>18</sup> Heathrow, *Our History*, [link](#).

<sup>19</sup> See, for example, The Independent, *First major UK airport scraps 100ml liquids rules with new scanners*, 2023, [link](#).

terminals where it had sole responsibility – averaging more than one per week.<sup>20</sup> Repeated IT system failures have also caused significant passenger disruption, often exacerbated by inadequate contingency planning.<sup>21</sup> Such failures are unacceptable for a major international hub, let alone the world's most expensive one.

### **Heathrow's hub status is declining as a result of very high charges and increasingly uncompetitive infrastructure**

54. Heathrow is the UK's primary gateway to the world and its only hub airport. Its hub status means that UK consumers and businesses benefit from a much broader choice and frequency of direct destinations at Heathrow than might otherwise be available. The unique and critical role that Heathrow plays in underpinning vital aspects of the UK economy means it is essential for the country to derive the maximum value possible from its only hub airport, whether under a two- or three-runway system configuration. This requires Heathrow to be an attractive and efficient option for connecting passengers who are choosing which hub to connect through.
55. High charges and increasingly inadequate and inefficient infrastructure result in Heathrow's standing in the eyes of connecting passengers declining further. This will contribute to Heathrow's hub status dwindling – the range and frequency of destinations offered by airlines at Heathrow will continue to fall behind other major competitor airports as connecting passengers choose other hubs outside of the UK.
56. As connecting passengers and airlines choose more efficient or better-value hubs, the viability of marginal routes from Heathrow is reduced. Airlines operating at Heathrow already serve fewer direct destinations (217) compared to key European hub competitors like Frankfurt (284), Paris Charles de Gaulle (278), and Amsterdam (268).<sup>22</sup>
57. Further 'dehubbing' of Heathrow, driven by a failure to provide value and efficiency, will inevitably harm UK consumers through reduced choice and connectivity, and negatively impact the wider UK economy (from reduced cargo and trade, business investment and activity, and tourism owing to the loss of specific routes and connectivity).

### **High capital costs, due to harmful incentives to grow the RAB, are a major driver of HAL's charges being so much higher than all its peers**

58. Inefficiently high capital costs are a major driver of HAL's charges being significantly higher than its peers. The regulatory system fails to adequately scrutinise or disallow inefficient spending before it enters the RAB, and it does not test the benefits delivered by the capital spend throughout its life, leading directly to inflated charges for users.
59. **Between 2014 and 2023, despite no major investments in new terminal facilities, or other similarly major infrastructure, HAL spent over £7 billion (in CPI 2024 real terms) in capital expenditure.**<sup>23</sup> Furthermore, this trend continues, with HAL reporting £1.1 billion in capital expenditure in 2024 alone.<sup>24</sup> This substantial spending has prevented the creation of material headroom in the RAB, despite £9.9 billion depreciation (in CPI 2024 real terms) of existing assets<sup>25</sup> – including Terminals 2 and 5 – during this period. Under normal circumstances, such depreciation should have created substantial financial capacity for much-needed terminal

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<sup>20</sup> Parliament Transport Committee, *Oral evidence: Heathrow power outage*, 2025, [link](#).

<sup>21</sup> Parliament Transport Committee, *Oral evidence: Heathrow power outage*, 2025, [link](#).

<sup>22</sup> FlightsFrom.com, as of 29/04/2025.

<sup>23</sup> Heathrow (SP) Limited, *Regulatory Accounts*, 2014 – 2023, [link](#).

<sup>24</sup> Heathrow Airport Limited, *Annual Report*, 2024, [link](#).

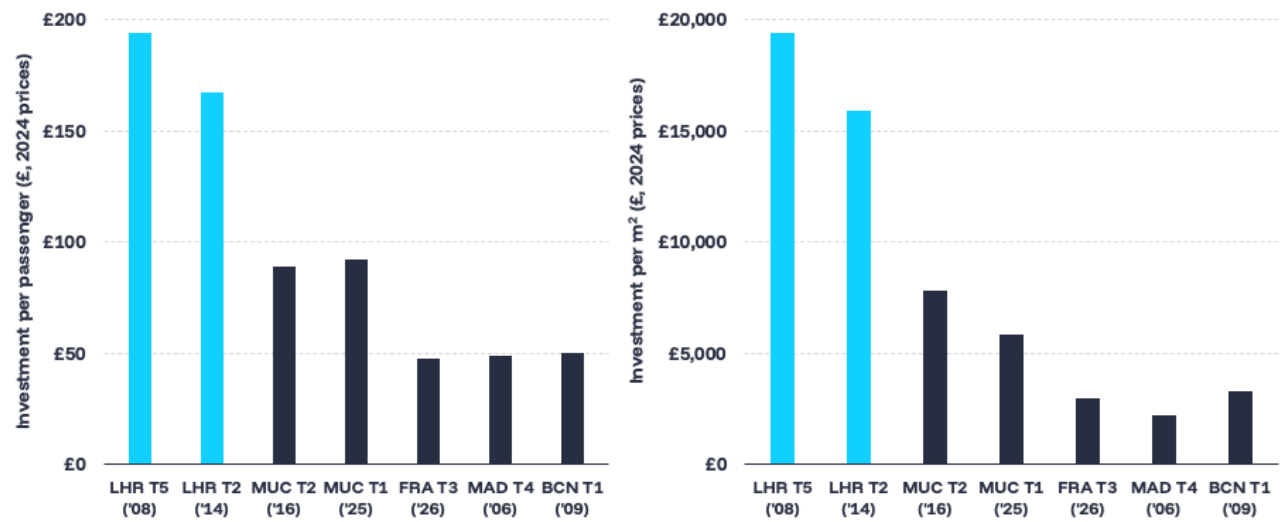
<sup>25</sup> Heathrow (SP) Limited, *Regulatory Accounts*, 2014 – 2023, [link](#)



redevelopment, in turn reducing the need for further increases in already very high charges. Instead, the RAB has been held largely flat in real terms through continuous high levels of inefficient capital expenditure beyond that related to capacity expansion that has delivered limited passenger benefits.

60. There are numerous other examples of HAL's inefficiency and poor cost control performance on projects beyond that related to capacity expansion, for example:
- **The expected costs for refurbishing the main vehicle tunnel have nearly quadrupled.** The original budget in 2014 for refurbishing the main tunnel was £86 million with an expected completion in 2016. The project is still ongoing, with an expected completion date of April 2027 and an expected cost of £319 million.
  - **The expected costs for refurbishing the cargo tunnel beneath the southern runway have more than quadrupled.** The original budget for the project was £45 million in 2014. The project is still ongoing with an expected budget of £200 million.
  - **The already very high cost of the T2 baggage system has increased by more than 10%.** The original budget for the T2 baggage system, which was due to be completed in the second half of 2027, was £695 million (based on the mid-point estimate) – this was already very expensive. Yet, the current estimate is now £787 million (again, based on the mid-point estimate), with an expected completion date of the fourth quarter of 2028.
61. Consistent with its harmful capital expenditure incentives, **HAL's expenditure on new terminals is much higher than its peers.** Capital expenditure by Heathrow is inefficient and ineffective. As detailed in the February Submission, Heathrow's key terminals (Terminals 2 and 5) cost approximately twice as much, or more, per square metre to construct compared to comparable terminal developments at major European hubs like Munich, Frankfurt, Madrid, and Barcelona.

**Figure 2: Heathrow's capital expenditure stands out as expensive relative to other major European airports**



Source: LHR T5: Parliament UK, [link](#); LHR T2, MUC T2, MUC T1, FRA T3: Airport Technology, [link](#); MAD T4: Estudio Lamela, [link](#), Moodie Davitt, [link](#); BCN T1: Aviation Week, [link](#), Barcelona Airport, [link](#).

62. Yet, these higher capital costs do not translate into superior passenger satisfaction. As demonstrated above, Heathrow's terminals often receive equivalent or lower passenger

satisfaction ratings compared to terminals at peer airports that were delivered much more cost-effectively.

63. Major international airports all face different operational environments and challenges that can affect their underlying efficient costs, for example, London is often cited as one of the most expensive locations for construction. However, the sheer scale of the difference between Heathrow's charges and those of all its major European hub peers and Gatwick makes it inconceivable that such factors alone could explain the scale of disparity at Heathrow. Clearly understanding in detail why Heathrow fails to address its challenges and provides such poor value for money compared to its peers, and the role that its harmful incentives under the current RAB-based regulatory model plays, should be a key area of investigation for the review.

### **HAL's harmful incentives mean consumers miss out on the significant single-till benefits**

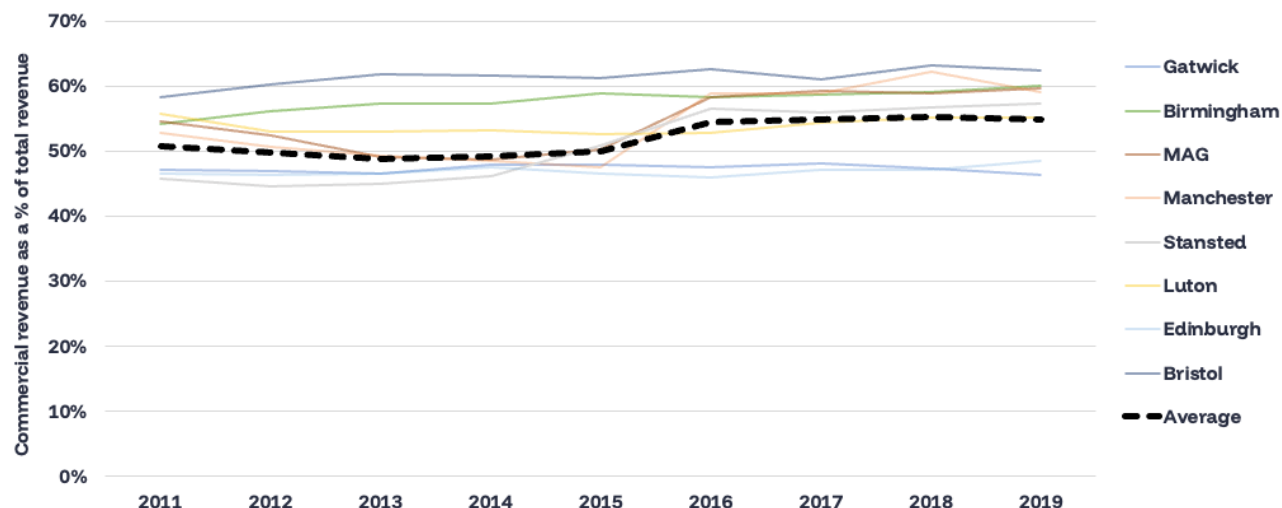
64. HAL's disproportionate and inefficient expenditure on under-productive commercial activities, which is underwritten by the regulatory regime, may actually have increased regulated charges and enabled gaming of the single-till mechanism.
65. The Parties strongly support the ongoing use of the single-till approach to setting regulated charges at Heathrow. The intention underpinning the single-till is that revenues from commercial activities (e.g. shops, restaurants, car parking, facility and property leasing, etc), which benefit from HAL's SMP position, help offset the costs of running the airport and, therefore, reduce regulated charges for consumers and other users.
66. In principle, the single-till model, therefore, shares the financial benefits of commercial activities with consumers and other users. However, HAL's harmful incentives under the current regulatory model undermine the realisation of these consumer benefits.
67. Consistent with this, the share of HAL's costs per passenger covered by commercial revenues has declined significantly over time. This is despite, for example, the provision of commercial activities being a very significant component of the Terminal 2 and 5 developments. As highlighted in our February Submission, this contribution has fallen, from representing approximately 60% of forecast costs in 2003 to only around 35% in 2023.<sup>26</sup>
68. This contrasts with the performance of other large airports (and airport groups) in the UK. Independent analysis commissioned by the CAA, published in April 2024<sup>27</sup>, shows other large airports in the UK increased – or at least maintained – commercial revenues as a share of total revenues. On average, commercial revenues made up 51% of total revenues in 2011, and this increased to 55% in 2019. This is shown in the chart below.

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<sup>26</sup> Figure 13 and paragraph 202 of Heathrow Reimagined, *Fundamental reform of Heathrow: Securing the right long-term model for passengers, airlines and the UK economy*, shared with the CAA on 5 February 2025. 'Forecast costs' covers the regulated allowance for operating costs, depreciation and cost of capital.

<sup>27</sup> PA Consulting for the CAA, UK Airports Financial Benchmarking, 2024, [link](#).

**Figure 3: Other UK airports have, on average, maintained or increased commercial revenues as a share of total revenues**



Source: Analysis of data set out in PA Consulting for the CAA, UK Airports Financial Benchmarking, 2024, [link](#).

69. This long-term trend aligns with a regulatory model that does not sufficiently incentivise HAL to maximise the net financial contribution from its substantial commercial estate for the benefit of users via the single-till. Ensuring that HAL's incentives are aligned with maximising the benefits of the single-till should be a critical element of regulatory reform.
70. These factors demonstrate that consumers are suffering harm from the current approach to economic regulation and the need for an urgent, broadly scoped fundamental review.

**C. THE CAA'S REVIEW MUST  
BE SUFFICIENTLY BROAD TO  
ADDRESS FAILINGS WHICH  
EXTEND BEYOND CAPACITY  
EXPANSION EXPENDITURE**

## Introduction

71. In a letter to stakeholders dated 26 March 2025, the CAA set out that it intends to “*review the framework for economic regulation for capacity expansion at Heathrow*” and that this “*review will look at options to ensure the regulatory model provides strong incentives for the efficient delivery of the substantial costs involved in expansion, and will consider the potential impact on the regulatory asset base and airport charges (including how changes should be best managed over the longer term)*”.<sup>28</sup>
72. The CAA states its intention is to “*set out further details on the work programme for capacity expansion after Heathrow has submitted its plans in summer 2025*” and that “*it is not possible at this stage to provide a timescale for completion of the review*”.<sup>29</sup>
73. Alongside announcing the review, the CAA’s letter also set out its intention to continue work on the H8 review and that, as part of that review, it will “*consider whether there are further steps we can take to strengthen and improve our assessment of capital efficiency and the incentives on HAL for the efficient delivery of the capital programme that will best support the operation of the airport over the period of the H8 price control*”.<sup>30</sup>
74. In light of the serious failings of the existing regulatory framework for Heathrow, the CAA’s announcement is a positive step forward. Ensuring that the regulatory regime provides strong incentives for efficient expenditure on capacity expansion is critically important. Absent reform, capacity expansion will result in substantial increases in charges, which are already the highest amongst Heathrow’s peers, risking the viability of any expansion.
75. However, the critical determinant of the review’s success will be its scope. As drafted, it is too limited by focusing on ‘capacity expansion’ capital investment only, and tacitly endorses the current regulatory regime and its inherent harmful incentives, until 2031 (the end of the H8 price control), and, in doing so, essentially guarantees further increases in charges at the most expensive airport in the world.
76. The failings and deep-rooted problems with the current model, and the resulting harm to consumers and the economy, extend significantly beyond capacity expansion expenditure incentives, as set out in the previous section. The Parties, therefore, continue to consider that an urgent fundamental review of the regulatory model and structure of Heathrow as a whole is necessary and unavoidable.
77. The review must not miss the opportunity to resolve the full range of harmful incentives inherent in the current regulatory model by putting in place the right long-term regulatory framework and structure for Heathrow as a whole, building on the previous reforms put in place by the CC in 2009. It needs to address the issues specifically relevant to capacity expansion, but also Heathrow’s broader ongoing operations, including HAL’s extensive plans for capital expenditure in H8 beyond that relate to capacity expansion.<sup>31</sup> These issues share common roots in Heathrow’s harmful incentives and the regulatory model’s inability to constrain them effectively. **HAL must not be allowed to embark on a new programme of major capital expenditure without a fundamentally reformed regulatory regime being in place first.**

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<sup>28</sup> CAA, *Letter to stakeholders: Capacity expansion at Heathrow and the H8 price control review*, 26 March 2025, [link](#).

<sup>29</sup> CAA, *Letter to stakeholders: Capacity expansion at Heathrow and the H8 price control review*, 26 March 2025, [link](#).

<sup>30</sup> CAA, *Letter to stakeholders: Capacity expansion at Heathrow and the H8 price control review*, 26 March 2025, [link](#).

<sup>31</sup> As explained further below.

78. By comprehensively addressing the full range of incentive problems in one overarching review and establishing the right long-term model, the CAA will not only further the interests of consumers and other users of Heathrow, consistent with its statutory duties, but will also promote greater long-term regulatory certainty for all stakeholders.
79. Drawing lessons from other sectors where regulatory change has been a catalyst for, not a hindrance to, major investment, fundamental forward-looking reforms can be implemented in a manner that ensures HAL and its investors continue to have strong incentives to undertake major investment efficiently, while also addressing the clear and manifest failings of the current regime.
80. For example, the major regulatory reforms Ofcom put in place following the *Strategic Review of Telecommunications* in 2005 resulted in a significant influx of investment from competing broadband providers such as TalkTalk and Sky in competition with BT. Similarly, the reforms that Ofcom implemented following its 2016 *Strategic Review of Digital Communications* have seen extensive investment in full-fibre broadband networks across the UK by over 100 providers other than Openreach.<sup>32</sup> Both regulatory reviews, which resulted in a short-term period of somewhat heightened regulatory uncertainty, have resulted in significant investment to deliver extensive longer-term consumer benefits, at sustainable and competitive pricing.
81. With appropriate priority and resource, a properly scoped and efficiently conducted review by the CAA can **deliver this reform without delaying progress toward Government's growth objectives**. Such a review would ultimately enhance the UK's international competitiveness by, over time, delivering better value, more efficient airport infrastructure, and the world-class hub airport the UK deserves.
82. The remainder of this section sets out:
- Heathrow Reimagined's views on the appropriate objectives for the review.
  - Why the review must be sufficiently broadly scoped to properly address all the harmful incentives under the current regime.
  - Why a twin-track approach to regulation is overly complex and impractical.
  - Why the fundamental issues with the current model cannot be resolved by incremental changes to the current regulatory regime.
  - Examples of the types of fundamental reform options the CAA should consider as part of the review.
  - Why the review needs to be completed in a timely manner to tackle the significant and ongoing harm under the current regime as quickly as possible.
  - Why the resulting reforms should be implemented airport-wide as rapidly as possible.

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<sup>32</sup> Ofcom, *Promoting competition and investment in fibre networks: Telecoms Access Review 2026-31 – Volume 1*, paragraph 2.35, [link](#).

## Establishing the right review objectives

83. Consistent with the CAA's duties,<sup>33</sup> the overarching objective of regulatory reform at Heathrow must be to secure an efficient airport that delivers improved value for money for UK consumers, businesses, and other users, while supporting the UK's economic growth ambitions. It cannot be focused primarily on financeability or regulatory certainty. Effective reform, enabled by a broadly scoped review, must fundamentally alter HAL's incentives and enhance the ability of the regulator and users to constrain harmful behaviour.
84. This means creating a regulatory environment that:
- Drives significant efficiency improvements, particularly in capital expenditure, to prevent a further widening of the gap in charges between Heathrow and peer airports. This includes promoting greater transparency and accountability.
  - Delivers infrastructure that is aligned with user needs, so that any major redevelopment or expansion is undertaken at costs and standards that reflect international best practice.
  - Ensures as much of the value chain for providing AOS at Heathrow as possible is exposed to competition to drive efficiency and better align outcomes with the needs of users.
  - Supports the UK's broader economic ambitions by making Heathrow a world-class hub airport that provides value-for-money for passengers and strengthens the country's international connectivity and competitiveness.
  - Ensures Heathrow remains an attractive destination for much-needed efficient investment, providing appropriate protection to current investors, and supporting the airport's ability to finance necessary infrastructure efficiently.
  - Ensures accountability for the delivery of the benefits associated with capital spend over the lifetime of the investment.
  - Uses expansion to close, not widen, the gap between Heathrow's charges and those of its peers – ensuring that growth and investment are not achieved at the expense of affordability, resilience or efficiency.
85. Achieving these objectives requires a regulatory model that fundamentally changes HAL's incentives and its ability to act on them. The new regime should:
- **Create strong incentives for efficient investment:** Directly counter HAL's current incentive to spend inefficiently. This requires a regulatory regime that rewards efficiency in delivering projects and investing in proportionate, value-for-money solutions for both expansion and ongoing capital expenditure that delivers clear, measurable benefits for Heathrow's users and the UK economy.
  - **Maximise the contribution of commercial activities:** Create incentives for HAL to maximise the NPV-positive contribution of commercial activities over their lifetime, ensuring the single-till substantially benefits users, rather than incentivising capital deployment irrespective of commercial viability.
  - **Promote operational efficiency:** Implement stronger drivers for operating efficiency.

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<sup>33</sup> As explained in detail in our February Submission.



- **Encourage innovation and responsiveness to user needs:** Shift incentives so that expenditure and operations are genuinely aligned with the priorities of passengers and airlines.

## **The review must be sufficiently broad to remedy all the current sources of harm to consumers and the UK economy**

86. The Stakeholders Letter sets out the CAA's intention for its review to "*review the framework for economic regulation for capacity expansion at Heathrow*".<sup>34</sup>
87. However, the problems with the current model, and the resulting harm to consumers and the economy, extend beyond just capacity expansion expenditure incentives. Consistent with the objectives set out above, the scope of the review, therefore, must be sufficiently broad to also consider:
- HAL's harmful incentives for ongoing capital expenditure beyond capacity expansion projects; and
  - HAL's harmful incentives beyond just capital expenditure (operating efficiency, responsiveness to user needs, etc).
88. We explain both of these in more detail in the following subsections.

### **Capital expenditure inefficiency issues extend beyond capacity expansion**

89. One of the major failings of the current RAB-based regulatory framework is that it incentivises HAL to grow the RAB through inefficient capital expenditure and is ineffective in preventing HAL from acting on that incentive. The CC identified these risks as early as 2009.<sup>35</sup> Despite this, these structural issues remain unaddressed more than 15 years later, with the problems becoming increasingly serious and entrenched.
90. Crucially, HAL's harmful capital expenditure incentives do not only arise in the context of capacity expansion – they affect all capital expenditure. It is critical that this major failure is addressed effectively on a forward-looking basis ahead of HAL embarking on any new major capital spend beyond H7, regardless of whether it is for capacity expansion or not.
91. Under emerging plans for H8 presented as part of Constructive Engagement<sup>36</sup>, it is clear that the scale of capital spend that HAL is proposing for non-expansion is far in excess of previous regulatory periods, even before taking the capacity expansion spend into account. Several capital expenditure projects commencing in H7 will be largely delivered in, and therefore much of their funding drawn from, the next price control period (H8). Consequently, H8 spending commitments for *existing* projects are expected to be equivalent to the entire capital envelope for H7. In addition, the portfolio for new capital expenditure in H8 – as proposed in Constructive Engagement - includes further programmes totalling double-digit billions of pounds. We expect these *new* projects to require a capital envelope for H8 which would be significantly greater than the H7 portfolio. Together, the total of these non-capacity expansion

<sup>34</sup> CAA, *Letter to stakeholders: Capacity expansion at Heathrow and the H8 price control review*, 26 March 2025, [link](#).

<sup>35</sup> The CC commented in 2009: "[The RAB model] provides an incentive for BAA at each regulatory review to make the projected capital expenditure and operating expenditure as large as possible, and to understate the scope for efficiency savings, traffic growth and growth of other revenues, and subsequently to outperform its projections." Competition Commission, *BAA airports market investigation*, 2009, paragraphs 6.17 to 6.28.

<sup>36</sup> Constructive Engagement, document titled *CE - Round 1, Theme 4 - Capital choices (seen only by the airlines)*.



commitments could be equivalent in size to the current RAB, with half falling into H8. This cannot fall outside the review.

92. Stakeholders, including the Parties, will continue to interrogate and challenge these plans throughout the H8 process, but our ability to do so effectively is severely constrained under the current model for the reasons set out in our February Submission.<sup>37</sup> It is therefore critically important that the scope of the CAA's review is sufficiently broad to also consider how HAL's harmful capital expenditure incentives, and its ability to act on those incentives, can be addressed on a forward-looking basis across all capital expenditure activities, not just those related to capacity expansion. This involves fully assessing the incentives and operation of the current RAB-model. Given the sheer scale of HAL's plans for capital expenditure beyond that related to capacity expansion in H8, failure to include such capital expenditure within the review scope will result in significant and ongoing harm to consumers, other users and the UK economy.
93. The purpose of ensuring that HAL's harmful capital expenditure incentives are addressed for all capital expenditure, including HAL's major plans for H8, is not to revisit the efficiency of previous capital expenditure decisions. Maintaining strong incentives for efficient investment is important to ensure that the much-needed redevelopment of Heathrow can go ahead in the years to come. The Parties recognise that how the CAA treats the recovery of historical capital expenditure can have material consequences for those incentives.
94. Rather, the review should be focused on ensuring that, going forward and from the beginning of the next regulatory period, HAL faces the right capital expenditure incentives and/or its ability to act on any residual harmful incentives is curtailed, such that future capital expenditure is efficient and delivers appropriate value. As set out above, experience from other sectors, such as telecoms, shows that wide-ranging reforms can be implemented without harming efficient investment incentives – indeed, reforms can strengthen such incentives. Therefore, there is no investment incentive reason for the CAA to unduly restrict the scope of its review.

### **The harm to consumers, other users of Heathrow and the UK economy does not only stem from capital expenditure inefficiency**

95. Ensuring that the regulatory regime and structure of Heathrow promote efficient capital expenditure is critical to promoting the interests of consumers and other users of Heathrow. But, as set out in the February Submission and summarised in the previous section, HAL's harmful incentives under the current regulatory regime extend beyond just capex inefficiency. They include HAL having:
  - No incentive to ensure commercial activities are NPV positive.
  - Weak incentives to drive operational efficiencies.
  - Weak incentives to innovate or be responsive to user needs.
96. Each of these harmful incentives, and the current regulatory regime's ineffectiveness at preventing HAL from acting on them, also contributes to the poor and declining value for money that Heathrow provides to its users. They contribute to higher charges and an inadequate passenger experience. Therefore, the review must be sufficiently broad in scope

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<sup>37</sup> The ongoing information availability and asymmetry limitations for airlines and other stakeholders to engage on and challenge HAL's capital expenditure plans were further evidenced by the Independent Reporter's report into round one of H8 Constructive Engagement. See: Steer, *H8 Constructive Engagement - Independent Reporter report – Round one*, March 2025 ([here](#))

to consider them in order to ensure it furthers the interests of consumers and other users of Heathrow. Comprehensively addressing the harmful incentives is important to ensure a new long-term regulatory model for Heathrow furthers the CAA's pursuit of its duties.

## **Focusing only on capacity expansion expenditure is overly complex and impractical**

97. Implementing a 'twin-track' approach to regulation, which is implied by reviewing the approach to economic regulation for capacity expansion only, is also overly complex and impractical. For example:
- There is unlikely to be a clear division between capital expenditure required for capacity expansion and that required for the maintenance of existing airport activities and facilities. Capacity expansion will, for a material part, take place on the existing site and alongside (or in replacement of) existing infrastructure. For example, it is unclear how costs would be allocated if investment is needed in existing terminals to realise the passenger throughput needed to support an expansion in runway capacity.
  - Some of the projects started in H8, including those related to capacity expansion, will not be completed in a single price control period as they are longer-term projects. It is unclear how such projects would be treated under a new framework for capacity expansion, and whether they could be reclassified and moved to the new regulatory framework or be locked into the flawed legacy regime.
  - The twin-track approach risks exacerbating existing perverse incentives, encouraging HAL to promote capital projects as 'H8' rather than expansion, given their ability to grow the RAB today. The ability of the Parties to challenge this approach will remain limited as a consequence of information asymmetries and lack of involvement in project scoping and development.
98. Depending on the reforms adopted by the CAA, it may also raise practical difficulties associated with allocating commercial activities and their revenues to capacity expansion and existing activities.
99. Dealing with such issues will increase the administrative complexity of the regulatory regime and risks creating incentives for HAL to pursue allocations that are to its own benefit (i.e. 'game the system') by taking advantage of the considerable information asymmetries.

## The review must be sufficiently broad to consider the types of fundamental reform needed to address the specific and deep-rooted issues with the current regime

100. The CAA's duties and the objectives for the review set out above require fundamental changes to the regulatory framework that extend well beyond incremental adjustments to the current application of the RAB-based model.<sup>38</sup> As we set out in our February Submission, H8 will not deliver these fundamental changes. The CAA's final H8 Method Statement, published in March 2025, envisages only a limited evolution to the existing regulatory model. While acknowledging criticisms, it explicitly assumes the existing framework remains appropriate for H8, proposing only to "*consider whether [it] can further sharpen the incentives for capital efficiency*" within that existing framework.<sup>39</sup> This approach is wholly insufficient. It fails to address the deep-rooted incentive problems described previously, which extend beyond capital efficiency, and wrongly pre-supposes the retention of the current application of the regulatory model without a fundamental assessment of its suitability and outcomes or consideration of alternative models for the airport as a whole.
101. Comprehensively addressing the deep-rooted problems with the current RAB-based model requires a package of reforms that realigns HAL's incentives and constrains its ability to act on any residual harmful incentives to the detriment of consumers and the UK economy. Such a package of reforms can and should be informed by insights from other jurisdictions and sectors. The current regulatory model and structure of Heathrow, including the CAA's current RAB-based model, are not the norm for airports internationally; other models and structures are used successfully. However, it is highly unlikely that there is a single model or approach elsewhere that could be applied directly. The review and reforms must be tailored to reflect the specific combination of features and circumstances at Heathrow, to ensure that harmful incentives are fully addressed.
102. A package of effective reforms would need to combine several key features, each designed to address specific failings of the current regime, including:
- **Maximising the use of competition where it is possible and can be effective:** As much of the value chain for providing AOS at Heathrow as possible should be exposed to competition to drive efficiency and better align outcomes with the needs of users. Regulation cannot fully replicate all the consumer and user benefits associated with effective competition. Greater use of competition can play a valuable role in putting in place the right incentives for the operator(s) of Heathrow, but it can also help to directly improve the ability of stakeholders to constrain HAL's ability to act on residual harmful incentives, by, for example, introducing comparable benchmarks across the Heathrow campus.
  - **Materially enhancing the effectiveness of regulation to police against residual harmful incentives:** Where effective and sustainable competition cannot be implemented in the Heathrow AOS value chain regulation will continue to be needed to minimise the risk that SMP activities harm the interests of consumers and other users of Heathrow. This means

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<sup>38</sup> For example, a longer control period based on the current regulatory model will not resolve HAL's harmful incentives or its ability to act on them. Rather, it will provide greater scope for HAL to shape the regulatory process even further to its advantage, for example, by using its information advantages, among other things, to generate even greater returns over a longer time period. The significant volume outperformance experience in H7, despite HAL's arguments during the H7 process, show the potential for HAL to drive greater outperformance potential over a much greater time horizon.

<sup>39</sup> CAA, *H8 method statement and business plan guidance*, 2025, [link](#).

that other changes are also required to materially enhance the effectiveness of regulation at Heathrow, including:

- **Open-book transparency:** Full, ongoing transparency over HAL's costs (operating and capital costs) and RAB is essential. This would allow, for example, detailed review and challenge of all major capital expenditure programmes and operational performance on a forward-looking basis, and ensure that the current significant information asymmetries no longer undermine regulatory oversight. The purpose of such transparency, particularly in relation to the RAB, would not be to reopen previous decisions about the efficiency of past capital expenditure, but rather to facilitate greater future accountability of HAL's decision-making on a forward-looking basis.
- **Reinforced CAA expertise and capacity:** The CAA must be equipped with sufficient resources and technical capability to more effectively scrutinise, challenge, and, where necessary, veto HAL's decision-making, particularly in relation to capital expenditure plans. This includes the ability to better benchmark efficient costs, assess value for money, and ensure that capital expenditure is aligned with user needs.
- **Stronger role for stakeholders in governance and decision-making:** Currently, stakeholders such as airlines have a limited consultee role in overseeing HAL decision-making, which is severely constrained by information limitations and asymmetries. Users (especially airlines) should have a far more active role in the specification, development, implementation, procurement, and oversight of major capital projects, moving from being mere consultees to genuine decision-makers alongside the CAA and HAL. They should also be better able to hold HAL to account for the ongoing effectiveness of expenditure in delivering the expected consumer benefits. This would limit HAL's ability to act on harmful incentives and ensure that investment is significantly more efficient.

103. We set out below (on a without prejudice basis) a range of illustrative examples of the types of reform options that could deliver certain aspects of the key features set out above as part of a package of reforms, specifically:

- Options for securing greater competition in terminal development and operations; and
- Capital investment committee models that are designed to reform capital expenditure governance and decision-making to strengthen the effectiveness of regulation.

104. These illustrative examples are not intended to be exhaustive of the full range of potential reform options the CAA should consider. Nor do they individually provide a comprehensive solution. Therefore, the CAA's review must:

- Be based on a full assessment of the incentives and operation of the current RAB-based model and the outcomes it has provided;
- Examine the full spectrum of regulatory and structural options that could address HAL's harmful incentives and its ability to act upon them;
- Consider the interaction between different reform elements across the entire regulatory model; and
- Assess the practicalities of implementing reforms across the whole airport.

## Exposing terminal operations to greater competition

105. A broadly scoped review should properly evaluate options for expanding the role that competition plays in delivering the various AOS across Heathrow.<sup>40</sup> As set out previously, regulation is unlikely to be a comprehensive substitute for competition where it can be effective and sustainable. As a result, policymakers and regulators have instigated structural reforms in various regulated sectors in the UK to expose as much of the value chain to effective and sustainable competition as possible. For example, over time, there have been extensive reforms in energy and telecoms. The CAA has previously indicated it is "*in favour of competitive arrangements where they can be shown to be in the interests of consumers*".<sup>41</sup>
106. Introducing well-designed competitive arrangements is a way to directly target HAL's weak incentives in relation to operational and capital expenditure efficiency, innovation, and responsiveness to user needs. Competition is more likely to be effective at securing better consumer outcomes than regulatory interventions targeted at preventing HAL from acting on harmful incentives.
107. Allowing competing third parties to invest in and operate terminals is an example of how competition could play a greater role in providing AOS at Heathrow. If effective, it would create a strong incentive to invest and operate efficiently, ultimately enhancing the overall consumer experience and driving better value for money, and on a potentially faster timetable than a single airport operator could provide.
108. Allowing competing investment into terminal development and ownership may even deliver much-needed passenger experience improvements far *sooner* than would be the case allowing HAL to pursue its masterplan, which sequences improvements in such a way that subjects consumers to the oldest parts of the airport until at least the late 2030s, if not into the 2040s. This would be an unacceptable outcome for consumers at the UK's only hub airport, particularly when juxtaposed with the concurrent investments in competing terminals at JFK, all of which will have been materially re-developed between 2000 and 2030. Ferrovial, until recently the largest shareholder of HAL, is part of a consortium investing almost \$10bn into the New Terminal One project at JFK, at the same time as a competing consortium anchored by the Vantage Group is rebuilding Terminal 6. None of these industry-leading infrastructure investors are currently permitted to unleash their competitive ingenuity at Heathrow, even though Terminal 1 has stood derelict since 2015, Terminal 3 will remain antiquated until around 2040, and Terminal 4 will remain antiquated indefinitely.
109. Implementation could take various forms, each requiring careful assessment as part of a broad review by the CAA, for example:
- **Independent management of terminals.** This model would introduce competitive tendering for the operation of major infrastructure, such as terminals, while HAL retains asset ownership. Fixed-term management contracts could be awarded based on criteria such as least cost and/or best value for money. This would create direct competitive pressure on operational efficiency and service quality, measured against defined minimum specifications potentially set collaboratively by airlines, HAL, and the CAA. This approach directly addresses weak operational efficiency incentives by replacing HAL's monopoly provision with contestable management contracts. However, this option is unlikely to fundamentally alter HAL's underlying incentive to spend capital inefficiently, and provides only limited operational benchmarks.

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<sup>40</sup> Consistent with the CAA's duties to promote competition in the provision of AOS under Section 1 of the Civil Aviation Act 2012.

<sup>41</sup> CAA, *Economic regulation of capacity expansion at Heathrow: policy update and consultation*, 2018, [link](#).

- **Long-term leases for terminal operations.** Awarding longer-duration leases (e.g. 50 years) for terminal operations through a competitive process could create stronger incentives for leaseholders to undertake a broader range of capital expenditure, including potentially significant terminal redevelopment, alongside driving operational efficiencies. Under this model, of which there are examples in the USA<sup>42</sup>, HAL would retain freehold ownership, while leaseholders (which could potentially include airlines or consortia) would take responsibility for terminal operations and terminal-specific investment during the lease period.

This model would introduce direct, facility-based competition between individual terminals seeking to attract airline customers, potentially driving significant improvements in efficiency, innovation, and passenger experience. It would better align terminal development and operation more closely with the needs of users (airlines and passengers) and potentially transform the terminal experience into an extension of the intense rivalry between airlines for other aspects of the passenger journey, ultimately benefiting UK consumers.

Leaseholders would be responsible for scoping, designing, and financing new terminal developments, likely in partnership with their current or prospective airline customers. Competition for airline customers and the need to agree commercial terms removes any incentive to spend capital inefficiently, as there is no RAB to grow and there would be only disbenefits from an increasing cost base. It would also maintain a role for the airport in ensuring coordination of investment across the campus, ensuring that any such investment is compatible with an overall campus masterplan (e.g. ensuring connectivity with baggage systems and surface access). It could also potentially reduce the regulatory burden on the CAA by allowing greater focus on the core airfield monopoly (though the individual terminal operators may also require regulating if they are also found to hold SMP).

The presence of multiple, distinct terminal operators under long-term leases could provide the CAA with far more robust benchmarking capabilities, leveraging performance data from providers sharing the unique characteristics of Heathrow's catchment, hub status, and airfield complexity.

- **Structural separation of airfields and individual terminals.** A more fundamental reform could involve the structural separation of airfield and terminal ownership, requiring HAL to divest terminal assets (freeholds) to independent owners/operators. This would introduce direct, facility-based competition between individual terminals seeking to attract airline customers, potentially driving significant improvements in efficiency, innovation, and passenger experience. The CC's 2009 BAA airport divestment remedy provides a precedent for structural separation to address competition concerns.

Regulation would likely still be required for the residual monopoly airfield activities and potentially for any terminals retaining substantial market power. However, the CAA would benefit from enhanced comparability and benchmarking opportunities across independently owned terminals.

Mechanisms could potentially be explored, for example, using the airfield RAB, to resolve any concerns, should they arise, regarding appropriate cost recovery for HAL for the divested terminal assets.

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<sup>42</sup> For example, at New York JFK and Newark airports.



This option likely involves significant changes to legal and regulatory structures, but it also offers arguably the strongest potential to counter HAL's weak incentives by replacing monopoly provision with competitive rivalry.

110. Introducing terminal competition was contemplated previously by the CC, which acknowledged potential benefits alongside risks that coordination of long-term investment across the airport could be weakened. However, Heathrow Reimagined believes this coordination concern should not constitute an *a priori* barrier to the serious consideration of terminal competition, particularly given the CAA's statutory duties to promote efficiency and consumer interests and in relation to the promotion of competition in the provision of AOS. Given the scale of failures and resulting consumer harm under the current model, the long-lasting benefits of introducing greater competition between terminals would vastly exceed the potential disbenefits associated with needing to develop processes to address any coordination issues.
111. Additionally, the potential expansion of Heathrow's capacity presents a unique catalyst. New or spare capacity is often necessary to allow for effective switching between providers, thereby maximising the potential benefits that terminal competition can deliver. The CAA has previously noted that the provisions made following the break-up of BAA were intended to ensure terminal competition would be possible.

### **Capital investment committee models**

112. As set out above, effective and sustainable competition cannot be introduced across all aspects of the provision of AOS at Heathrow. Therefore, economic regulation will continue to be required even if, for example, terminal operations could be exposed to effective and sustainable competition.
113. A key aspect of improving the effectiveness of regulation to stop HAL acting on its harmful incentives, particularly in relation to capital expenditure (should the RAB-based model continue to be adopted following a fundamental review), is to establish a stronger role for stakeholders in capital expenditure governance and decision-making.
114. The CAA's review should consider the use of capital investment committee models to facilitate this type of role. Such models would involve establishing a new structure dedicated to developing and managing major capital expenditure schemes. The committee(s) would include representatives from HAL, the airline community, CAA and potentially other relevant stakeholders (e.g. passenger representatives). The aim would be to significantly enhance stakeholder scrutiny and control over investment proposals and improve alignment with the needs of airport users.
115. The new structure would replace the current ineffective processes and would represent a significant move beyond the ineffective consultative approach of Constructive Engagement to ensure genuine transparency, influence and control for stakeholders. It would mean that airlines and other stakeholders would no longer face 'take it or leave it' choices with much more ability to explore alternative and more effective ways of delivering the required infrastructure. It would also be responsible for the ongoing monitoring of major capital schemes to ensure that the anticipated benefits are delivered as fully and as early as possible.
116. Such a committee, which could take different forms as set out below, could be tasked with identifying, prioritising, specifying, and tendering major capital expenditure schemes to ensure efficient delivery, demonstrate clear consumer benefit, and align with user needs. Its responsibilities could encompass overseeing the scoping, design, build, and financing aspects

during the development phase, alongside monitoring the delivery throughout the project's duration. In doing so, it could allow for greater competition in the process through greater use of tendering at various stages throughout the major scheme lifecycle. Upon project completion, HAL could acquire the resulting infrastructure, although alternative ownership or operational models could also be considered.

117. This enhanced governance approach directly targets HAL's ability to act on its incentive to inflate capital spend by increasing transparency around investment decisions (particularly in combination with greater open-book transparency) and shifting aspects of the decision-making power to give stakeholders much greater influence and control. It would transition the airline community from its current position, often as highly limited consultees, towards becoming active decision-makers on an equal standing with HAL from the earliest stages of the capital project development process. All committee members would be able to, for example, access the information and analysis needed to fully assess the merits of capital projects, including alternative approaches to delivering the scheme's objectives.
118. For such a model to be effective, the CAA must have a key leadership and oversight role throughout the investment lifecycle. This role would see the CAA playing a stronger, more active, and more decisive role in defining appropriate capital expenditure budgets, monitoring the prioritisation of specific schemes, and ensuring efficiency is rigorously pursued and maintained during development, delivery and operation.
119. The implementation of such a governance body could take various forms, each requiring careful assessment as part of a wide-ranging review to determine the most effective model for Heathrow's specific context, balancing efficacy and practicality. These illustrative examples demonstrate potential ways to institutionalise stronger oversight and embed meaningful stakeholder control to help mitigate HAL's ability to act on its harmful incentives:
  - **Cross-industry committee:** A committee structure established without creating a separate legal entity. It would function similarly to a board of directors overseeing major capital schemes, with equal voting rights allocated to airlines and HAL, and a casting vote for the CAA. This approach would necessarily rely on enhanced information provision from HAL to the committee and would likely require clear governance protocols and processes to be put in place from the outset.
  - **HAL subsidiary:** A new legal entity structured as a wholly-owned subsidiary of HAL with the committee as the board of directors of that entity. Governance arrangements, including equal voting rights for airlines and HAL (with a CAA casting vote), would be established to allow for greater operational independence and accountability, insulating decision-making from HAL's direct management influence. While the staff responsible for developing and managing major capital expenditure schemes overseen by the subsidiary would remain HAL employees, their management would report directly to this subsidiary board.
  - **Joint venture:** A separate legal entity jointly owned by airlines and HAL, with equal voting rights and a CAA casting vote. This structure would offer the strongest level of structural independence, embedding user interest through shared ownership and control of the development and management of major capital expenditure schemes. It would involve transferring relevant HAL staff responsible for developing and managing major capital expenditure schemes to the new entity. The joint venture's management would report solely to the joint venture's board, insulating it from direct HAL management and board control and influence.



120. The success of establishing any new capital investment committee model would be critically dependent on complementary reforms. These are essential enablers for effective governance and regulation:
- **Measures to significantly improve transparency**, such as an ‘open book’ approach to enable effective forward-looking scrutiny of costs, asset information and plans, are fundamental to allow for detailed review and meaningful, evidence-based challenge by the CAA and stakeholders. This would address the significant information asymmetries that currently favour HAL, with transparency key to holding the airport accountable for efficient delivery.
  - **Bolstering the CAA’s capacity and technical expertise** is crucial to strengthen its ability to protect consumer interests. The CAA needs the resources and in-house knowledge to effectively scrutinise HAL’s proposals, oversee the committee’s function, exercise informed judgement (including any casting vote), set appropriate efficiency targets, and enforce compliance. The Parties recognise that this would require additional funding, including from the industry.
  - **More effective use of benchmarking**, drawing on relevant national and international comparisons for both capital and operational costs, is necessary to provide objective reference points for assessing the efficiency of proposed expenditure and operational performance, informing regulatory judgements and incentive setting.
121. Together, these complementary measures are necessary to empower the reformed governance structure to the maximum possible extent to limit HAL’s ability to act on its harmful incentives and ensure outcomes that genuinely further consumer interests.

## **The review must be completed in a timely manner**

122. The regulatory model at Heathrow needs to be fundamentally reformed. Despite being the world’s most expensive major international airport, HAL’s experience and service continue to decline in the eyes of passengers and users. Fundamental reform is needed urgently – the review needs to be completed, and reforms implemented, as quickly as possible:
- **Under the current regulatory model, consumers and other users continue to face serious harm from poor and declining value for money.** Delays to fundamental reforms will only delay the realisation of the benefits for consumers, other users of Heathrow, and the UK economy.
  - **HMG has set a clear timetable for Heathrow capacity expansion that we support.** The Parties recognise the need to complete any review without delaying expansion, but fundamental regulatory reform is a necessary pre-requisite before HAL embarks on very expensive major capacity expansion. With urgent action, there is no reason why fundamental regulatory reform cannot be compatible with and supportive of pursuing expansion in a timely manner, as proposed by HMG. An appropriately scoped review, consistent with the CAA’s duties, could be undertaken within the same time frame as the CAA’s currently planned review if it is given the necessary resources and priority by the CAA.
  - **HAL is planning significant capital expenditure beyond that related to capacity expansion under H8 – this must not go ahead until the regulatory regime is reformed.** While HAL’s plans for H8, as set out above, are still subject to the regulatory process, they underline

that the urgency of regulatory reform is not just about the vast amounts that HAL is contemplating spending on major capacity expansion, but the risks of substantial inefficient capital expenditure (which will result in ongoing consumer harm for decades) that HAL is planning in the short-term over H8. Furthermore, as illustrated by the examples in the previous section (e.g. the main and cargo tunnels), there is a risk that the costs of these projects could increase substantially once they are underway, suggesting that the true scale of capital expenditure could be even higher.

123. The Parties stand ready to support the CAA to undertake the review in an effective and timely manner. Given the CAA's sectoral expertise and proximity to the issues under review, there is no reason why a fundamental review should not be completed within 12 months of being launched. Such a time scale would be consistent with that set out in statute for market studies under the Enterprise Act<sup>43</sup>, and the timescales adopted by the CMA for recent market reviews<sup>44</sup>.
124. The Parties stand ready to discuss with the CAA its intended timelines for the review and how they can assist it in expediting the review.

## **Reforms should be implemented airport-wide as rapidly as possible**

125. For the reasons set out above, HAL must not be permitted to embark on major new capital expenditure, including non-capacity expansion expenditure, without a fundamentally reformed regulatory regime. This includes the very significant capital expenditure plans HAL is developing for H8. Allowing HAL to embark on large capital projects without reform risks subjecting consumers and users to decades of further harm, particularly if that spend continues to be subject to the current ineffective and harmful regulatory regime post-review.
126. In light of this, the Parties continue to consider the appropriate approach in this case would be to adopt a time-limited rollover of the H7 price control arrangements. This would provide protection to consumers<sup>45</sup>, provide clarity and certainty to stakeholders in the short-term, and allow time for the outcomes of the regulatory review to be put in place before HAL embarks on the major capital plans it has been developing, including for H8, thereby providing greater regulatory certainty for the airport operator(s) before capital starts to be spent. Also, by starting H8 once the review has been completed, it would remove any ambiguity over whether H8 would need to be reopened or curtailed in any way as a result of the review, further enhancing regulatory certainty for all stakeholders. While it may result in a short delay to some capital projects planned for H8, such delay is outweighed by the benefits of ensuring such projects are undertaken efficiently under a reformed regime.
127. However, the CAA has set out in its Stakeholders Letter its intention to progress its H8 price control process alongside the review. Should the CAA continue down this path, it must send a clear signal to all stakeholders that it intends to ensure that reforms identified by the review will be implemented airport-wide at the earliest opportunity, including, where possible, within

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<sup>43</sup> For example, Ofcom undertook a comprehensive market study into cloud services ([here](#)) in twelve months over late 2022 and 2023.

<sup>44</sup> For example, the CMA completed a review of the vet sector in nine months in 2023/2024 ([here](#)).

<sup>45</sup> The Stakeholders Letter set out that the CAA was continuing the H8 review “so that there are appropriate protections in place for consumers during the period when Heathrow will be developing its plans for capacity expansion and potentially starting the construction of new infrastructure”. However, a time-limited rollover of the H7 price control arrangements would also provide protection to consumers.

the H8 period should it have started. The CAA should also set out clear mechanisms for how it will integrate the review's outcomes within the H8 process and control period.

128. Waiting until H9 (or later) to implement any reforms identified through the review will only prolong the entrenched harm to consumers and the UK economy from the current model, which is contrary to the CAA's duties. Consumers and Heathrow's other users continue to face serious harm from poor and declining value for money. The plans HAL is developing for very substantial capital expenditure (including spend that is beyond that related to capacity expansion) on projects that will take years to deliver and will further increase the harm for decades unless based on a fundamentally reformed regulatory model.
129. The CAA applies a high bar to change aspects of the regulatory framework midway through a price control period, given the potential for increased regulatory uncertainty. However, in the event that implementation of reforms cannot be undertaken ahead of the commencement of H8, the Parties consider that this threshold is met:
- it is in the interests of consumers (and therefore consistent with the CAA's duties) that any short-term uncertainty is outweighed by the potential for very significant long-term consumer benefits from comprehensively addressing the harm associated with the current failing model; and
  - risks of short-term uncertainty can be managed by the CAA clearly signalling in advance its intentions and setting out the mechanisms it intends to use to implement the changes. For example, as part of its RII0-2 framework, Ofgem allowed for re-opening price controls and set out guidance on its approach to doing so.<sup>46</sup>

## Supporting a CAA wide-ranging, transparent and urgent review

130. The Parties reiterate their steadfast commitment to engaging constructively with the CAA throughout the announced review process. They recognise the significance of this undertaking and support the CAA in fulfilling its statutory duties.
131. Ensuring that the review is conducted in an open and transparent manner and based on clear terms of reference and associated processes is important. Such an approach will help to provide all parties with greater visibility and certainty about the review. It will also help to ensure the CAA engages with the widest possible range of relevant stakeholders, including (but not limited to) consumer representatives, airlines (including those not based in the UK), and investors. To help develop the full range of potential solutions, the CAA should also seek to engage directly with other airport regulators and operators both in the UK and overseas (including those in the US and Asia), alongside learning lessons where appropriate from economic regulation in other UK sectors. Many such organisations typically would not respond to the CAA's normal consultation processes, and, therefore, their views may not be captured by a standard consultation process – a proactive approach by the CAA is required.
132. A key next step for the review should be to publish as soon as possible the review terms of reference, intended timetable and process. This should clearly define the review's specific objectives, scope, methodology, and the expected roles and responsibilities of the CAA, HAL, and key stakeholders. The process must provide meaningful opportunities for early and ongoing engagement with all key stakeholders. This includes transparent ways to submit and

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<sup>46</sup> Ofgem, *Re-opener Guidance and Application Requirements Document: Version 3*, 2023, [link](#).

consider evidence, chances to review emerging findings, and clarity on key deliverables and reporting milestones. Critically, the process must also establish how the review's work and findings will integrate with the ongoing H8 price control determination and implementation. Adopting a well-structured and transparent approach is vital to build confidence among all parties (including investors) and ensure the review delivers robust, evidence-based outcomes efficiently.

133. The Parties stand ready to provide the CAA with additional information, detailed analysis, and relevant expertise as required. They are prepared to dedicate resources, including potentially engaging external consultants if deemed helpful by the CAA, to assist in conducting a comprehensive, evidence-based, and timely review. The Parties look forward to understanding the CAA's intended process and timeline in more detail and discussing how they can best contribute to its successful and efficient execution.

## D. CONCLUSION

## **A fundamental review that extends beyond capacity expansion capital expenditure is needed urgently**

134. The current regulatory model at Heathrow is fundamentally flawed and is failing to promote the interests of consumers, other users of Heathrow, and the UK economy. As a result of its substantial market power and an ineffective regulatory regime, HAL has harmful incentives, and the regulatory regime is ineffective at ensuring it is not able to act on those incentives. The result is that Heathrow is, by far, the world's most expensive major airport, yet the service and infrastructure it provides are inadequate, resulting in poor and declining value for money.
135. Urgent and fundamental reform of the regulatory model and structures at Heathrow is now unavoidable. Incremental adjustments within the current framework, such as those already planned for H8, cannot deliver the scale of change required to address these systemic problems. Therefore, the CAA's announcement that it is to conduct a review of economic regulation at Heathrow is a welcome step forward.
136. Ensuring that the regulatory regime provides strong incentives for efficient expenditure on capacity expansion should be a key focus of the CAA's review. However, the deep-rooted issues extend far beyond capital expenditure for capacity expansion, pervading Heathrow's entire operation, including the very significant levels of ongoing capital expenditure beyond that related to capacity expansion planned for H8. While ensuring the right regulatory model and associated incentives are in place for any future capacity expansion is critical, a review focused solely on capacity expansion expenditure will fail to address the full set of problems stemming from the existing regulatory model and lock in consumer and economic harm for the long-term, which is contrary to the CAA's duties.
137. The CAA's review presents an important and timely opportunity for fundamental reform and to establish the right long-term regulatory framework and structure for Heathrow as a whole, building on the successful reforms put in place by the CC in 2009. This would give the airport and stakeholders long-term regulatory confidence and certainty to underpin the substantial investment needed at Heathrow. Such a framework and set of structures should comprehensively address all the incentive problems with the current regime and the resulting harm. Such reform is essential to reverse the airport's decline, deliver value for money for users, better support the UK's connectivity and growth ambitions, and ensure any future major capital expenditure is efficient and affordable.
138. A fundamental review is required urgently. The current regime results in very significant and ongoing harm to consumers, other users of Heathrow and the UK economy. HAL's emerging plans for very high levels of capital expenditure on capacity expansion, but also capital expenditure beyond that related to capacity expansion during H8, will result in significantly greater harm for decades to come without urgent, fundamental reform. HAL must not be permitted to embark on any major capital expenditure programmes until the regulatory regime has been fundamentally reformed. Given the CAA's sectoral expertise and proximity to the issues in play, there is no reason why a fundamental review should not be completed within 12 months of being launched.

139. While the Parties continue to consider a time-limited rollover of the H7 price control arrangements to be the right way forward in this case, given the scale of harm associated with the current regulatory failings, the CAA should send a clear signal to stakeholders of its intention to ensure that reforms identified by the review will be implemented at the earliest opportunity, including where necessary within the H8 period, should it continue down the H8 path.
140. Heathrow Reimagined and its members are committed to engaging constructively with the CAA and other stakeholders throughout this critical process. The Parties can provide the necessary evidence, analysis, and expertise to support an effective and timely review that delivers a regulatory framework and structures fit for the future, ultimately securing a world-class, efficient, and value-for-money hub airport for the UK.