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**Iberia response to UK CAA consultation CAP3201: Proposals on the regulatory treatment of early costs of capacity expansion at Heathrow Airport**

## **Introduction**

Iberia welcomes the opportunity to respond to the Civil Aviation Authority's ("CAA") consultation on proposals concerning the recovery of early costs associated with capacity expansion at Heathrow Airport.

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

Iberia supports airport expansion where it is efficient, affordable and in the interests of consumers. However, the proposals currently being advanced for Heathrow expansion raise serious concerns, including around affordability. Expansion pursued without adequate safeguards risks increasing charges, weakening incentives for efficiency and undermining consumer benefits. It is therefore essential that the regulatory framework is robust, proportionate and fully aligned with the CAA's statutory duties towards consumers.

In this context, Iberia opposes the CAA's proposals to allow Heathrow Airport Limited ("HAL") or other promoters to recover early expansion costs from consumers prior to the granting of development consent. Under the current proposals, HAL would be permitted to recover at least £320 million of expansion expenditure for 2025-2026, years before planning consent is granted. The proposed safeguards do not provide adequate protection for consumers, and Iberia urges the CAA to withdraw the current proposals and reconsider its approach.

Notwithstanding our position, Iberia outlines further below the minimum safeguarding requirements that would be needed in the event the CAA decides to proceed with licence modifications.

## Key concerns

### **1. Early cost recovery places pre-DCO development risk on consumers in a manner inconsistent with the CAA's statutory duties**

Expenditure incurred prior to the granting of a Development Consent Order ("DCO") is inherently uncertain and speculative. Allowing such costs to be recovered through regulated charges transfers development risk away from the promoter and onto passengers, who receive no assurance that expansion will proceed, or that it will do so in the form or timeframe currently envisaged.

In normal commercial practice, early-stage development risk is borne by investors. Airlines themselves routinely invest billions of pounds in aircraft, fleet and route development at full commercial risk, without any guarantee of recovery. By contrast, the CAA is proposing to insulate HAL from downside risk at the most uncertain stage of the project, weakening cost discipline and reinforcing HAL's monopoly position. This approach contradicts the principle that the risk should sit with the party best placed to manage it, and with the CAA's duty to protect consumers from inefficiency and unnecessary costs.

The risk that the expansion scheme does not proceed as currently proposed, or within the assumed timelines, remains high. In these circumstances, transferring early development risk to consumers is neither proportionate nor justified.

### **2. Insufficient independent assessment and undue focus on timetable**

The proposals appear to place excessive emphasis on maintaining the Government's preferred expansion timetable, without a sufficiently robust and independent assessment of the costs, benefits and affordability of early expansion expenditure.

It is important to acknowledge that accelerated delivery is not, in itself, a consumer benefit. Consumers benefit from expansion only where it is delivered efficiently and where it results in improved connectivity and service quality at affordable charges.

The CAA is having to rely on analysis commissioned by HAL as an interested party. Without a detailed, independent assessment of the costs and benefits of early expenditure and its impact on airport charges, it is not credible to assume that accelerating spend is in consumers' interest.

### **3. Risks to contestability and the wider regulatory framework**

Given HAL's significant market power, effective and robust economic regulation is essential. Contestability - the possibility that alternative delivery or financing models could be credibly pursued, plays an important role in disciplining costs and incentives.

By providing early assurances on cost recovery, the proposals risk entrenching HAL as the default developer for expansion; in turn weakening contestability. These risks are heightened given the CAA's ongoing review of the regulatory framework for capacity expansion. Proceeding with early cost recovery in parallel risks pre-empting the outcome of that strategic review and constraining future regulatory choices.

#### **4. Risk of duplication and weak cost controls**

The CAA has not demonstrated that the £320 million of early costs proposed for 2025–26 are additional to the substantial pre-COVID expansion costs already included in HAL's Regulatory Asset Base and funded by consumers. Reliance on ex-post review to address potential duplication is unworkable given the information asymmetry in favour of HAL and the reduced regulatory leverage once costs are sunk.

Iberia is also concerned that the proposed cap on early costs appears readily reopenable. A cap that can be revised under timetable pressure does not function as a genuine constraint and weakens incentives for cost control.

#### **5. Land acquisition and single till risks**

Early recovery of land and property acquisition costs is particularly concerning, as such expenditure is largely irreversible. This can influence future decisions on scheme design and threaten the boundary of the single till. Allowing consumers to fund land acquisition while permitting HAL to retain any subsequent upside outside the single till would distort risk allocation and undermine core single-till principles, and must therefore be immediately prevented.

#### **6. Insufficient guardrails proposed**

The safeguards proposed by the CAA do not provide meaningful protection for consumers. Reliance on an ex-post review framework, combined with a high threshold for disallowance, sets an unduly high bar for regulatory intervention and weakens incentives for efficiency. The CAA has previously acknowledged the limitations of ex-post approaches, limitations which are even more acute in the context of speculative early expansion costs.

Likewise, a cap that can be revisited or relaxed in response to timetable pressures does not operate as a genuine safeguard. The absence of clear, enforceable arrangements for true-up, disallowance and clawback further undermines the effectiveness of the proposed framework.

#### **7. Cumulative impact on charges and affordability**

The CAA has not adequately assessed the cumulative impact of early expansion costs when combined with other significant upward pressures on Heathrow charges, particularly those proposed under the H8 process for setting airport charges for the upcoming regulatory period (amounting to increases of at least 47% in real terms, in 2024 prices), and the very substantial

expansion costs being advanced by HAL as promoter (estimated to be at least £49 billion in 2024 prices).

For Iberia, our Heathrow - Madrid route plays a vital role in feeding long-haul connectivity through Madrid. Further increases in airport charges at Heathrow risk undermining the affordability and sustainability of these feeder services, ultimately reducing air connectivity and consumer choice on both sides of the route.

### **Recommendations for strengthening safeguards**

Strictly without prejudice to our overall position, in the event the CAA chooses to press ahead with its proposals to allow early cost recovery, the regulatory framework needs to be significantly strengthened and at a minimum include:

- **Ex-ante regulatory approval:** All recoverable costs must be subject to prior CAA approval against clear criteria, with added scrutiny for expenditure that creates irreversible commitments or significantly reduces further optionality, such as land/property acquisition
- **Binding cap:** Any cap must operate as a hard limit. Costs above the cap should not be recoverable without a fresh ex-ante CAA determination following consultation, with the burden of proof resting entirely on HAL.
- **Clear demonstration of non-duplication:** HAL must demonstrate that early costs are genuinely incremental and do not duplicate the £500m expenditure already funded through the Regulatory Asset Base and passed onto consumers.
- **Protection of the single till:** Any land or property acquired through early cost recovery must remain within the single till and any value uplift must accrue to consumers.
- **Effective clawback:** There must be a clear and enforceable mechanism to claw back costs from HAL if the expansion scheme does not proceed.
- **Alignment with the wider regulatory review:** The treatment of early costs must remain fully capable of being aligned with the outcome of the CAA's ongoing review of the regulatory framework for capacity expansion.

### **Conclusion**

For the reasons set out above, Iberia urges the CAA to withdraw its current proposals on early cost recovery and reconsider its approach. If the CAA nevertheless decides to proceed, the framework must be substantially strengthened to ensure that risk is appropriately allocated,

affordability is protected, and efficiency, contestability and consistency with the CAA's wider regulatory review remain central to decision-making.

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



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