

Heathrow capacity expansion – consultation on a shortlist of regulatory models

CAP 3251

Published by the Civil Aviation Authority 2026

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

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First published May 2026

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

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CHAPTER 1

Introduction and summary

Purpose and context

- 1.1 In November 2025 we published a working paper for consultation on regulatory models for expansion (the “Working Paper”).¹ In the Working Paper, we examined the case for changing the current regulatory model. We provisionally determined that there was sufficient evidence to consider options to improve the current regulatory model applied to Heathrow Airport Limited (“HAL”) to further the interests of consumers, consistent with our statutory duties.
- 1.2 The Working Paper also set the following longlist of potential options for consultation:
- **Regulatory model 1:** Changes to the current capital expenditure (capex) governance framework:
 - Regulatory model 1a: Changes to capex governance processes; and
 - Regulatory model 1b: Separating HAL’s system planning function from its operational function.
 - **Regulatory model 2:** Targeted adjustments to the existing incentive regime.
 - **Regulatory model 3:** Long-term regulatory framework for expansion.
 - **Regulatory model 4:** CAA oversight/mandate of procurement:
 - Regulatory model 4a: Enhanced scrutiny of HAL’s approach to procurement; and
 - Regulatory model 4b: Mandate Design and Build contract.
 - **Regulatory model 5:** Contracts for delivery and operation:
 - Regulatory model 5a: Operation (management contract); and
 - Regulatory model 5b: Design, Build, Operate.
 - **Regulatory model 6:** Third party builds assets, then transfers ownership to HAL.
 - **Regulatory model 7:** Third party continues to own and operate assets:

¹ CAP3195: Working paper on regulatory models, CAA, November 2025

- Regulatory model 7a: Upstream supplier model; and
- Regulatory model 7b: Direct competition for airport operation services.
- **Regulatory model 8:** Transfer of ownership and operation of an existing asset.
- **Regulatory model 9:** New frameworks for setting airport charges:
 - Regulatory model 9a: Price benchmarking;
 - Regulatory model 9b: LRIC; and
 - Regulatory model 9c: “Lighter touch” regulation.

1.3 In January 2026 we received a large number of responses from stakeholders, together with external reports that they had commissioned, including on capital governance, charges benchmarking and precedent for regulatory models from other major capital projects. There are some common themes across the responses we received, such as the need to make sure capital governance is fit for purpose for a project of the scale and complexity of the expansion of Heathrow Airport². However, the responses set out very different views on the appropriate regulatory models that should be in place for both the “business-as-usual” activities of the airport and for expansion.

1.4 In this document, we set out our updated assessment of both the case for improving the current framework and our approach to evaluating the longlist of options. Based on our updated approach to evaluation, this document sets out for consultation the shorter list of models on which we propose to subsequently undertake more detailed work. This includes some models where there are dependencies on the outcome of other processes such as planning.

1.5 To inform our assessment of the regulatory models, we have commissioned two expert reports, which we have published alongside this document:

- a report by Centrus which presents its views on the financeability of the regulatory models;³ and
- a report by Steer, which presents its technical assessment of the likely impact of the regulatory models on the operations of the airport, costs and service quality.⁴

² In this consultation, we refer to the development of a third runway and associated infrastructure at Heathrow Airport as “expansion”.

³ Financeability assessment of regulatory models for Heathrow Airport, Centrus, May 2026

⁴ Technical assessment of the CAA regulatory models for Heathrow expansion, Steer, May 2026

- 1.6 The Government is planning to issue a public consultation on revisions to the Airports National Policy Statement (“ANPS”) by July 2026. We understand the consultation on the revised ANPS will provide an update on the overall economic case for expansion. It will also include the planning requirements for expansion proposals and the grant of Development Consent Orders (“DCOs”) under the Planning Act 2008.
- 1.7 We intend to issue a high-level update on our strategy and approach to subsequently undertaking more detailed work on regulatory models for expansion in July 2026. A more detailed document will follow in September 2026. The July 2026 update will allow stakeholders to take into account our latest views in considering how best to respond to the Government’s consultation on the revised ANPS in the summer of 2026.
- 1.8 In addition to our work on regulatory models, we will continue with our work on the early costs (that is those costs incurred by credible developers with sufficiently mature plans before the grant of any DCOs). We published a Draft Decision on these costs for 2025 and 2026 in April 2026 and intend to publish a final decision on these matters in July 2026. Our Draft Decision involved allowing the efficient early costs of Heathrow West Limited (“HWL”), an alternative developer, up until November 2025 and the efficient early costs of HAL for 2025 and 2026. We also plan to consult on the treatment of early costs for 2027 and beyond later in 2026.
- 1.9 The Draft Decision⁵ included an update on work on the overall costs and benefits of expansion for consumers and we will update on our assessment of these matters later this year. This work will inform both our policy on early costs and our approach to implementing the regulatory framework for expansion.
- 1.10 We will also continue to work with the Government to ensure that the development of the regulatory framework takes appropriate account of the requirements in the ANPS as it is revised. The Secretary of State for Transport (“SoS”) has also written to the CAA explaining the Government’s priorities in relation to expansion.⁶

The case for changing the current regulatory framework

- 1.11 We have re-examined the provisional conclusions we set out in the Working Paper on the case for change, based on further analysis and evidence provided by stakeholders. Our view is that there continues to be a case for improving the

⁵ CAP3238 Draft Decision on the regulatory treatment of early costs of capacity expansion at Heathrow airport; CAA; April 2026

⁶ [cap3241-secretary-of-state-priorities-letter-final.pdf](#)

current regulatory framework overall, although the new evidence changes our findings in particular areas.

- 1.12 Our findings in relation to airport charges, service quality and capital efficiency are:
- HAL's aeronautical charges per passenger are high relative to average adjusted charges for comparator airports. The gap in charges between HAL and comparators is also likely to grow as a result of HAL's planned additional capital expenditure on expansion. This supports our focus on ensuring that HAL's charges are no higher than necessary;
 - on service quality, we have reviewed further evidence and recognise the improvements in HAL's service quality since the COVID-19 pandemic. Nonetheless, evidence suggests it remains below its pre-pandemic level and its recovery appears to lag behind certain other airports, as evidenced by cross-sectional comparisons; and
 - although we have not reached a firm view on whether HAL's expenditure on specific capital projects has been inefficient, capital expenditure has been the primary driver of HAL's high charges. This suggests that a degree of inefficiency may have taken place. It emphasises the importance of putting in place stronger and improved capital governance arrangements and incentives, particularly given the challenges and potential scale of the expansion programme.
- 1.13 We also note that the existing regulatory framework was designed to regulate the business-as-usual activities of a two runway airport, rather than the particular challenges of expansion.
- 1.14 We conclude that the strength of the case for change remains broadly consistent with our previous findings. We remain of the view that there is a strong case to revisit the current regulatory model to determine how it can be improved in the context of expansion. This includes considering models that would better use competitive forces to help protect consumers.
- 1.15 Looking forward, we also see significant advantages in focusing attention on the development of the future regulatory framework, rather than continuing with work on the case for change. Therefore, unless new compelling evidence and/or arguments emerge that suggest we should take a different approach, we do not intend to provide further updates on the case for change in future documents or carry out further substantive analysis of the underlying issues.

Framework for evaluation

- 1.16 In the Working Paper, we set out a framework to evaluate the longlist of regulatory models using a set of criteria linked to our statutory duties and proposed to apply judgement to assess the models in the round.
- 1.17 We have carefully considered the views from stakeholders, including on additional criteria that we should include, proposals for weighting specific criteria and the use of “pass” and “fail” ratings for certain criteria. Overall, we have not made any substantial changes to the framework, although we have sought to clarify where in the evaluation framework we are considering the issues raised by stakeholders.
- 1.18 We disagree with HAL and airlines that we should place more weight on the particular criteria that they each consider to be the most important. For instance, placing the most weight on timeliness, financeability and deliverability, as suggested by HAL, could mean prioritising speed over the effectiveness of the regulatory model in protecting consumers.
- 1.19 Heathrow Reimagined⁷ and the airlines have suggested that there is a point at which airport charges could become sufficiently high that they become “unaffordable” in the sense that the fares that airlines would need to charge passengers would not be financially sustainable. They claim that in these circumstances, the benefits of expansion to passengers would be lost and there would not be the increases in connectivity, frequency and route choice to fill the large amount of additional new capacity that expansion is expected to provide.
- 1.20 We acknowledge that affordability in this sense is a very important consideration. It is also important to recognise that the choice of regulatory model(s) will not, in itself, determine the overall economics of a particular scheme for the expansion of Heathrow Airport. The overall costs and benefits of a particular scheme will largely be driven by its broad specification and scope that emerge from the developers proposed scheme and the outcome of the planning process. The ANPS currently specifies the length and broad position of a new runway at Heathrow Airport. It also specifies targets for increases in airport capacity, targets for surface access and protections for local communities in terms of noise levels. The Government has also said that HAL’s proposal for a northwest runway of up to 3.5km is the preferred scheme to inform its review of the ANPS.
- 1.21 Once the broad characteristics of the expansion scheme have been finalised, taking account of the broad constraints created by the planning process and the plans of the developer(s), the regulatory model will provide incentives and other

⁷ Heathrow Reimagined is a campaign group calling for a fundamental review of Heathrow's regulatory model. Its members include airlines, the Arora Group and other interested parties.

arrangements designed to protect consumers. The regulatory model will incentivise important incremental improvements in cost efficiency, reducing the potential adverse impacts of cost over-runs and supporting efficient financing. The incremental benefits that a regulatory model can reasonably be expected to deliver are captured through our proposed evaluation criteria, particularly in respect of costs and financeability. Nonetheless, it would be unrealistic to expect any regulatory model to transform the economics of a particular expansion scheme.

- 1.22 We are carrying out further work on affordability as part of our work on early costs, which will inform both the work on early costs and our approach to developing the regulatory framework for expansion. Consistent with our statutory duties, we will only support an expansion scheme if the evidence suggests it will further the interests of consumers.
- 1.23 We do not propose to set “pass” and “fail” tests for each model, such as on the timetable as suggested by HAL. We propose to take a balanced approach to assessing models for the shortlist that would best further the interest of consumers.
- 1.24 The final assessment criteria for the shortlist are:
- avoid undue delay and disruption: the model is practicable to support the delivery of expansion and avoid any undue delay and disruption. By undue delay, we mean unnecessary delay that would inappropriately delay the delivery of benefits to consumers of expansion. This would have the effect that any benefits that would otherwise have accrued to consumers during the period of any delay would be lost. However, we do not expect delivery according to a fixed date irrespective of costs;
 - promote efficient costs: the model promotes efficiency and control of the costs of expansion, while delivering the benefits of expansion for consumers;
 - raise sufficient finance: the model supports the raising of sufficient finance to enable the delivery of expansion (including the costs of environmental mitigations) at an efficient price;
 - practical to implement: it is likely to be practical to implement the model in a timely way;
 - promotes competition: the model promotes competition in the provision of airport operation services where appropriate, which will in turn deliver benefits to consumers; and
 - promotes service quality: the model promotes an appropriate level of service quality, including improvements where appropriate.

Shortlist of credible options for the regulatory model

- 1.25 In the Working Paper, we provided a longlist of regulatory models that can broadly be grouped into four types of models:
- variation of the current regulatory framework, which focused on changes to the capex governance processes, system planning and incentives;
 - long-term regulatory framework, including for setting the cost of capital for expansion;
 - interventions to facilitate competition in the delivery of infrastructure, with different models of competition in the design, build, finance, operation and ownership of assets; and
 - new frameworks for setting airport charges, such as price benchmarking, long run incremental costs and “lighter touch” regulation.
- 1.26 In this document we provide a shortlist of regulatory models that we propose to take forward for further consideration. If confirmed after this consultation, we would then undertake more detailed evaluation and design work on them. The shortlist is:
- Regulatory models 1a, 2 and 4a combined as a package that would enhance capital governance, improve incentive arrangements for capital efficiency and provide strengthened oversight of HAL’s procurement processes. These models would be intended to encourage capital efficiency and reduce the risk of cost over-runs in the expansion programme;
 - Regulatory model 3 would introduce a longer-term framework for the cost of capital, for example through a cost of capital for expansion and/or caps and collars on returns. This model is designed to encourage efficient financing and avoid any undue upward pressure on HAL’s cost of capital, so that airport charges would be lower than otherwise;
 - Regulatory model 4b would enable the CAA to mandate competitive tendering by HAL for the design and build of assets. Regulatory model 5b builds on regulatory model 4b, and would enable the CAA to mandate competitive tendering by HAL for the design, build and operation of assets. These models would encourage competition and capital efficiency and are consistent with our statutory duty to promote competition where appropriate; and

- Regulatory model 7b would allow for direct competition between HAL and an alternative developer. This could, for instance, be applied in the circumstances where an alternative developer was to apply for and be awarded a DCO by the Secretary of State for the development of new terminal and/runway and associated facilities at Heathrow Airport. This model could encourage competition and efficiency. Nonetheless, there would also be some complications in implementing such a model. It would be important to ensure that an approach involving the build, operation, ownership of assets and direct competition with HAL worked in a way to further the interests of consumers across the whole airport.

- 1.27 These models are not mutually exclusive and can be complementary in providing benefits to consumers. For example, we have identified benefits in taking a coherent overall approach to capital governance, incentives and independent scrutiny of procurement, by suggesting a package combining models 1a, 2 and 4a. This package could also be combined with a longer-term framework to provide certainty on efficient financing and introducing competition for activities and new infrastructure where this would further the interests of consumers.
- 1.28 As noted above, we plan to issue a key high-level update on our recommendations on the approach to regulatory models for expansion in July 2026. This may involve a further reduction in the number of models under consideration. Where further detailed work will be required, it is likely that we will want to take forward models that both improve the existing regulatory framework and make better use of competitive forces. Whether it will be appropriate to further reduce the number of regulatory models under consideration in July 2026 will depend on several factors. These include: the assessment of responses to this consultation, further analysis that we will undertake and any relevant wider developments, such as the Government's consultation on revisions to the ANPS.
- 1.29 We briefly summarise our findings on the models below and provide further detail on our assessment in chapter 4, chapter 5, chapter 6 and chapter 7.

Variation of the current regulatory framework

- 1.30 We consider there is a strong case for further developing the current regulatory framework and approach to capital governance. A strengthened framework could better focus on the challenges of expansion and addresses issues that have been set out in the evidence provided by HAL and airlines. These include the need for additional independent scrutiny of HAL's plans, making sure information provided is sufficient and timely, and setting effective and meaningful incentives on costs and delivery.
- 1.31 Our view is that this will be best achieved by packaging three of the longlist models into a single regulatory model:

- Model 1a: Changes to the capex governance processes;
- Model 2: Targeted adjustments to the existing incentive regime; and
- Model 4a: Enhanced scrutiny of HAL's approach to procurement.

- 1.32 We are minded to implement a new senior capital committee chaired by an independent person appointed by the CAA, after consultation with HAL and airlines. This committee would oversee the scrutiny of each stage of the capital governance process. The existing approach to governance is not designed to provide scrutiny of programmes at the scale and complexity of expansion. It relies heavily on airlines to provide ongoing scrutiny of capex plans and does not provide independent assurance across some aspects of capital governance. We will review the approach to current governance and make changes to address these future challenges and current issues, while also ensuring that we do not introduce unnecessary bureaucracy.
- 1.33 The committee would be attended by senior representatives from HAL and airlines. We would also consider whether there should be attendees from other stakeholders, including consumer representatives. We would expect the committee to be supported by independent technical experts in planning, procurement and delivery of major infrastructure projects.
- 1.34 We do not propose that this committee has powers of veto over HAL's capital plans, delivery and approach to procurement or use of HAL's internal audit function. However, HAL would need to explain clearly to the committee where it chooses to deviate from the advice that the committee and its experts provide. Committee views should be transparent and available for publication where possible.
- 1.35 For this oversight and scrutiny to be effective, there would need to be protections in place where HAL under-delivers against the required standards. These could include new incentive arrangements and longer-term caps and budgets. The package of regulatory interventions we apply would need to be consistent with a "fair bet" for a rational investor choosing to commit capital to the project to secure the benefits for consumers from these programmes. We would remain responsible for setting capex allowances at each price control review and developing incentives to further support capital efficiency.
- 1.36 The approach to developing capex governance for expansion will be informed by examples of improvements made to governance regimes to deliver large, time critical capex projects in other sectors (such as the Accelerated Strategic Transmission Investment framework, project SPEED by Network Rail and Thames Tideway Tunnel). These precedents demonstrate the importance of clear, proportionate and tailored approaches to governance. We want to ensure that intervention is targeted at the elements of HAL's plans that have the most significant impact on consumers. Excessive scrutiny in areas that are less

material could result in a cumbersome process that could undermine timely delivery of expansion. But it is also important that the rapid delivery of expansion is not inappropriately prioritised over an adequate level of scrutiny.

- 1.37 We intend to commission further expert advice on how to best develop these arrangements, including the various tools and mechanisms that we could apply to provide additional scrutiny and the roles of different stakeholder parties. We will draw on the evidence and proposals submitted by stakeholders and we will engage with HAL and airlines on this scope of work. This will inform our approach to implementing these new arrangements.
- 1.38 We also examined an option for HAL's capital planning function to be separated from its delivery and ownership of the relevant assets. We have not shortlisted this option as we consider similar benefits can be delivered through the combined capex governance and incentives model set out above. There is also a material risk that attempting to formally separate planning from delivery would have adverse unintended consequences and cause unnecessary delays to expansion.

Long-term regulatory framework

- 1.39 We have considered whether we should amend the current approach of five-year price controls by making certain longer-term commitments. The intention of doing so would be to better match aspects of the regulatory framework with the investment horizons associated with expansion. It could reduce unnecessary uncertainty and prevent any undue upward pressure on HAL's cost of capital. This would further the interests of consumers by helping to secure that airport charges would be no higher than necessary. Examples of where determinations or commitments have been made over longer periods than five years include Thames Tideway tunnel and the RAB-based frameworks for UK nuclear projects. We have explored a range of possible options for longer-term regulatory frameworks, including:
- a long-term determination of the cost of capital;
 - a long-term determination of the cost of capital for expansion, with the cost of capital for business-as-usual activities redetermined every five years (as it is under the current arrangements);
 - a long-term cost of capital premium applied to the business-as-usual cost of capital, with the business-as-usual cost of capital redetermined every five years;
 - a formal lengthening of the HAL price control period; and
 - a "cap and collar" mechanism to set a maximum and minimum level of return that investors would be allowed to recover over the longer term.

- 1.40 At this stage, our favoured approach is to determine a longer-term cost of capital for expansion activities and/or establish a cap and collar mechanism on longer term returns. These approaches could reduce unnecessary uncertainty and prevent any undue increase in the cost of capital. Nonetheless, we would also need to guard against any disproportionate protections for investors and ensure the overall regulatory framework continued to provide incentives for efficiency and affordable charges. In particular, setting a longer-term cost of capital or collars on returns would only make sense in the context of meaningful incentives for capital efficiency, to avoid circumstances where HAL would be rewarded for delivering expansion inefficiently.

Approaches to facilitate competition

- 1.41 Greater reliance on competitive forces could have significant advantages in terms of promoting efficiency and protecting consumers. We also have a statutory duty to promote competition in the provision of airport operator services where appropriate.
- 1.42 We have received strong representations from a range of stakeholders on both the potential benefits of competition and potential material issues and risks to both the ongoing operation of the airport and the financeability of expansion. We have considered these matters to the extent practicable at this stage, including seeking expert advice, to inform our evaluation and shortlisting of options.
- 1.43 The short list includes regulatory models that would enable us to ensure that HAL makes appropriate use of contracting strategies: particularly design and build contracts (regulatory model 4b) and design, build and operate arrangements (regulatory model 5b). We are of the view that we should be able to resolve any practical challenges associated with implementing new arrangements and that introducing these arrangements would be within our powers and consistent with our existing duties under CAA12. Nonetheless, we will continue to consider these matters and provide an update in our July 2026 high-level update. There are wider issues relating to competitive models involving more direct competition as discussed below.

Regulatory model 4b: mandate design and build contract

- 1.44 Under this model, HAL would be required to tender competitively for the combined design and construction of certain packages of works. HAL would retain ownership, financing, and operational responsibility and would bear ultimate responsibility for managing and coordinating its contractors. Similar models have been implemented at other international airports, including Istanbul New Airport, La Guardia Airport, Newark Liberty International airport and Changi Airport.
- 1.45 This model has similar benefits to design, build and operate arrangements (model 5b discussed below), but would not involve competition, and the potential

associated benefits, in the operational phase of the project. It would also avoid the complexities of separate operating arrangements and may be appropriate for projects where there is no reasonable prospect of third-party operation of an asset.

- 1.46 On balance, we consider that there are significant potential advantages in ensuring that HAL makes sufficient use of competitive processes to support the efficient and effective delivery of expansion and that this regulatory model should be shortlisted for further consideration.

Regulatory model 5b: design, build and operate

- 1.47 This model is similar to regulatory model 4b above but involves the scope of competition extending to the operation of the infrastructure after it has been built. Under this option, HAL would be required to tender competitively for the combined design, construction and operation of packages of works. HAL would also retain responsibility for ownership and ultimate responsibility for financing, and for managing and coordinating its contractors. While the CAA is not aware of any similar models in airport operation in the UK, a similar model has been successfully implemented in the water sector under the Direct Procurement for Customers (“DPC”) framework.
- 1.48 This model has the potential to deliver significant benefits to consumers, because it extends competition to all phases of the project lifecycle, while allowing HAL to remain the “guiding mind” behind the expansion scheme as a whole. However, it could be more challenging to implement than design-build models, since the requirements during the operational phase may be difficult to forecast early in the project lifecycle.
- 1.49 Based on similar considerations as those apply to regulatory model 4b, we have included regulatory model 5b on our shortlist for further consideration.
- 1.50 In relation to both regulatory model 4b and regulatory model 5b, we will be looking to HAL to bring forward proposals for a procurement strategy. This should demonstrate and provide comfort to stakeholders that its approach to expansion will make optimal use of competitive tendering and manage construction risks appropriately.
- 1.51 We will engage with HAL and other stakeholders on this strategy, and commission an expert independent review of HAL’s approach. In parallel to this, we will develop proposals for backstop licence obligations that would allow us to require HAL to take further steps in relation to competitive procurement if the arrangements and plans it brings forward are not sufficiently robust, comprehensive or persuasive.

Regulatory model 7b: Direct competition for airport operation services.

- 1.52 Regulatory model would 7b involve competition from an alternative developer that would design, build, finance, own and operate an asset, such as a new terminal. The alternative developer would then directly provide services to airlines and recover its revenues from them, in direct competition with HAL. A natural focus for this model would be on inter-terminal competition since terminals represent a key point of interface between the airport and its airline customers. This model has the potential to deliver significant consumer benefits. Competition in the development and operation of new infrastructure would act as an incentive on both HAL and the alternative developer to deliver more efficiently and to improve service standards. A similar model has been implemented at JFK International Airport.
- 1.53 The alternative developer would need to be able to acquire the necessary land to support its development of airport infrastructure. One way that this could be achieved is if the alternative developer were to apply for and be granted a DCO. We understand that HWL, an alternative developer, has already signalled its intention to apply for a DCO. In these circumstances, the further development of this model would also future proof the regulatory framework by allowing for arrangements that could flex to accommodate alternative providers within Heathrow Airport.
- 1.54 Implementation of this model would be dependent on a developer obtaining the necessary land that will be necessary to make this a viable option for them to pursue. However, this does not appear to represent an insurmountable obstacle with respect to the development of this model. Our understanding is that a DCO could be used by a prospective developer to obtain the necessary land. In this light, the deployment of this regulatory model would likely be conditional on an alternative developer both:
- being able to formulate appropriate proposals for a DCO in a manner consistent with the revised version of the ANPS (which will emerge from the Government's consultation process in due course); and
 - obtaining the grant of such a DCO.
- 1.55 Given the possibility of such a developer emerging, it would not be appropriate for us to rule out this regulatory model at this stage.
- 1.56 Direct competition, in general, always has the potential to improve consumer outcomes by incentivising parties to offer their best proposition to users. This could include lower costs or a superior service offering in areas that matter to consumers. While there are challenges in terms of the implementation of and underlying economics underpinning this model, we will work with stakeholders to understand whether and how the benefits of this model could be achieved in subsequent stages of our work.

Other competitive models

- 1.57 We have decided not to take forward regulatory models 5a and 6 (as these would provide limited benefits to consumers) and regulatory model 8 as it is not clear that we would have the necessary powers to implement such an approach. We also have concerns about the proportionality of attempting to mandate the sale/transfer of existing assets.

New frameworks for setting airport charges

- 1.58 We previously presented alternatives to the current framework for setting maximum allowed charges at Heathrow, all of which involved departing from the principal of allowing recovery of efficiently incurred costs. We highlight significant drawbacks associated with these regulatory models and have not included these models in the shortlist.

Views invited and next steps

- 1.59 We are seeking responses to this consultation by 5pm on 15th June 2026. These should be sent to economicregulation@caa.co.uk. While we understand that an approximate four week consultation period is relatively tight, it is in the context of having already published a working paper on these matters in November 2025 and that there will be subsequent phases of more detailed work and consultation. We also expect our broad approach to the regulatory framework for Heathrow Airport to continue to evolve over time and we would need to consult further on how best to implement changes to support expansion and protect consumers.
- 1.60 We expect to publish the submissions we receive on our website as soon as practicable after this consultation period ends. Any material that is regarded as confidential should be clearly marked as such, with an explanation of why the information is confidential, and included in a separate annex. We have powers and duties with respect to the disclosure of information under Section 59 of CAA12 and the Freedom of Information Act 2000 and it may be necessary to disclose information consistent with these requirements.
- 1.61 We plan to issue a key high-level update on our strategy and approach to regulatory models for expansion in July 2026, with a more detailed document following in September 2026. The July 2026 update will allow stakeholders to take into account our latest views in considering how best to respond to the Government's consultation on the revised ANPS in the summer of 2026.
- 1.62 In addition to our work on regulatory models, we will continue with our work on the early costs. We published a Draft Decision on these costs for 2025 and 2026 in April 2026 and intend to publish a final decision on these matters in July 2026. We plan to consult on the treatment of early costs for 2027 and beyond later in 2026. The Draft Decision included an update on work on the overall costs and benefits of expansion for consumers and will update on our assessment of these

matters later this year. This work will inform both our policy on early costs and our approach to implementing the regulatory framework for expansion.

- 1.63 We expect to start our work on implementing the regulatory framework to support expansion later in the summer of 2026. This will be carefully coordinated with our work on the business-as-usual H8 price control for the period 2027-2031, for which we expect to issue Final Proposals in November 2026.
- 1.64 A key part of our further work will be to ensure that the overall package of models and measures that we identify as appropriate works together in a coordinated way to further the interests of consumers. This will include ensuring that the regulatory framework makes appropriate use of competitive forces and supports an efficient approach to expansion, an affordable level of airport charges, effective financing and timely delivery.

CHAPTER 2

Case for change

Introduction

- 2.1 In the Working Paper, we examined the case for changing the current regulatory model. We provisionally determined that there was sufficient evidence to warrant revisiting the current regulatory model applied to HAL.
- 2.2 This assessment was based on an examination of the performance of the current regulatory model against outcomes that matter to consumers. This included:
- An analysis of airport charges, both over time and relative to comparator airports;
 - An assessment of the extent to which observed differences could be explained by factors outside HAL's control;
 - Evidence on service quality, including trends over time and comparisons with other airports; and
 - An assessment of the efficiency and economy of capital expenditure.
- 2.3 In this chapter, we re-examine the provisional conclusions we set out in the Working Paper on the case for change, based on further analysis and evidence provided by stakeholders.
- 2.4 We start by discussing the broad approach we have adopted to the case for change, including comments from stakeholders on the characteristics of the current regulatory model. We then revisit our assessment of how the current regulatory model has performed in terms of:
- airport charges;
 - service quality; and
 - capital expenditure.
- 2.5 Based on all of the above, we set out a summary of our updated views on whether the case for change remains in the light of the new evidence considered, and whether the strength of this evidence has changed.

The broad approach to the case for change

- 2.6 Heathrow Reimagined and the airlines have consistently stated that the current regulatory framework inherently creates harmful incentives and is ineffective at preventing the airport operator from acting in a way consistent with these

incentives. They stated that RAB-based regulatory model incentivises HAL to grow the asset base, without regard to efficiency, service quality or other outcomes that consumers value.

2.7 Furthermore, Heathrow Reimagined stated that the Working Paper did not adequately explore the links between what it characterises as relatively poor outcomes at Heathrow and weaknesses in the existing regulatory. It viewed this as an important omission and set out its views on the weaknesses in the existing regulatory arrangements and incentives for dealing with:

- capital expenditure;
- service quality;
- commercial activities;
- operating expenditure;
- information asymmetry;
- information control;
- benchmarking; and
- financeability constraints.

2.8 The Working Paper did explain in broad terms some of the limitations with the existing regulatory model, including difficulties with benchmarking and information asymmetry. It stressed the importance of considering whether alternative regulatory arrangements might make better use of competitive forces to help protect consumers in the future.

2.9 We also note that some of the statements by Heathrow Reimagined on the existing regulatory model do not appear to be consistent with the available evidence on these matters. For instance, it says that “HAL earns a return regardless of whether capital has been spent efficiently or has delivered benefits”. This ignores existing incentive arrangements for capital expenditure providing clear incentives for efficiency and delivery obligations on HAL. We also note that the existing arrangements provide clear incentives with respect to service quality.

2.10 Nonetheless, we accept that that we should seek to improve regulatory arrangements to the extent that it is practicable. As we explained in the Working Paper expansion creates significant new challenges that the existing regulatory framework was not designed to deal with. These factors all support our work to review and improve the regulatory framework, including in relation to opportunities to rely more on competitive forces and process to help protect the interests of consumers.

- 2.11 Evidence in respect of charges, quality of service and capital efficiency, are considered in the sections below. We also seeking to improve our assessment of, and incentives in relation to, operating expenditure and commercial revenues in the context of the H8 price control review as discussed in our Initial Proposals for the H8 price control published in March 2026⁸.
- 2.12 We also note that the suggestion by Heathrow Reimagined – that the current regulatory model inherently creates harmful incentives on HAL to maximise the value of the RAB – is likely to depend on a range of factors. These include the efficacy of incentive arrangements for capital efficiency and whether the allowed return is systematically in excess of HAL’s cost of capital. None of our observations on these matters necessarily undermine our work to see if regulatory arrangements and models can be improved so they better protect consumers. However, they are important context for our decisions on these matters.
- 2.13 HAL supported the need for changes to the regulatory model for expansion to be delivered successfully and efficiently, and to provide clear benefits to consumers. It also suggested that the views of incumbent airlines may be unduly influenced by the relatively high profits they make because of the present capacity constraints at Heathrow Airport. It suggested that the CAA should give greater weight to the principles of better regulation and challenges of delivering mega-projects in our work on the case for change.
- 2.14 As we have explained above, a key driver of our work on regulatory models is the challenges associated with expansion. Given these challenges, we regard our work to review the regulatory models for expansion as a proportionate, targeted and transparent approach to dealing with these issues. Our approach is also based on a careful review of the evidence available, rather than a simple consideration of stakeholders’ views, as discussed below.

Airport charges

- 2.15 In the Working Paper, we concluded that HAL’s charges are high compared to other airports that are subject to greater competition. We identified factors over which HAL has relatively little control that partly, but not fully, explain the charge gap between HAL and other airports. This included construction costs, differences in taxation, and additional sources of revenue earned by comparator airport beyond those earned by HAL. We noted that capital costs have been the principal driver of charge increases, and that HAL is planning significant additional capital expenditure, which is expected to raise charges further.

⁸ [CAP3232: Economic regulation of Heathrow Airport: H8 initial proposals – Summary | UK Civil Aviation Authority](#)

- 2.16 The remainder of this section summarises stakeholders' views and evidence submitted in response to the Working Paper. We then set out our updated assessment and conclusions on whether there is a case for changes to the regulatory model in relation to airport charges.

Stakeholders' views

HAL

- 2.17 HAL submitted an updated benchmarking report by KPMG⁹ (the "updated KPMG report"). This expanded upon a previous report by KPMG submitted alongside the H8 Business Plan (the "July 2025 KPMG report"). This explored key drivers of aeronautical revenue per passenger and assessed the relative impact of these in the context of Heathrow and seven comparator airports.
- 2.18 KPMG introduced the following changes to its previous benchmarking analysis:
- expanded the comparator set from seven to thirteen airports¹⁰;
 - updated some of its comparator adjustments;
 - introduced new comparator adjustments (Purchasing Power Parity¹¹ and rail investment);
 - corrected a small number of errors in its original analysis.
- 2.19 The updated KPMG report estimated an adjusted aeronautical revenue per passenger of £28.67 across the comparator sample. This is lower than the July 2025 KPMG report's estimate of £33.08, but still higher than Heathrow's 2024 revenue per passenger of £26.57.
- 2.20 HAL also presented two additional factors to explain the difference in revenue per passenger between itself and comparator airports, but did not explicitly quantify their impact:
- lower depreciation rates in earlier regulatory periods have increased the size of the RAB and, in turn, current aeronautical charges¹²; and

⁹ Comparator Analysis of Aeronautical Revenue, KPMG, January 2026.

¹⁰ The July 2025 KPMG report compared Heathrow to seven other airports: Amsterdam, Madrid, Frankfurt, Dublin, Gatwick, Singapore and Toronto. In the updated KPMG report, KPMG widened the comparator group to thirteen airports, adding New York (JFK), Los Angeles (LAX), Melbourne (MEL), Hong Kong (HKG), Copenhagen (CPH) and Zurich (ZRH).

¹¹ Purchasing Power Parity is an economic theory and technique used to determine the relative value of currencies by comparing the cost of a standardised "basket of goods" between countries.

¹² HAL stated that if a consistent 5% depreciation rate had been applied since 1997, the current RAB would be around £730 million lower. HAL estimated that this resulted in around £175 million of additional regulatory depreciation in 2024, and an overall increase in HAL's charges by approximately £2.60 per passenger.

- many comparator airports benefit from forms of state support, including direct grants, preferential financing arrangements and public ownership structures. HAL stated that these can reduce charges, and that differences in funding arrangements should be recognised when comparing Heathrow's charges with those of other airports.

Heathrow Reimagined

2.21 Heathrow Reimagined disputed the evidence set out in the July 2025 KPMG report. It commissioned a report by Oxford Global Projects ("OGP") which included further evidence related to aeronautical charges at Heathrow and indicated that KPMG's assessment suffered from various methodological flaws.

Airlines

2.22 IAG submitted a report by CEPA assessing the potential charge profile associated with HAL's proposed £49 billion expansion and renewal programme. CEPA's central case modelling showed per-passenger aeronautical charges rising from baseline 2024 charges of £26.57 to around £35 per passenger in H8 (2027-2031), and a peak of just over £50 in H10 (2037-2041), before declining to £39 in H12 (2047-2051).

2.23 IAG and several other airlines supported the arguments set out by Heathrow Reimagined.

Our assessment

2.24 We consider the following areas where new evidence has been submitted below. This includes:

- considering the updated charge benchmarking, based on new evidence presented by HAL's advisers, KPMG¹³;
- responding to HAL's statements in respect of depreciation and government support; and
- commenting on the trajectory of future charges, taking into account the new evidence provided by IAG's advisers, CEPA.

Updated charge benchmarking

2.25 In the Working Paper, we amended the analysis in the July 2025 KPMG report to exclude adjustments we considered could not plausibly explain material differences in charges (construction costs, taxation policies, and wider revenues). We estimated the adjusted average charge for the comparator airports to be £20.87.

¹³ This analysis has been informed by the new evidence presented by OGP, so we do not separately comment on the OGP report within our consideration charge benchmarking.

- 2.26 We have undertaken a similar analysis of the updated KPMG report below, including the additional factors and evidence concerning the expanded comparator set.
- 2.27 It is important to note that we did not receive the full set of airport-level adjusted charge calculations from KPMG for each comparator airport, or the detailed underlying inputs required to fully replicate their benchmarking results. We have, therefore, been unable to validate KPMG's calculations. Our updated benchmarking analysis has generally assumed that KPMG's calculations are correct as presented and has validated these where possible.
- 2.28 The updated KPMG report breaks down the differences in airport revenue per passenger between Heathrow and comparator airports into seven main drivers. It also presents associated quantitative modelling of each driver's contribution to the difference in fares between Heathrow and comparators:
- Cost of construction: Comparator airports located in lower-cost construction environments are adjusted to London price levels using construction cost indices, increasing their implied asset base and associated capital charges;
 - Rail investment: Adjustments are applied where comparator airports participate in rail infrastructure to ensure consistent treatment of related costs, revenues and asset impacts;
 - Airline operating model: Comparator airports are aligned to Heathrow-type airline behaviour (for example, premium and transfer mix, wide-body share), which KPMG treats as an external driver influencing infrastructure needs, passenger numbers, operating costs and revenue profiles;
 - Differences in prices between countries: Variations in the cost of goods, services and labour are normalised to support consistent international comparison.
 - Tax environment: Adjustments for differences in national tax regimes, including items such as social security contributions, property related charges and VAT related effects;
 - Operating restrictions: Comparator airports without constraints such as Heathrow's night restrictions are adjusted to reflect differences in utilisation; and
 - Other revenue: Adjustments align comparator airports' other revenue categories to a Heathrow-type operating scenario.

Cost of construction

- 2.29 We agree that adjusting for differences in local construction costs is reasonable. KPMG's approach relies solely on the Arcadis International Construction Cost Index, while the Turner & Townsend 2024 index provides an alternative

assessment of relative cost levels across jurisdictions. These are two of the most commonly referenced global construction cost benchmarks, but they differ in building coverage and underlying data sources and can produce significantly different estimates of relative construction costs across countries.¹⁴ For example, taking London as the common baseline (index = 100), New York is indexed at 88 in Arcadis (2024) but 128 in Turner & Townsend (2024). Similarly, Amsterdam is indexed at 45 and 75 respectively, illustrating the sensitivity of relative cost comparisons to the choice of index.

- 2.30 There is no clear evidence or argument for preferring one cost index over another. We treat the Arcadis index and the Turner & Townsend 2024 index as equally valid, giving them equal weight in the adjustment. We have, therefore, applied a construction cost adjustment based on the average of the Arcadis and Turner & Townsend 2024 indices.

Rail investment

- 2.31 The updated benchmarking sets out the key assumptions underpinning the rail adjustment. These rest on clear evidence that Heathrow uniquely owns and operates significant rail assets, including Heathrow Express, its contribution to the Elizabeth line, and its airside transit system.
- 2.32 These assets materially increase Heathrow's RAB, depreciation and operating costs. Conversely, comparator airports generally benefit from rail connections that are owned and operated by external transport authorities rather than by the airport itself. When benchmarked to HAL, it is, therefore, reasonable to assume comparator airports would face similar rail related asset and cost exposure. On this basis, we accept KPMG's adjustment.

Differences in price levels across countries

- 2.33 The new Purchasing Power Parity adjustment introduced in the updated KPMG report adjusts operating costs and non-aeronautical revenues for differences in underlying price levels across countries. It is applied only to operating expenditure and non-aeronautical revenues, to ensure that it does not "double count" the adjustment applied in respect of construction costs. The Purchasing Power Parity data used in the analysis is sourced from the World Bank.

¹⁴ The Arcadis International Construction Cost Index and the Turner & Townsend International Construction Market Survey are widely used industry benchmarks that compare relative construction costs across global cities. Both draw on market data and underlying construction input costs, although they differ in methodology and scope. In particular, the Arcadis index covers a broader range of building types, including industrial and logistics, health and education, as well as commercial and residential sectors. The Turner & Townsend index is more focused on a narrower set of building typologies, primarily residential and commercial. These differences in coverage contribute to variation in the relative cost estimates produced by each index, but do not provide a clear basis for preferring one index over another.

- 2.34 We consider that the rationale and quantification of this adjustment are both reasonable and have included it in our assessment. We also note that the magnitude of its impact is limited.

Tax environment

- 2.35 Structural tax differences are relevant because taxes on employers, property and related business activities directly affect airports' costs and are recovered through aeronautical charges.
- 2.36 We previously recognised that UK airports face a higher tax burden than international comparators and, so, differences in taxation plausibly explain part of the difference in charges at Heathrow compared to other airports. However, we have reconsidered the magnitude of the adjustment that is attributed to differences in VAT.
- 2.37 We now consider that the adjustment applied by KPMG (provided by HAL) is based on an illustrative and unverified £100 million estimate of the impact of the removal of VAT free shopping. To reflect the material uncertainty around this figure, we have applied only 50% of KPMG's VAT adjustment in making our assessment.

Operating restrictions

- 2.38 The updated KPMG report introduced new information on operating hours and nighttime restrictions across the comparator airports.
- 2.39 However, this information does not directly address the challenge we highlighted in the Working Paper: namely, that it does not adequately consider Heathrow's utilisation compared with its comparators.
- 2.40 As a result, considering operating restrictions in isolation may provide a misleading view of relative utilisation and throughput. This is because throughput depends not only on the length of the operating day, but also on the rate at which movements are accommodated within those hours. While restrictions may reduce the number of available operating hours, Heathrow operates at very high levels of capacity utilisation during permitted periods. For instance, in 2024, Heathrow operated 474,029 movements against a cap of 480,000 (98.8% utilisation), which is known to be high among comparator airports. This indicates that capacity is used intensively despite the presence of restrictions. Consistent with our view in the Working Paper, we therefore consider that it would be inappropriate to adjust for operating restrictions without also accounting for HAL's relatively high utilisation.

Other revenue

- 2.41 We have further examined the basis for this adjustment. This adjustment relies on two key assumptions:

- higher levels of “other revenue” levels at comparator airports automatically reduce aeronautical charges; and
- that this revenue can be earned without incurring a corresponding cost.

2.42 In our view, neither assumption is valid. Commercial income does not necessarily offset charges in the context of the dual till regimes under which comparator airports typically operate. Further, we consider that the generation of such revenue typically requires additional capital, space and operating expenditure. On this basis, we do not accept KPMG’s adjustment is appropriate for our analysis.

Airline operating model

2.43 As in the July 2025 KPMG report, the updated KPMG report introduced a series of adjustments to reflect differences in HAL’s operating model compared with other airports. KPMG considered that these differences:

- mean that the number of passengers that travel to and from the airport is lower than would otherwise be the case. This results in higher aeronautical charges per passenger, due to the loss of economies of scale that this reduction in passenger numbers would imply;
- increase the costs that HAL incurs in respect of accommodating widebody aircraft; and
- affect the non-aeronautical revenue HAL earns, as premium passengers spend more than economy class passengers. This is offset by the retail expenditure forgone by HAL to provide lounges for these passengers.

2.44 In the Working Paper, we considered a cross-sectional comparison of airports, and we did not observe any significant relationship between passenger numbers and aeronautical revenues. KPMG has subsequently presented additional evidence that suggests that airports exhibit economies of scale.¹⁵

2.45 We consider that the evidence in respect of airport economies of scale is mixed, with some studies finding constant or limited returns to scale,¹⁶ while others find increasing returns to scale.

2.46 However, if economies of scale are assumed to exist, KPMG’s operating model adjustment does not take into account the significantly higher passenger volumes at Heathrow than at comparator airports. We consider that scale is a

¹⁵ Martín, J.C. & Voltes-Dorta, A. (2011). The econometric estimation of airports’ cost function. *Transportation Research Part B*, 45(1), 112–127.

¹⁶ Lechmann, M. & Niemeier, H.-M. (2013). *Economies of scale and scope of airports – a critical survey*. *Journal of Air Transport Studies*, 4(2), 1–25.

relevant factor when comparing across airports and hence should be included in the assessment.

- 2.47 Our assessment suggests that the impact of differences in HAL's operating model and differences in HAL's overall scale compared to other airports broadly offset each other. We therefore have not included an adjustment in our analysis to reflect the impact of lower passenger numbers under HAL's operating model.
- 2.48 We have also reconsidered our previous view on the cost of accommodating widebody aircraft in the light of the updated evidence presented by KPMG. Airports with a higher proportion of widebody aircraft require more expensive infrastructure per passenger (asset intensity), including longer runways, larger stands and greater operational spacing requirements. We now consider that the adjustment in respect of the higher proportion of widebody aircraft at Heathrow Airport is reasonable and have therefore accepted this adjustment. The widebody adjustment applied represents 47% of the total operating model adjustment based on estimates provided by KPMG.
- 2.49 We consider that it is plausible that HAL's operating model could result in both higher spending by premium passengers and foregone revenue due to additional required lounge space. However, we consider that the available evidence on these factors is limited. As such, we propose to exclude both factors from our assessment.

Depreciation rate

- 2.50 HAL noted that higher historical regulatory depreciation would have resulted in lower charges today. While a hypothetical charge profile with higher charges in the past and lower charges today can be constructed, it is not clear why this would represent a more appropriate comparison to other airports. In particular:
- HAL did not examine the depreciation profile of other airports, which may also have exhibited lower depreciation rates in the past; and
 - even if HAL's historical depreciation had been lower than other airports in the past, this might faithfully reflect HAL's underlying economics and those of the relevant airports.
- 2.51 We therefore do not accept that HAL's depreciation profile is a relevant consideration in explaining the charge gap between HAL and other airports.

Government financial support

- 2.52 HAL stated that low aeronautical charges at some European airports may be influenced by government subsidies or other forms of public financial support. We do not consider that the evidence presented by HAL demonstrates government support has a material impact on charges, for the following reasons:

- the evidence provided was limited to a single example concerning the Avinor group in Norway;
- the Avinor grants cited by HAL relate to capital projects elsewhere in the group, rather than recurring support for Oslo Airport;
- HAL provided no evidence to demonstrate that such support materially reduces Oslo's aeronautical charges. More broadly, we have assessed whether disclosed government support contributes to lower aeronautical charges in EU comparator airports, only finding limited evidence that this is the case. Further detail is set out in Appendix C; and
- an EU-wide State aid control regime applies to airport financing, meaning that any public support must either reflect market financing (under the Market Economy Operator Principle) or be subject to regulatory approval. This limits the extent to which airports can benefit from sustained below-market financing that would materially reduce aeronautical charges.¹⁷

Expected future changes in HAL charges

- 2.53 We do not comment in detail in this document on HAL's forecast expenditure and the impact on charges. However, we accept CEPA's broad observation that significant charge increases are expected in the context of expansion, and that these are likely to widen the current charge gap between HAL and other airports.
- 2.54 We have further examined available evidence from comparator airports, which largely indicates that capex-related charge increases are linked to materially smaller and more incremental investment programmes than those proposed at Heathrow.¹⁸ This confirms our view that HAL's charges would be expected to increase more than those of comparator airports under the current expansion plans.

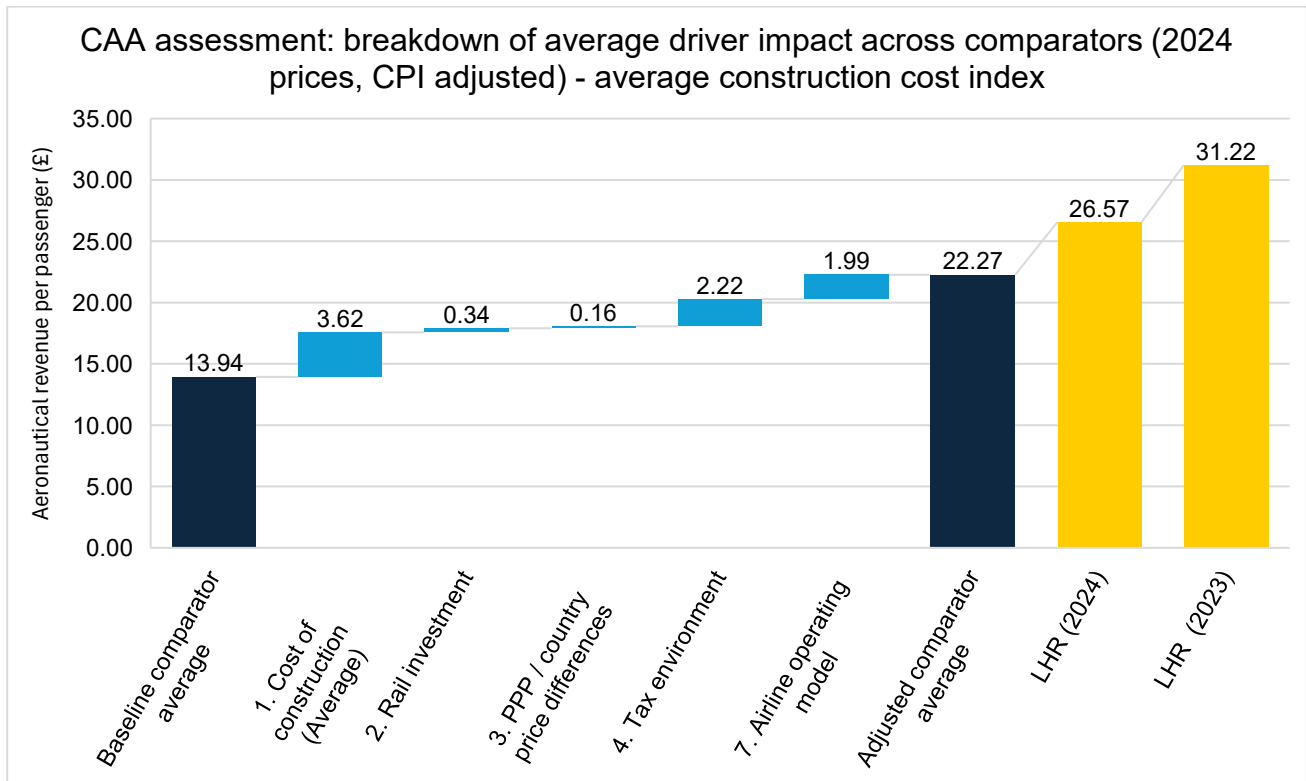
Conclusion in respect of airport charges

- 2.55 Figure 2.1 presents our updated view of the appropriate average comparator charge. This builds on our analysis presented in the Working Paper and is presented after including the adjustments from the updated KPMG report that we have accepted in our methodology.

¹⁷ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=planjo:20140328-018>

¹⁸ For example, Schiphol (Amsterdam) reported a 41% increase in charges for 2025 with a further 5% planned for 2026, linked to a programme of investment and service-quality improvements, while Fraport's (Frankfurt) multi-year charge agreement implies a cumulative increase of around 17% over 2025-2028 alongside its ongoing Terminal 3 expansion. Both programmes are materially smaller in scale than Heathrow's proposed £49 billion scheme.

Figure 2.1: Our assessment of average benchmarked aeronautical charges across comparators



Source: CAA assessment

2.56 The adjusted comparator average charge of £22.27 is slightly above the figure used in the Working Paper but remains materially below HAL’s actual aeronautical revenue per passenger of £26.57 in 2024¹⁹. The gap between HAL’s aeronautical charges and the average adjusted charges for comparator airports has decreased to £4.30 (in 2024 charges) based on the new evidence submitted. Overall, there is clear evidence that HAL’s charges in 2024 are high relative to comparator airports, even after making reasonable adjustments for factors outside HAL’s control. Furthermore, it remains the case that HAL’s charges are expected to increase significantly under its planned additional £49 billion capital expenditure. This confirms the case for considering potential changes to the regulatory model.

Service quality

2.57 In the Working Paper we concluded that HAL’s service quality may have deteriorated since 2021. This was based on HAL’s relative position in the Skytrax global rankings falling significantly since 2021, HAL paying out a high observed

¹⁹ HAL’s 2023 charge of £31.22 was influenced by the one-off effect of the pandemic together with the impact of the holding cap in 2022 and 2023. As such, we do not consider that this figure should be used for comparison with adjusted comparator airport charges, but have included it for completeness.

level of rebates between 2021 and 2023, and HAL itself acknowledging that it has faced service quality issues²⁰.

- 2.58 We also noted that the new Measures, Targets and Incentives (“MTI”) regime introduced in the H7 price control has only been in place for a limited period. As such, it was not yet practical to determine the longer term effect of this framework on consumer outcomes.
- 2.59 This section describes stakeholders’ views and evidence submitted as part of this consultation process and then presents our assessment of the evidence. We then set out our updated conclusion on whether there is a case for reviewing potential changes to the regulatory model related to service quality.

Stakeholders’ views

HAL

- 2.60 HAL stated that we should adopt a more balanced approach when drawing conclusions on HAL’s service quality performance and consider a wider set of service quality metrics. HAL stated that its wider set of service quality metrics demonstrated improvement over time, and presented the following evidence:
- Airport Service Quality (“ASQ”) data, which HAL stated shows that its ASQ performance has improved slightly since 2022;
 - Quality Service Monitor (“QSM”) data, which HAL stated shows that it is delivering its highest QSM rating in over a decade;
 - CAA passenger survey Net Promoter Scores (“NPS”), which HAL stated shows Heathrow consistently maintaining high promoter (9-10) ratings and achieving relatively strong ratings compared to a peer group of four other UK airports; and
 - airline punctuality and security queue delays over time.
- 2.61 HAL also expressed concern over our choice of service quality metrics in the Working Paper. In particular, HAL stated that Skytrax data should not be used as a tool to make regulatory decisions, based on concerns about its robustness.
- 2.62 HAL stated that the CAA should take a more detailed view of the reasons for MTI scheme rebates, when these occurred, and that the CAA’s assessment should take account of both rebates and bonuses.

Heathrow Reimagined and airlines

- 2.63 Heathrow Reimagined supported our view that HAL’s service quality has not recovered after the covid-19 pandemic to the same extent as other airports but

²⁰ Heathrow’s H8 Business Plan 2027-2031, Heathrow Airport Limited, July 2025, Page 165.

considers that the Working Paper understated service quality issues when interpreting this data.

- 2.64 Heathrow Reimagined submitted an additional cross-sectional comparison of ACI Airport Service Quality data against other global, European and “large airports”. Heathrow Reimagined stated that for Q3 2025, HAL’s ASQ score of 4.05 was below the average for airports in each of these groups. It also reiterated its observation that HAL fell from 8th globally in the Skytrax rankings in 2021 to 22nd by 2023, and has remained there.
- 2.65 Heathrow Reimagined stated that harmful incentives embedded in the RAB-based regulatory model were the underlying driver of HAL’s under-performance, and that failing to draw this link was a significant omission in the Working Paper.
- 2.66 Several airlines supported the arguments set out by Heathrow Reimagined.

Our assessment

- 2.67 Overall, we consider that the evidence on HAL’s service quality performance is less definitive than the evidence on HAL’s aeronautical charges. There remains a case for change with respect to service quality, but it is not as strong as the case for change for charges.

HAL’s service quality over time

- 2.68 We have reviewed the evidence submitted by HAL in respect of its service quality over time. This suggests that its service quality has improved since the pandemic, contrary to our previous finding in the Working Paper that it had deteriorated between 2022 and 2025. However, we note that there is some evidence to suggest that its service quality continues to lag its pre-pandemic performance:
- HAL’s CAA Passenger Survey Passenger Experience NPS improved between 2022 and 2025, particularly so between 2024 and 2025. However, HAL’s NPS for 2025 remains lower than in 2019; and
 - HAL’s QSM score improved between 2016 and 2025. However, its ASQ performance is more mixed: while HAL’s ASQ performance has improved between 2022 and 2025(Q1-Q3), its ASQ scores in 2025 (Q1-Q3) also remain below its scores for 2019.
- 2.69 We have reconsidered our interpretation of HAL’s rebates to airlines over time. We continue to consider that rebates, by themselves, are a relevant measure of instances of poor service quality. Where HAL earns both bonuses and rebates, this suggests HAL has underperformed some metrics while outperforming others. We consider that “netting off” the bonuses and rebates would conceal important information regarding underperformance against certain metrics.

2.70 We note that HAL's rebate payments fell consistently every year between 2022 and 2025, to less than £2 million in 2025. This downwards trend in annual rebates paid will tend to reflect reductions in instances of poor service quality between 2022 and 2025. However, total rebates paid in 2025 remained higher than rebates paid in 2019, which is consistent with the evidence above suggesting that HAL's service quality remains below its pre-pandemic level.

Cross-sectional comparisons of HAL's service quality

2.71 HAL submitted evidence demonstrating that it achieved relatively better service quality performance for the CAA passenger survey NPS metric than other major UK airports. Heathrow scored a 45% NPS for January to September 2025, compared to 28% at Gatwick, 35% at Stansted, and 34% at Manchester.

2.72 However, we consider this evidence is less relevant than other data considering a wider set of comparators, importantly including other "large airports" which are likely to be closer in nature to Heathrow than the UK comparators presented by HAL.

2.73 We disagree with HAL's view that Skytrax and ACI ASQ data are not reliable measures of service quality. They are both commonly cited measures of service quality, used across the industry to benchmark performance. Indeed, HAL has previously highlighted high levels of service quality performance with reference to ACI ASQ²¹ and Skytrax rankings²².

2.74 Skytrax has published its World Airport Awards for 2026, and Heathrow's ranking has improved significantly since 2025, increasing from 22nd to 16th. However, this remains below its pre-pandemic ranking of 8th place. This indicates that HAL's service quality performance has declined when compared to other international airports since before the pandemic.

2.75 We have also collected ACI ASQ service quality satisfaction index data for HAL and comparator airports for the full year 2025. HAL's score of 4.05 for 2025 was:

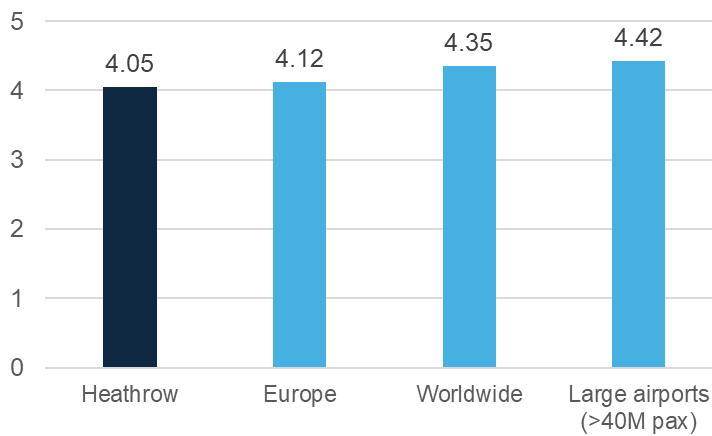
- significantly below the average score of all airports globally (4.35) and all "large airports" (4.42); and
- slightly below the average for all European airports (4.12).

This demonstrates that there is room for improvement in HAL's service quality performance.

²¹ <https://mediacentre.heathrow.com/pressrelease/detail/8181> and https://www.heathrow.com/content/dam/heathrow/web/common/documents/company/investor/reports-and-presentations/annual-accounts/sp/Heathrow_SP_Limited_ARA_2019.pdf

²² <https://mediacentre.heathrow.com/pressrelease/detail/9286>

Figure 2.2: ACI ASQ service quality index scores (2025), for Heathrow, all European airports, all worldwide and all “large airports”



Source: [Heathrow 2025 Annual Results, P6](#) and [ACI ASQ 2025 Q4 Barometer](#)

Conclusion in respect of service quality

- 2.76 Our updated view of HAL’s service quality is more nuanced than that which we set out in the Working Paper. We acknowledge that our previous statement that HAL’s absolute service quality has declined since the pandemic is not supported by the updated evidence. There is some evidence that HAL’s service quality has improved since then. However, there is also evidence to suggest that HAL’s service quality remains below its pre-pandemic level; and that HAL’s comparative service quality performance declined when viewed against other international airports during the pandemic and has not fully recovered since.
- 2.77 Furthermore, the ACI ASQ data shows that HAL’s service quality satisfaction index score is below the average for other comparator groups, including European airports, all airports globally and “larger airports”. We also do not consider that there is sufficient evidence to suggest that HAL’s higher level of charges relative comparator airports can be justified on the basis of higher service quality.
- 2.78 Based on HAL’s:
- lower relative performance since before the pandemic; and
 - lower ACI ASQ satisfaction index scores relative to comparators
- we consider that there is room for improvement in HAL’s service quality performance, and that this could warrant revisiting the current regulatory model. However, the case for change in respect of service quality is weaker than we set out in the Working Paper.
- 2.79 We do not accept the assertions made by Heathrow Reimagined that a RAB-based regulatory model drives under-performance in respect of service quality.

The RAB is one element of the regulatory framework, which is complemented by service quality incentives. Nonetheless, it is appropriate to consider whether these arrangements can be improved in the future and whether arrangements relying more on competitive forces could enhance service quality.

Capex efficiency

- 2.80 In the Working Paper we considered the conflicting evidence that had been presented to us regarding the efficiency of HAL's past investment projects. We also identified some features of HAL's proposed expansion programme that could raise challenges under our current capex governance framework.
- 2.81 On the efficiency of HAL's past investment, we noted that our ex post reviews of HAL's past investment projects had not consistently identified material inefficiency. However, we noted some evidence that suggested that the costs of developing Terminals 5 and 2 were relatively high. We also noted that capital costs have been the principal driver of increasing airport charges at Heathrow, which could indicate that some capital inefficiency has occurred.
- 2.82 On the suitability of the current capex governance framework, we concluded that there is a case for examining amendments or alternatives to the current regulatory model on a prospective basis. This reflected several different considerations, including:
- characteristics of expansion (such as cost volatility, complexity, uniqueness and long duration) that might limit our ability to set strong incentives for cost efficiency; and
 - whether the current process that focuses capex incentives on a project-by-project basis can be successfully applied to a major capital programme such as a new terminal.

Stakeholders' views

HAL and business organisations

- 2.83 HAL stated that multiple independent reviews across a number of price control periods had failed to demonstrate significant capex inefficiency. It also stated that T5 and T2 were delivered on time and on budget and are widely used as a basis for other UK infrastructure projects to build on. It submitted evidence including:
- a new Best Practice Review by Amey, which HAL stated found its Capital Governance Handbook to be closely aligned to best practice. It also raised questions about the CAA's H7 framework and its suitability in the context of a large and multi-dimensional series of infrastructure programmes;

- a report by KPMG on the costs of capex delivery, which HAL originally submitted with its H8 Business Plan. HAL stated that this report confirmed that many cost drivers at Heathrow are outside of its control, and that its delivery processes operate within expected or best practice ranges given the environment;
- a 2024 Steer report, which HAL also submitted with its H8 Business Plan, which benchmarked construction costs for 20 airport terminals worldwide. HAL stated that this showed that it falls in the mid-range of benchmarks and supported its position that it delivers projects efficiently within a constrained “live” operational site; and
- a recent Jacobs case review which HAL stated confirmed that T2 and T5 provided examples of best practice in capital delivery.

2.84 HAL challenged the statement in our Working Paper that the costs of delivering T5 and T2 were relatively high. It stated the construction and delivery of both T5 and T2 provide strong evidence-based lessons on how cost efficiency can be achieved in large, complex, live airport environments.

2.85 HAL contrasted the delivery of both terminals (broadly on time and within approved budgets) with international evidence it said suggested average cost overruns were 30-50%, and considerably higher in comparable transport schemes. It presented an adjusted recalculation of the cost comparisons included in the Working Paper, stating that this showed that the costs of T5 and T2 were in line with the distribution of other projects’ costs.

2.86 HAL supported our views that the current capex governance framework may not be suitable for the scale of the expansion programme. It referred to initial views on potential improvements that it set out in its H8 Business Plan. It stated that a framework that promotes financeability, timely decision-making and disciplined delivery can materially reduce the likelihood of systemic failure. By contrast, it stated that a framework that introduces fragmentation, uncertainty, or excessive rigidity can amplify risks and drive adverse outcomes.

2.87 Several business organisations (including Business LDN, London Chamber of Commerce and Industry, Logistics UK and Make UK) supported the RAB model and noted that T5 and T2 had been delivered on time and on budget.

Heathrow Reimagined

2.88 Heathrow Reimagined, in contrast, welcomed our analysis of capital efficiency and the conclusion that T5 and T2 costs were relatively high. However, it stated that the evidence supports a far stronger conclusion on whether this reflects inefficiency. It said that capex inefficiency must be central to explaining the gap between charges at Heathrow and at other airports. It also stated that our

Working Paper does not substantively assess HAL's opex efficiency performance, which it described as a notable omission.

2.89 Heathrow Reimagined also submitted additional evidence, including:

- a report by OGP that benchmarks HAL's capital costs against a range of other projects worldwide. Heathrow Reimagined stated that this provides compelling evidence of HAL's capital inefficiency. It stated that:
- T2 and T5 costs (when baggage systems are included) fall within the 70th to 90th percentiles;
- T2 and T3 baggage handling systems are above the 95th percentile; and
- cost premia were also found for runways and car parks.
- a report by Dr Paul Mansell, which assessed the capital governance framework and HAL's delivery performance. Heathrow Reimagined said that this report identifies persistent governance and delivery problems and supports and strengthens the findings in our Working Paper.

2.90 Heathrow Reimagined commented on Steer's report for HAL, to which we referred in our Working Paper, describing it as being fundamentally flawed. It stated that OGP's appraisal of HAL's benchmarking reports corroborates its concerns and identifies common methodological weaknesses across the evidence base commissioned and provided by HAL.

2.91 Heathrow Reimagined listed five fundamental failures of the current capex governance framework, including:

- HAL's incentives to actively undermine the effectiveness of capex governance;
- The focus on delivery to specification rather than user benefits;
- The significant time and resource requirements;
- The limited remit of the Independent Fund Surveyor; and
- Opportunities for HAL to adjust project parameters after Gateway 3 approval.

2.92 It stated that its evidence strengthened our finding that reform is warranted, and that it must address the underlying incentive structure rather than solely looking to refine existing processes within the current model.

Airlines

2.93 IAG supported Heathrow Reimagined's submission. It stated that part of the reason for HAL's high costs is the lack of meaningful oversight by CAA of HAL's capex, as well as information asymmetries between HAL and airlines.

- 2.94 IAG additionally set out its own calculations of “net fixed asset productivity”, based on reviewing the annual reports covering six other hub airports. It concluded that HAL has significantly higher net fixed assets per passenger and per air traffic movement than most peer airports.
- 2.95 Several other airlines also supported the arguments set out by Heathrow Reimagined.

Our assessment

- 2.96 The range of evidence submitted by stakeholders demonstrates the difficulty of making reliable comparisons across major capex projects. These projects are often in different countries (or continents) and often exhibit considerably different characteristics. Stakeholder submissions use different methods and different groups of comparators that reach divergent conclusions about the efficiency of HAL’s capex.
- 2.97 The main new quantitative evidence included in the latest submissions was the OGP study commissioned by Heathrow Reimagined. We have concerns about the conclusions that can be drawn from this study, specifically on the question of HAL’s capex efficiency.
- 2.98 For example, we note that OGP’s “reference class forecasting” method makes only limited adjustments for differences between projects or for external factors that might drive cost differences. We consider that this approach could provide useful information if there is a sufficiently large sample of genuinely comparable projects. However, we note that:
- OGP’s sample sizes for runway and baggage handling projects are quite small. Furthermore, the relatively “flat” distribution of unit costs observed for these categories raise serious questions about the comparability of the projects in OGP’s sample. Even for car parks, which exhibit a slightly larger sample, we have reservations about the lessons that can be drawn from comparisons with projects in quite different environments. For example, the only UK comparators in OGP’s sample are car parks at railway stations, hospitals and town centres; and
 - even in the case of airport terminals, for which OGP has a larger sample, we note that most comparators are from North America and the Asia-Pacific regions. Furthermore, OGP acknowledged that its sample includes only 19 examples of new terminals built on existing airports, and that this group includes “a range of mid-size international terminals” as well as some large brownfield developments. OGP have been unable to provide information that would allow us to identify the position of specific projects in the overall distribution. This further reduced our ability to draw robust conclusions in relation to cost efficiency.

- 2.99 We have similar concerns about the conclusions that can be drawn from IAG's "net fixed asset productivity" comparisons, specifically in relation to capex efficiency. This assessment is based on high level accounting data from annual reports for a relatively small number of potential comparators. We note that there is a very wide range between IAG's reported outturns. For example, the highest observation is over 20 times the lowest observation. This raises questions about the usefulness of this particular measure.
- 2.100 There remains reasonable evidence that suggests that the costs of Terminal 5 and Terminal 2 were relatively high in comparison with projects at other airports. However, it is far more difficult to reach conclusions on the extent to which such cost differences may reflect inefficiency rather than specific features of the Terminal 5 and Terminal 2 projects. They could also reflect factors outside of HAL's control that may lead to higher costs at Heathrow than at some other airports.
- 2.101 We acknowledge the argument put forward by HAL and some business organisations that Terminal 5 and Terminal 2 were examples of successful delivery of complex, major infrastructure projects. We do not consider that this disproves the existence of any cost inefficiency, noting that even projects that are delivered "on budget" may still demonstrate some inefficiency if the original budget was relatively generous.
- 2.102 Nevertheless, we accept that, in delivering Terminal 5 and Terminal 2, HAL avoided the substantial cost increases and/or extensive delays that have affected some other major investment projects.
- 2.103 Stakeholders generally agreed with the statement in our Working Paper that we should consider the most appropriate regulatory model as it applies in the context of major capex programmes. Two separate but related questions to be considered are:
- whether the current system of ex ante efficiency incentives is appropriate for a major capex programme. Cost estimates for such programmes may be difficult to review and may change over time as the programme progresses; and
 - whether the underlying governance framework is appropriate for dealing with a major investment programme that is likely to evolve over time rather than be taken forward as a series of discrete well-defined projects.
- 2.104 We introduced ex ante capex efficiency incentives in H7 in part as a response to the difficulty of applying our previous framework of ex post incentives. We will now need to consider how best to maintain (or increase) pressure on capital efficiency if we decide to dilute or remove the current ex ante incentives for some or all aspects of the expansion programme.

- 2.105 We note Heathrow Reimagined's comment that we did not consider opex efficiency in the Working Paper. This is because HAL's opex inefficiency, if any, does not directly influence our determination of opex allowances, which are primarily based on observable benchmarks that HAL cannot influence. As such, HAL's actual opex does not directly explain the trajectory of HAL's charges.

Conclusion in respect of capex efficiency

- 2.106 The evidence submitted by stakeholders in respect of capex efficiency is difficult to interpret and dependent upon assumptions that are highly uncertain. We have not reached a firm view on whether the relatively high costs of Terminal 5 and Terminal 2 reflect an element of inefficiency and, if so, how large this was. We also recognise that both the Terminal 5 and Terminal 2 projects appear to have avoided the very substantial cost overruns and extensive delays that have beset some other major infrastructure projects.
- 2.107 However, our observation in the Working Paper that capital costs have been the main driver of charge increases still applies. This suggests that there may have been some element of capex inefficiency historically, even if there is some uncertainty about how this relates to individual projects.
- 2.108 The case for change appears stronger in relation to the current capex governance framework and its suitability in relation to HAL's proposed expansion programme. The current form of ex ante efficiency incentives and the current process based around fixed gateways may be difficult to apply to a major investment programme that is likely to evolve over time. If we change or depart from the current framework, however, it will be important to consider how best to maintain pressure on HAL's capital efficiency.

Summary of our updated views on the case for change

- 2.109 Our updated findings in relation to airport charges, service quality and capital efficiency are:
- HAL's aeronautical charges per passenger are high relative to average adjusted charges for comparator airports. The gap in charges between HAL and comparators is also likely to grow as a result of HAL's planned additional £49 billion capital expenditure;
 - While we recognise the improvements in HAL's service quality since the pandemic, there is evidence to suggest it remains below its pre-pandemic level. Moreover, its recovery appears to lag behind certain other airports, as evidenced by cross-sectional comparisons; and

- Although we have not reached a firm view on whether HAL's expenditure on specific capital projects has been inefficient, capital expenditure has been the primary driver of HAL's high charges, which suggests that a degree of inefficiency may have taken place.

- 2.110 We also note that the existing regulatory framework was designed to regulate the business-as-usual activities of a two runway airport, rather than the particular challenges of expansion.
- 2.111 Bearing all of the above in mind, we conclude that the strength of the case for change remains broadly consistent with our previous findings. We remain of the view that there is a strong case to revisit the current regulatory model to determine whether it can be improved and whether an alternative approach would be expected to better serve the interests of consumers.
- 2.112 We also see significant advantages in focusing attention on development of the future regulatory framework rather than continuing with work on the case for change. Therefore, unless new compelling evidence and/or arguments emerge that suggest we should take a different approach, we do not intend to provide further updates on the case for change in future documents or carry out further substantive analysis of the underlying issues.

CHAPTER 3

Evaluation framework

Introduction

- 3.1 In the Working Paper, we set out a draft evaluation framework that included a set of questions that we said we intended to use to create a shortlist of preferred regulatory models for further development and future consultation. This covered the following areas:
- appropriate support for expansion;
 - costs;
 - finance;
 - practicality;
 - promotion of competition; and
 - service quality.
- 3.2 We also set out a high-level illustration of how we would assess each regulatory model against these criteria, under which we would score each model as “fully”, “satisfactorily”, “partially” or “unsatisfactorily” meeting each criterion.
- 3.3 This chapter deals with stakeholder responses on these matters and provides our views and sets out our updated approach on the evaluation framework.

Stakeholders' views

HAL

- 3.4 HAL stated that the criteria we proposed in the Working Paper were ambiguous, subjective and did not reflect the evaluation criteria most important to delivery.
- 3.5 It proposed that we revisit the evaluation framework and give a higher priority and weighting to timeliness, financeability and deliverability. It suggested that some criteria should be considered using “pass/fail” tests, which we interpret as meaning that each regulatory model would need to meet a minimum threshold associated with each criterion to be included in the shortlist.
- 3.6 HAL proposed new pass/fail tests in respect of:
- **Timeliness:** a regulatory model must meet the Government’s objectives in respect of the timetable for expansion;

- **Financeability:** a regulatory model must support the Government's objectives for expansion being entirely privately funded. It commissioned a report by Freshfields and Santander examining the financeability of the regulatory models set out in the Working Paper; and
- **Deliverability:** a regulatory model must be consistent with "megaproject" best practice.

3.7 It proposed amendments to two of the criteria we outlined in the Working Paper:

- **Service quality:** HAL stated that service quality should be assessed based on consumer willingness-to-pay (for example, sustainability, accessibility, and resilience), not based on a CAA-defined notion of appropriate service level; and
- **Competition:** HAL stated that competition should be evaluated across the whole value chain, especially airline competition. Fragmentation-based competition in airport asset ownership/operation should not be assumed to be beneficial.

3.8 HAL also proposed the introduction of an additional criterion pertaining to sustainability and local communities.

Heathrow Reimagined

3.9 Heathrow Reimagined stated that the evaluation criteria must prioritise elements that address what they consider to be the fundamental problems with the current regulatory model, namely:

- the promotion of efficiency, aligned to our criterion in respect of costs;
- effective competition; and
- service quality.

3.10 Heathrow Reimagined also stated that other criteria should be deprioritised:

- Appropriate support for expansion, on the grounds that regulatory models that support the delivery of expansion without properly addressing the underlying failings in the current regulatory model will not further the interests of consumers; and

- Finance: it said that we should have regard to notionally efficient airport operators being able to access sufficient debt and equity finance. However, finance considerations should not be given primacy in our assessment. It noted that our objective should be to ensure that financing costs are efficient, but not to minimise financing costs at the expense of efficiency. It stated that financeability should be extended to include all service providers at the airport, not just the airport operator(s). It also stated its view that financeability should not be assessed with reference to HAL's actual financial structure.

- 3.11 Heathrow Reimagined agreed that the regulatory model needs to be practical to develop and apply in a reasonably timely manner. It indicated that we should exercise caution when considering what constitutes a disproportionate level of disruption to HAL's business activities, and that these should be focussed on the consumer impact of any such disruption.
- 3.12 It proposed the inclusion of an additional criterion in respect of affordability. In this context, we understand that Heathrow Reimagined is principally referring to affordability from the perspective of airline users, but with consequent impacts on passengers. The rationale for this proposal is that the consumer benefits of expansion are contingent on airlines investing in the additional services and connectivity needed to utilise new capacity.

Airlines

- 3.13 Several airlines endorsed the views of Heathrow Reimagined, and/or expressed similar or supporting views, particularly in support of an explicit affordability criterion. IAG further added that our evaluation framework should be informed by updated modelling and analysis of airline economics.
- 3.14 Some airlines also proposed additional criteria that they considered we should include when carrying out our assessment of regulatory models:
- Compliance with the US-UK Air Transport Agreement: Airlines for America also stated that we should introduce a formal mechanism to ensure that charges remain cost-related, transparent and non-discriminatory under the US-UK Air Transport Agreement and other international obligations;
 - Futureproofing: IATA suggested that the assessment should evaluate complexities or consequences of further adjustments to the model in the future;
 - International competitiveness and connectivity: Airlines for America stated that we should quantify the effects on transatlantic fares, frequencies and connectivity when setting charges; and
 - Risk allocation: IATA suggested that we should provide a clear and structured presentation of how risks are allocated in the different models.

- 3.15 Other airlines have also referred to additional criteria, but in our view, these suggestions are already fully covered by our existing criteria, and so we do not refer to these here.
- 3.16 In addition to the new criteria they set out, some airlines expressed views on the approach we intended to use to evaluate each model against individual criteria. In particular, Airlines for America stated that we should explicitly quantify: (i) charge impacts, (ii) cost savings, (iii) service quality and its impacts and (iv) finances.
- 3.17 IAG also highlighted that some of the models we set out in the Working Paper could be applied simultaneously, and that we should be clear which models are mutually compatible and where there are trade-offs.

Other stakeholders

- 3.18 We have received differing views from other respondents. Business groups including BusinessLDN, the London Chamber of Commerce and Industry, and Make UK have generally proposed prioritisation of timely delivery of expansion, regulatory certainty and investor confidence.
- 3.19 Make UK has also stated that we should also explicitly consider:
- operational resilience and integration;
 - implementation and transition risks;
 - broadening our assessment of consumer benefits from price alone to include connectivity, new routes, frequency, minimum connection times, resilience and quality of experience; and
 - the nationwide economic impact of expansion.
- 3.20 The Council for the Independent Scrutiny of Heathrow Airport (“CISHA”), on behalf of the Heathrow Passenger Forum, stated that we should include a criterion in respect of the wider passenger experience, including Passengers with Reduced Mobility and transfer passengers.
- 3.21 CISHA also provided its own response, commenting on the community impacts of the regulatory models under consideration. The response referred to our “environmental” duties, noting that these are often a proxy for community impacts. It said that the regulatory framework should not undermine the intended level of environmental and community mitigations set through the ANPS and process for obtaining development consent.
- 3.22 Transport for London indicated that we should prioritise environmental considerations, with corresponding implications for the treatment of surface access projects.

3.23 The Heathrow Strategic Planning Group stated that:

- the evaluation criteria as proposed did not give sufficient weight to the delivery of infrastructure that is necessary to meet user needs and expectations;
- the criteria over-emphasise competition without countervailing considerations about the impacts of reduced integration in the asset base and in operations;
- any future regulatory model must allow reasonable measures to mitigate the environmental effects of the airport; and
- we should be clear about how we will reflect the Government's objectives on climate change, noise and air quality alongside the efficient and timely delivery of new capacity.

Our assessment

3.24 We have considered the views of stakeholders and set out our updated views on the evaluation framework for the longlist of regulatory models below. We discuss in turn:

- the overarching principles underpinning the evaluation framework;
- further clarification of the criteria we set out in the Working Paper in the light of stakeholders' comments; and
- our views on the additional criteria proposed by stakeholders.

3.25 We then conclude in respect of the evaluation criteria.

Overarching principles

Weighting and prioritisation of criteria

3.26 Several stakeholders have proposed that we should assign greater weight to certain criteria than to others. In some cases, stakeholders have proposed that we adopt a binary classification of each regulatory model as passing or failing a particular criterion, and to reject those that fail.

3.27 We disagree with these proposals for several reasons:

- The assessment is being conducted in the presence of considerable uncertainty regarding the outcomes that will result under each model. For example, it is not possible to determine with certainty whether some regulatory models will result in expansion being financeable or affordable. At this stage, the assessment of these matters can only be based on an indicative view as to whether, and to what extent, a particular regulatory model is likely to result in a more favourable outcome than the current regulatory model;

- Some criteria cannot easily be interpreted in a binary manner. For example, it is not obvious that there is a single level of airport charges beyond which expansion becomes “unaffordable” and hence should be rejected. Similarly, it is not clear that there is a binding threshold beyond which a regulatory model will cease to be deliverable. In these cases, setting minimum thresholds for “failing” a regulatory model is likely to be relatively arbitrary and could lead to regulatory models being inappropriately excluded from the shortlist; and
- It would not be consistent with our duties to adopt a mechanistic approach to balancing the potentially competing interests of consumers. Different criteria may be more or less important for different regulatory models, and a mechanistic approach to weightings could fail to recognise these nuances.

3.28 We therefore intend to retain the broad approach set out in the Working Paper to these matters, exercise our judgement on a case-by-case basis regarding how regulatory models should be assessed against each criterion, and how the criteria should be aggregated into an overall assessment. We acknowledge that relying on an approach that is not based on explicit weights, thresholds or hierarchies implies a degree of subjectivity in our approach to evaluating regulatory models. Nonetheless, we remain of the view that our approach will best support the reasonable discharge of our statutory duties, in the context of an assessment conducted in the presence of considerable uncertainty and complexity.

Quantifying metrics on which to base our assessment

3.29 Some stakeholders have highlighted the importance of explicitly quantifying various outcomes under different regulatory models when carrying out our assessment, including charge impacts, cost savings, service quality and its impacts and finances.

3.30 While we refer to quantitative evidence where it is available, it is important to emphasise the significant limitations on the availability of this evidence. For example:

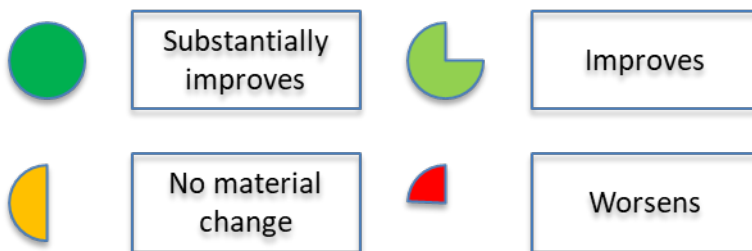
- The impact of the amendments we propose to aspects of the regulatory framework, such as the capital governance arrangements, cannot be forecast at this stage with a high level of precision. This will depend in part on how HAL responds to the incentives these mechanisms create and other factors outside of HAL’s direct control, such as developments in supply chains, emerging technical or engineering challenges;
- We cannot predict with certainty how credit rating agencies and the investor community will react to our proposals, or how this might affect the cost and availability of debt and equity finance; and

- Where we apply a competitive model, we will not have visibility of the outcome of the bid process. Therefore, we cannot forecast with any precision at this stage the cost savings or financial impact of appointing a third party to undertake specific elements of the expansion scheme.

3.31 Our assessment will, therefore, necessarily involve some subjective and high-level judgements regarding the likely impact of regulatory models on particular outcomes. The starting point for our assessment will, therefore, be the red, amber and green (“RAG”) ratings that we outlined in the Working Paper. We previously characterised the ratings in terms of the extent to which a particular model satisfied each criterion. We have refined this approach and now consider that it would be more objective and transparent to base the ratings on whether a model improves or worsens consumers outcomes relative to the current regulatory model.

3.32 The RAG ratings are illustrated in Figure 3.1 below.

Figure 3.1: Illustrative RAG rating



3.33 To ensure that we adopt a consistent approach throughout our assessment, we will focus on an assumption that each model is implemented in a reasonably effective form. This is useful for capturing the potential benefits of each model, while recognising that there are substantial risks around implementation that could reduce these benefits. We also asked our advisers, Steer and Centrus, to carry out their assessment on this basis.

Combining models

3.34 We agree with stakeholders that several of the regulatory models we outlined in the Working Paper are mutually compatible. Specifically, regulatory models (1a, 2 and 4a)²³ could all be applied simultaneously if they were found to be in the interests of consumers and in combination with competition models. By contrast, only a single competitive model (4b to 8) can be applied at any one time for a single asset, such as a terminal. However, different competitive models might, in principle, be applied to different assets. Steer provided its view on a mapping of

²³ See the list of models in Chapter 1 Introduction and summary.

the models that could be applied together in its report, and this is published alongside this document.²⁴

- 3.35 It is likely that we will take multiple models forward into the implementation stage, as there will be advantages in both improving the approach to regulation and making better use of competitive forces to deal with the challenges of expansion. We will reach final conclusions on these matters as we make final decisions on the approach to regulatory models.

Clarification of existing criteria

- 3.36 In this section, we clarify some of the criteria we set out in the Working Paper, including in response to stakeholders' views.

Appropriate support for expansion

- 3.37 Several stakeholders have referred to factors that we consider are relevant to our assessment under this criterion.
- 3.38 We confirm the position we set out in the Working Paper that this criterion would include consideration of the impact of regulatory models on the timing of expansion, including possible delays. We will consider the impact that delay would have on consumers in terms of the disadvantages of delaying the benefits of expansion. We will also seek to implement models in a way consistent with the Government's timetable. However, the approach to economic regulation does not guarantee delivery of expansion to the Government's timetable, which will be driven by a wide range of factors.
- 3.39 This criterion will also reflect our assessment of how each regulatory model could affect operational resilience, integration, implementation and transition risks, as highlighted by Airlines for America. This is reflected in the scope of the Steer report, published alongside this document.

Promotes Competition

- 3.40 HAL's view is that we should consider competition in a broad sense, encompassing airline competition as well as competition between airport operators. Our statutory duties require us to promote, where appropriate, competition in airport operation services and this will be the focus of our consideration of the competition models identified in the Working Paper. Nonetheless, our consideration of timeliness discussed above and the advantages of delivering benefits to consumers will involve taking account of reductions in scarcity rents at Heathrow Airport. These benefits would flow from greater competitive pressure on airline fares, and so we will be considering the

²⁴ Technical assessment of the CAA regulatory models for Heathrow expansion, Steer, May 2026.

impact on consumer outcomes of wider competitive forces associated with expansion.

- 3.41 We agree with HAL that inter-terminal competition specifically may have an impact on airline competition in a manner that can affect consumer benefits. Specifically, there may be dynamics between incumbent and new airline users that could affect the consumer benefits of expansion.
- 3.42 We will consider these factors as part of our assessment of costs: as set out in the Working Paper, this criterion will consider whether a regulatory model promotes efficiency and control of the costs of expansion, while delivering the benefits of expansion for consumers.

Raise sufficient finance

- 3.43 We note feedback from Heathrow Reimagined that we should base our assessment of financeability on the notional company.
- 3.44 Regardless of whether the assessment is based on the notional or actual company, a significant quantum of debt and equity finance will need to be raised to fund expansion. Therefore, for expansion to be financeable, the regulatory framework will need to result in an investable proposition for shareholders and creditors. This is the key question we are seeking to address in our assessment.
- 3.45 As indicated above, the available quantitative evidence in respect of the impact of regulatory models on financing is limited. For example, we will not, at this stage, be able to produce robust forecasts of credit metrics under each model that would allow us to differentiate the impact on the notional company from that of the actual company. Therefore, in most respects, the finance assessment will not differentiate between the notional or actual company.
- 3.46 However, there are elements of HAL's actual financing structure that may be relevant to the delivery of the consumer benefits of expansion, which we will need to consider. For example, it may be appropriate to consider the impact of HAL's Whole Business Securitisation arrangements in the context of the application of models that may trigger covenant breaches. This is particularly the case with competitive models.

Practical to implement

- 3.47 In the Working Paper, we indicated that we were minded to include a criterion that assesses whether a model would be more or less practical to implement relative to the current regulatory model. In this case, a "red" rating would mean that we consider the model would be more difficult to implement, rather than necessarily implying that the model would worsen consumer outcomes.

Promotes service quality

- 3.48 We note stakeholders' views regarding the impact of regulatory models on the passenger experience (including persons with reduced mobility and transfer passengers) and intend to consider this within the criterion pertaining to service quality.

Additional criteria proposed by stakeholders**Affordability and airline economics**

- 3.49 We have a primary duty to further the interests of consumers, which include present and future passengers and those with a right in property carried by the service (that is, cargo owners). This definition of consumers does not include airlines.
- 3.50 As such, affordability from an airline perspective is only relevant to our assessment to the extent that it affects consumers. Heathrow Reimagined and the airlines have suggested that there is a point at which airport charges are sufficiently high that they become "unaffordable". We interpret this to mean that the fares that airlines would need to charge passengers in order to be financially sustainable would not be consistent with the expected increases in passenger demand. In these circumstances, the benefits of expansion to passengers would be lost and there would not be the increases in connectivity, frequency and route choice to fill the large amount of additional new capacity that expansion is expected to provide.
- 3.51 We acknowledge that affordability in this sense is a very important consideration. It is also important to recognise that the choice of regulatory model will not, in itself, determine the overall economics of a particular scheme for the expansion of Heathrow Airport. The overall costs and benefits of a particular scheme will largely be driven by its broad specification and scope. The ANPS currently specifies the length and broad position of a new runway at Heathrow Airport and specifies targets for increases in airport capacity, targets for surface access and protections for local communities in terms of noise levels. The Government has also said that HAL's proposal for a northwest runway up to 3.5km in length is the preferred scheme to inform its review of the ANPS.
- 3.52 Once the broad characteristics of the expansion scheme have been finalised, the regulatory model will provide important incentives and other arrangements designed to protect consumers. These should encourage incremental improvements in cost efficiency, reduce the potential adverse impacts of cost over-runs and support efficient financing. Nonetheless, it would be unrealistic to expect any regulatory model to transform the economics of a particular expansion scheme. The incremental benefits that a regulatory model can reasonably be expected to deliver are captured through our proposed evaluation criteria, particularly in respect of costs and financeability.

- 3.53 We are also carrying out further work on affordability in our work on early costs, which will inform both the work on early costs and our approach to developing the regulatory framework for expansion. Consistent with our statutory duties, we will only support an expansion scheme if the evidence suggests it will further the interests of consumers.
- 3.54 Overall, we consider that it would not be appropriate to add an affordability criterion for evaluating the regulatory models set out in the Working Paper.

Environmental considerations

- 3.55 Several stakeholders have emphasised the importance of environmental considerations and requested further clarification of how we intend to reflect these considerations in our assessment.
- 3.56 We noted in the Working Paper that we would consider whether a model might enable a licensee to take reasonable measures to mitigate the environmental effects of the airport. We indicated that we would do so based on whether the model in question is capable of supporting the capital expenditure required for expansion. This includes environmental mitigations and requirements proposed by developers and/or are requirements established by the planning process, such as the relevant ANPS and DCO.
- 3.57 We note CISHA's observation that environmental mitigations are also relevant to our primary duty, insofar as they are valued by consumers and/or affect the cost of delivering airport operation services.
- 3.58 It is important to note that our recommendation in respect of the shortlist of regulatory models will not, at this stage, specify the precise calibration of allowances and determination of revenue streams. We will not be in a position at this stage to comment on precise funding arrangements for particular environmental projects or mitigations.
- 3.59 Where appropriate, we will consider whether different regulatory models could, in principle, have differing impacts in respect of environmental mitigations. We will do so as part of our assessment of whether a model is capable of supporting the delivery of expansion in a reasonable way.

Compliance with the US-UK Air Transport Agreement

- 3.60 In relation to A4A's comment regarding compliance with the US-UK Air Services Agreement, we are mindful that our duties under CAA12 permit us to consider only those international obligations that have been notified to the CAA by the Secretary of State for the purposes of chapter 1 of CAA12. At present, no such obligations have been notified to the CAA and, as such, the CAA is not permitted to take these matters into account in its work on the economic regulation of capacity expansion. That said, we do not consider that our approach is inconsistent with the above agreement.

Futureproofing

- 3.61 We note IATA's suggestion that the assessment should evaluate complexities or consequences of further adjustments to the model in the future. We consider that this is one aspect of our consideration of the practicality of implementing a regulatory model.
- 3.62 In the following section, we highlight some specific cases where this is relevant: for example, where we might require HAL to enter into a contract with a third party, what arrangements we would put in place at the end of the contract term.
- 3.63 It is important to caveat this by noting that the way in which particular regulatory models will evolve may be difficult to foresee with a high level of confidence. We intend to further develop our thinking on these issues, and update these as additional information becomes available. Wherever possible, we will ensure that our proposals take appropriate account of potential future scenarios.

International competitiveness and connectivity

- 3.64 Stakeholders have suggested that we include a separate criterion in respect of international competitiveness and connectivity.
- 3.65 We note that there is a close relationship between these factors and the concept of affordability referred to above. As with affordability, it is important to note that no regulatory model will, by itself, guarantee a particular level of airport charges, or, therefore, a particular level of international competitiveness and connectivity.
- 3.66 We agree that, all else being equal, regulatory models that are likely to result in lower charges are preferable from consumers' perspective. However, this is already reflected in our criterion in respect of costs and financeability. As such, a separate criterion in respect of international competitiveness and connectivity would risk "double counting" this consideration.

Broader economic impacts

- 3.67 While we recognise that expansion will have significant consequences beyond its impact on consumers, we reiterate that our primary duty is to further the interest of consumers, while having regard to a range of other matters specified in the CAA12. So, we cannot rely on other factors, including factors affecting the broader economy, as a basis for determining our policy in respect of regulatory models.

Summary of our updated views on the assessment framework

- 3.68 We have provided further clarity in respect of the way we intend to assess regulatory models against the criteria we set out in the Working Paper. However, having considered stakeholders' views, we do not consider that there is a strong case for changing or including further criteria in our assessment.

- 3.69 In particular, we have not adopted the suggestions by HAL for pass/fail tests or its suggestions for changes to the service quality and competition criteria. Nor have we adopted the suggestion by Heathrow Reimagined for an affordability criterion.
- 3.70 The criteria we have used in the following chapters to evaluate each model are as follows:
- Avoid delay and disruption: the model is practicable to support the delivery of expansion and avoid any undue delay and disruption. By undue delay, we mean unnecessary delay that would inappropriately delay the benefits to consumers of expansion. We expect expansion to be delivered efficiently and not delivered according to a fixed date irrespective of costs;
 - Promotes efficient costs: the model promotes efficiency and control of the costs of expansion, while delivering the benefits of expansion for consumers for this efficient cost;
 - Raise sufficient finance: the model supports the raising of sufficient finance to enable the delivery of expansion (including the costs of environmental mitigations) at an efficient price, so making sure costs to consumers are no higher than necessary;
 - Practical to implement: it is likely to be practical to implement the model in a timely way, to the benefit of consumers;
 - Promotes competition: the model promotes competition in the provision of airport operation services where appropriate, which will in turn deliver benefits to consumers; and
 - Promotes service quality: the model promotes an appropriate level of service quality, including improvements where appropriate, to the benefit of consumers.

CHAPTER 4

Shortlist of regulatory models – variations of the current framework

Introduction

- 4.1 This chapter sets out our evaluation of those regulatory models from the longlist that are variations of the current regulatory framework and which focus on changes to capex governance, system planning, incentives and procurement. Specifically, the regulatory models assessed in the chapter are:
- Regulatory model 1a: changes to the capex governance framework;
 - Regulatory model 1b: separating HAL’s system planning function from its operational function;
 - Regulatory model 2: targeted adjustments to the existing incentive regime; and
 - Regulatory model 4a: enhanced scrutiny of HAL’s approach to procurement.
- 4.2 We evaluated all the models using the evaluation criteria from chapter 3 and our assessment was informed by the external reports from Steer and Centrus that are published alongside this document.
- 4.3 Based on our assessment of each of these models, we propose to take forward models 1a, 2 and 4a as a package to support an integrated approach across capital governance, incentives and regulatory oversight of procurement. The intention is that these arrangements will work together in a coherent package to further the interests of consumers and minimise any unintended consequences.

Regulatory model 1a – changes to capex governance processes

Introduction

- 4.4 In the Working Paper, we identified two models that involved changes to the current capex governance framework:
- model 1a, which included enhancements to capex governance processes; and
 - model 1b, which involved separation of HAL’s “system planning” function from its operational function.
- 4.5 The current capex planning governance process and incentives include the following key features:

- HAL provides details on its long-term capital plans in its Masterplan and its latest capex forecast in its Business Plan submissions every five years for price control reviews;
- there are four milestones (“P1” to “P4”) for programmes, and six gateways (“G2” to “G7”) for individual projects within programmes. HAL consults airlines as programmes are initiated, and options are identified and evaluated;
- the preferred investment option is identified and an investment decision is confirmed at Gateway 3 (“G3”), and this a key point in the process. Progress beyond G3 usually requires agreement from HAL and airlines. G3 is also the stage at which a capex baseline is established and, for projects over £1 million, Delivery Obligations (or “DOs”) are agreed between HAL and airlines to provide targets and incentives for output, quality and timing of the projects;²⁵ and
- HAL bears 25% of any overspend or underspend against the capex baseline established at G3, adjusted for any further budget increases agreed with airlines (subject to a change control process) and non-delivery of the DOs.

4.6 The Working Paper explained that model 1a could involve making improvements to the current capex governance processes for both: (i) “business-as-usual” capex and (ii) the major capital investment required to expand Heathrow Airport. These changes could include:

- providing greater scrutiny of the cost efficiency of HAL’s proposals, such as expanding the remit of the existing Independent Fund Surveyor (“IFS”)²⁶ to assess costs on an ex ante, project-by-project basis, or appointing an alternative third-party assessor with enhanced functions to arbitrate between HAL and airlines;
- assuring that appropriate information is used in the process, including by specifying information requirements using templates and guidance, requiring an in-depth independent review of information provided and escalation or enforcement in the event of non-compliance;
- strengthening the CAA’s role and that of airlines by, for example, requiring airlines to approve plans before G3, and/or providing clearer and earlier escalation of issues for our review;

²⁵ HAL and airlines can agree to exempt some projects over £1m from DOs, and have done so, typically for projects where delivery is outside of HAL’s control.

²⁶ The IFS, first appointed in 2014, jointly by HAL and the airlines, provides independent assurance on HAL’s capital programme.

- raising the capex threshold for DOs from £1 million, to allow a more proportionate approach; and
- setting incentives and enforcement measures around HAL's compliance with the capex processes.

Stakeholders' views

HAL

- 4.7 HAL supported shortlisting regulatory model 1a, with the intention of allowing the development of high quality, risk-based capital governance appropriate for an integrated "megaproject" that meaningfully consults customers and consumers on design. HAL stated that changes to the current capital governance regime are necessary and should support efficiency, transparency, and consumer voice and value, but said that poorly designed governance would make the programme for expanding Heathrow Airport unworkable.
- 4.8 HAL's response focused on the need to ensure effective and bespoke capital governance for expansion, given its scale, risk and integration which means it differs significantly from its business-as-usual work. HAL's response included a number of lessons from other megaprojects to protect consumer outcomes, including avoiding governance processes that would slow down decision-making, fragment accountability, or introduce additional approval layers. HAL pointed to examples from other megaprojects (such as HS2, Berlin's Brandenburg Airport and Chicago O'Hare's Phase 2 modernisation) where rigid, fragmented or unclear governance, dispersed approvals and inappropriate veto rights acted to delay and/or increase the cost of megaprojects.
- 4.9 It said that airlines should play a significant role in shaping the design of expansion, airlines should reasonably expect a high level of assurance and noted the potential benefits that collaboration with airlines can have on efficiently configuring the infrastructure. However, HAL also said that risks to decision making include:
- airlines focusing on their own commercial interests and delaying projects that do not align with these interests;
 - low value projects receiving disproportionate governance attention that does not balance the potential benefits against the additional time and effort taken;
 - airlines being required to provide expertise beyond their technical capability; and
 - consensus not being reached between different airlines given the highly diverse business models within the airline community at Heathrow.

- 4.10 HAL put forward a range of features that it said that revised capital governance should encompass, including:
- explicitly treat expansion as a megaproject, not business as usual;
 - applying risk-based governance templates to different work scopes;
 - involving airlines and consumers through joint assurance and transparency in areas where there is significant benefit from consultation;
 - strengthening external technical and cost assurance by means of a collaborative panel for areas where there is limited benefit to be obtained through consultation; and
 - keeping approvals predictable and fast so to protect the schedule. This would require: (i) sufficient resourcing from all parties, (ii) transparent and high-quality information to support decisions, and (iii) rapid escalation to resolve issues and move on.
- 4.11 It submitted a range of supporting evidence on capital governance produced by independent advisers. In brief, this evidence concluded that a bespoke and flexible approach to capital governance for expansion is required to ensure success, drawing on a range of case studies to support these conclusions. We provide a more detailed summary in Appendix D.
- 4.12 In its H8 Business Plan, HAL proposed changes to the existing capital framework in the context of a “two runway” airport. We summarised these in our H8 Initial Proposals as including:
- evolutionary change over major changes as the capex framework is relatively new;
 - simplification of DOs, such as targeted removal of the schedule element, higher thresholds for asset renewal DOs, and sequential DOs for large complex projects; and
 - tailored project governance structures, such as lighter governance for asset renewals.

HAL’s proposals for governance and incentives for expansion

- 4.13 On 20 March 2026, HAL provided a further submission on its proposals for capital governance and incentives for expansion, which it requested we consider as part of this consultation. We describe these proposals immediately below.
- 4.14 HAL described its proposals as ‘emerging’, in recognition of the need for further detailed design work in collaboration with stakeholders.
- 4.15 It proposed four governance templates for different aspects of expansion (the DCO, property, core aviation infrastructure and novel infrastructure), each of

which involve bespoke treatment of assurance, stakeholder involvement and incentives.

Assurance

4.16 On assurance, HAL proposed “Joint Independent Assurance” (“JIA”), which would be jointly appointed by it and airlines, with CAA approval. HAL sees the JIA as only being required for expansion investments, with the IFS continuing to have a role in assuring ongoing investments (that is, long-term asset replacements in the range of £500 million to £1 billion). HAL viewed the JIA as a step change from the current arrangements, with JIA assurance providing expert, ongoing challenge through key phases of delivery, with multi-party reporting. HAL saw aspects of the JIA’s remit as assurance of a wide range of activities, including legal aspects of the DCO, property acquisition, the programme and schedule, cost estimates and procurement. In addition, HAL also saw the JIA having a strong role in the governance and implementation of the incentive regime.

Stakeholders

4.17 HAL stated that best practice stakeholder involvement shows that megaprojects require a tailored approach that distinguishes between:

- areas suited to co-design; and
- areas requiring sponsor or expert led decision making.

4.18 It noted that airlines would be closely involved in decision making for core aviation investments, whereas, for the DCO process, airlines’ involvement should be more proportionate, noting that many decisions relate to programme delivery and third party interfaces. HAL also proposed that, where stakeholders have a role in approving project decisions, there should be associated accountability mechanisms and mechanisms to support timely delivery (for example approval service level agreements (“SLAs”) and fast track escalation for schedule-critical issues).

Incentives

4.19 HAL said that the expansion capex programme should be covered by efficiency incentives, tailored according to the quality of cost forecasts and the degree of control over delivery and change. HAL proposed forward-looking incentives where it has a higher ability to robustly forecast costs and to control delivery, with sharing rates varying according to the degree of certainty and control.

4.20 For investments that are novel, complex, externally driven or subject to significant unobservable risk, HAL proposed ongoing real-time verification of costs by the JIA. HAL proposed that the JIA would assess incurred expenditure against need, timeliness and efficiency on an ongoing basis, rather than through periodic retrospective reviews. As circumstances change (for example, designs

mature, evidence improves and the potential for control increases), investments may move from this to a forward-looking approach.

Heathrow Reimagined

4.21 Heathrow Reimagined identified several issues with the current capex governance framework that it considered require intervention to fix and ensure that capital planning, approval and monitoring are effective. It said these issues relate to HAL's control of information flow, the timing and framing of decisions, as well as incentives on HAL to prioritise capex projects that maximise the value of its RAB. Heathrow Reimagined also said that the CAA has delegated regulatory oversight of capex to airlines without the necessary powers. It set out its views on the issues on each stage of the capex governance process. Taking these in turn:

- Capital planning: stakeholders have very little influence on long-term strategic capital planning and lack transparency over HAL's long-term capital plan, meaning they cannot properly scrutinise the longer-term impacts of those decisions. The only meaningful point of control airlines have is the "go/no-go" decision at G3, where HAL has already taken decisions over which projects to bring forward.
- Capital Approval: the capital approval process is not working as effectively as it should be as:
 - it is poorly targeted with scrutiny not focused on high risk areas;
 - stakeholders are overwhelmed with large quantities of data while also lacking key information crucial to their assessment (including robust business cases);
 - HAL often provides poor and opaque financial analysis;
 - it does not make effective use of genuinely independent third party experts;
 - it has ineffective escalation mechanisms and dispute resolution processes;
 - it does not allow stakeholders to effectively interrogate alternative options;
 - there are examples of where the system has been "gamed" by HAL and airlines have been left with "take it or leave it" decisions that has meant it had to accept HAL's proposals; and
 - there is insufficient CAA involvement in the early stages of the process.
- Capital monitoring: the current capital incentives and DOs were introduced by the H7 price control decision and have, therefore, been in place only for a limited period of time. However, Heathrow Reimagined considered the potential penalties lack "teeth" and do not effectively replicate the sanctions that would occur in a competitive market.

- 4.22 Heathrow Reimagined also provided a detailed report by Dr Mansell from Green Impact that assessed the current capital approval regime. This report found that the current governance framework does not address the disconnect between regulatory processes and asset lifecycles, generates a large quantity of information that is often insufficient for robust decision making and that trust and collaboration have been eroded. Dr Mansell made 20 individual recommendations for improving capital governance at Heathrow, with the first of these being an overarching recommendation to conduct a further, more in depth review with access to HAL's senior leadership. Further detail on this report is provided in Appendix D.
- 4.23 It supported short-listing regulatory model 1a and considered this regulatory model should lead to effective long-term structural reform of the capex governance, comprising:
- a new Capital Investment Committee ("CIC"), described further below;
 - a requirement for robust business cases and supported by an effective information control process that ensures scrutiny is focussed on the right projects;
 - stakeholders being provided with sufficient time to input their views and avoid being confronted with no real choice but to approve HAL's plans;
 - more effective use of independent third parties;
 - establishment of effective escalation processes;
 - regular reporting on performance delivery, including thorough scrutiny of cost overruns and delays;
 - periodic reviews post-completion to check that the outcomes in the business cases are delivered, with RAB disallowances if not; and
 - robust accountability measures on HAL for underperformance.
- 4.24 Heathrow Reimagined said that previous attempts to improve capex governance have failed because they have focussed on process improvements while leaving HAL in control. It said that the CAA should introduce a new CIC to shift control of capital governance from HAL to the CIC and CAA.
- 4.25 The proposed CIC, described in the responses from Heathrow Reimagined and IAG, would have a number of key features, including:
- acting as a separate and additional capex governance function convened and chaired by the CAA with airline representation;

- HAL remaining responsible and accountable for all aspects of the capex lifecycle, but with the CIC providing more effective oversight and control than currently;
- the CIC overseeing the entirety of the capital lifecycle from capital planning (including Heathrow master planning) through approvals and monitoring, placing responsibility for oversight of HAL's capex decisions with the CAA rather than HAL (enabling more agile and targeted capital governance);
- the CIC having the ability to call on HAL's internal audit function;
- a requirement on HAL to develop a long-term (10 to 15 year) view of required infrastructure investments which the CIC would review, scrutinise and challenge before it is finalised;
- detailed business plans being required for each project exceeding a monetary threshold (to be determined through consultation) which the CIC would assess in detail, with the powers to request additional information, commission independent expert review and require HAL to consider alternative approaches or refine its proposals;
- increased ex ante scrutiny through control of the governance process;
- the ability of the CIC to mandate the use of competitive procurement processes on a project-by-project basis to test cost estimates and ensure value for money; and
- credible ex post enforcement through RAB disallowance and other sanctions, where HAL materially or repeatedly fails to comply with CIC-approved business cases, fails to deliver committed outcomes or demonstrates poor capex performance. The CIC would have the powers to: (i) scrutinise proposed cost overruns, (ii) either approve or reject them from being added to the RAB, and (iii) implement remedial measures where projects fail to deliver expected outcomes.

4.26 Heathrow Reimagined noted its proposals for the CIC could incorporate aspects of regulatory model 1b on a separate planning function.

4.27 Heathrow Reimagined set out steps that would be necessary to support the introduction of a CIC. These included increasing the CAA's capacity and technical expertise, as well as ensuring appropriate resources are supplied by both HAL and airlines, both of which would require additional funding from industry. It also proposed to increase transparency through access to HAL's internal audit function and make more effective use of benchmarks drawing on national and international comparisons, to ensure the CIC has the right information to inform its regulatory judgements.

Airlines

- 4.28 IAG co-authored and endorsed Heathrow Reimagined's response and submitted further supplementary information. It considered that there is a lack of meaningful oversight by the CAA of HAL's capex and there are information asymmetries between HAL and airlines. IAG said that the CAA has "over-delegated" the role of scrutinising HAL's capex proposals to airlines and HAL has inappropriate control over access to information and the timelines for providing information. It stated that airlines only have superficial approval rights and its role is mainly consultative for matters like project scope, delivery approaches, and the approvals process.
- 4.29 IAG supported the proposed CIC and its detailed proposals are summarised above.
- 4.30 Other airlines supported enhanced capital governance and considered that greater transparency was required to ensure costs are efficient. In particular:
- AOC/LACC said that the CAA must implement a step-change in capex scrutiny and governance and that incentives must be changed to encourage cost efficiency and disincentivise growth of the RAB;
 - Air Canada supported strengthened governance through independent scrutiny of major projects with airlines having access to clear business cases and project information;
 - easyJet supported strengthening the current gateway process;
 - Star Alliance submitted that the future approach must enable more informed scrutiny of projects to prevent cost overruns, excessive profits and service failings; and
 - IATA supported a much stronger role for the CAA in scrutinising capex, operating expenses and service levels, as well as the conditions under which services are provided to airlines at Heathrow.

Other stakeholders

- 4.31 Responses from a number of business organisations (London Chamber of Commerce and Industry, Logistics UK and Make UK) emphasised the need to retain a RAB based model and indicated that this should be enhanced or subject to strong governance.
- 4.32 The Heathrow Passenger Forum stated a preference for an evolutionary approach to avoid disruption and added risk, and this model should be considered. It also said consumer interests, not just HAL and airline interests, should be prioritised.

Our assessment

- 4.33 We agree with HAL, Heathrow Reimagined and airlines that regulatory model 1a should be shortlisted. These stakeholders have all identified common issues that should be addressed by this model, including:
- making effective use of engagement between HAL and airlines;
 - taking a proportionate and targeted approach;
 - putting in place tailored incentives on HAL to control costs and make sure investments are in consumers' interests;
 - allowing for effective escalation of issues;
 - not relying on airlines to provide scrutiny of HAL's capex beyond their areas of expertise; and
 - putting more emphasis on independent advice and scrutiny.
- 4.34 A new capital committee should be used to provide scrutiny of HAL's capital plans and delivery and provide a step change in the current capital governance processes. This could allow the processes to have an appropriate focus on expansion and overall strategy and approach and could seek to address the current lack of trust between HAL and airlines in the capital planning process, which may result in unnecessary delays, cost overruns and insufficient scrutiny of capex plans. We agree with Heathrow Reimagined's suggestion that HAL could be required to provide clear long-term plans for the committee to review and that stakeholders should have the opportunity to interrogate alternative options.
- 4.35 We disagree with Heathrow Reimagined that this new capital committee should be chaired by the CAA. Our view is that it would not be appropriate for the CAA to chair the capital governance process given our role as regulator for setting the capex framework and escalations. However, we consider that an independent chair (possibly appointed by the CAA in consultation with stakeholders) may be appropriate.
- 4.36 HAL has also set out legitimate concerns that providing dispersed veto rights and multiple, complex layers of governance would increase the risk of undue delays and costs to expansion and other key investment programmes. We would propose that the committee would provide scrutiny of HAL's plans and advise the CAA, but would not provide additional powers of veto over the planning and delivery of HAL's capital programmes.
- 4.37 We agree with HAL that expansion should be treated as a megaproject that might require bespoke arrangements that do not apply to business-as-usual capital governance. Further consideration will be required to decide how to also

improve the governance of business-as-usual capex, appropriately coordinate between programmes and avoid unnecessary bureaucracy.

- 4.38 Consistent with the suggestions of HAL and Heathrow Reimagined there should be a proportionate approach to the scrutiny of different parts of its capital plans and that the process should be predictable. For example, that airlines should be more closely involved in decision making for core aviation investments, but may have less direct scrutiny of property costs. We would expect this to be balanced with more independent scrutiny of these areas by independent experts and/or technical advisers, who can advise the committee and CAA. We do not consider that speed should be prioritised over effectiveness, but consider that the governance process should protect against unnecessary delays.
- 4.39 We agree with Heathrow Reimagined that there should be incentives on HAL's compliance with the governance process and quality of information provided and an effective route for escalation. Capital governance requires high quality and proportionate information to be provided at the right time in order to be effective, and there should be consequences for not doing so. We discuss this further below under the potential future approach to capital governance and incentives.
- 4.40 We disagree with Heathrow Reimagined that any new committee should have the ability to call on HAL's internal audit functions, as we propose this assurance and scrutiny should be provided by the capital committee and independent experts. We agree that HAL should be required to produce robust business cases and that any new committee should have the ability to request additional information as required and consistent with guidance provided to HAL.
- 4.41 Below we set out our evaluation and assessment of regulatory model 1a consistent with the framework established in chapter 3. Later in this chapter, we set out our emerging views on a proposed approach to a package of measures for capital governance, incentives and scrutiny of procurement, for consultation.

Avoid delay and disruption

- 4.42 An effective and flexible capital governance process that leads to better engagement between stakeholders, and with more proportionate and targeted scrutiny on high risk projects should reduce delay and disruption compared with the current position. Responses from both HAL (concern around dispersed veto rights) and airlines (lack of adequate data to scrutinise decisions) indicate that the current capex governance process, without significant enhancement, could lead to delays and disruption.
- 4.43 As part of its assessment, Steer concluded that improved governance could reduce delay and disruption to the investment programme by improving coordination and clarity of accountability.

Promotes efficient costs

- 4.44 Airlines have set out in their responses concerns that the current capex governance process is leading to insufficient scrutiny of capex plans. We share airline concerns that it is crucial that information is adequate and timely to ensure that there is sufficient time to scrutinise capex proposals without unduly delaying the delivery of the programmes and benefits to consumers. We expect that greater scrutiny and more effective involvement should increase confidence that investment is made in the right projects at the right time to the benefit of consumers. In the case for change, we set out that the evidence on capex efficiency in past projects is mixed.
- 4.45 Enhanced scrutiny of HAL's capex plans, focussing on the areas where risk and, therefore, the potential for cost overrun are highest, would seek to improve cost efficiency compared to the current approach. Our advisers Steer have also assessed that enhancements to the current capex governance processes should help in establishing an efficient cost baseline, by ensuring a higher degree of information sharing and adding more controls to the approval processes.

Raise sufficient finance

- 4.46 We consider that improvements to capital governance under this model have the potential to improve financeability. Moving from a system that both HAL and airlines consider is not fit for purpose for expansion to one that is materially improved could increase investor confidence by reducing the probability of cost overruns and delays.
- 4.47 This is supported by our advisers Centrus, which considers that additional governance to facilitate scrutiny and timely information from HAL to airlines is positive from the perspective of financeability. It also considers that there are benefits to this model through its familiarity to investors, although it does not find material impacts on the scale, equity attractiveness or debt additionality.
- 4.48 This suggests there should be some improvement to financeability under this model, though the materiality is not clear. We therefore assess this criterion as neutral at this stage, but note the potential for a positive assessment as we develop this model further.

Practical to implement

- 4.49 This model would be practical to implement and we should be able to implement these arrangements in a timely manner through the licence, capital governance guidelines, capital governance handbook and capital governance protocol. Providing more scrutiny and transparency of capex plans could also identify additional areas where alternative, competitive procurement options are required.







Promotes competition

4.50 This regulatory model does not in itself have a material impact on competition and would be in addition to any competition models that are implemented, so we consider it is neutral compared with the current position.

Promotes service quality

4.51 We consider that effective capex governance could improve service quality compared with the current position. Greater transparency on longer-term investments and more focus on delivering for consumers as part of capex governance arrangements could improve service quality.

Table 4.1: Summary of assessment of regulatory model 1a

Criteria	Score	Justification
Avoid delay and disruption		Independent technical advice indicates that there will be no negative impact to the timelines for expansion. If implemented, more agile governance may reduce delay.
Promotes Efficient costs		Independent assessment suggests that this model has the potential to reduce costs through enhanced scrutiny and flexibility.
Raise Sufficient finance		This model could have positive impacts on financeability, though materiality is unclear and so may be positive when completed further work on model.
Practical to Implement		The CAA can implement changes to capital governance under its existing powers and it is unlikely to require significant periods of time to do so.
Promotes competition		This model does not impact on competition for the market or within the market relative to the current position.
Promotes service quality		Enhanced governance with increased flexibility focussing on the riskiest projects could foster greater collaboration and enable more innovative solutions that boost value for money.

Regulatory model 1b – separating HAL’s system planning function from its operational functions

Introduction

4.52 Under model 1b, HAL’s “system planning” function would be separated out, allowing for a particular focus on long-term planning, business cases and reducing any potential conflicts of interest with other functions within HAL. This

could take the form of full legal separation, where ownership is either retained within HAL or transferred to a third party, or only functional separation. We noted in the Working Paper that separation of the system planning role would likely involve significant regulatory, legal and operational interventions.

Stakeholders' views

HAL

- 4.53 HAL did not support model 1b and considered that this model would both expropriate HAL's assets and undermine confidence in investment. HAL expressed a range of concerns over the model, which it stated were also relevant to the CIC as proposed by Heathrow Reimagined:
- there is no evidence of failure in the current integrated model, which provides transparency and proportionality, and includes countervailing power from airlines through capex governance;
 - planning decisions at airports are inseparable from the operational realities and any separation would undermine innovation as well as accountability for system level performance and resilience;
 - there would be increased complexity, and weakening of HAL's control, that would undermine investors' confidence such that it would be unclear whether the model would be privately financeable;
 - HAL would be exposed to the operational risks (including safety, security and service) from failures by the system planner but without recourse; and
 - establishing a separate entity would require significant regulatory and legal intervention, which would be incompatible with Government's timelines for expansion.
- 4.54 HAL also noted that conferring more rights to airlines could create new conflicts of interest, with likely misalignment between the interests of airlines and consumers, and could lead to outcomes similar to issues seen with HS2.

Heathrow Reimagined

- 4.55 Heathrow Reimagined proposed the introduction of a CIC to operate alongside other complementary reforms, which could include a separate system planner that the CIC would oversee.
- 4.56 It noted that model 1b could enhance the CIC model as the additional structures and processes required would reinforce the alignment of the interests of the system planner and consumers. Oversight could also be strengthened as part of separation and this could provide more scrutiny of system planning and remove the incentive on HAL to increase the RAB. It also considered that a notionally

efficient airport operator or alternative provider would be able to access sufficient finance at an efficient cost.

Airlines

- 4.57 Other airlines supported the response from Heathrow Reimagined. IAG agreed with the Heathrow Reimagined response, as well as providing some additional comments.
- 4.58 IATA recommended that, in the context of introducing competition, the CAA should consider separating activities by type of infrastructure and by type of role. Without endorsing model 1b, IATA identified coordination as one of the types of role (alongside design, build and operate) which could include the separate system planning function of model 1b. It also emphasised the importance of airlines being involved in system planning at an early stage to help shape requirements.

Other stakeholders

- 4.59 HWL did not comment specifically on model 1b, but its response focused on the importance of a level playing field and issues related to coordination and information provision to avoid duplication, which could be part of a system planning function.
- 4.60 Responses from London Chamber of Commerce and Industry (“LCCI”), Logistics UK, Make UK and BusinessLDN preferred refinements to existing models rather than untested, alternative models, to avoid the additional risks to securing efficient finance and the timely delivery of expansion.
- 4.61 The Heathrow Strategic Planning Group considered there would be potential benefits of formal separation between HAL’s system planning and operational functions, but noted the substantial organisational change processes such a model would require.

Our assessment

- 4.62 This model would require significant intervention and time to implement, and there is limited precedent and evidence that this model would be workable and provide proportionate benefits at a major hub airport. We also note HAL’s points around whether the CAA has the necessary powers to introduce these changes and the main focus of Heathrow Reimagined is the introduction of a CIC rather than the separation of HAL’s system planning functions from its other activities. Similarly, we have not seen evidence (including from stakeholder responses) that this regulatory model would be necessary to address the issues with the current capex governance arrangements.
- 4.63 We set out our more detailed assessment below and do not propose to consider this regulatory model further.

Avoid delay and disruption

- 4.64 We consider that separation of airport system planning from other functions risks undermining accountability and misaligning incentives that could cause challenges and disruption in airport operations. Effective implementation of this model would include significant complexity in designing protocols and incentives to make sure any approach did not reduce HAL's accountability for safety, security and service quality. This may be difficult to achieve in practice and lacks an equivalent precedent in an airport setting.
- 4.65 Our technical advisers, Steer, considered that the new interface between the separated planning and operational activities could increase coordination requirements and governance complexity that could lead to delays and disruption to the expansion timetable. While effective governance and coordination could support in mitigating these risks, this would be difficult to implement in the context of expansion.

Promotes efficient costs

- 4.66 This model would likely lead to more efficient costs if:
- separation of the system planner role was to reduce the incentive to incur inefficient capex to increase the RAB; and
 - these advantages were to outweigh the potential disadvantages in terms of introducing additional complexity and the challenges of ensuring that any system operator function was incentivised to deliver whole life asset efficiency.

On balance it is not clear that the evidence suggests that this is the case.

- 4.67 We also note that improvements in transparency and scrutiny of future planning could be achieved by improvements to the current capex governance in a way that requires less disruption and intervention.
- 4.68 Bearing the above in mind, we assess this model as neutral in terms of efficiency compared with the current regulatory model.

Raise sufficient finance

- 4.69 We consider that this model could weaken HAL's financeability, by reducing its control over investment decisions and because it would be unfamiliar to investors.
- 4.70 Our assessment is that financeability would be worse than under the current regulatory model. This is supported by advice from our advisers, Centrus, which considered that this model would have a negative impact on HAL's financeability because:
- it would reduce HAL's control over investment decisions, shifting HAL towards a contracted operator, which is likely to be less attractive to investors;

- the model does not create standalone investment opportunities for new equity providers and additional interface risks may be viewed negatively by finance providers;
- it represents a material departure from existing arrangements; and
- increased complexity in coordination may elevate construction risk and undermine lines of accountability.

Practical to implement

4.71 We consider it would be complex to establish a separate planning function as:

- it would be necessary to identify what the planning function comprises, as there is no established definition. It is likely to be difficult to determine which activities should be included within its scope and, so, any boundary might reflect an element of “arbitrariness”;
- even once defined (and in the easier case of functional separation within HAL) the planning function would require direct access to appropriate information and expertise, which currently resides with HAL but would need to be operationally independent; and
- separation of system planning would likely require significant changes, including allocation of staff, separate accommodation, separate IT systems, design of the regulatory framework for these functions, and price control and licence amendments.

4.72 Our advisers, Steer and Centrus, both consider separation would take many years. They cite precedent of the creation of the National Energy System Operator (“NESO”) in the UK, which took six years from conception to becoming operational. This process was also made less complex than a similar potential process at Heathrow Airport given that:

- there was already separation within National Grid between some aspects of the “system operator” functions and the “transmission owner” functions; and
- this process was supported by National Grid.

4.73 We therefore consider this model is negative in terms of practical implementation.

Promotes competition

4.74 This model could be used alongside competition models to remove conflicts and support a level playing field between HAL and third parties. However, we could look at more proportionate and timely approaches to enable a level playing field between competitors at the airport and that do not require a formal separation of functions, for example enabled through licence or contract terms should this be required.







4.75 We therefore consider this model has some positives in respect of promoting competition.

Promotes service quality

4.76 As set out above, separation of system planning from other functions risks undermining accountability and misaligning incentives between planning and operations which could have a negative impact on service quality if this is not effectively mitigated. Steer has proposed some potential mitigations such as governance protocols and formalise coordination arrangements between planning and operational functions, so there may not be a material negative impact.

4.77 Overall, we have assessed this model as having a neutral impact on service quality compared with the current regulatory model.

Table 4.2: Summary of assessment of regulatory model 1b

Criteria	Score	Justification
Avoid delay and disruption		Separation of functions risks undermining accountability and creating disruption, while an interface between planning and operation creates a risk of delay from additional governance required.
Promotes efficient costs		Direct improvement seems marginal, as there is limited evidence of conflicts of interest between system planning and other functions.
Raise Sufficient finance		Unfamiliarity, additional interfaces and complexity, and HAL's loss of control are all factors in this model that could undermine the financeability of expansion.
Practical to implement		Separation requires significant changes and risks creating complex interfaces that would be difficult to manage. The CAA does not have powers to impose legal separation.
Promotes competition		There is no direct benefit, but could be used alongside competition models to remove conflicts and support level playing field for third parties.
Promotes service quality		Not clear that the model would have a significant impact on service quality.

Regulatory model 2 – targeted adjustments to the existing incentive regime

Introduction

- 4.78 Model 2 includes changes to the existing capital incentives for efficiency and timely delivery of benefits to reflect the characteristics of specific programmes and projects. The Working Paper included the following options:
- different sharing rates for capex over and underspend based on the characteristics of specific projects or activity. For example, we could apply lower rates (so that HAL would bear a lower risk) for projects where costs are largely outside HAL's control or where confidence in the cost forecast is low;
 - limiting HAL's exposure to extreme cost overspends that may undermine financeability. For example, we could reduce HAL's share of risks as cost overruns increase and/or cap the total possible level of cost overrun;
 - setting cost allowances and DOs for complex or novel projects in stages, rather than at a single point in the process (at the G3 stage); and
 - a mechanism to adjust cost allowances, in addition to the existing change control process, including re-opening of allowances and use of specific cost indices, to provide additional flexibility.

Stakeholders' views

HAL

- 4.79 HAL supported shortlisting regulatory model 2 and it proposed a move to a mix of programme, tranche and project tools that evolve with design maturity and risk certainty.
- 4.80 It said that the current approach reduces flexibility in delivery due to the proscriptive and uniform approach currently applied, which is contrary to best practice. It cites a review by KPMG²⁷ that found that achieving confident G3 costings for large, complex projects requires disproportionate time and cost and may inadvertently slow delivery. HAL considers this would not enable the successful delivery of expansion.
- 4.81 HAL proposed changes to the incentives as follows:
- set incentive targets progressively as designs mature and risks are better evidenced;

²⁷ H7 Capex Delivery Obligations Framework – Lessons Learnt, KPMG, March 2025.

- avoid uniform incentives that create perverse behaviours and apply higher sharing where forecasts are robust and lower/staged exposure where uncertainty is high;
- include downside protections against extreme outcomes such as caps/step-downs to protect credit ratings and market access;
- link outputs to runway opening, capacity release, resilience and service rather than granular DOs that can lock in immature scope and slow delivery;
- provide reopeners for exogenous risks and use ex post cost reviews for “first-of-a-kind” elements to avoid early lock-in and rework;
- pair incentives with accelerated regulatory pathways; and
- avoid failure models that contain asymmetric incentives that load downside risk onto HAL or undermine predictability for investors by being overly complex.

Heathrow Reimagined

4.82 Heathrow Reimagined did not comment in detail on regulatory model 2. It considered that targeted incentive adjustments would incrementally improve HAL’s capex incentives but would not be sufficient to address the fundamental issues with the current capex governance arrangements.

4.83 It also discussed the current incentive regime, noting that:

- the current focus of capital monitoring and enforcement is on the capex incentives and DOs regime that the CAA introduced in H7; and
- Heathrow Reimagined has serious concerns about the incentives and their ability to provide the appropriate level of accountability.

Airlines

4.84 In general, responses from airlines provided limited comments on model 2, although several airlines confirmed their support for the response from Heathrow Reimagined. Some airlines commented that incentives should:

- align cost recovery with the delivery of benefits, rewarding genuine outperformance and penalising failings; and
- promote cost efficiency rather than the growth of the RAB and charges.

4.85 IAG suggested establishing an enforceable budget cap for expansion and masterplan renewal of no more than £25 to £30 billion in real terms, based on

analysis by Oliver Wyman on affordability of HAL's capex programmes for airlines.²⁸

Other stakeholders

- 4.86 Make UK, Logistics UK and BusinessLDN provided general comments that the CAA could provide more targeted and stronger incentives.
- 4.87 The Heathrow Strategic Planning Group considered that people living around the airport would have an expectation that a new regime for economic regulation will include incentives and penalties for delivery, particularly for the mitigation measures to address the impact on local communities.

Our assessment

- 4.88 We agree with HAL that there are strong arguments in favour of implementing more flexible incentives that better reflect the characteristics of individual projects and programmes. This may include projects/programmes where HAL is exposed to greater levels of outside risk having lower risk sharing rates and projects/programmes that have lower levels of outside risk having a higher risk sharing rate. We also agree it may be appropriate to set incentives and targets progressively as designs mature and the risks are better understood. Nonetheless the overall focus of the incentive regime should be in providing HAL with strong incentives to act efficiently and to minimise the scope for expensive cost over-runs.
- 4.89 Both HAL and airlines have made suggestions about providing protections against extreme outcomes. We agree with HAL that caps and re-openers may be appropriate to support financeability. We also agree with IAG that there could be merit in placing a cap on the costs of expansion to help protect consumers from excessive cost escalation. Nonetheless, these mechanisms would need to be carefully considered and calibrated and it is unlikely that a simple overall cap on costs would be in the interests of consumers, given the difficulty in forecasting the needs of consumers and costs many years into the future and the importance of developing an approach to the regulatory framework consistent with efficient financing costs.
- 4.90 We will consider further the comments from HAL, business stakeholders and the Heathrow Strategic Planning Group on the appropriate scope of delivery incentives as part of our implementation work on regulatory models.
- 4.91 We propose to short-list regulatory model 2 and we set out our more detailed evaluation and assessment below. Later in this chapter, we set out our emerging

²⁸ LHR Affordable Capex Envelope: Report (Phase I), Oliver Wyman, March 2026.

views on a proposed approach to a package of measures for capital governance, incentives and scrutiny of procurement, for consultation.

Avoid delay and disruption

- 4.92 This regulatory model should support the efficient delivery of the expansion programme by providing targeted incentives where this will be most effective in mitigating the risks and supporting timely delivery. This should support the wider governance process and potential disruption from significant cost overruns.
- 4.93 We note that both HAL and airlines have set out to us that they are seeing examples where the current approach to incentives is leading to disproportionate time and effort to agree DOs etc.
- 4.94 We therefore assess this model as having the potential to improve the current approach to capital incentives.

Promotes efficient costs

- 4.95 Better targeted cost incentives should provide a significant beneficial impact on cost control during expansion. This could also be the case if we were to introduce an overall incentive on the total costs of expansion, which could reduce the risks of severe cost overruns. HAL and airlines have set out significant concerns that the current approach, with uniform incentives, which we are concerned could lead to a relatively risk-averse and high-cost approach by HAL to setting cost allowances for expansion. Therefore, a more targeted and flexible approach could have significant benefits for cost efficiency.
- 4.96 This is supported by the assessment from Steer, our technical advisers, which found that changes to incentives could have a significant beneficial impact in the protection to consumers for cost overruns.
- 4.97 We therefore assess this model as improving on the current approach to capital incentives in terms of providing better and more targeted incentives on delivery and cost efficiency.

Raise sufficient finance

- 4.98 This model has the potential to improve on the current regulatory model in terms of supporting sufficient finance, by providing more targeted incentives where there are the highest risks and HAL has control over delays and cost overruns. As set out above, we will also consider appropriate mechanisms to provide protections against extreme outcomes, which might otherwise harm financeability.
- 4.99 Centrus, our financial advisers, consider that the ability to adjust overspend/underspend sharing and reopeners are useful levers for the CAA to be able to create a model that would attract equity and debt at sufficient scale. In addition, it considers that investors are very familiar with the model and that

forward looking cost allowances, DOs, and defined reopeners can reduce regulatory friction, speed up decision-making, and improve alignment between HAL, airlines, and the CAA.

- 4.100 We agree with this assessment and therefore consider this model should improve on the current approach to capital incentives in attracting capital to promote financeability.

Practical to implement

- 4.101 We consider this regulatory model can be developed and implemented relatively quickly as part of a package of capital governance changes for expansion, in advance of expansion work commencing. There is therefore no material change compared with the current regulatory model.







Promotes competition

- 4.102 This regulatory model can replicate competitive outcomes but does not alter the conditions for competition that HAL is subject to. Therefore, we assess that model as neutral.

Promotes service quality

- 4.103 We note that the existing approach to capex incentives has a strong focus on DOs. Nonetheless, a project-by-project approach will be less suited to the circumstances of expansion and so a more flexible and targeted approach to DO's for expansion programmes may strengthen the delivery of infrastructure that provides an appropriate level of service quality.
- 4.104 Steer, our technical advisers, found that targeted adjustments to the existing incentive regime could provide a significant beneficial impact to service quality improvement.
- 4.105 Overall, we assess this model as improving on the current approach to service quality.

Table 4.3: Summary of assessment of regulatory model 2

Criteria	Score	Justification
Avoid delay and disruption		Should support the efficient delivery of the expansion programme by providing targeted incentives where this will be most effective in mitigating the risks and supporting timely delivery.
Promotes efficient costs		More targeted incentives for cost efficiency and helps protect consumers from cost overruns.
Raise sufficient finance		Model could be attractive to equity investors and lenders by providing more targeted and flexible incentives, with appropriate protections against extreme outcomes.
Practical to implement		The CAA can implement changes to capital governance under its existing powers and does so as part of a typical price control review.
Promotes competition		This model does not directly impact on competition.
Promotes service quality		Targeted incentives could provide a beneficial impact for consumers if HAL is encouraged to improve the quality of service it provides.

Regulatory model 4a – enhanced scrutiny of HAL’s approach to procurement

Introduction

- 4.106 Under regulatory model 4a, there would be an enhanced level of scrutiny over HAL’s capex procurement approach. HAL would retain primary responsibility for its procurement activities but there would be additional mechanisms, for example to:
- review HAL’s procurement strategy;
 - monitor major tenders; and
 - provide observations or require HAL to further justify its approach, including if competition had not been used effectively.
- 4.107 Under this model we would not impose a requirement on HAL to tender specified design and build contracts, which is a feature of regulatory model 4b, considered

below. The emphasis would be on transparency and assurance that HAL is pursuing efficient, value-for-money outcomes.

Stakeholders' views

HAL

- 4.108 HAL proposed that regulatory model 4a should be explored and shortlisted. HAL said it would support:
- setting clear scope and materiality thresholds, so the CAA's oversight would be limited to defined priority areas and that evidence requirements would be proportionate and focused on outcomes;
 - plans and agreements that included clear mitigation measures to resolve issues quickly;
 - assurance that adds value and avoids duplication, for example, jointly commissioned independent assurance reports;
 - use of experienced contractors; and
 - procurement oversight that complements revised capital governance (model 1a) and incentive (model 2) arrangements, without creating new veto points in the process that could cause delay.
- 4.109 More broadly, HAL supported transparent, quality oversight of procurement that would preserve HAL as the procuring client and would avoid an approach that would involve mandating the contracting out of capex projects or programmes. HAL cited the findings of its consultants (Freshfields and Santander) that there could be a negative effect on its financeability from an approach that would materially constrain or override HAL's procurement decision making.

Heathrow Reimagined

- 4.110 Heathrow Reimagined said that model 4a was insufficient, on its own, to address the problems it perceived with the existing capex governance arrangements. It considered that mandated competitive procurement (under model 4b) could have significant value, as part of a wider set of reforms. It therefore considered that model 4a was insufficient and should not be shortlisted under its proposed package of reforms.

Airlines

- 4.111 easyJet strongly supported a more direct role for the CAA in overseeing procurement, alongside capex governance changes, to promote transparency, more meaningful scrutiny and efficient investment.

- 4.112 In general, airline responses supported stronger regulatory oversight of capex governance. IATA noted this would be particularly important if there is no competition.

Other stakeholders

- 4.113 In general, BusinessLDN and Logistics UK stated there was a role for strengthened governance. BusinessLDN noting that this could help ensure projects are kept to time and budget.

Our assessment

- 4.114 We agree with HAL that this model should be shortlisted and we consider there is a case for enhancing the scrutiny of HAL's procurement practices. We agree with the principles that the approach should be proportionate and focused, though HAL would need to demonstrate that it has considered the full range of options in its overall strategy for procurement.
- 4.115 We consider effective scrutiny of HAL's procurement strategy will be important in providing assurance to CAA and stakeholders that HAL's approach will provide the best chance of delivering expansion in an efficient and timely way. However, we also agree with Heathrow Reimagined that this model, on its own, would be insufficient to address the issues with the current model. For this model, we assess below that it may only lead to modest improvements to efficiency.
- 4.116 Nonetheless, we propose that this model should be part of a package of capital governance enhancements we propose to take forward with models 1a and 2, for consultation. In this package of models, the scrutiny of procurement would be complemented by stronger capex governance and incentives, providing an overall approach that should provide for effective scrutiny to improve efficiency, financeability and service quality.
- 4.117 The detailed evaluation and assessment of this regulatory model is set out below.

Avoid delay and disruption

- 4.118 We recognise that effective scrutiny of procurement could have positive impacts on the timely delivery of capex by promoting collaboration between parties and supporting an effective approach to procurement.
- 4.119 However, we also note that enhanced scrutiny over HAL's procurement could mean additional time and interventions compared with the current arrangements. We would seek to mitigate this through designing a targeted process and putting in place additional skills and resources to support this. Steer, our technical consultants, concluded that this model would have no material risk of delay or disruption of expansion.

- 4.120 On balance, we have assessed this model, on its own, to be broadly neutral compared with the current regulatory approach. However, we consider it could have a modest positive impact when considered in an overall package of measures to improve capital governance and incentives.

Promotes efficient costs

- 4.121 This model has the potential to promote more efficient costs, by applying scrutiny to procurement processes and by promoting effective use of competition in the procurement process. However, we would not be mandating competitive procurement, and the extent of the benefits are uncertain and the improvement in cost efficiency may be marginal.
- 4.122 Steer considered that this model could be beneficial in establishing an efficient cost baseline and challenging HAL's proposals, and may allow for greater cost control during construction, for example by supervising decisions on risk allocation, contract type, tender process and tracking changes. It also considered that with appropriate technical support then the CAA could undertake detailed assessments on procurement strategy, cost estimation, and execution efficiency to reduce costs.
- 4.123 Overall, this model should improve efficiency compared with the current regulatory model, and so we assess it as positive on cost efficiency, but the scale of this improvement may be limited in practice.

Raise sufficient finance

- 4.124 This model could support financeability by providing additional and ongoing assurance to investors on the efficiency of costs, reducing requirements for backward looking assessments of efficiency, though these impacts may be relatively minor.
- 4.125 Centrus said this model could have a marginally beneficial impact on financeability, as the involvement of the CAA in the procurement process may have the potential to provide additional comfort to investors, increase transparency, and because investors are familiar with similar arrangements in other contexts.
- 4.126 Bearing in mind the marginal nature of these improvements to financeability, we assess this model as neutral compared with the current regulatory model.

Practical to implement

- 4.127 We expect this model would be practical to implement under the CAA's current powers. It would require additional resources from CAA (in particular arranging for independent expertise in procurement) but this should be manageable by ensuring additional scrutiny is proportionate and appropriately targeted.

4.128 We assess this as neutral and no material change to the current regulatory model.







Promotes competition

4.129 This model has the potential to encourage competition but the lack of backstop powers to support change may limit its effectiveness.

Promotes service quality

4.130 We would not expect this model to drive significant improvements in service quality and we assess this model as neutral compared with the current regulatory model.

Table 4.4: Summary of assessment of regulatory model 4a

Criteria	Score	Justification
Avoid delay and disruption		Enhanced scrutiny could risk minor delays, but we could mitigate these through targeting and additional resources. Any impact is not expected to be significant.
Promotes efficient costs		Potential to promote efficient costs (for example through scrutiny of the efficient baseline and supporting more effective competition in the procurement process) but the impact may be relatively modest.
Raise sufficient finance		Likely to have a positive but minor impact on financeability.
Practical to implement		We expect that this would be relatively straight-forward to implement, although it would require some additional resources.
Promotes competition		No material change compared to existing structure but could be used alongside competition models.
Promotes service quality		Would not drive significant improvements in service quality.

Developing an integrated approach

Overview

4.131 In this section we set out an initial proposed package of regulatory models 1a, 2 and 4a that integrates together aspects of capital governance, incentives and the regulatory oversight of procurement for consultation. This proposal would seek to enhance capital governance and incentive arrangements for capital efficiency,

and strengthen the oversight of HAL's procurement processes. These models all aim to encourage capital efficiency and reduce the risk of cost over-runs on the expansion programme.

- 4.132 Further work will be needed to develop an appropriate approach, including in due course the integration with other regulatory models we may decide to take forward, including regulatory model 3 (longer-term frameworks) and competition models.
- 4.133 We are consulting on these high-level proposals and will be commissioning an expert review of the approach to governance that should be implemented, including the various tools and mechanisms that we could apply to provide additional scrutiny and clarify the roles of different stakeholders. This will inform the next stage of design of the governance process. We set out more detail on our proposed next steps in chapter 8.

Potential future approach to capital governance and incentives

Capital committee and independent assurance

- 4.134 HAL has set out the importance of clear roles and responsibilities and avoiding too many layers of governance. Heathrow Reimagined and airlines have raised concerns with the current approach to governance, which they consider does not allow for sufficient scrutiny of capex programmes and projects, and have proposed a new capital investment committee.
- 4.135 We consider there could be merit in setting up a new capital committee ("committee"), to provide oversight across strategic capital planning, approval, monitoring, "lessons learned" reviews and reporting on HAL's compliance with processes. We set out below some initial principles for the committee for consultation. We plan to commission expert advice on the best governance approach for Heathrow Airport, which will need to consider the functions of any new capital committee and any overlap with the existing functions of the IFS, the capital portfolio board, the future portfolio group, and other programme and working groups, to avoid unnecessary duplication, complexity and bureaucracy.
- 4.136 The CAA could appoint an independent chair of the committee, who would report to the CAA. This should introduce more independence into the process to support more collaboration between different stakeholders and stakeholder confidence in the process. We would not chair the committee, given this would raise a conflict when capital governance issues are escalated to us for a regulatory decision. The committee could include representatives from the CAA, HAL and airlines. We also want to consider the appropriate way for representatives from consumer groups and other stakeholders to provide input to the committee on areas that affect them. Committee views should be transparent and available for publication where possible.

- 4.137 We would expect independent technical support to provide assurance to the CAA, committee and stakeholders on planning, procurement, costs, property and delivery of major infrastructure projects. This would represent a broader scope than the current remit of the IFS. These experts could be appointed by CAA jointly with HAL and airlines, or by the CAA only in cases a greater degree of independence from HAL is appropriate. We will also consider how best to integrate this with the approach to assurance on early costs set out in the draft decision on the recovery of early costs that we published in April 2026. Taken together, this would seek to address HAL and airline concerns that airlines do not have the relevant expertise across all of these areas to scrutinise proposals effectively.
- 4.138 We would not be setting up the committee to either: (i) be responsible for managing HAL's capital planning; or (ii) have powers to veto HAL's capital programme decisions. We consider that HAL should retain responsibility for its capital planning and have appropriate incentives for the timely delivery of an efficient capital plan.

Long-term capital planning

- 4.139 We want to see more collaboration between HAL, airlines and other stakeholders on long-term plans for capital investment and we expect the committee will play a part in helping establish this coordination.
- 4.140 There should be better dialogue and information on the long-term capital strategy, including in relation to optioneering, the timescales and early cost estimates. This should be updated at regular intervals and would cover a reasonable period of time (for example, the next 15 years). While HAL provides details on its long-term plans in its Master Plan and updates in its Business Plan, airlines do not consider the long-term plans are transparent and have been subject to sufficient scrutiny. The report by Dr Mansell also identified that HAL is not currently required to produce a strategic plan as a weakness in the current process.
- 4.141 We consider that the capital committee could be responsible for:
- specifying the information it expects to see in the long-term strategy and capital plans;
 - scrutinising plans and the evidence base, drawing on a broad set of independent assurance; and
 - holding HAL to account where it does not provide suitable information in a timely and transparent way.
- 4.142 This approach would also need to be flexible to allow HAL and stakeholders to bring forward urgent and required projects that did not form part of existing long-term plans.

Capital governance

- 4.143 A tailored and proportionate approach will be required for capital governance given the significance, scale and complexity of expansion. Evidence submitted by stakeholders in response to the Working Paper indicates that there is no “one size fits all” approach to delivering major infrastructure projects that works to ensure that they are delivered on time and for an efficient cost. A flexible approach could include:
- reviews of business cases, optioneering and procurement strategy by the committee with guidelines so the committee acts in a proportionate manner and does not unduly delay progress with excessive requests for detail. The committee could set out guidance detailing what best practice looks like to provide HAL with clarity on its expectations on the quality of information it expects to see;
 - scrutiny to focus on the higher value and risk projects, while also making sure there is sufficient timely scrutiny of urgent projects. HAL has suggested we adopt different approaches for four categories of costs: DCO costs, property, core aviation infrastructure and novel infrastructure. We would need to consider if there are other formal groupings that would be appropriate;
 - ongoing independent assurance and monitoring of procurement, costs and other technical matters, such as property strategy. In cases where the committee believes that HAL is proposing a cost budget that is significantly above the efficient level, the committee could seek independent expert advice on the costs and benefits of alternative options to provide advice to the CAA on cost efficiency; and
 - a clear and timely escalation process, where matters can be fast-tracked and/or resolved at working level where appropriate.
- 4.144 Further consideration will need to be given to how this approach will be integrated with arrangements for the oversight of early costs discussed in the draft decision on early costs we published in April 2026 and with the existing capex governance arrangements for business-as-usual spending.

Capital monitoring

- 4.145 The committee would be responsible for developing an appropriate approach to monitoring the delivery of expansion capex, identifying risks and assessing HAL’s risk mitigation strategy.

Incentive framework

- 4.146 We should have in place strong and targeted incentives on HAL for the efficiency of costs and the timely delivery of benefits from capex. This is especially important for expansion given the experience of megaprojects running late and over budget. These may need to be flexible to be effective, as uniform cost and

delivery incentives may have unintended consequences, such as encouraging HAL to take a high-cost, risk-averse approach. These incentives could include:

- cost efficiency sharing rates that are tailored to cost certainty and levels of risks to the particular programme and project. This could mean HAL bears more than the current 25% of cost risks where the scope is well-defined and within HAL's control, and bears lower cost risks where the scope is uncertain and subject to significant external cost risks;
- backward looking *ex post* reviews of costs and ongoing monitoring of costs will be required before it is possible to set a reliable cost baseline and apply *ex ante* incentives. Costs found to be demonstrably inefficient should be removed from the RAB;
- continuation of DOs to set incentives on the timely delivery of benefits from investment. In line with the current approach, these could be set based on outcomes or outputs as appropriate;
- incentives around the quality and timeliness of information provided to the committee. This would relate to the information provided as part of the long-term planning, business planning and ongoing governance process and whether the information allows for effective decision making. The committee would make a recommendation for the CAA to consider and implement; and
- a budget cap for expansion, to provide backstop protection to limit the risks to consumers from significant cost escalation. This could be a cap or a threshold where overspend above this cap is subject to a different incentive rate. Nonetheless, these mechanisms would need to be carefully considered and calibrated and it is unlikely that a simple overall cap on costs would be in the interests of consumers, given the difficulty in forecasting the needs of consumers and costs many years into the future and the importance of developing an approach to the regulatory framework consistent with efficient financing costs.

Procurement

- 4.147 The committee will also have an important role in the effective scrutiny of HAL's procurement strategy. This should support the appropriate use of competitive forces to help manage costs and delivery. If we take forward regulatory models that provide backstop powers to mandate design/build or design/build/operate arrangements the committee would have a key role in encouraging HAL to lead the development of an approach to procurement that would win the confidence of stakeholders and avoid the need for regulatory intervention.

Next steps

- 4.148 Further work will be needed to develop an appropriate approach to governance and incentives to make sure the approach is workable and effective in the

context of both business-as-usual and expansion capex. We plan to commission an expert review of the approach to governance that should be implemented, including the various tools and mechanisms that we could apply to provide additional scrutiny and clarify the roles of different stakeholders. We will draw on the evidence and proposals submitted by stakeholders and responses to this consultation. We will engage with HAL and airlines on the scope of this work and would expect the expert adviser to work with the CAA and stakeholders on the detailed design of the approach during the course of this work.

CHAPTER 5

Shortlist of regulatory models – longer-term regulatory framework

Introduction

- 5.1 Regulatory model 3 (longer-term regulatory framework) would involve the CAA making commitments in respect of one or more price control parameters that would extend beyond a standard five year price control period.
- 5.2 In the Working Paper we discussed a range of possible initiatives that might be consistent with a longer-term framework. This included arrangements in respect of both capital governance and the cost of capital. In this document, we have addressed considerations around long-term capital governance arrangements in chapter 4. This chapter focusses on issues around making longer-term commitments to the cost of capital and/or setting HAL's price control for an extended number of years.
- 5.3 Our approach to setting business-as-usual price controls for HAL already involves a degree of longer-term commitment through the use of a RAB to fund capital expenditure. The essence of regulatory model 3 is to go further than these existing arrangements and consider whether there should be longer-term commitments regulatory allowances for returns and the cost of capital.
- 5.4 In doing so, we are seeking to provide an appropriate level of certainty to investors given the large capital commitments that expansion will involve. The intention would be to identify efficient and effective financing arrangements and avoid any undue pressure on HAL's cost of capital, such that airport charges would be lower than otherwise, consistent with furthering the interests of consumers.
- 5.5 In setting previous price controls for HAL we have typically set controls for five-year periods. For instance, the current H7 price control covers the period from 2022 to 2026. Alongside issues such as longer-term commitments to the cost of capital, this chapter also considers whether we should use a longer period for the overall price control determination.
- 5.6 We start by discussing the views of stakeholders on this model that were provided in response to the Working Paper. We then present our assessment of these views and develop a number of options that illustrate how this regulatory model could work. We then present the evaluation and assessment of this model and our decision to include it in the shortlist of models for further consideration.

Regulatory model 3 – long-term regulatory framework for expansion

Stakeholders' views

HAL

- 5.7 HAL expressed support for a longer-term framework of between 15 and 20 years. It welcomed further consideration of this model in future consultation rounds, with an expectation that these future consultations would address issues such as design choices, scope, and safeguards in full.
- 5.8 HAL's reasoning included that:
- a credible multi-period commitment to the cost of capital and the capital framework could lower the cost of capital and strengthen credit ratings by reducing the frequency of wholesale price control resets. This would give investors greater visibility of their remuneration through the peak construction years. The model would, therefore, make financing costs more efficient, with consumers benefiting from lower costs;
 - it could provide airline customers with materially greater price certainty, enabling them to plan fleet, network and product investments with greater clarity than five year price control periods. A longer, smoother charging profile would reduce volatility and risk for airlines, enabling more confident long-term investment in passenger services, resilience, and network growth. It would also avoid costly stop-start cycles for both HAL and its airlines; and
 - it could provide HAL with more certainty to effectively engage with the supply chain to exploit efficiencies in delivery, by enabling contractors and strategic partners to plan capacity, secure resources, and commit to delivery models that optimise cost and performance.
- 5.9 HAL also stated that long-term commitments should be combined with normal resets to other key price control building blocks (including opex, revenue, volume) along with an approach to price control reopeners that should be trigger-based, with tight thresholds and timelines. These reopeners should also have tightly defined thresholds and timelines to help manage forecast errors if costs, revenues or passenger volumes were to rise or fall compared to forecast levels.
- 5.10 HAL added that long-term commitments should be used alongside profiling to smooth charges across construction and ramp-up periods and use a single RAB. It also supported a commitment to periodic, standardised reporting against long-term outputs (such as capacity release, resilience and service) with proportionate independent assurance.
- 5.11 HAL cited various case studies as relevant precedents when considering this model, referring to its accompanying report reviewing megaprojects

(“Megaproject outcome drivers, benchmarking fact base”)²⁹. These included the Thames Tideway Tunnel, UK nuclear precedent comparing Sizewell C and Hinkley CfD, Ofgem’s Accelerated Strategic Transmission Investment (“ASTI”) framework for electricity transmission, Dublin Airport’s North Runway and the Chicago O’Hare Modernization Program.

5.12 The report particularly referred to:

- Thames Tideway Tunnel: HAL stated that this had a bespoke long-term regulatory framework which reduced re-determination risk and provided stable investor expectations across the construction period. This enabled continued delivery despite cost escalation.
- Ofgem’s ASTI framework: HAL considered this precedent as evidence that long-term regulatory stability alone can be insufficient for expansion megaprojects, with ASTI showing that stable frameworks are most effective when combined with defined fast-track pathways for time-critical investments.
- UK Nuclear RAB precedent: HAL commented that the UK Nuclear RAB precedent such as Sizewell C compared to Hinkley CfD demonstrate that upfront, long-term regulatory commitments materially reduce financing risk and the cost of capital without removing delivery discipline.

Heathrow Reimagined

5.13 Heathrow Reimagined did not support regulatory model 3, expressing strong opposition to both multi-period commitments to specific price control parameters such as the regulated cost of capital and to charge profiling.

5.14 It also clarified that the appearance of overlap between Heathrow Reimagined and HAL on longer-term planning is misleading and that they have fundamentally different objectives. Heathrow Reimagined commented that HAL is seeking to protect itself from risk and enable itself to act on harmful incentives with less scrutiny. By contrast, Heathrow Reimagined seeks longer-term planning transparency and airline influence through oversight from a Capital Investment Committee within a framework of terminal competition and enhanced governance.

5.15 Heathrow Reimagined opposed a long-term framework because locking returns and charges over multiple control periods, even for specific assets, would undermine regulatory certainty and the CAA’s own independence. This would be because the CAA would be limited to reviewing whether HAL was following the pre-set price path or achieving the locked-in return, rather than exercising substantive regulatory judgement.

²⁹ Megaproject outcome drivers, benchmarking fact base, HAL, January 2026.

- 5.16 Heathrow Reimagined stated that less frequent redetermination of the price controls or a policy commitment to maintain specific parameters (such as the cost of capital) over longer periods would increase forecast error risk for both investors and consumers, with errors persisting for longer. It also considered that HAL would seek to argue that any heightened risk of forecast error would need to be reflected in a higher longer-term regulated cost of capital, which would further harm consumers should the CAA accept this.
- 5.17 Heathrow Reimagined added that the risk of forecast error asymmetrically favours HAL given both:
- HAL's significant information advantage, which is made larger under a longer price control; and
 - the CAA's financing duties, which Heathrow Reimagined said would result in the CAA either implicitly or explicitly giving HAL the benefit of the doubt.
- 5.18 Heathrow Reimagined said that HAL would tend to receive an overly favourable treatment with a longer duration control price control as it would keep the gains, but where it would otherwise lose out, it would invoke financeability concerns to put pressure on the CAA to revisit its decisions. This would remove any potential benefits to consumers and lead to excessively high charges and profits.

Airlines

- 5.19 Airlines generally had more limited comments on a long-term regulatory framework overall.
- 5.20 easyJet stated that this model has more risks than advantages. It said the model would fundamentally prioritise project financing over the protection of passengers, which will prematurely constitute an unacceptable risk transfer from investors to consumers over decades. It stated that consumers would be permanently locked into paying for an overpriced and underutilised asset if costs proved to be lower than forecast, or if demand falters. This would contrast with the way in which investors would be shielded from such downside risks.
- 5.21 easyJet also argued that the model would severely curtail the CAA's ability to adapt and intervene in the public interest given the framework would likely be positioned as a binding "regulatory contract". This would make it exceptionally difficult for the CAA to respond to unforeseen events or to rectify poor performance by the airport operator without facing legal challenge.

Other stakeholders

- 5.22 Several other stakeholders expressed support for this model given the need to support investor confidence to enable investment and prioritise timely delivery, including Business LDN, Make UK, Heathrow Strategic Planning Group, Logistics UK and the London Chambers of Commerce and Industry.

- 5.23 Business LDN stated further that any regulatory model must maintain confidence among investors, with HAL's ability to attract private finance at competitive rates being central to its success. As such, multi-period regulatory commitments that extend beyond the standard five-year price control periods could provide the stability needed for long-term programmes, compared to models that could introduce uncertainty and raise the cost of capital.
- 5.24 Make UK commented that, among several credible "RAB-plus" variants that could strengthen this model while preserving its core advantages, introducing multi-period commitments could provide clearer long-term regulatory pathways. This could reinforce investor confidence without reducing consumer safeguards. It stated that a new framework could also benefit from targeted uncertainty mechanisms, with specific reopeners for risks such as planning or scope change, avoiding the need for risk premia to be captured in allowed returns.
- 5.25 Heathrow Strategic Planning Group stated that, in principle, there could be significant benefits in moving to a long-term regulatory framework for expansion and this should be a significant focus for the next stage of work by the CAA.
- 5.26 The Council for Independent Security of Heathrow Airport also considered this model as one of those that were worth considering at this stage as part of adopting an evolutionary approach.

Our assessment

- 5.27 We indicated in the Working Paper that the likely scale of HAL's future capital programme (regardless of whether expansion takes place) means that there are benefits from providing comfort to investors that the regulatory framework will not be inappropriately amended once capital has been committed. Providing this comfort could serve to reduce the level of return necessary to compensate investors for risk, with correspondingly lower costs being passed on to consumers. However, a regulatory model involving less frequent redeterminations could also expose investors to increased forecasting error. Investors may then require greater compensation for bearing this risk, which could increase the costs to consumers.
- 5.28 Stakeholders have raised several considerations in respect of these matters, on which we comment below.

Investor and consumer certainty

- 5.29 We agree with HAL and other parties that a credible multi-period commitment to the allowed return could lower the cost of capital and strengthen credit ratings.
- 5.30 Mismatches between price control periods and investment horizons may be perceived negatively by investors. While these issues tend to be manageable in the context of a five year business-as-usual price control review, the characteristics of expansion would be very different. The mismatch between the

duration of the regulatory period and the investment horizon has been noted as a negative factor by credit rating agencies.³⁰ Although those agencies have not, to date, applied negative notching to reflect this, the scale of expansion may mean that such a mismatch may be regarded as more significant. All else being equal, it could increase the cost of capital of the expansion scheme that is ultimately paid by consumers. A longer-term commitment to the allowed return could mitigate this risk.

- 5.31 We acknowledge that longer-term commitments also create the potential for forecast error, which, all else being equal, could result in HAL making windfall gains or losses. However, we consider that there are means of limiting the potential for forecast error (outlined below), while retaining the benefit of improved matching between the commitment period and investors' forecast horizon.

Regulatory certainty and CAA independence

- 5.32 We disagree with Heathrow Reimagined that longer-term commitments would reduce regulatory certainty. On the contrary, we consider that by reducing the scope for regulatory discretion, less frequent redeterminations can reduce perceptions of regulatory risk. We are also unclear how a longer-term commitment would, by itself, undermine our independence. We would ensure that the commitments would be determined in an impartial and evidenced-based manner, with key airline stakeholders being able to appeal the resulting licence modifications to the CMA.

Asymmetry of outcomes

- 5.33 We note the view of Heathrow Reimagined that uncertainty associated with longer-term price control periods gives rise to asymmetric risk in favour of investors. We acknowledge that this is a risk and that this was feature of Ofgem's extension to 8 years of the price controls set under its RIIO-1 framework³¹. Nonetheless, we remain of the view that we should explore ways of mitigating these risks given the other advantages of this model, including a lower costs of capital than would otherwise be the case.
- 5.34 A lower cost of capital would reduce airport charges and so, all else being equal, would further the interests of consumers. In developing our approach to these

³⁰ S&P Global Ratings notes that the credit impact of Heathrow's expansion depends, inter alia, on "the predictability of the time horizon that investments will be remunerated".

A Long Taxiing for Heathrow Toward a Third Runway, S&P Global Ratings, August 2025

Fitch observes in previous HAL rating commentary that "the regulatory process that leads to the cap determination is transparent but creates material uncertainty each time it is reset".

Fitch Affirms Heathrow Funding and Heathrow Finance Notes; Outlook Stable, Fitch Ratings, December 2025.

³¹ See Electricity Networks, National Audit Office (NAO), January 2020.

matters, as discussed further below, we will prioritise approaches that would not benefit investors in an inappropriate way, at the expense of consumers.

Further considerations

5.35 In order to explore this model further we have considered three options for implementing a longer-term framework:

- longer-term cost of capital commitments;
- formal lengthening of the price control period; and
- cap and collar mechanism on returns.

5.36 These are discussed in turn below.

Option 3.1: long-term cost of capital commitments

5.37 A long-term determination of the cost of capital could apply to a single RAB for both business-as-usual and expansion activities or apply specifically to expansion. We summarise three sub-options below. For all sub-options, we have assumed that the other elements of HAL's price control would be reset every five years as is currently the case. The options we have identified are:

3.1a: A long-term combined cost of capital determination covering business-as-usual and expansion activities;

3.1b: A long-term cost of capital determination for expansion applied to a separate "expansion RAB", with redeterminations of the "business-as-usual cost of capital" every five years; and

3.1c: A long-term "cost of capital premium" over the "business-as-usual cost of capital". This would mean both the "business-as-usual cost of capital" and the "expansion cost of capital" being redetermined every five years, but setting a long-term expansion-specific premium which would be fixed for a longer period. The resulting expansion cost of capital would be applied to a separate expansion RAB.

5.38 We have asked Centrus to examine these options, which are set out in its report published with this document.³² Centrus noted that, while there is merit in a longer-term commitment in respect of expansion assets, there are risks associated with amending the current approach of setting five-year price control determinations for business-as-usual activities. Specifically, Centrus consider that credit rating agencies are familiar with the current approach for business-as-usual activities, and may view amendments to this framework with caution.

³² Financeability assessment of regulatory models for Heathrow Airport, Centrus, May 2026

- 5.39 There may also be benefits in a separate expansion RAB as this could create a clearer link between expansion-specific risks and returns.
- 5.40 Centrus highlighted that an explicit cost of capital (as opposed to a cost of capital premium over the business-as-usual cost of capital) for expansion may be preferable for investors, since it provides them with greater certainty over returns. On this basis, we prefer Option 3.1b at this stage.

Option 3.2: formal lengthening of price control period

- 5.41 This option would involve a formal lengthening of the HAL price control. This could also potentially include a mechanism to conduct a focused mid-period reopener if required.
- 5.42 We consider that this approach suffers from the same drawback identified above in respect of Option 3.1a: namely, that it would involve amending the current approach of setting five-year price control determinations for business-as-usual activities, which credit rating agencies may view cautiously. We also note the additional complexity compared to focusing on long-term cost of capital and the difficulties noted above that Ofgem encountered in setting RIIO-1 price controls for an extended period of time. As such, we provisionally consider that Option 3.1b is preferable to this option.

Option 3.3: cap and collar mechanism on returns

- 5.43 We agree with Heathrow Reimagined that there is the potential for larger and more persistent forecast errors where price control parameters are set for longer periods. Setting a long-term cost of capital that encompasses both the construction and operations phases of the expansion scheme would involve significant uncertainty, given the very long timescales involved. Our present view is that it would not be practicable to determine the cost of capital for a period beyond that associated with the construction of key expansion assets.
- 5.44 Nonetheless, there may be merit in setting upper and lower bounds for the returns that investors can expect to earn during the period of the expansion scheme (that is for the construction period and an operations phase). This would allow for a degree of discretion in redeterminations of the cost of capital to reflect new information but would reduce the level of uncertainty in respect of lifecycle returns overall.
- 5.45 Under this option, we would set:
- a maximum lifecycle return that investors would be permitted to earn (the “cap”); and
 - a minimum lifecycle return that investors are guaranteed to receive (the “collar”).

- 5.46 If returns were to fall outside the cap or collar, a further layer of risk-sharing could potentially apply, either to overall realised returns or through targeted components of those returns (such as capex or opex) depending on how incentive or cost-sharing mechanisms are structured. The mechanism could also potentially include a “gain share” arrangement in the event that the sale value of expansion assets were to exceed an agreed threshold.
- 5.47 We intend to take forward option 3.1b and option 3.3 and assess these further.

Summary of assessment

- 5.48 The principal criterion that is relevant to the evaluation of a long-term regulatory framework is in supporting the raising of sufficient cost-effective finance to enable the delivery of expansion at an efficient price. This will limit upward pressure on airport charges and benefit consumers.
- 5.49 As set out above, we consider that this regulatory model has the potential to improve both the cost and availability of finance for expansion, since it better aligns key elements of the price control framework with the longer-term financing arrangements necessary to support expansion. Nonetheless, we would also need to guard against any disproportionate protections for investors and ensure the overall regulatory framework continued to provide incentives for efficiency and affordable charges. In particular, setting a longer-term cost of capital or collars on returns would only make sense in the context of meaningful incentives for capital efficiency, to avoid circumstances where HAL would be rewarded for delivering expansion inefficiently.
- 5.50 We will consider how best to implement these arrangements further, including in relation to the options for a longer-term expansion cost of capital and caps and collars on returns, as discussed above. We will also consider how to best guard against the risks highlighted by airlines of inappropriate and asymmetric benefits flowing to investors, at the expense of consumers.
- 5.51 By contrast, we do not consider that this model has a significant direct impact on other criteria, as set out below.

Avoids delay and disruption

- 5.52 We would not expect this regulatory model to directly affect the prospect of delays and/or disruption to airport operations, since it would not affect operational control, accountability or the underlying delivery structure and interfaces.

Promotes efficient costs

- 5.53 We would not expect this regulatory model to directly affect costs, since longer-term commitments relating to the cost of capital and returns do not necessarily incentivise greater cost efficiency.

Practical to implement

- 5.54 This model can be implemented in the context of the current regulatory framework and CAA's statutory powers. We acknowledge that setting longer-term determinations for price control parameters involves forecasts that are subject to a greater degree of uncertainty and work would need to be undertaken to address these difficulties. We would also need to consider carefully how to avoid the disadvantages highlighted by airlines, including the risk that these arrangements could benefit investors in an inappropriate way, at the expense of consumers.

Promotes competition

- 5.55 This model does not directly promote competition, since it does not, by itself, facilitate the involvement of third parties.







Promotes service quality

- 5.56 We would not expect this regulatory model to directly affect service quality, since longer-term commitments relating to the cost of capital and returns do not necessarily incentivise better service quality performance.

Overall assessment

- 5.57 Overall, we consider that a long-term framework should be shortlisted for further development, as it offers clear advantages for raising sufficient finance.
- 5.58 We have considered several options for how a long-term framework could be implemented. These include aligning the period over which the cost of capital is determined with the construction period and providing greater certainty to investors over the returns they can expect to make over the project lifecycle.
- 5.59 Setting a separate expansion cost of capital aligned to the construction period, while retaining the current approach of five-year resets of business-as-usual activities, would provide greater certainty for investors over their forecast horizon. It would also retain a well-understood framework for business-as-usual activities. Setting maximum and minimum bounds for returns over a greater part of the project life cycle may also be a helpful approach in providing investors with some certainty over their whole-life returns, while protecting consumers over the longer term.

Table 5.1: Summary of assessment of regulatory model 3

	Score	Justification
Avoid delay and disruption		Model has no direct impact.
Promotes efficient costs		Model has no direct impact.
Raise sufficient finance		Model can provide greater alignment between the period over which allowed returns are set and investors' forecast horizons.
Practical to implement		This model can be implemented in the context of the current regulatory framework and CAA's statutory powers.
Promotes competition		Model has no direct impact.
Promotes service quality		Model has no direct impact.

Conclusion

5.60 For the reasons set out above we have decided to include regulatory model 3 (longer-term regulatory framework) in our shortlist of models.

CHAPTER 6

Shortlist of regulatory models – competition models

Introduction

- 6.1 In the Working Paper, we outlined several regulatory models, the intent of which was to introduce competition into one or more phases of the delivery and operation of airport assets. The underpinning rationale for these models is that competitive tension could provide incentives for parties to achieve efficient costs and service levels, since competitors are penalised for inefficiency by losing business to their rivals, either through:
- being unsuccessful during a bid process (“competition for the market”); or
 - customers switching to a competitor (“competition in the market”).
- 6.2 In this section, we first discuss overarching considerations for competition models in general. We then examine issues that are specific to individual competition models, before concluding which models we intend to include in the shortlist.
- 6.3 This chapter evaluates and assesses the following models:
- regulatory model 4b: mandate contract for design and build contract.
 - regulatory model 5a: operation (management contract) only;
 - regulatory model 5b: design, build and operation.
 - regulatory model 6: third party builds assets, then transfers ownership to HAL;
 - regulatory model 7a: wholesale supplier model;
 - regulatory model 7b: direct competition for airport operation services; and
 - regulatory model 8: transfer of ownership and operation of an existing asset.

Overarching issues

Stakeholders’ views

HAL

- 6.4 HAL stated that its preferred regulatory approach is an evolved version of the existing single-RAB framework. It said this approach should retain a clear link between efficient costs and prices, stabilise cashflows, and support the timely

delivery of consumer benefits. HAL highlighted that the RAB-based model at Heathrow has resulted in significant investment that has benefitted consumers.

- 6.5 HAL indicated that third-party involvement in delivery should be carefully explored where it is proven to drive efficiencies, deliver better service, be financeable, and meet the timetable for expansion. HAL noted that such arrangements would need to be consistent with it remaining the responsible owner and operator of key assets.
- 6.6 HAL cautioned against models that would result in fragmentation of ownership, delivery or operation of critical assets. It also cautioned against mandated contracting models that would remove flexibility, lock in immature designs and amplify interface risk.
- 6.7 HAL commissioned a report by Freshfields and Santander, examining the financeability impacts of each regulatory model. That report sets out the advantages of a single-RAB, single-till approach, while also acknowledges that some competitive procurement models, when limited to assets that are not critical to the timely delivery of expansion, could be broadly neutral for financeability.
- 6.8 Nonetheless, the report also suggests that models involving third-party ownership would:
- raise the cost of capital;
 - place upwards pressure on airport charges;
 - threaten HAL's investment-grade credit profile; and
 - fail to deliver genuine construction-risk transfer.

Heathrow Reimagined

- 6.9 Heathrow Reimagined favoured the use of both competition for the market and competition in the market to facilitate terminal competition, while undertaking competitive procurement for non-terminal infrastructure. It noted that core airport infrastructure, such as runway operations, taxiways, airfield maintenance, ground-based navigation systems and inter-terminal transit may not be well suited to 'competition in the market' models.
- 6.10 It stated that, rather than solely attempting to mitigate the harmful incentives that it considered are an inherent characteristic of the current regulatory model, competition would fundamentally remove them. Well-functioning competition creates strong incentives for firms to be efficient, innovative and focused on the needs of their customers. It also highlighted that similar reforms have been undertaken in other sectors.

- 6.11 Heathrow Reimagined stated that pursuing regulatory remedies that would introduce greater competition for the provision of airport operation services should be the first-order priority for this review.

Airlines

- 6.12 Airlines generally concurred with Heathrow Reimagined's view and underscored the importance of introducing effective competition in the provision of airport operational services. IATA highlighted its guidance on concession agreements, and the principles that could guide the design and implementation of competition models.
- 6.13 IAG said that competition and stronger incentives should be introduced across Heathrow's value chain wherever possible to curb excessive costs. It considered that many of the problems in Heathrow's investment outcomes arise at the design and build stages, where HAL's incentives encourage over-specification and higher capital expenditure.
- 6.14 In relation to design, IAG emphasised that HAL currently controls scope and standards, while airlines have limited ability to challenge "gold-plating", even though early design choices lock in the majority of whole-life costs. To address this, IAG supported competitive design tenders, output-based specifications focused on required performance rather than bespoke solutions, the use of independent design authorities or standard reference designs, and strict design-to-cost disciplines. It highlighted that controlling design inflation is critical because design decisions typically determine 70–80% of lifetime costs and therefore have a major impact on passenger charges.
- 6.15 For the "build phase", IAG argued that HAL's role in managing engineering, procurement and construction is undermined by weak incentives to minimise costs, since higher capex increases HAL's regulated returns. It therefore advocated for stronger competitive tendering, fixed-price or pain/gain-share contracts, and, where appropriate, delivery through independent project companies or ring-fenced special purpose vehicles.

Other stakeholders

- 6.16 Business groups, the Heathrow Strategic Planning Group, Transport for London and CISHA/HPF generally preferred an evolutionary approach to amending the current regulatory model and urged a cautious approach when considering more significant changes, including introducing competition.
- 6.17 Heathrow West Limited supported the introduction of competition at Heathrow. It highlighted the importance of considering how regulatory models might apply if a third party were to be successful in obtaining a DCO.

Our assessment and overview of high-level issues

The broad case for competition models

- 6.18 Our review of precedents suggests that, where effective, competition can materially improve upon regulation and lead to significant consumer benefits. For example, in its impact assessment on the introduction of competition in new onshore transmission networks, Ofgem estimated that competition could lead to cost savings of up to 22%³³. While these figures relate to the introduction of competition in a different sector, we consider the prospect of achieving similar savings in the context of expansion to be sufficiently material to warrant further consideration of these models.
- 6.19 Set against these potential benefits, we must also consider whether the introduction of competition models could impose additional costs and/or inappropriately delay the realisation of the consumer benefits associated with expansion.
- 6.20 We intend to work with HAL and other stakeholders to determine how best implement the competition models shortlisted in this document, with a view to identifying how they can be best implemented effectively, including avoiding any undue delays. As explained further below, regulatory model 7b (direct competition for airport operation services) raises wider issues and complexities, which we will continue to discuss with Government and stakeholders.
- 6.21 We also acknowledge HAL's observation that these models may give rise to challenges associated with potential fragmentation of roles, the costs of managing interfaces between different parties, and the management of disputes. However, in our view, these challenges should be surmountable where all parties work together to drive successful outcomes.

Licensing issues raised by regulatory models

- 6.22 CAA12 requires any party who is the "operator" of part of a "dominant airport" to hold a licence in order to charge for airport operation services.
- 6.23 Whether a third party needs a licence depends on a CAA "operator determination" and is based on whether it has overall responsibility for the management of the entirety of the relevant airport area or part of it. In making such a determination, we would consider issues including how much control a potential operator would have over services provided, pricing, quality, access, and development. At this stage, our provisional view is that:

³³ Ofgem (2022), "Impact Assessment on developing arrangements to allow for early competition to be applied to future projects on the onshore electricity transmission network", March, p6.

- under models where a third party develops and owns a terminal independently of HAL, the third party is more likely to require a licence; whereas
- under other competitive models where a third party is a sub-contractor to HAL and provides services with less commercial control, the third party is less likely to require a licence.

6.24 In considering whether to make an operator determination, we would also need to consider whether to undertake a new market power determination for Heathrow Airport.

6.25 Models with multiple operators will require formal arrangements, such as through contracts, to define responsibilities, interfaces, and payment mechanisms. There is strong precedent for such frameworks in other regulated sectors, often supported by licence conditions.

6.26 We can prepare for future determinations and consult on our approach, but it is likely that we would only be able to make final determinations on these matters once planning consent has been granted.

Scope of competition

6.27 All else being equal, the consumer benefits of competition will be greater where the scope of competition is broader in its application. However, this is likely to be constrained by some or all the following factors.

- More time may be needed to implement competition models, depending on our approach to these matters and the complexity of the model. For example, when considering early and late competition models, Ofgem expected that between one³⁴ and four³⁵ additional years would be required to implement these models. This means that it could be more challenging to introduce competition for assets that must be built earlier in the expansion timetable.

³⁴ Ofgem (2023), “Final impact assessment on Pathway to 2030 workstream’s decision on the Delivery Model option”, March, paragraph 4.2.

³⁵ Ofgem (2023), “Final impact assessment on Pathway to 2030 workstream’s decision on the Delivery Model option”, March, paragraph 4.3.

- Expansion cannot proceed without development consent. As such, unless and to the extent that they are to obtain development consent, third parties are likely to be required to adhere to the broad asset designs contained in HAL's DCO. This may constrain the scope for third parties to adopt substantially different design choices, which in turn may constrain the cost savings available from competition. For example, Ofgem determined cost savings of 22%³⁶ under early competition models (where the third party undertook substantial design activities). This compared with 3.25%-9.50%³⁷ under late competition models (where the third party undertook detailed design only).
- We agree with Heathrow Reimagined that some assets are either safety-critical or highly integrated into broader airport operations (such as runway operations, taxiways, airfield maintenance, ground-based navigation systems and inter-terminal transit). In these cases, we consider that it will be necessary for HAL to retain ownership and control of these assets.

6.28 We set out other constraints on implementing competition models in paragraphs 4.50 and 4.51 of the Working Paper³⁸.

6.29 We take account of the above in our evaluation and assessments set out further below.

Comparing contract and ownership models

6.30 In terms of ease of implementation, we consider that models where a third party is appointed as a contractor to HAL could have advantages over models where the third party owns the assets in its own right. This is because contractor models allow HAL to manage the third-party contractor within its portfolio of contractors while remaining the "guiding mind" behind expansion overall. This limits challenges associated with fragmentation and interface points compared with models that involve a third party owning and/or operating assets in its own right.

6.31 In addition, contract-based competition models could be implemented through a modification to HAL's licence, whereas models that would require us to regulate the third party through an economic licence are more likely to require wider changes and may also be dependent on the outcome of the DCO process.

³⁶ Ofgem (2022), "Impact Assessment on developing arrangements to allow for early competition to be applied to future projects on the onshore electricity transmission network", March, p6.

³⁷ Ofgem (2022), "Impact Assessment on developing arrangements to allow for early competition to be applied to future projects on the onshore electricity transmission network", March, p6.

³⁸ CAP 3195- Working Paper on Regulatory models, November 2025

Financeability and cost of capital

- 6.32 We agree with HAL that financeability considerations will be important, particularly in respect of HAL and the third party's credit ratings. We note the challenges that HAL (and its advisers, Freshfields and Santander) have highlighted in respect of the potential negative impact of competitive models on financeability. However, as noted by Heathrow Reimagined and confirmed by our advisers, Centrus, introducing competition could significantly broaden the pool of available capital by allowing new investors to contribute to the expansion scheme in a way that could put downward pressure on the overall cost of capital overall. We also note that competition could reduce the amount of capital that HAL must raise, which could improve the investability of the expansion scheme from HAL's perspective. Overall, we consider that competition has the potential to improve, or at any rate not worsen, the financeability of the expansion.

Regulatory model 4b: mandate contract for design and build

- 6.33 Under this model, we would have powers to require HAL to competitively tender the combined design and construction of packages of works that either HAL, the CAA, or an independent capital governance process would specify. HAL would let and manage these contracts, but there would be regulatory oversight over the development and implementation of the contracts.
- 6.34 This approach could involve the CAA setting licence conditions or guidance that would require HAL to adopt design- and- build procurement for particular projects or categories of works. HAL would retain ownership and operational responsibility throughout and would bear ultimate responsibility for managing and coordinating its contractors.

Stakeholders' views

HAL

- 6.35 HAL opposed model 4b, citing poor performance across evaluation criteria. It argued that mandating contracting approaches like compulsory design and build would increase bureaucracy, reduce flexibility, and slow decision-making, risking mobilisation delays and jeopardising delivery in line with Government milestones. HAL referred to megaprojects such as HS2 and Berlin Brandenburg, as examples of cases of where rigid procurement structures had led to delays and re-baselining.
- 6.36 On cost efficiency, HAL said it had found no evidence that regulator-mandated procurement improves outcomes, citing instances where mandated contracting increased claims, re-work, and integration costs. HAL stated that model 4b offered no financeability benefits, arguing that restricted procurement limits risk management and may raise financing costs due to increased uncertainty.

- 6.37 HAL said that model 4b would require extensive licence modifications, increasing governance and documentation burdens, and would add regulatory complexity. HAL argued that these factors would make model 4b slower and harder to implement, increasing the risks of mobilisation delays and jeopardising timely delivery.
- 6.38 HAL found no significant competition or service quality benefits. It cautioned that mandated contracting could deter bidders, reduce supply chain competition, and restrict design adjustments, potentially impacting passenger outcomes³⁹.
- 6.39 HAL noted that neither Terminal 2 nor Terminal 5 were delivered through mandated design -and- build contracts: instead, design -and- build contracts were used selectively and where appropriate, within an integrated programme that allowed HAL to manage interfaces and operational dependencies effectively.
- 6.40 The financeability assessment carried out on behalf of HAL by Freshfields and Santander concluded that this model would be broadly neutral for HAL, as any benefits would be limited to procurement outcomes and would not affect the cost of capital, revenue recovery, cashflows, or HAL's overall risk exposure. If the model were to materially restrict HAL's procurement decision-making, it could negatively impact financeability and increase financing costs.
- 6.41 HAL concluded that model 4b would introduce significant risks without clear benefits and said we that should not proceed with this model.

Heathrow Reimagined

- 6.42 Heathrow Reimagined said that model 4b would offer only incremental improvements. It recognised that mandated competitive procurement could introduce discipline and reveal cost efficiencies for some assets but emphasised that it would not address HAL's fundamental incentives, since HAL would retain both the assets and operational control.
- 6.43 Heathrow Reimagined saw model 4b as potentially beneficial only as part of a broader, structural package of reforms. It noted that model 4b may help in relation to semi-separable assets, where competitive tendering could reduce costs or improve discipline, but stressed that this would remain insufficient as a standalone model because HAL's capital governance arrangements, information asymmetries, and commercial incentives would persist. It emphasised that, even under model 4b, HAL would retain control over defining baselines, evaluating tenders and selecting delivery pathways.

³⁹ CAP3195 – CAA Working Paper on Regulatory Models, Response by Heathrow Airport Ltd , 20 January 2026, page 64-66

Airlines

- 6.44 IAG viewed model 4b as an essential mechanism to introduce competition across the value chain, particularly in design- and- build activities, where the impact on costs is greatest. In its view, tighter competitive and governance discipline at these stages would materially reduce capex, protect passengers from higher charges, and limit unnecessary growth in the RAB, making expansion more affordable and viable.
- 6.45 Other airline responses generally supported the views of Heathrow Reimagined and IAG.

Our assessment

Avoid delay and disruption

- 6.46 Model 4b does not appear to materially improve or worsen the level of support for expansion compared to the current regulatory model. We are not persuaded that this regulatory model would increase bureaucracy, reduce flexibility, slow decision-making, risk mobilisation delays, or jeopardise delivery to the extent that HAL has suggested. As HAL has observed, under the current regulatory model, HAL has successfully appointed several contractors to undertake the design and construction of airport assets. It is not clear to us that a mandated competitive contractual tender would be substantially less effective.
- 6.47 We do not consider that this model materially affects the ability for the assets needed for expansion to be constructed within Heathrow's physical constraints. As HAL would retain ownership, overall accountability for the airport "system", and responsibility for the "passenger-journey", airport operations would remain integrated and unaffected.

Promotes efficient costs

- 6.48 Model 4b can be expected to promote an efficient cost baseline, since competition for design- and- build contracts would provide an incentive for bidders to put forward cost efficient bids. Moreover, consolidating design and delivery responsibilities can provide greater cost certainty.
- 6.49 HAL has stated that there is no evidence to suggest that regulator-mandated procurement, including model 4b, would improve outcomes compared to the current regulatory model, and has said that any potential benefits are uncertain when set against perceived delivery risks. As highlighted above, the introduction of competitive processes in other sectors has driven significant cost savings.
- 6.50 Moreover, if the procurement approach was accompanied by appropriate risk-allocation arrangements and cost-control mechanisms, this could provide meaningful additional protection against cost overruns. Such measures could strengthen risk management and improve cost discipline, ultimately offering

stronger safeguards for consumers. Overall, we consider that model 4b is moderately better than the current model on cost efficiency.

Raise sufficient finance

- 6.51 Our analysis indicates that this model would not materially broaden access to or the cost of new debt or equity. HAL would retain ownership, financing, and operational responsibilities throughout, thereby maintaining the present fundamental risk profile. We therefore agree with the finding by Freshfields and Santander that this model is broadly neutral in respect of this criterion.

Practical to implement

- 6.52 As with all competition models, there are likely to be significant challenges associated with implementing bid processes, overseeing the contractual arrangements, and ensuring that market arrangements are functioning in the interest of consumers. While our view is that these are likely to be manageable, they necessarily involve a degree of additional complexity over the current regulatory model.

Promotes competition

- 6.53 HAL has expressed concerns that mandating a design- and- build approach under model 4b could narrow the pool of capable bidders for large and complex airport assets, potentially weakening effective competition compared with existing procurement practices.
- 6.54 We agree that bidder appetite and market capacity are relevant considerations, although do not consider this would undermine the case for mandating competitive procurement under model 4b where this is appropriate to further the interests of consumers. A mandated procurement approach could provide greater assurance that competitive discipline is applied consistently and transparently. Should concerns arise in practice regarding bidder interest, we would expect proportionate market testing to be undertaken, including engagement with the supply chain, to assess viable contracting structures and risk allocation arrangements to support effective competition.
- 6.55 As such, model 4b represents a potential improvement over the current regulatory model, while involving less fundamental change than models involving a broader application of competition.







Promotes service quality

- 6.56 We have reviewed whether regulatory model 4b would support an appropriate level of service quality. We assess that mandating the use of a design and build contract would not materially affect how responsibility, coherence or resilience for service-quality outcomes are managed or delivered, as it would not change existing accountability structures, coordination or operational arrangements.

Summary of assessment

- 6.57 Competitive tendering of contracts for the design and construction of assets can result in significant cost savings compared with non-tendered solutions, while adequately managing risks associated with fragmentation and financeability. We note that HAL already undertakes such tenders in the context of its existing operations and is at liberty to do so in the context of expansion. We could seek backstop powers that would enable us to ensure that HAL makes appropriate use of contracting strategies that involve the competitive provision of assets.
- 6.58 We propose to short-list this model and summarise our assessment in the table below.

Table 6.1: Summary of assessment of regulatory model 4b

Criteria	Score	Justification
Avoid delay and disruption		No reason to expect that this model would materially worsen issues around fragmentation, integration and accountability compared with HAL's current practice.
Promotes efficient costs		Can support an efficient cost baseline, and realise cost savings associated with consolidation of activities within a single contractor.
Raise sufficient finance		HAL retains ownership, financing obligations, and all associated revenue risks, resulting in an unchanged fundamental risk profile for lenders and investors.
Practical to implement		Requires regulatory intervention in HAL's procurement processes and the development of a potentially complex tendering mechanisms.
Promotes competition		Introduces competition in the design and construction phases, but not the operational phase.
Promotes service quality		Would not change existing accountability structures, coordination arrangements or mechanisms through which service quality improvements are delivered.

Regulatory model 5a: operation (management contract)

- 6.59 Under this model, HAL would undertake the design and build of the asset but would outsource day-to-day operations of an asset to a third party under a competitively tendered management contract. Where appropriate, we could require HAL to contract certain operational functions.

Stakeholders' views

HAL

- 6.60 HAL considered model 5a workable as a targeted, voluntary approach to outsourcing discrete, non-core operational services where this can improve efficiency and consumer outcomes. It said that it already uses competitive procurement extensively for services such as car parks, passenger assistance and baggage operations, and is open to further outsourcing where it adds value without compromising resilience or system accountability. It indicated that existing regulatory incentives (opex outperformance, commercial revenue incentives, MTI service bonuses/penalties) already motivate HAL to outsource where it is efficient, reducing the need for regulatory mandates.
- 6.61 However, HAL strongly opposed any mandated version of model 5a. It said that compulsory outsourcing would increase legal and regulatory complexity, fragment accountability, and introduce interface risks. It indicated that these factors would reduce cash-flow predictability, weaken financeability, and increase both debt and equity financing costs. It further indicated that implementing mandated outsourcing could also require primary legislation, market power determinations, and new licences for third-party operators, which could create multi-year uncertainty, delay mobilisation and threaten timely capacity delivery.
- 6.62 HAL's advisers, Freshfields and Santander, concluded that outsourcing airport operations to a third party would have minimal financial impact on Heathrow. They indicated that since HAL would retain ownership, revenue risk and funding responsibility, there would be no material change to the cost of debt, equity returns, or access to capital markets.

Heathrow Reimagined

- 6.63 Heathrow Reimagined's comments largely aligned with its views in respect of model 4b.

Airlines

- 6.64 In line with its views in respect of regulatory model 4, IAG considered that regulatory model 5a would deliver only marginal benefits because it would leave HAL fully in control of asset ownership, design, specification, and capital delivery. While outsourcing operations could introduce some limited competitive pressure on day-to-day efficiency, IAG considered that this would not address the structural problems it considered are inherent in the RAB model.
- 6.65 Other airline responses generally supported the views of Heathrow Reimagined and IAG.

Our assessment

Avoid delay and disruption

- 6.66 Overall, we consider that this model does not materially improve or worsen the support for expansion compared with the current regulatory model.
- 6.67 Delegating operational responsibility for specific assets to a third party in a suitably targeted way would not alter accountability for the airfield or wider system performance. As a result, Heathrow's ability to operate as a single, coherent system would not be materially affected. We therefore disagree with HAL that this model would inappropriately fragment accountability or introduce interface risks.
- 6.68 Because the management contract would relate to ongoing operations rather than delivery activities, it would not influence the ability to construct any assets or affect logistics within Heathrow's constrained site. Delivery coordination, governance structures, and programme arrangements would also remain unchanged. As such, we would not expect that this model would affect the likelihood of delays in the delivery of expansion.

Promotes efficient costs

- 6.69 We consider that this model does not materially improve or worsen cost efficiency compared with the current regulatory model.
- 6.70 Creating a regulatory framework that would allow the mandatory market testing of operational services would not affect the CAA's ability to establish an efficient cost baseline prior to delivery, nor would it materially influence the incentives or protections that limit cost escalation during the delivery phase.
- 6.71 We consider that competition during the operational phase might result in marginal cost savings over the current regulatory model, but it is not clear that these savings are as substantial as those available during the delivery phase. Capital costs will dominate the delivery phase of expansion and were identified as the key driver of the charge gap between HAL and comparator airports, with operating costs playing a smaller role.
- 6.72 Overall, we consider that this model is broadly neutral in terms of its impact on efficient costs.

Raise sufficient finance

- 6.73 Our assessment indicates that this model would not materially affect Heathrow's capacity to raise either debt or equity. Under this model, HAL would retain ownership, financing obligations, and all associated revenue risks, resulting in an unchanged fundamental risk profile for lenders and investors.

- 6.74 We note that HAL has suggested that this model could reduce cash-flow predictability, weaken financeability, and increase both debt and equity financing costs. However, HAL's advisers, Freshfields and Santander, concluded that outsourcing airport operations to a third party would have minimal financial impact on Heathrow.
- 6.75 Overall, we assess that this model would not provide a significant benefit to the overall financeability of expansion.

Practical to implement

- 6.76 As with all competition models, there may be significant challenges associated with implementing a mandated bid process. While our view is that these are likely to be manageable, we agree with HAL that they would necessarily involve additional complexity over the current regulatory model.
- 6.77 We do not share HAL's view that this model would necessarily require primary legislation, market power determinations, or new licences for third-party operators. Such arrangements have not been necessary to support HAL's existing arrangements for the contracting out of operational services. We expect that contractual models could be implemented through a modification of HAL's licence.

Promotes competition

- 6.78 This model involves the introduction of competition in the operational phase of the project lifecycle, but not the design or construction phase. As such, it represents a partial improvement compared with the current regulatory model, but the impact is likely to be less substantial than that of models involving a broader application of competition.

Promotes service quality

- 6.79 Under a management-contract approach, operational responsibility for specified service and/or assets would be delegated to a third-party operator, while HAL would retain ownership and overall accountability for the airport. This separation could weaken the clarity of responsibility for service outcomes and introduce challenges to the coherence and resilience of passenger processes, as coordination across operational boundaries becomes more complex.
- 6.80 However, some of these adverse effects could be mitigated by strengthening governance arrangements and embedding performance-linked incentives within the management contract. Competition could also be introduced in a way that helped drive service levels up. Clear accountability frameworks, shared performance objectives and stronger contractual obligations could help to improve operational alignment and support a more coherent approach to service quality across the airport as a whole.

6.81 Overall, we consider that this model is unlikely to have a material impact on service quality compared to the current regulatory model.







Summary of assessment

6.82 At this stage of the process, we do not have sufficient evidence to suggest that regulatory model 5a would materially improve consumer outcomes over the current regulatory model. Although it would introduce competition into the operations phase of the project, it would not generate significant savings in capital costs. As such, models that involve a broader scope of competition, such as model 5b, would be preferable from a consumer perspective.

6.83 Furthermore, we consider that many of the challenges associated with other competition models, such as implementing bid processes, overseeing the contractual arrangements and ensuring that market arrangements are functioning in the interest of consumers, would also apply to this model.

6.84 We therefore propose to exclude this model from the shortlist.

Table 6.2: Summary of assessment of regulatory model 5a

Criteria	Score	Justification
Avoid delay and disruption		Unlikely to materially cause delay or disruption during construction, as this involves an existing asset. There could be some challenges associated with contracting out services, although these could be managed through appropriate governance and contractual arrangements.
Promotes efficient costs		Scope for only limited cost savings, with the possibility of implementations costs.
Raise sufficient finance		HAL would retain ownership, financing obligations, and all associated revenue risks, resulting in an unchanged fundamental risk profile for lenders and investors.
Practical to implement		Requires regulatory intervention in HAL’s procurement processes and the development of a potentially complex bid mechanism.
Promotes competition		Competition would be introduced for the operational phase of the asset lifecycle, but not the design or construction phases.
Promotes service quality		Creation of an operational boundary between HAL and the third party would create risks, but competition would also present opportunities for service improvements.

Regulatory model 5b: design, build and operate

- 6.85 Under this model, a competitively procured third party would be responsible for designing, building, and operating a new asset on HAL's behalf and within a contractual structure.
- 6.86 It essentially combines a mandated design- and- build contract (see model 4b) with a management contract (see model 5a). The motivation for doing this is that the contractor would have a greater incentive to ensure that the design and build was fit for purpose, since it would then be exposed to the operational risk associated with providing services under the management contract.

Stakeholders' views

HAL

- 6.87 HAL opposed mandating regulatory model 5b, arguing that compulsory frameworks of this kind would introduce substantial legislative, regulatory and commercial complexity. It stated this would be inconsistent with timely privately financed expansion and inconsistent with the CAA's statutory duties.
- 6.88 It noted that model 5b resembles similar models used in the water and energy sectors but emphasised that these precedents had long lead times and created significant administrative burden and led to delivery delays. For example, HAL highlighted that:
- the Haweswater Aqueduct Resilience Programme ("HARP") Aqueduct has been subject to a five-year gap between designation and delivery;
 - two other projects designated under Ofwat's "DPC" framework have failed to be implemented; and
 - Ofgem's Competitively Appointed Transmission Operation ("CATO") framework took around a decade to design and still has not led to the issue of any licences.
- 6.89 HAL also referred to the Independent Water Commission's review, which raised concerns about DPC models, including a high administrative burden, the need for government or customer support for uninsurable risks, and increased fragmentation due to greater participation and complexity. HAL stated that these issues showed mandatory competition for the design, construction and operation of an asset is incompatible with the delivery timescales for expansion.
- 6.90 It stated that the CAA lacks the legal powers under CAA12 to impose commercial structures, force HAL to divest assets, or licence alternative operators without a market power determination. It indicated that any mandatory version of model 5b would require primary legislation, extensive licence

modifications, new regulatory frameworks, and potential new operator licences, which would involve years of delay.

- 6.91 HAL highlighted that a mandatory approach to implementing model 5b would undermine system integration for core expansion assets. It argued that separating design, build and operational responsibilities would increase interface risks, compromise resilience, and repeat observed failures in megaprojects where fragmented accountability led to late-stage integration issues.
- 6.92 HAL also identified significant financeability risks. Analysis by Freshfields and Santander concluded that design, build and operate arrangements could increase construction phase debt costs by 100 to 150 bps and require expected equity returns substantially in excess of 10%. It stated that this would materially increase the cost of capital borne by consumers. HAL warned that lenders and investors would not view model 5b as meaningfully transferring risk away from Heathrow, as HAL would remain exposed to overall delivery and schedule risk, while losing control over assets on the critical path to delivering expansion.
- 6.93 Nonetheless, HAL acknowledged that elements of model 5b might be appropriate on a targeted, voluntary basis for non-core, “off critical path” assets. It noted that Heathrow’s “Alternative Property Model” and certain joint venture structures could deliver competitive benefits while maintaining system integration and preserving financeability. HAL proposed screening criteria for any optional use of models like model 5b, including:
- separability from core operations;
 - maintenance of resilience and compliance;
 - alignment with Government milestones;
 - demonstrable market interest; and
 - protection of passenger outcomes through robust assurance.
- 6.94 HAL concluded that a mandatory form of model 5b should not be shortlisted. It proposed that a proportionate, criteria-led, non-mandated variant might add value in limited circumstances, but that mandatory application would delay expansion, fragment accountability, increase the cost of capital, and ultimately harm consumer outcomes.

Heathrow Reimagined

- 6.95 Heathrow Reimagined supported the short-listing of model 5b and said the CAA and stakeholders should have full visibility of, contracting terms, specifications, and commercial arrangements for outsourced activities. This would provide the necessary oversight to ensure that these processes are managed efficiently and are based on an appropriate allocation of risk.

- 6.96 It indicated that this model is limited by the third-party terminal operator acting as a sub-contractor to HAL and would deliver some “competition-for-the-market” benefits. Nonetheless, it would not result in independent terminal operators, unencumbered by HAL’s harmful incentives, competing over pricing and service quality to attract airlines to their terminals. As such, they considered that the full potential of terminal competition would not be realised and the fundamental problems with the current model, stemming and HAL’s harmful incentives would not be properly addressed.
- 6.97 It further indicated that the application of competition under this model should operate under the oversight of an independent capital investment committee, to ensure that the right assets are being procured and under the right terms.

Airlines

- 6.98 IAG generally supported Heathrow Reimagined’s representations in respect of model 5b. It stated that design, build and operate arrangements can drive capital efficiency and promote competition through the value chain.
- 6.99 It highlighted the high impact of competition during the design stage on capex efficiency and noted that that design decisions determine 70 to 80% of whole-life costs. It stated that this would prevent the over-specification that permanently inflates the RAB. It also highlighted the high impact of competition during the construction stage, as it reduces the “build big, build bespoke” bias embedded in the RAB.
- 6.100 Other airline responses generally supported the views of Heathrow Reimagined and IAG.

Our assessment

Avoid delay and disruption

- 6.101 We are not persuaded by HAL’s view that model 5b would materially increase the risks of delay. As set out above in our discussion of regulatory model 4b, models involving competitive procurement can be implemented while avoiding undue delays. We acknowledge the challenges referred to by HAL that have been faced in other sectors when implementing similar models. However, we consider that substantial learning from those models could be applied to facilitate effective and timely implementation.
- 6.102 We are also not persuaded by HAL’s statements on the risk of fragmentation, reduced resilience and increased complexity. We note that HAL already operates a portfolio of contractors in its day-to-day operations and has done so previously in the context of major capital projects such as Terminal 5. Our adviser, Steer, has indicated that this model would not be expected to materially undermine support for expansion overall. We would also seek to apply the model in a

focused way and, exclude assets and operations that are safety-critical and/or highly integrated into broader airport operations.

Promotes efficient costs

- 6.103 Model 5b can be expected to promote an efficient cost baseline, since competition for the market provides an incentive for bidders to put forward efficient bids. As the scope of competition encompasses operations as well as design and build, we consider that the potential cost savings relative to non-tendered solutions are correspondingly high. Moreover, consolidating design and delivery responsibilities can provide greater cost certainty.
- 6.104 Requiring the use of a single design, build and operate contractor does not, by itself, materially influence the incentives or protections that limit cost escalation during delivery. Nonetheless, if introduced with appropriate risk-allocation arrangements and cost-control mechanisms, this approach could provide meaningful additional protection against cost overruns. Such measures could strengthen risk management and improve cost discipline, ultimately offering stronger safeguards for consumers.
- 6.105 Overall, we consider that this model outperforms the current model in terms of cost efficiency.

Raise sufficient finance

- 6.106 We are not persuaded by HAL's view that this model would materially worsen the financeability or financing cost of expansion.
- 6.107 We consider that this model has the potential to attract significant third-party equity and debt capital, given investor appetite for infrastructure assets of this type, and their familiarity with similar frameworks applied in other sectors. A long term, availability-based revenue stream for a new airport asset is likely to be attractive to a broader group of investors than HAL's current shareholders, including global infrastructure funds, pension investors, and sovereign wealth funds.
- 6.108 We are also not persuaded that this model would necessarily worsen HAL's financial position. Depending on how the contract was structured, it could facilitate meaningful transfer of construction and lifecycle performance risks to an appropriate third-party provider. In addition, by placing design, build and operational obligations on the third party, the model could reduce HAL's exposure to cost overruns and delivery uncertainty. An appropriate approach to risk allocation and contract design should mitigate any adverse impacts on HAL's credit metrics.
- 6.109 Overall, we are of the view that this model does not materially worsen the financeability of expansion and could lead to a marginal improvement compared with the current regulatory model.

Practical to implement

- 6.110 As with all competition models, there may be challenges associated with implementing bid processes, overseeing the contractual arrangements and ensuring that market arrangements function in the interests of consumers. While we consider these challenges to be manageable, we agree with HAL that they necessarily involve additional complexity compared with the current regulatory model.
- 6.111 Consistent with the reasoning we set out in relation to regulatory model 4b, we disagree with HAL that this model would necessarily require primary legislation, market power determinations or new licences for third-party operators.

Promotes competition

- 6.112 This model would introduce competition across a significantly broader range of activities comprising airport operation services than either the current regulatory model or other more narrowly focussed regulatory models.
- 6.113 As set out above in our assessment of model 4b, we have responded to the concerns HAL has raised around market appetite and do not consider these concerns undermine the case for these competitive procurement models of this type.

Promotes service quality

- 6.114 Under this model, responsibility for designing, building and operating a defined asset would be transferred to a single third-party operator, while HAL retains overall system accountability. This would introduce an additional operational boundary within the airport system, which could give rise to e potential service-quality challenges.
- 6.115 With operational control delegated to a third party, HAL's ability to drive consistent, airport-wide service quality improvements may be reduced, and mechanisms for joint planning or investment in service enhancements would become harder to manage. However, in our view, these risks can be mitigated. Strengthened governance arrangements, a clear definition of system-wide responsibilities, and performance-linked contractual incentives could help improve alignment between the operator and HAL. Competition could also help drive up service- quality standards.
- 6.116 Overall, we consider that this regulatory model would not be expected to materially improve or worsen service quality compared to the current regulatory model.







Summary of assessment

- 6.117 Tendering contracts for the design, construction and operation of assets can result in significant cost savings compared with non-tendered solutions, while

adequately managing issues associated with fragmentation and financeability. We note that HAL already undertakes such tenders in the context of its existing operations and is at liberty to do so in the context of expansion. We would, therefore, expect to apply this model only where we considered that HAL was not appropriately tendering contracts for key expansion assets.

- 6.118 Model 5b extends model 4b by applying competitive procurement to operations as well as design and construction. We would expect that this model could deliver additional cost savings compared with model 4b (which we have proposed to include in the shortlist). However, it may also introduce additional complexity, as it could be challenging to specify operational requirements early in the project lifecycle.
- 6.119 Overall, we consider that both models 4b and 5b have the potential to deliver significant benefits to consumers. We therefore propose to shortlist this model.

Table 6.3: Summary of assessment of regulatory model 5b

Criteria	Score	Justification
Avoid delay and disruption		No reason to expect that this model would materially worsen issues pertaining to fragmentation, integration and accountability compared with HAL's current practice.
Promotes efficient costs		Competition across the asset lifecycle could result in the creation of an efficient cost baseline, while costs associated with points of interface and outsourcing of operations can be managed through appropriate contractual provisions and governance.
Raise sufficient finance		Likely to be significant appetite for infrastructure assets of this kind, while impacts on HAL's credit rating and risk profile can be managed through appropriate contract structuring and risk transfer.
Practical to implement		May require regulatory intervention in HAL's procurement processes and the development of a potentially complex bid mechanisms.
Promotes competition		Facilitates competition across the asset lifecycle.
Promotes service quality		Creation of an operational boundary between HAL and the third party creates risks for service quality. However, these issues can potentially be managed through appropriate contractual structures and governance.

Regulatory model 6: third party builds assets, then transfers ownership to HAL

- 6.120 Under this model, a third party would design, finance, and build a new asset, and then transfer it to HAL upon completion. HAL would become the long-term owner and operator, with the asset entering HAL's RAB. This model is similar to, but distinct from model 4b discussed above. An important question under this model is how the price that HAL pays the third party for the assets (and is then added to HAL's RAB) would be determined.

Stakeholders' views

HAL

- 6.121 HAL opposed regulatory model 6, stating that the model performs poorly in terms of timeliness, financeability, deliverability, efficiency, competition and service quality. HAL stated that model 6 would introduce structural fragmentation, increase risk, and undermine the conditions required for privately financed expansion. It emphasised that separating design and build responsibility from long term operation is incompatible with the tightly integrated nature of Heathrow's expansion programme and would repeat well-documented megaproject failures, such as those seen at Berlin Brandenburg Airport.
- 6.122 HAL stated that model 6 would create material risks to the timetable, as it would require primary legislation, licence modifications, complex commercial contracting, and potentially a market power determination. It stated that these steps would lead to delays of several years before construction could begin, resulting in the expansion scheme missing the government's milestones and leading to significant losses of consumer benefit.
- 6.123 HAL raised concerns regarding financeability, citing analysis by Freshfields and Santander, which found that the model would lead to higher financing costs. The analysis also concluded that the model would weaken HAL's credit quality, increase liquidity and refinancing risk at the point at which the asset was transferred to HAL.

Heathrow Reimagined

- 6.124 Heathrow Reimagined said that model 6 would inject varying degrees of greater competition in procurement, delivery and financing of new terminals. However, when applied on a standalone basis to terminals, it considered that the model would not sufficiently change HAL's harmful incentives sufficiently nor deliver the full benefits of direct competition between independent terminals.
- 6.125 It stated this model is similar to model 4b and shares the same fundamental limitations, particularly that HAL would continue to be the operator and long-term

owner of the new terminal. It would not involve independent terminal operators competing over pricing and service quality to attract airlines.

Our assessment

Avoid delay and disruption

- 6.126 In general, we agree with HAL that this model involves several challenges in respect of coordination and fragmentation of responsibility.
- 6.127 Where a third party owns and delivers assets prior to transfer, temporary coordination and interface risks would arise during the delivery period. Although HAL would ultimately regain full operational accountability, the handover process would also introduce short-term complexities that would need to be carefully managed.
- 6.128 Overall, we assess that this model could have adverse impacts compared with the current regulatory model, and the additional uncertainties associated with the transfer of assets would make this a more difficult approach than regulatory model 4b.

Promotes efficient costs

- 6.129 There is greater uncertainty under this model regarding the arrangements for the competitive process and the price to which assets would be transferred, compared to regulatory model 4b. Taking this into account, we are not clear that we can conclude that there would be overall efficiency gains that would benefit consumers.
- 6.130 Overall, we consider that this insufficient evidence to suggest that this model would materially improve or worsen cost efficiency compared with the current regulatory model.

Raise sufficient finance

- 6.131 Our assessment indicates that while this model would likely transfer construction risk to a third-party during delivery, it would not create a long-term investment opportunity for mainstream infrastructure capital. Instead, it would rely on short-term development equity or contractor financing, which typically requires higher returns and is not available at the scale required for major airport infrastructure. As a result, the approach would not broaden the investor base or mobilise significant new capital for expansion.
- 6.132 HAL would also be required to purchase the completed asset from the third party, creating a significant upfront liquidity requirement at the point of transfer. This may be viewed negatively by credit rating agencies.
- 6.133 Overall, we agree with HAL that this model would be likely to worsen the financeability of expansion compared with the current regulatory model.

Practical to implement

- 6.134 As with all competition models, challenges would arise in putting these arrangements into effect. These challenges are particularly acute under model 6, as:
- the process and arrangements for handover could introduce additional complexity; and
 - more generally, we agree with HAL that ownership of assets by a third party during construction might create a case for regulatory intervention but without providing the tools for such intervention to be effective. The process by which intervention could be facilitated is unclear at this stage.

Promotes competition

- 6.135 This model would involve the introduction of competition into design and build activities, but not operations. As such, it represents a partial improvement over the current regulatory model, but to a lesser extent than models involving a broader application of competition.

Promotes service quality







- 6.136 We disagree with HAL that this model would risk poorer passenger outcomes. During the operational phase, our assessment is that HAL's ownership and control would maintain unified accountability for service quality, align incentives, and preserve process coherence. The service quality frameworks and opportunities for improvement would remain broadly the same as those under the current regulatory model. As such, we consider that model 6 would neither improve nor worsen service quality compared to the current regulatory model.

Summary of assessment

- 6.137 We consider that this model has several disadvantages and is likely to worsen outcomes compared with the current regulatory model.
- 6.138 The process of transferring a completed asset to HAL is, in and of itself, complex. For example, it could require detailed arrangements governing the handover and other transfer terms that would be more effectively addressed through a single contractual framework. As noted above, third-party ownership during construction would create interface issues and fragmentation risks that could be difficult to manage.
- 6.139 As indicated in the accompanying report by Centrus, there may be limited investor appetite for the design and construction of a project without an accompanying long-term revenue stream. This contrasts with model 4b, where the third party would be likely to be a construction firm rather than a financial investor and, therefore, would not require a long-term revenue stream.
- 6.140 Finally, we note that this model would materially broaden the investor base.

6.141 Overall, we propose to exclude this model from the shortlist.

Table 6.4: Summary of assessment of regulatory model 6

Criteria	Score	Justification
Avoid delay and disruption		Temporary coordination and interface risks arise during construction, and the handover process introduces complexity.
Promotes efficient costs		Competition for design and build can create an efficient cost baseline, but this may be offset by coordination issues and uncertainty about the terms of asset transfers.
Raise sufficient finance		Does not create a long-term investment for investors seeking stable, long-term cashflows. The point of handover may create liquidity risk for HAL.
Practical to implement		Requires regulatory intervention in HAL's procurement processes and the development of a potentially complex bid mechanism.
Promotes competition		Competition is facilitated for the design and build phase of the asset lifecycle, but not the operational phase.
Promotes service quality		Little change from the current regulatory model, as HAL retains operational control and ownership after construction is complete.

Regulatory model 7a: wholesale supplier model

- 6.142 Under this model, a third party would not only design, finance and build the asset, but would also retain ownership of and operate the asset. The third party would recover its required revenues through a charge to HAL. The charge levied by the third party on HAL could take the form of an availability payment. In effect, the third party would act as a provider of services that would be an input into the overall airport operation services. Implementing this would require us to modify HAL's licence in due course to address these charging arrangements and include the relevant costs in the price control on its airport charges.
- 6.143 We would generally expect that the third party would be appointed through a competitive process under which parties would submit bids for the charges they would levy, with the successful bidder being chosen based on the best value bid. The charge would then be based on the outcome of this process. Consideration would need to be given to the period over which the bid charges would apply. Where these were for a limited term, consideration would need to be given to what would happen once this term expires. Depending on the approach taken, the third party might become an "operator" of part of the airport, so requiring a

licence under CAA12. Before granting any such licence, we would consider the need to undertake market power and operator determinations.

- 6.144 Alternatively, this model may arise were a third party to seek and obtain a DCO, for instance acquiring the land and other rights to develop a terminal in the process and operate its own assets.

Stakeholders' views

HAL

- 6.145 HAL did not support shortlisting model 7a and, in line with its views on competitive models generally, commented that these models fragmented accountability across multiple operators within a complex hub airport.
- 6.146 HAL's response considered models 7a, 7b and 8 together and, in general, did not provide comments specific to model 7a. It concluded that these models should all be discarded as they failed against each of the evaluation criteria it put forward. HAL's conclusions were supported by the two reports it had commissioned from Oxera and Mott McDonald. It said that Oxera could not identify any relevant infrastructure that was implemented under model 7a.

Service quality

- 6.147 HAL argued that multi-operator or fragmented airport models (such as JFK, LAX) consistently produced poorer outcomes for passengers as these models created:
- higher costs, due to duplicated systems and governance;
 - delayed capacity delivery, slowing the benefits passengers would otherwise receive earlier; and
 - lower and less consistent service quality, because no single party was accountable.
- 6.148 HAL contrasted this with its integrated single-operator model at Heathrow Airport, which, in its view, has delivered better coordination, efficiency, and service quality.
- 6.149 HAL referred to analysis in Mott MacDonald's report which compares ASQ overall satisfaction scores of two multi-operator airports, LAX and JFK, to Heathrow. According to the analysis presented, Heathrow scored significantly higher ASQ ratings for Q3 2025 than the other two airports and exhibited a lower score variation between terminals. HAL attributed the difference in scores to:
- the absence of integrated infrastructure to support inter-terminal connections; and
 - no common-use systems, no integrated baggage operations and limited airside connectivity.

- 6.150 HAL also cited a recommendation from the Begg report on a snow incident at Heathrow in 2010, which said that Heathrow needed a unified command structure. Since then, HAL has developed the centralised “Airport Operations Centre” as single decision-making hub, replacing fragmented crisis cells.

Competition

- 6.151 HAL said that regulatory models 7 and 8 changed incentives and control over terminal capacity in ways that reduced effective competition between airlines. It stated that these models typically relied on long-term anchor-tenant agreements and exclusive or preferential access to facilities to secure financing and revenues. These entrenched incumbent carriers and created structural barriers to new entrants.
- 6.152 HAL stated that fragmentation also reduced the flexibility needed for dynamic allocation of gates and stands as, under regulatory models 7 and 8, physical and contractual boundaries would limit HAL’s ability to reassign capacity quickly to support new routes or new entrants. HAL referred to figures quantified by Mott MacDonald which showed that Heathrow achieved 30% more passengers-per-gate than JFK/LAX.
- 6.153 Overall, HAL said that multi-operator airports had lower system-wide utilisation and the inability to orchestrate airport-wide optimisation. This meant that they delivered fewer choices, weaker competitive pressure on fares, and entrenched incumbent airline positions to a greater extent than under an integrated, single-operator framework.

Efficiency

- 6.154 HAL reiterated some of the observations it had made in respect of service quality, for example, on fragmented accountability, duplicated infrastructure and lower asset utilisation.

Financing

- 6.155 HAL said that fragmenting ownership and operation concentrated demand risk within individual terminals or assets rather than spreading it across the airport system as third-party operators typically relied on long-term anchor tenants to secure financing. This created exposure to the financial performance of a few airlines. If those carriers reduced schedules or exited, the terminal’s revenue base would erode sharply, increasing volatility in cashflows. Overall, this would increase the cost of capital.
- 6.156 It said that financing risk under multi operator models, as evidenced by JFK’s New Terminal One (“NTO”), translated into a material cost for consumers. It noted that Fitch Ratings flagged that NTO’s bonds concentrated revenue risk at a single terminal and faced competition from other JFK terminals, highlighting the volatility introduced by intra airport competition.

- 6.157 HAL also stated that fragmentation under models 7 and 8 introduced novel risk profiles that lenders and rating agencies were unfamiliar with. For instance, if ownership and operation were split, and HAL still bore system-level obligations (safety, resilience, integration) but lost control over planning and delivery of assets, this could result in higher debt margins.
- 6.158 HAL referred the report by Freshfields and Santander which found that introducing competition in airport services would substantially undermine financeability by increasing the both the costs of capital and the risk of materially higher airport charges through the following mechanisms:
- multiple ownership would destabilise HAL’s cashflows by weakening the single-till revenue structure that underpins its current investment-grade credit profile, leading lenders to view the shift as a structural increase in business risk. This would raise borrowing costs for both HAL and any third-party operator;
 - competition for airport services would also materially increase revenue and margin volatility, reducing the predictability of returns for equity investors. Downside risk would be largely uncapped due to competitive pressure, while upside potential would remain restricted by regulation and market dynamics - making the investment proposition significantly less attractive and pushing required equity returns higher;
 - lower credit ratings would raise both debt and equity costs, requiring an estimated minimum uplift of 50bps to HAL’s cost of capital; and
 - the introduction of these models would “undermine the predictability and stability of Heathrow as a regulated asset, increasing IRR requirements and financeability risk”.

Deliverability

- 6.159 HAL highlighted examples of where fragmented ownership had led to significant delays in the delivery of large programmes, such as Berlin Brandenburg airport.

Local communities, sustainability and coordinating construction

- 6.160 According to HAL, under a multi-operator model, accountability for issues such as noise mitigation, air quality and surface access became diffuse, creating uncertainty over who was responsible for compliance and stakeholder engagement. HAL said that similar considerations applied during construction and that if HAL lost control of critical assets such as terminals, landside roads, and the logistics strategy, coordination of mitigation measures became significantly more complex.
- 6.161 It considered that multiple delivery bodies operating within a constrained footprint would struggle to optimise traffic flows, manage construction emissions, and

minimise disruption to local roads. This would also increase the likelihood of duplicative logistics infrastructure. The result would be higher delivery costs, greater environmental impact, and reputational risk.

- 6.162 In addition, HAL argued that fragmented accountability for safety and security introduced systemic risk. In a live operational environment, clarity over who held responsibility for compliance was critical. A single controlling mind ensured coherent engagement, integrated mitigation strategies, and streamlined assurance: conditions essential for timely, efficient, and socially responsible delivery of expansion.

Timeliness

- 6.163 HAL said that models 7 and 8 could not be implemented under the current statutory framework as these models introduced mandatory third-party involvement in the design, construction, ownership, or operation of Heathrow assets, so were arrangements that fell outside the powers conferred on the CAA by CAA12.
- 6.164 It noted that comparable frameworks in other regulated sectors, such as the CATO and Specified Infrastructure Projects Regulations (“SIPR”) frameworks, required primary legislation and took between three and ten years to implement.
- 6.165 Moreover, HAL said that before licensing any new operator, the CAA would need to make a market power determination.

Heathrow Reimagined

- 6.166 Heathrow Reimagined stated that the benefits to consumers from terminal competition would be maximised by putting in place a model in which independent terminal operators were able to compete directly with other terminals over all possible dimensions of competition (design, build, operate, finance, own).
- 6.167 It considered that model 7a, alongside models 5a and 5b, are limited by the third-party terminal operator acting as a sub-contractor to HAL. While these models could deliver some competition-for-the-market benefits, they would not result in the full potential of terminal competition being realised, and the fundamental problems with the current model stemming and HAL’s harmful incentives would not be properly addressed.

Airlines

- 6.168 IAG’s views broadly aligned with its views in respect of model 5b. It stated that design, build and operate arrangements could drive capital efficiency and competition through the value chain.
- 6.169 It also made the same comments over the risks of over specification as it has in relation to model 5b above.

- 6.170 IAG also highlighted the value of a third-party undertaking activities at multiple stages of the value chain, for example, because doing so would align design choices with build costs and allow for the benchmarking of opex efficiency.
- 6.171 Other airline responses generally supported the views of Heathrow Reimagined and IAG.

Our assessment

- 6.172 We note that stakeholders have tended to provide comments in respect of ownership models collectively and have not always clearly differentiated between individual models. Several of these comments are principally applicable to models 7b and 8, rather than this model: for example, this model would not entail direct competition between the third party and HAL. As such, comments in respect of direct competition and comparisons to airports that are subject to such competition are not relevant here and are discussed in the context of model 7b below.

Avoid delay and disruption

- 6.173 We agree with HAL that structural separation of ownership and long-term operation could increase challenges around operational interfaces and coordination complexity within the airport system. We have asked our technical advisers, Steer, to examine these issues. Steer has indicated that, under this model, operational accountability would be structurally divided between the asset owner/operator and the wider airport system, during both the construction and operational phases of the project. This could reduce the clarity of system-wide operational control and increase coordination risk. In our view, while mitigation measures such as strengthening governance procedures reduce some coordination and governance risks, structural fragmentation and increased operational interfaces remain material risk drivers.
- 6.174 This fragmentation could potentially result in delays in the delivery of expansion, and challenges associated with operational resilience.

Promotes efficient costs

- 6.175 We disagree with HAL that this model would result in higher costs of delivery overall. While we acknowledge the possibility of duplicated infrastructure and governance in some cases, we would seek to apply this model to assets that are reasonably discrete and separable, which should serve to minimise any duplication.
- 6.176 Moreover, we consider that any such costs could be outweighed by the efficiencies generated through the competitive process. As indicated by Steer, this model can be expected to promote an efficient cost baseline, since competition for the market would provide an incentive for bidders to put forward efficient bids. Since the scope of competition would encompass all stages of the

project lifecycle, we consider that the potential cost savings could be correspondingly high. Moreover, consolidating design and delivery responsibilities can provide greater cost certainty.

- 6.177 If, the approach to procurement were to be accompanied by appropriate risk allocation arrangements and cost control mechanisms, this could provide meaningful additional protection against cost overruns. Such measures could strengthen risk management and improve cost discipline, ultimately offering stronger safeguards for consumers.
- 6.178 We acknowledge that once expansion becomes operational, the ownership and operation of an asset may introduce risks to long-term operating costs. Increased coordination requirements and reduced flexibility in operational structures could lead to higher ongoing costs, even where day to day operating efficiencies are maintained. However, we consider that with appropriate regulatory and contractual mechanisms in place, including clear risk allocation, robust cost-control provisions, and incentives to support efficient operation, these risks can be mitigated.
- 6.179 Overall, we consider that this model significantly outperforms the current model in terms of cost efficiency.

Raise sufficient finance

- 6.180 We disagree with HAL, Freshfields and Santander that this model would undermine the financeability of expansion or should reasonably be expected to increase the cost of capital.
- 6.181 As with model 5b, we consider that this model has the potential to attract significant third-party equity and debt capital, given investors' appetite for infrastructure assets of this type, and their familiarity with similar frameworks applied in other sectors such as the CATO framework. We accept HAL's statement that a third party would need to raise significant upfront capital, but based on Centrus's advice, we expect that there is a reasonable prospect that this would be forthcoming.
- 6.182 A long term, availability-based revenue stream for a new airport asset is likely to be attractive to a broader group of investors than HAL's current shareholders, including global infrastructure funds, pension investors and sovereign wealth funds. We note that credit rating agencies generally regard such arrangements more favourably than contractor models when considering the impact on the incumbent regulated business's financeability. This is because the third party is regarded as having a direct claim on user revenues, rather than HAL acting as an intermediary and being exposed to liquidity risk.
- 6.183 In addition, depending on the arrangements that are put in place for the terms on which the third party would provide wholesale services to HAL, this model could

facilitate meaningful transfer of construction and lifecycle performance risk away from HAL.

- 6.184 We acknowledge that a pure availability-based payment structure may weaken HAL's overall demand risk profile if not carefully designed, as fixed contractual payments could increase HAL's revenue exposure during periods of lower traffic. This creates a need for detailed work on risk allocation and contract design to avoid adverse impacts on HAL's credit metrics. Overall, these issues should be manageable.
- 6.185 This model should have a material positive impact on raising sufficient finance for the expansion.

Practical to implement

- 6.186 We agree with HAL that this model raises a number of practical challenges for the CAA and its ability to resolve these in a timely manner.
- 6.187 As with other competition models, there are likely to be significant challenges associated with implementing bid processes, overseeing the contractual arrangements and ensuring that market arrangements are functioning in the interest of consumers. In addition, the CAA would need to assume responsibility for developing any appropriate licence conditions on the party that develops and operate the assets.
- 6.188 We also note that under this model it may be necessary to develop contractual arrangements for the operation of the airport, potentially similar to the industry codes used in the energy sector.
- 6.189 The CAA might also need to constrain the charges that the third-party levies on HAL to the level specified in the bid, for example through an economic licence. We consider that this might involve additional statutory changes compared with a contractual model such as model 5b.
- 6.190 Overall, we consider that this model presents significant implementation challenges, over and above those associated with contractual models such as regulatory model 5b.

Promotes competition

- 6.191 This model would involve the introduction of competition across the full project lifecycle. As such, it represents a significant improvement over the current regulatory model and to a greater extent than models involving a narrower application of competition.

Promotes service quality

- 6.192 This regulatory model would introduce structural separation between asset owner/operator and the airport system resulting in permanent operational boundaries during construction and operation. This could reduce the clarity of







accountability and reduce coherence and resilience across the airport, increasing the reliance on coordination arrangements. We consider that this could be more acute than under a contractual model, since HAL would not retain the same control over the third party's behaviour.

- 6.193 Set against this, Steer's report suggests that these issues can, in principle, be managed through binding system-wide governance, regulatory oversight of interface performance, mandatory interoperability standards and shared resilience protocols.
- 6.194 Overall, we consider that this model would not be expected to materially improve or worsen service quality over the current regulatory model.

Summary of assessment

- 6.195 The benefits of this model are similar to those that could be achieved under model 5b: namely, the development of an efficient cost baseline due to competition applied throughout the lifecycle of the relevant assets. In addition, consistent with model 5b, this model is likely to improve on the current regulatory model in the financing of expansion. There is likely to be significant appetite from investors, which could broaden the pool of capital available to finance expansion. The financial impact on HAL is likely to be manageable.
- 6.196 However, there are also disadvantages of this model. We agree with HAL that implementation of this model would likely require more extensive changes compared with contractual models such as model 5b, although the precise requirements are uncertain at this stage. If changes to the statutory framework were required this could create significant delays.
- 6.197 We agree with HAL that third party ownership of assets would necessarily reduce HAL's control over the parts of the airport system as a whole, creating interface and coordination challenges. Both HAL and our independent technical advisers agreed that structural separation between asset owner/operator and the airport system results in additional risks during construction and operation.
- 6.198 Overall, we propose to exclude this regulatory model from the shortlist.

Table 6.5: Summary of assessment of regulatory model 7a

Criteria	Score	Justification
Avoid delay and disruption		Could result in adverse impacts due to additional delivery and operational interfaces, and a potentially complex relationship between the developer of the asset and HAL.
Promotes efficient costs		A competitive process creates an incentive for the successful bidder to put forward an efficient cost baseline throughout the project lifecycle.
Raise sufficient finance		Likely to be interest from investors, given familiarity with this model from SIPR arrangements in the water sector.
Practical to implement		Requires regulatory intervention in HAL's procurement processes and the CAA may need to assume responsibility for developing the terms under which the third party would operate, and include these in its licence. May require statutory changes to implement.
Promotes competition		Introduces competition through the lifecycle of the project.
Promotes service quality		There is no clear reason to expect that the third party would improve on HAL's service quality level.

Regulatory model 7b: direct competition for airport operation services

- 6.199 Regulatory model 7b is the second of the two competitive models involving design, build, finance, ownership and operation of an asset, which we set out the Working Paper.
- 6.200 Under this model, the third party would directly provide services to airport users and recover its required revenues from them. In doing so, it would compete directly with HAL's own provision of services to users. It is likely that we would need to carry out market power determinations to ascertain the extent of competition between the third party and HAL. Where we found that competition was not fully effective, we may need to intervene, for example by regulating the third party under an economic licence.
- 6.201 Competition between the third party and HAL would expose HAL to competitive pressure in respect of the services being provided. HAL would have an incentive to constrain its costs and improve its service quality to retain or attract users, which would directly benefit consumers. It would also potentially provide the CAA

with additional information on efficient costs elsewhere within HAL's operating cost base.

- 6.202 To facilitate this model, HAL would be required to develop and price a wholesale product for other aspects of airport operations. The CAA would oblige HAL to offer these services and regulate the wholesale cost. This would require us to determine, monitor and enforce the allocation of costs between the competed services and the wholesale service, as HAL may have an incentive allocate costs to the latter. We might also need to apply a non-discrimination requirement, so that the cost of the wholesale services provided to HAL's own downstream assets is no lower than that charged to the third party or its customers.
- 6.203 We expect that the implementation of this model would be dependent on this model being allowed for under any revised ANPS and any third party applying for and obtaining a DCO that would enable it to compulsorily purchase the land and property necessary to undertake the design, construction and operation of the relevant assets. As such, this model can be seen as an illustration of how we might regulate the airport under such a scenario.

Stakeholders' views

HAL

- 6.204 HAL provided its comments on this model as part of its combined comments on regulatory models 7 and 8. These were set out under model 7a above.

Heathrow Reimagined

- 6.205 Heathrow Reimagined supported the introduction of direct inter-terminal competition and stated that it is most effective means of the most effective option to address what they consider to be HAL's harmful incentives. In addition to its general comments on competitive models, it considered that this model would provide several advantages:
- Direct competition for the right to develop and operate terminals would enable much greater capex efficiency, both for new terminals and maintaining, enhancing or redeveloping existing terminals. Those developing terminals would have a clear incentive to make efficient capital investment, given that the savings would be retained by the terminal operator through higher margins and greater passenger volumes through its terminal.
 - Direct competition between independent terminals would also result in improved operational efficiency as operators would significantly strengthen incentives to operate terminals efficiently and effectively.

- Terminals competing to attract and retain airlines would face strong incentives to be responsive and innovative to the needs of users, or risk losing those users to other terminals. It said that this was evident at JFK, which was undertaking a wholesale transformation, with multiple operators investing private capital in response to historic poor performance.
- The presence of new terminal operators that compete directly with HAL could create valuable benchmarks with which to assess HAL's performance and provide additional information with which to regulate HAL more effectively.

- 6.206 Heathrow Reimagined considered that equivalent reforms in other sectors (such as telecoms) had supported investment and innovation while transforming consumer outcomes. It stated that the separation of terminal operation from airfield activities at other major international airports, including the world's busiest airport (Hartsfield-Jackson Atlanta), demonstrated that implementing a similar separation at Heathrow was operationally feasible.
- 6.207 It noted that historical issues at JFK reflected factors outside terminal operators' control, particularly TSA security and US Border controls, rather than fundamental issues with competition itself.
- 6.208 Heathrow Remained agreed with the CAA on the potential need to develop non-discrimination arrangements to mitigate the risk that a vertically integrated HAL would seek to undermine terminal rivals.

Airlines

- 6.209 There was limited specific commentary in the airlines/airlines groups responses on this model.
- 6.210 easyJet supported models that would introduce genuine competition "for the market" by tendering for third parties to design, build, finance, and operate major projects like new terminals or baggage systems, as this:
- was the most effective way to drive efficiency and innovation; and
 - has the potential to deliver significant cost savings and innovation.
- 6.211 However, it also recognised that the scope for genuine competition at a congested hub airport may be limited. It said any such model must be carefully designed in a way that would avoid inefficiencies and promotes genuine competition, including supporting the conditions for viable competitive entry.

Our assessment

Avoid delay and disruption

- 6.212 We agree with HAL that this model will involve challenges associated with fragmentation and operational interfaces, and that these would be more acute

compared with other models, even after mitigation measures are introduced. As highlighted by our advisers, Steer, direct competition would:

- introduce multiple independently governed operational systems within the airport. This would materially reduce clarity of system-wide operational accountability and would increase the coordination risk between construction and live operations;
- for airport development and operation, introduce parallel delivery and operational structures. While physical constraints would remain unchanged, coordination of construction logistics within a live operating airport environment would become more complex because there would be multiple accountable parties.
- introduce parallel delivery structures and independent governance arrangements for assets. This would materially increase the complexity of the coordination required, dependency risk and exposure to delay.
- introduce multiple independently governed terminal systems operating alongside a unified airfield operator during construction. This would materially reduce clarity of accountability at operational system boundaries and increase the risk to passenger journey coherence during construction. This fragmentation might also have an impact on the efficient use of gate capacity and staff resources.

6.213 We note Heathrow Reimagined's observation that Heathrow was already a multi-operator environment, with numerous different service and infrastructure providers, and this demonstrates that fragmentation issues can be managed. While we agree with Heathrow Reimagined that Heathrow is already a multi-operator environment, the existing multi-operator environment currently present at Heathrow is coordinated by a single operator (HAL). The introduction of a second operator would introduce fragmentation and interface risks which are not currently present.

6.214 Based on the above, we assess that this model is likely to perform more poorly than the currently regulatory model under this criterion on a like for like basis. Nonetheless, we also note that it is not clear that the existing model would be sufficiently flexible to accommodate the grant of a DCO to an alternative developer. If such circumstances were to crystallise then this model would represent a pragmatic way of integrating an independent operator into the existing regulatory framework. Bearing these diverse considerations in mind we have provisionally scored this model as neutral in terms of avoiding delay and disruption.

Promotes efficient costs

- 6.215 Where there is effective competition between HAL and the third party, either through initial commercial arrangements facilitating the development of capacity by an alternative developer or for example where these arrangements would provide for a degree of spare terminal capacity exists to facilitate user switching then:
- there may be strong incentives to deliver the construction at a lower cost and to operate efficiently while ensuring high service quality; and
 - the third party would also optimise risk allocation and control cost escalation which would have a significant beneficial impact on consumers as it would protect them from costs overruns.
- 6.216 However, as noted above, these benefits are contingent on detail of arrangements that have yet to be decided upon. Furthermore, there are potential additional costs associated with this model that may at least partially offset any efficiencies from direct competition:
- additional coordination requirements between HAL and the third party; and
 - as noted by HAL, this model might reduce asset utilisation and involve higher costs involved with the construction of additional terminal capacity.
- 6.217 Based on the above, we consider that further work is needed to understand whether this model will lead to substantial cost savings over the current regulatory model. At present we have assessed the model as likely to generate moderate efficiency savings.

Raise sufficient finance

- 6.218 Centrus has examined the impact of this model on the assumption that limited spare capacity exists at the airport level. On this basis, Centrus indicated that this model could support the financing of the expansion scheme in various ways. As with other competitive models, this model could support the financing of expansion by broadening the equity investor base. In addition, a significant capex project within the Heathrow campus would attract global interest from major infrastructure investors. Centrus highlighted that this model is untested in the UK airport context, but that it aligns with the existing structure used for JFK New Terminal One so there is some precedent with which investors may be familiar.
- 6.219 Centrus also considered that the model would allocate design, build, and lifecycle risk fully to the third party and would remove some construction risk from HAL. It highlighted that a direct relationship between the third party and users could support HAL's credit rating, since it would not be required to act as an intermediary between HAL and consumers. At the same time, Centrus noted that

the implementation of this model might trigger the application of covenants included in HAL's financing arrangements and require HAL to obtain bondholder consents.

- 6.220 However, where there is material spare capacity to facilitate direct competition between the third party and HAL, there are significant disadvantages associated with this model. As noted by HAL, direct competition with HAL might increase the risk exposure of both the third party and HAL, since both parties would be exposed to competitive pressure, and might result in both parties being subject to weaker credit metrics and a higher cost of capital.
- 6.221 Bearing these diverse considerations in mind we have provision scored this model as neutral in terms of financeability.

Practical to implement

- 6.222 This model does not require us to address some of the practical challenges associated with other competitive models, in that it does not require us to put in place, monitor or enforcement a competitive tender process. However, it would require us to ensure that consumers did not fund any unnecessary duplication of assets.
- 6.223 In practice, we expect that the application of this model would be dependent on a third party successfully obtaining a DCO. Nonetheless, similar to aspects of regulatory model 7a, the CAA would need to consider issues such as wholesale charges, licensing and contractual arrangements for the overall operation/coordination of the airport.
- 6.224 On balance, this model would raise significant issues relating to implementation.

Promotes competition

- 6.225 This model has the potential to allow for competition "in the market" across the entire project lifecycle. It may naturally focus on terminal competition, since terminals represent the natural point of interface between the airport and its users.
- 6.226 For competition to be most effective users would need be able to credibly switch between the new and existing terminals. There remains significant uncertainty about how practicable this would be without a better understanding prospective commercial arrangements and the extent of spare capacity to facilitate ongoing switching. The impact of competition on consumer choice may also depend on the commercial strategy of the owner and operator of the new terminal and the types of consumers on whom they choose to focus.
- 6.227 There may also be the potential for the owner and operator of the new terminal to act in a manner that would limit the effectiveness of terminal competition. For example, if the owner and operator of the new terminal were to be an incumbent

airline, it might have an incentive to offer discriminatory terms to competing airlines, including new users. This might also be the case where the third party was an external investor, but where an incumbent airline acted as an anchor client and, hence, exerted significant influence over the new terminal.

- 6.228 Overall, we are of the view that this model has the potential to increase competition, but there would be a significant number of issues to work through.

Promotes service quality







- 6.229 Where terminal competition can be implemented effectively, this model could create strong incentives to improve service quality throughout the operational life of the assets. It would also provide a similar incentive on HAL to maintain and improve its service quality. However, we note that there are also aspects of this model that could undermine service quality at the airport.
- 6.230 As noted by our advisers, Steer, independently governed terminal systems operating alongside a unified airfield operator during construction and operation. could materially reduce the clarity of accountability at operational system boundaries. This, in turn, could increase the risk to passenger journey coherence and resilience, particularly for transit passengers.
- 6.231 We note and agree with the observations set out by HAL and its advisers, Mott MacDonald, that other airports where inter-terminal competition exists (specifically, JFK and LAX) exhibit poorer service quality outcomes overall. However, we consider that there are many drivers of this observation, and it is not necessarily driven solely by the presence of inter-terminal competition.
- 6.232 Overall, we consider that it is unclear whether this model would result in materially improved service quality outcomes compared with the current model, even where terminal competition is effective. Where it is not effective, for example, because there is insufficient terminal capacity to facilitate switching by users, this model could lead to a deterioration in service quality.

Summary of assessment

- 6.233 We agree with Heathrow Reimagined that this model offers certain advantages over other competitive models that focus on “competition for the market”, under which the third party is chosen based on an upfront commercial proposition for the right to undertake activities in respect of individual assets. It could involve dynamic competition, under which competitive constraints apply continuously, as opposed to competition based on arrangements applied at a single point in time. In principle, this offers greater benefits to consumers, as it provides an incentive on both the third party and HAL to adapt efficiently to changes in market conditions on an ongoing basis. We agree with Heathrow Reimagined that such models have been successful in other sectors, though it should be noted that these were undertaken in very different contexts and circumstances.

- 6.234 This model also avoids the need to develop and implement an upfront tendering framework, which would remove a potential obstacle to the timely delivery of the asset.
- 6.235 However, it also exhibits certain disadvantages:
- for competition to be most effective, users would need be able to credibly switch between the new and existing terminals. There remains significant uncertainty about how practicable this would be without a better understanding prospective commercial arrangements and the extent of spare capacity to facilitate ongoing switching. The impact of competition on consumer choice may also depend on the approach of the owner and operator of the new terminal and the types of consumers on whom they choose to focus;
 - this model is likely to require the CAA to undertake at least an operator determination to determine the need for the third party to have a licence, adding complexity to the regulatory process;
 - we share HAL’s concern with the potential for an independent operator to behave in a manner that would undermine the operation of effective competition at the airport. For example, where a terminal was owned and operated by an incumbent airline, or where an incumbent airline acted as an “anchor” user that exerted significant influence over the new terminal, the third party might face an incentive to offer discriminatory terms that favour its own operations over others’ (such as those of new users); and
 - there are challenges associated with airport fragmentation and points of interface with this model.
- 6.236 Overall, it is not clear that this model offers clear advantages over other short-listed models (particularly regulatory models 4b and 5b). At the same time, we note that this model may provide insights as to how the regulation of Heathrow Airport might need to be developed in the event that a third party such as Heathrow West Limited is successful in obtaining development consent for a new terminal. As such, we propose to include this model in the shortlist, on the basis that it provides an indication of how we might regulate the airport under this scenario.

Table 6.6: Summary of assessment of regulatory model 7b

Criteria	Score	Justification
Avoid delay and disruption		Could result in adverse impacts due to additional delivery and coordination interfaces. However, provides a way forward if an alternative developer gains a DCO for a new terminal.
Promotes efficient costs		Direct competition creates an incentive for the alternative developer to deliver efficiently and constrain charges, however there may be some additional costs associated with coordination, spare terminal capacity and asset utilisation.
Raise sufficient finance		In the absence of spare capacity, this model is likely to support financeability, since it would widen the pool of capital available for expansion. Where material spare capacity exists, this could expose the third party and HAL to significant demand risk and, hence, financing constraints.
Practical to implement		The absence of a competitive bid process could simplify the implementation process for this model, although further consideration would need to be given to, for example, licensing issues. This model is likely to be dependent on a third party obtaining a DCO, which it can do under the current regulatory model.
Promotes competition		Prospect of direct competition between terminals, but a lack of clarity at this stage as to the effectiveness of competition.
Promotes service quality		An alternative developer may have the incentive to improve service quality through direct competition with HAL. Nonetheless, there may also be difficulties with interfaces and coordination.

Regulatory model 8: transfer of ownership and operation of an existing asset

- 6.237 Under this model, HAL would be required to transfer ownership and operation of an existing asset to a third party. Since the asset would already be built, the scope of the third party's activities would be the operation and maintenance of the asset, as under regulatory model 5a. Similar to regulatory model 7, the third party could act either as an upstream supplier to HAL or directly compete with HAL in the provision of services to users.
- 6.238 Challenges in respect of determining the boundaries of roles and responsibilities between the third party and HAL would be likely to be particularly acute in this model. This is because existing assets are unlikely to have been designed in a

modular fashion and may be more highly integrated into the overall operation of the airport.

- 6.239 The CAA also does not have powers to require the transfer of assets under CAA12.

Stakeholders' views

HAL

- 6.240 HAL provided its comments on this regulatory model as part of its combined comments on regulatory models 7 and 8. These were set out above under model 7a.
- 6.241 HAL noted that the CAA under CAA12 does not have the powers “to impose, or force HAL to enter into, particular commercial solutions to promote competition” nor does it have the power to “force HAL to divest assets”⁴⁰.

Heathrow Reimagined

- 6.242 Heathrow Reimagined said that enabling competition between existing terminals (alongside new terminals) would intensify competitive rivalry to the benefit of consumers. Greater competitive rivalry would contribute to a more efficient, user-focused airport, thereby increasing the likelihood of successful expansion. Extending competition to existing terminals would also more comprehensively address HAL's substantial market power and deliver greater benefits against the CAA's assessment criteria, particularly efficiency, affordability, and promoting competition.
- 6.243 It considered that for the benefits of terminal competition to be realised, it must extend to the capex required to maintain, enhance, and potentially extend existing terminals, not only the day-to-day operation of those terminals. If future capex remained subject to HAL's harmful incentives, consumers' interests would be further harmed by unnecessary inefficiency, leading to even higher charges and further deterioration in value for money.
- 6.244 It considered that regulatory model 8 would be practical to implement, as evidenced by experience from other airports internationally where terminals and airfield operations are operated independently, as well as experience from other sectors where competition has been successfully introduced. It said that it saw no reason why a well-managed process would introduce any incremental risks to expansion or the Government's timetable.

⁴⁰ HAL response to CAP3195 – CAA Working Paper on Regulatory Models, page 84.

Airlines

- 6.245 There was limited specific commentary in the airlines/airlines groups responses on this model.
- 6.246 As indicated above, easyJet recognised that the scope for genuine competition at a congested hub airport may be limited. It said any such model must be carefully designed in a way that avoids inefficiencies and promotes genuine competition, including supporting the conditions for viable competitive entry.

Our assessment

Avoid delay and disruption

- 6.247 Since this model would involve the transfer of an existing asset, there are limited direct impacts on the delivery or timing of expansion. However, the processes needed to determine whether this was an appropriate way forward would be likely to be lengthy, contentious and could serve as a very significant distraction from the delivery of expansion. This could be resolved where it is implemented after expansion is complete.
- 6.248 As noted by our advisers, Steer, the transfer of ownership and operation of an existing terminal asset introduces a permanent operational boundary within the airport system. This would create a need for arrangements that govern the coordination between the third party and HAL to be defined contractually. Once these coordination measures are in place, this model does not result in a material change compared to the current regulatory model.

Promotes efficient costs

- 6.249 As this model involves the transfer of ownership and operation of an existing asset to a third party, there would be no impact on costs during the design and construction phases.
- 6.250 Competition during the operation phase would provide an incentive to constrain operating costs. If this model were to involve direct competition between the third party and HAL, incentives to promote ongoing efficiency would depend on the availability of spare terminal capacity to facilitate switching.
- 6.251 As noted by our advisers, Steer, the transfer of ownership and operation of an asset to a third party could have an adverse impact on operating costs due to fragmentation of airport operations and the presence of multiple points of interface. Steer considered that this impact could be partly mitigated through contractual and governance arrangements.
- 6.252 Overall, we expect this model to have a limited impact on cost efficiency compared to the current regulatory model.

Raise sufficient finance

- 6.253 As with other competitive models involving ownership and operation of airport assets at scale, this model would attract significant new investor interest and, in turn, would bring additional debt capacity, as noted by our advisers, Centrus.
- 6.254 However, Centrus noted that the separation of a core asset from its existing asset base could significantly alter HAL's overall risk profile. Specifically, Centrus noted that HAL's risk profile would shift towards a greater focus on construction and delivery of expansion, since it would lose a "safe" operational asset. All else being equal, this could increase HAL's risk exposure and its cost of capital.
- 6.255 We also note that the new finance would be directed to funding asset transfers rather than expansion. While HAL would benefit from cash transfers, it is unclear how it would choose to use this cash.
- 6.256 Overall, it is not clear that this model would have a material impact on financing expansion.

Practical to implement

- 6.257 This model would require HAL to divest existing assets. CAA12 does not contain explicit powers for the CAA to force divestment of assets, and other approaches are likely to involve delays that are inconsistent with the timely delivery of consumer benefits from expansion. We therefore disagree with Heathrow Reimagined that this model would be practical to implement. While similar models may have been implemented in other sectors, the circumstances and legislative framework were considerably different.
- 6.258 There are also challenges in respect of defining interfaces between the transferred assets and HAL, where these have not previously been built in a manner that enables a clear physical and technical separation from other parts of the airport. The CAA would need to define roles and responsibilities between HAL and third party, including, potentially, challenges associated with assigning an economic licence to the operator of the divested terminal, and the commercial relationships between HAL and the new operator.
- 6.259 Overall, we consider that this model is not practical to implement.

Promotes competition

- 6.260 Under this model, competition would be introduced during the operational phase of the asset lifecycle, but not during the design or construction phases.
- 6.261 If direct competition were to exist between HAL and the third party, this would be effective if there were sufficient flexibility/spare capacity to allow for switching between service providers, including in relation to terminals.
- 6.262 In this case, we are also concerned with the potential for the owner and operator of the new terminal to act in a manner that would limit the effectiveness of

terminal competition. For example, if the owner and operator of the new terminal were to be an incumbent airline, it might have an incentive to offer discriminatory terms to competing airlines, including new users. This might also be the case if the third party were to be an external investor, but where an incumbent airline acted as an anchor client and, hence, exerted significant influence over the new terminal.

- 6.263 Overall, we consider that there is potential for this model to improve competition compared to the current regulatory model, although this will be contingent on the availability of spare terminal capacity where there is direct competition between HAL and third party for the provision of airport operation services.

Promotes service quality

- 6.264 The impact of this regulatory model in respect of service quality aligns with our views of regulatory models 7a and 7b respectively, depending on whether the third party acts as a wholesale supplier to HAL or competes directly with HAL for the provision of airport operation services.
- 6.265 Where the third party acts as a wholesale supplier to HAL, it may have the incentive to improve service quality through incentive mechanisms embedded in the HAL's licence. However, there is no obvious reason to expect that the third party would improve on HAL's service quality level.
- 6.266 Where the third party competes directly with HAL for the provision of airport operation services, it may have the incentive to improve service quality through competition with HAL, which would be contingent on the availability of flexible/spare capacity to facilitate competition.
- 6.267 In both cases, the existence of a permanent operational boundary between HAL and the third party could undermine service quality. Overall, we do not expect that this model would materially improve or worsen service quality compared with the current regulatory model.

Summary of assessment







- 6.268 We highlighted in the 2018 Technical Information Note⁴¹ that CAA12 does not contain explicit powers for the CAA to force divestment of assets. Regardless of whether the third party would act as a wholesale supplier to HAL or compete directly with HAL for the provision of airport operation services, this model would necessarily entail such a divestment. Therefore, implementation of this model would be reliant on other approaches. One possibility would be dependent on the conduct and result of a market investigation under the Enterprise Act 2002, similar to the process that led to the breakup of BAA plc. We note that we would

⁴¹ [CAA \(2018\). Technical information note on the CAA's approach to dealing with licensing issues raised by potential alternative developers of new capacity at Heathrow Airport.](#)

not be able to initiate or control such a process, and its outcome cannot be predicted with confidence. Another possibility would be primary legislation. It is not clear either of these approaches represent a practicable way forward and may in any case act as a significant distraction to expansion.

- 6.269 On this basis alone, we consider that it would not be appropriate to include this model in the shortlist.
- 6.270 More generally, we consider that the scope of competition under this model would be limited to the operational phase of the asset lifecycle, with corresponding implications for its expected impact on key criteria. This is compounded by the creation of permanent operational boundaries between HAL and the third party that could increase costs and adversely affect service quality, particularly for transit passengers, though these can be partly managed through enhanced governance.
- 6.271 Overall, we do not see a strong case for including this model on the shortlist.

Table 6.7: Summary of assessment of regulatory model 8

Criteria	Score	Justification
Avoid delay and disruption		The process for implementing this model is unclear, but it could act as a significant distraction to expansion. There could be some challenges associated with the creation of a permanent boundary between the competed asset and the broader airport, though these can be partly managed through enhanced governance.
Promotes efficient costs		We expect the cost savings to be relatively marginal, since the scope of competition would not include construction of the asset: while competition could provide an incentive to minimise operational costs, the creation of a permanent operational boundary could create costs associated with fragmentation issues.
Raise sufficient finance		This model would attract significant investor interest and in turn would bring additional debt capacity. However, this new financing would be focused on the transfer of existing assets, rather than expansion.
Practical to implement		CAA12 does not contain explicit powers for the CAA to force divestment of assets. Implementation would require use of different powers, perhaps under the Enterprise Act 2002 or primary legislation.
Promotes competition		Competition would be introduced for the operational phase of the asset lifecycle, but not the design or construction phases. This may significantly limit the effectiveness of competition. Also, it is not clear that there would be sufficient flexibility/spare capacity to allow for competition in operational/terminal services.
Promotes service quality		Creation of an operational boundary between HAL and the third party would create risks, but competition would also present opportunities for service improvements.

Conclusion

6.272 For the reasons set out above we have decided to include the following competition models in our shortlist:

- regulatory model 4b: mandate contract for design and build;
- regulatory model 5b: mandate contract for design, build and operation; and
- regulatory model 7b: third party ownership / direct competition.

CHAPTER 7

Shortlist of regulatory models – New frameworks for setting airport charges

Introduction

- 7.1 Under these regulatory models (price benchmarking, long-run incremental costs and lighter touch regulation), we would develop alternative approaches to setting maximum allowed airport charges and so there would be significant changes to how we regulate Heathrow Airport and expansion.
- 7.2 These models perform poorly in our assessment. This is because that they are unlikely to reflect the efficient costs of expansion and could undermine the prospects of raising finance efficiently, and/or would create new risks and opportunities for both windfall gains and losses. There was also very limited support for these models by stakeholders and our assessment is that they would not further the interests of consumers. We do not propose to short-list any of these pricing framework models. We set out stakeholders' views and further detail of our assessment below.
- 7.3 This chapter assesses each of the following models in turn:
- regulatory model 9a: price benchmarking;
 - regulatory model 9b: long-run incremental costs; and
 - regulatory model 9c: lighter touch regulation.
- 7.4 In each case we provide a brief summary of respondents' views and then set out our evaluation and assessment, based on the criteria identified in chapter 3.

Regulatory model 9a: price benchmarking

Introduction

- 7.5 Model 9a would involve price benchmarking by setting maximum allowed charges for the airport as a whole by reference to the charges levied by comparable airports globally. This is intended to ensure that charges remain competitive with comparable airports.

Stakeholders' views

HAL

- 7.6 HAL did not support this model as it stated that the model breaks the link between efficient costs and prices. HAL would retain cost risk while being exposed to revenue risk driven by benchmarks outside its control.
- 7.7 In its report for HAL, Freshfields and Santander concluded that adopting comparator-based charges would introduce significant financial and regulatory risks for HAL. This approach could both cap prices and erode financial headroom, which may not enable efficient cost recovery or a reasonable return on capital. It noted that basing returns on external comparator outcomes rather than HAL's cost base could mean HAL's actual cost of capital could fluctuate materially above or below the required cost of capital to raise efficient finance, undermining investor confidence.
- 7.8 HAL stated that the substantial cashflow uncertainty this model could create would alter credit exposure of existing lenders with a high likelihood of weakening covenant headroom. It noted that reducing charges to levels aligned with peers would materially weaken debt metrics below investment-grade thresholds, increasing the cost of debt. It concluded large-scale expansion would likely become unfinanceable without substantial government financial support or guarantees.

Airlines

- 7.9 A number of airlines rejected price benchmarking as inappropriate for HAL. AOC/LACC considered that price benchmarking is an inappropriate basis for setting charges but it can play a useful role to help ensure that long-term capex envelopes are consistent with improving the attractiveness of Heathrow to passengers and airlines.
- 7.10 IATA regarded this model as a simplistic approach for a fully privatised and highly capacity-constrained airport with significant market power. It noted that price benchmarking does not fundamentally use costs to set charges, which goes against ICAO principles and the accepted regulatory practice of cost-relatedness. It further stated that in Portugal, Hungary and Austria where charges are set using a non-cost-based price cap, there is evidence that charges are significantly higher than costs.
- 7.11 Airlines for America welcomed the CAA's willingness to examine models that incorporate benchmarking of HAL's charges against those at comparable global hubs. It stated that, while HAL's charges must ultimately be cost-based and consistent with ICAO principles and the U.S.-UK Air Transport Agreement, HAL's pricing process would benefit from examining how other comparable airports are able to offer lower charges.

Other stakeholders

- 7.12 Heathrow Strategic Planning Group highlighted our views from the November 2025 Working Paper as illustrating the significant problems with implementing price benchmarking in a robust manner.

Our assessment







- 7.13 As stated in our Working Paper, this model would seek to set charges in line with comparable airports, rather than based on efficient costs. We agree with HAL and airline responses that this model would break the link between prices and efficient costs and so not follow our previous regulatory practice. Bearing this in mind, this approach would be unlikely to promote efficient costs for expansion or be in the interest of consumers.
- 7.14 We agree with HAL that this model would lead to uncertain financial risks for HAL and would be unlikely to attract the necessary equity and debt investment to support expansion. This is consistent with the assessment by our adviser, Centrus, which considered this model would reduce attractiveness for new long-term infrastructure investors.
- 7.15 We also do not find any direct precedent for using benchmarking to set charges. This supports the airline view that this model would be difficult to implement in practice in a robust manner. Our adviser, Steer, considered the examples of Changi Airport and Brussels Airport do not match the definition of model 9a, as price benchmarking is used as a reference point to determine airport charges, but weight is still given to the bottom-up assessment of costs.⁴²

Overall assessment

- 7.16 We do not propose to shortlist this model and our evaluation and assessment is summarised in the table below.

⁴² For Changi Airport, cost recovery and the return on capital invested are the main factors used for the charge determination. For Brussels Airport, the source of the airport charges is the outcome of the dual-till regulatory regime.

Table 7.1: Summary of assessment of regulatory model 9a

Criteria	Score	Justification
Avoid delay and disruption		Model does not have a direct impact on operational delivery, so assessed as neutral.
Promotes efficient costs		Does not appropriately link to determining HAL's efficient cost recovery when used as a primary tool for setting charges.
Raise sufficient finance		Likely to reduce equity attractiveness and debt capacity for a large-scale, long-duration expansion programme.
Practical to implement		Model could be implemented within the CAA's existing regulatory powers, so assessed as neutral, although some complexity in how to complete robust benchmarking.
Promotes competition		Model does not have a direct impact.
Promotes service quality		Model does not have a direct impact.

Regulatory model 9b: long-run incremental costs

Introduction

- 7.17 Under model 9b, charges would be set by reference to the long-run incremental costs ("LRIC"): the forward-looking cost associated with providing an additional increment of output. This approach seeks to replicate the longer-term outcomes that economic theory suggests that competitive markets should deliver. Prices would be set at the level consistent with the expected costs of potential new entrants seeking to build and operate assets.
- 7.18 LRIC is widely used in the telecoms sector to regulate wholesale access and promote competition. It seeks to ensure that incumbent providers cannot set excessively high prices for wholesale access, which in turn promotes downstream competition for retail providers.

Stakeholders' views

HAL

- 7.19 HAL did not support this model. It said that it would break the link between costs and price by using an "increment" of output that is not meaningful in the context of airports, where capex is "lumpy" and interdependent.

- 7.20 It said this would lead to significant financeability challenges, as revenues in the early years may be insufficient to service debt during the construction phase of expansion, leading to pressure on liquidity and material credit downgrade risk, in the absence of government support or explicit revenue guarantees. Furthermore, investors could face substantial risk that it would not recover its costs if demand or utilisation falls short of expectations, deterring investment at an efficient cost.

Heathrow Reimagined

- 7.21 Heathrow Reimagined stated that moving from the current RAB-based model to a LRIC-based model would not adequately address the problems with the existing regime.
- 7.22 It noted that use of LRIC to set regulated charges in other contexts such as access charges in the telecoms sector and said that in these markets, participants have the choice between consuming regulated services or self-providing them. It said this is less relevant to airports, as airlines cannot decide to build a runway or terminal to avoid HAL's very high charges and poor service quality.
- 7.23 Heathrow Reimagined referred to previous CAA and Competition Commission assessments of the significant challenges related to implementing a LRIC approach, given it would require estimating the efficient level of future capex.

Airlines

- 7.24 Airlines for America agreed with our previous Working Paper that LRIC could be an inappropriate proxy for competitive prices. It stated that this model relies on subjective judgments and forecasts that could lead to inaccurate estimates of charges and high levels of risk.

Other stakeholders

- 7.25 Heathrow Strategic Planning Group stated that using LRIC to cap charges would require a robust basis for determining the future costs associated with an increment in operational outputs and the ability to do this is unproven.

Our assessment

- 7.26 The LRIC approach is intended to set efficient prices which are closer to a long-run competitive level compared to where prices would be set under a RAB-based model. As noted by stakeholders, there are inherent difficulties with this approach in relation to expansion in terms of estimating these costs and dealing with the potential variations in the expected level of returns.
- 7.27 The Competition Commission report on the Q5 price control review⁴³ also noted challenges associated with determining the appropriate increment, establishing

⁴³ [BAA airports: Evaluation of the Competition Commission's 2009 market investigation remedies](#)







reliable long-term forecasts and making an accurate estimate of the efficient level of capex.

- 7.28 We agree with HAL, Heathrow Reimagined and airlines that it will not be practical to provide a robust estimate of LRIC to set charges. In practice, the LRIC estimate is likely to be highly sensitive to the assumptions made, and it would not be straightforward to take into account the lumpy investment cycle of the airport.
- 7.29 We also agree with HAL that this model could also harm the financeability of expansion. The lumpiness of costs and sensitivity of the calculation to the “increment” of output chosen, means LRIC could provide significant short-term over- or under-recovery of costs, and unmanageable volatility in returns. Our adviser, Centrus, considered that this model is likely to weaken investor confidence in the context of expansion given it provides limited protection against the risks associated with long construction periods.

Overall assessment

- 7.30 We do not propose to shortlist this regulatory model and our evaluation and assessment is summarised in the table below.

Table 7.2: Summary of assessment of regulatory model 9b

Criteria	Score	Justification
Avoid delay and disruption		Model does not have a direct impact on operational delivery, so assessed as neutral.
Promotes efficient costs		Model may provide efficient forward-looking incremental costs in the medium to long term, but can lead to short-term over- or under-recovery of efficient costs
Raise sufficient finance		Long run setting of prices and the greater risk of cost under-recovery is likely to weaken investor confidence.
Practical to implement		The model can be implemented within the CAA's existing regulatory powers, so assessed as neutral. However, it is likely to be difficult to provide a robust estimate in practice.
Promotes competition		Model does not have a direct impact on competition.
Promotes service quality		Model does not have a direct impact.

Regulatory model 9c: “lighter touch” regulation

Introduction

7.31 Under model 9c, we would take a relatively light-touch approach to the regulation of HAL, allowing HAL more freedom to set its charges and manage its capacity and service quality levels. This would be appropriate where appropriate protections for consumers are provided by competition.

Stakeholders' views

HAL

7.32 HAL stated that the lessening of regulatory certainty under this model would likely reduce investor confidence and raise financing costs. It stated that there is no precedent for privately funding a project of comparable scale to expansion without a model that explicitly links prices to costs.

7.33 It noted that this approach would require a market power determination and licence changes that could take significant time to implement, especially as

stakeholder consensus is unlikely. It also said the cost of these delays would outweigh any hypothetical upsides.

Heathrow Reimagined

- 7.34 Heathrow Reimagined said that lighter touch regulation would be unjustified because HAL still holds entrenched substantial market power, faces no competitive constraints in the provision of airline operating services and continues to raise charges above competitive levels.

Airlines

- 7.35 Airlines for America did not support a lighter touch approach, believing that reduced regulatory scrutiny could weaken incentives for cost efficiency when HAL holds sufficient market power.

Other stakeholders

- 7.36 Heathrow Strategic Planning Group stated that a shift to lighter touch regulation would be a significant change, requiring a fundamental review of market power. It expressed concern that established forward investment plans could be reopened through commercial negotiation.







Our assessment

- 7.37 Consistent with the concerns expressed by airlines, we consider that reduced regulatory scrutiny and HAL's ability to set higher charges could likely weaken incentives cost efficiency and service quality. Our previous assessment has found that HAL holds substantial market power and so it is unclear that effective competition from other London or international airports and airline bargaining power would be sufficient to constrain HAL's market power in the absence of other mitigations.
- 7.38 We also agree with HAL's comment that this model may harm financeability and increase financing costs by removing a formal link between prices and costs, and that this model could cause significant delays to expansion.

Overall assessment

- 7.39 Based on our assessment, we do not propose to shortlist this regulatory model. The table below summarises our assessment.

Table 7.3: Summary of assessment of regulatory model 9c

Criteria	Score	Justification
Avoid delay and disruption		Material change to the existing framework which could risk protracted airline negotiations ahead of expansion, as well as requiring a market power assessment.
Promotes efficient costs		Heathrow could leverage its market power in charge negotiations with airlines, weakening incentives for cost efficiency.
Raise sufficient finance		Reduced investor confidence and higher financing costs.
Practical to implement		Implementable within the CAA's existing regulatory powers, but would likely require a market power determination.
Promotes competition		No direct impact.
Promotes service quality		Service quality commitments would be non-binding with reduced transparency. In absence of market pressures, service levels might deteriorate.

Conclusion

7.40 Bearing all of the above in mind we have decided not to include regulatory model 9a (price benchmarking), regulatory model 9b (LRICs) and regulatory models 9c (light touch regulation) in our shortlist of models.

CHAPTER 8

Next steps

Introduction

- 8.1 This chapter:
- summarises our short list of regulatory models;
 - explains the further work we intend to do on the shortlist of regulatory models in the lead up to summer 2026 and beyond; and
 - sets out next steps for our work on capacity expansion.

Shortlist of regulatory models

- 8.2 In this document we provide a shortlist of regulatory models that we propose to take forward for further consideration. The shortlist is:
- Regulatory models 1a, 2 and 4a combined as a package that would enhance capital governance, strength incentive arrangements for capital efficiency and improve oversight of HAL's procurement processes. These models should encourage capital efficiency and reduce the risk of cost over-runs on the expansion programme;
 - Regulatory model 3 would introduce a longer-term framework for the cost of capital, for example through an expansion cost of capital and/or caps and collars on returns. This model is designed to encourage efficient financing and avoid any undue upward pressure on HAL's cost of capital, so that airport charges would be lower than otherwise, consistent with furthering the interests of consumers;
 - Regulatory model 4b would enable the CAA to mandate competitive tendering by HAL for the design and build of assets and regulatory model 5b, which builds on regulatory model 4b, would enable the CAA to mandate competitive tendering by HAL for the design, build and operation of assets. These models would encourage competition and capital efficiency; and
 - Regulatory model 7b would allow for direct competition between HAL and an alternative developer, for instance in the circumstances where the alternative developer was awarded a DCO by the SoS for the development of new terminal at Heathrow Airport. This model could encourage competition and efficiency.

Further work on these regulatory models

Tasks relating to our broad approach

- 8.3 We will engage further with HAL, other potential developers, airlines and other interested parties on our short-list of regulatory models. The focus of this engagement will be understanding the views of stakeholders, including how we might best combine the various regulatory models together into an overall framework that will best support expansion.
- 8.4 Our present view is that we have the necessary powers to implement the regulatory models that would strengthen the regulatory framework for HAL in terms of its obligations in relation to capital governance, capital efficiency incentives procurement and competitive tendering. Nonetheless, we would welcome any further views from stakeholders on these matters in the light of the further information set out in this consultation.
- 8.5 Regulatory model 7b and possible arrangements for direct competition raise wider issues, including the relationship with the planning process and the powers of the SoS to grant DCOs. We will consider these matters further, taking account of any new information that the Government provides in its consultation on the revised ANPS, which is planned for later this year.

Tasks for capital governance model, incentives and procurement model

- 8.6 We will commission an expert review to support the CAA in designing the capital governance framework for investment. This will require engagement and close working with HAL and airlines and will focus on establishing a tailored approach to governance of capital expenditure on enhancement. Following the expert review, we may need to work with stakeholders to implement the final approach.
- 8.7 Following this work, we will develop plans for the transition to the new governance and incentive arrangements and how this interacts with the H8 price control framework. This will likely include:
- plans to put in place the new capital committee and the required independent assurance, reporting arrangements, and escalation and incentive mechanisms. Any appropriate streamlining of and integration with existing governance arrangements;
 - guidance on the principles for the application of forward-looking budgets and delivery obligations, including which projects/programmes would be in scope of these arrangements and at what point during the project development; and

- how the capital governance framework will integrate with other aspects of the regulatory framework, including the approach to efficiency incentives, procurement and competitive tendering, the affordability of airport charges and the longer-term aspects of the regulatory framework, including as discussed further below.

Tasks for long-term regulatory framework

- 8.8 We will do further analysis to finalise our approach, including further work to assess the preferred options identified in Chapter 5 of setting a separate expansion cost of capital aligned to the construction period and setting maximum and minimum bounds for returns over a greater part of the project life cycle. The intention behind this work will be to identify arrangements that reduce any undue uncertainty about the regulatory framework for investors, prevent any inappropriate increase in HAL's cost of capital and ensure airport charges are lower than they otherwise would be, so to further the interests of consumers.
- 8.9 In carrying out this further work, we will seek to guard against the risks highlighted by airlines that these arrangements could benefit investors in an inappropriate way, at the expense of consumers. A key part of this further work will be ensuring that the overall package of models and measures that make up the broad regulatory framework for expansion contains appropriate incentives to ensure an efficient approach to expansion and an affordable level of airport charges.
- 8.10 To appropriately support the above and our wider work on the regulatory framework, we will engage further with HAL and any other promoters on their approaches to financing and engage with current and potential investors, as well as credit rating agencies, to ensure that our broad approach to the regulatory framework and its implementation are consistent with the efficient financing of expansion.

Tasks for models that would mandate arrangements for competitive procurement

- 8.11 In relation to regulatory model 4b and regulatory model 5b, which focus on powers to mandate competitive tendering by HAL for design and build or design build and operation of assets, we will be looking to HAL to bring forward proposals for a procurement strategy. This should demonstrate and provide comfort to stakeholders that its approach to expansion will make the best use of competitive tendering and manage construction risks appropriately.
- 8.12 We will engage with HAL and other stakeholders on this strategy, and commission an expert independent review of HAL's approach. In parallel to this we will develop proposals for backstop licence obligations that would allow us to compel HAL to take further steps in relation to competitive procurement if the

arrangements and plans it brings forward are not sufficiently robust, comprehensive or persuasive.

- 8.13 Regulatory model 7b, which would allow for direct competition between HAL and an alternative developer, for instance in the circumstances where the alternative developer were awarded a DCO, raises wider issues around the potential benefits and implementation. We will engage further with HAL, potential alternative developers and the DfT with a view to establishing an agreed way forward on these matters. We will also need to consider any issues raised by Government in relation to these matters when it consults on the revised ANPS in the summer of 2026.

Next steps

- 8.14 We plan to issue a high level update on our recommendations on the strategy and approach to regulatory models for expansion in July 2026, with a more detailed document following in September 2026. The July 2026 update will allow stakeholders to take into account our latest views in considering how best to respond to the Government's consultation on the revised ANPS in the summer of 2026.
- 8.15 In addition to our work on regulatory models, we will continue with our work on the early costs (that is those costs incurred by credible developers with sufficiently mature plans before the grant of any DCO). We published a draft decision on these costs for 2025 and 2026 in April 2026⁴⁴ and intend to publish a final decision on these matters in July 2026. We plan to consult on the treatment of early costs for 2027 and beyond later in 2026. The draft decision included an update on work on the overall costs and benefits of expansion for consumers and will update on our assessment of these matters later this year. This work will inform both our policy on early costs and our approach to implementing the regulatory framework for expansion.
- 8.16 To support the publication of the high level update in July 2026, responses to this consultation are requested no later than 5pm on 15th June 2026. While we understand that an approximate four week consultation period is relatively tight, it is in the context of having already published a working paper on these matters in November 2025. We also expect our broad approach to the regulatory framework for Heathrow Airport to continue to evolve over time and to consult further on how best to implement changes to support capacity expansion and protect consumers. Nonetheless, we will consider any further representations we receive from stakeholders on whether this timetable provides an adequate consultation period.

⁴⁴ CAA, Draft Decision on the regulatory treatment of early costs of capacity expansion at Heathrow airport, April 2026, CAP 3238

- 8.17 We expect to start our work on implementing the regulatory framework to support expansion later in the summer of 2026. This will be carefully coordinated with our work on the business-as-usual H8 price control for the period from 2027 to 2031, for which we expect to issue Final Proposals for in November 2026.

APPENDIX A**Abbreviations**

AAHK	Airport Authority Hong Kong
ACL	Airports Coordination Limited
AICC	assets in the course of construction
AIO	assets in operation
ANPS	Airports National Policy Statement
AOC/LACC	Heathrow Airline Operators Committee / London Airline Consultative Committee
ASQ	Airport Service Quality
capex	capital expenditure
CATO	Competitively Appointed Transmission Operation
CC	Competition Commission
CE	Constructive Engagement
CIC	Capital Investment Committee
CISHA	Council for the Independent Scrutiny of Heathrow Airport
CMA	Competition and Markets Authority
DAA	Dublin Airport Authority
DCO	Development Consent Order
DfT	Department for Transport
DOs	Delivery Obligations
DPC	Direct Procurement for Customers
EU	European Union
FSC	full service carrier
G2 to G7	Gateways for projects in Heathrow capital governance process
GAL	Gatwick Airport Limited
H3	a runway at Heathrow, north west of the existing airport

H8	Heathrow price control for 2027 to 2031
HAL	Heathrow Airport Limited
HARP	Haweswater Aqueduct Resilience Programme
HH	westward extension of the northern runway at Heathrow Airport
HPF	Heathrow Passenger Forum
HKIA	Hong Kong International Airport
HSPG	Heathrow Strategic Planning Group
HWL	Heathrow West Limited
IAG	International Airlines Group
IATA	International Air Transport Association
ICAO	International Civil Aviation Organisation
IFS	Independent Fund Surveyor
IP	Infrastructure Provider
JIA	Joint Independent Assurance
LRIC	Long run incremental costs
MTI	Measures, Targets and Incentives
NESO	National Energy System Operator
NPS	Net Promoter Scores
NTO	JFK's New Terminal One
OGP	Oxford Global Projects
Opex	operating expenditure
P1 to P4	Milestones for programmes in Heathrow capital governance process
PATMs	Passenger Air Transport Movements
PPP	purchasing power parity
QSM	Quality Service Monitor
RAB	Regulatory Asset Base
SLAs	Service Level Agreements
WACC	Weighted Average Cost of Capital

APPENDIX B

Our duties

1. The CAA is an independent economic regulator. Our duties in relation to the economic regulation of airport operation services (“AOS”), including capacity expansion, are set out in the CAA12.
2. CAA12 gives the CAA a general (“primary”) duty, to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of AOS.
3. CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of “consumers”.
4. The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.
5. In discharging this primary duty, the CAA must also have regard to a range of other matters specified in the CAA12. These include:
 - the need to secure that each licensee is able to finance its licensed activities;
 - the need to secure that all reasonable demands for AOS are met;
 - the need to promote economy and efficiency on the part of licensees in the provision of AOS;
 - the need to secure that the licensee is able to take reasonable measures to reduce, control and/or mitigate adverse environmental effects;
 - any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
 - the principles of transparency, accountability, proportionality and consistency and that regulatory activities should be targeted only at cases where action is needed.
6. In relation to the capacity expansion at Heathrow, these duties relate to the CAA’s functions concerning the activities of HAL as the operator at Heathrow.
7. CAA12 also sets out the circumstances in which we can regulate airport operators through an economic licence. In particular, airport operators must be subject to economic regulation where they fulfil the Market Power Test as set out in CAA12. Airport operators that do not fulfil the Test are not subject to economic regulation.

As a result of the market power determinations we completed in 2014 both HAL and GAL are subject to economic regulation.

8. We are only required to update these determinations if we are requested to do so and there has been a material change in circumstances since the most recent determination. We may also undertake a market power determination whenever we consider it appropriate to do so.

APPENDIX C

Further detail on aeronautical charges

- C1 This Appendix presents further detail in respect of the impact of government support on comparator airport charges.
- C2 HAL has stated that comparatively low aeronautical charges at some European peer airports may be partly explained by various forms of government support, including grants, loans, equity injections, tax relief and wider off-balance sheet measures.
- C3 Avinor AS, the Norwegian state-owned group that owns and operates Oslo Airport within a wider national network, has been presented by HAL as an illustrative example. HAL highlighted that, in 2024, Avinor's 2024 investment grants were around 40 per cent of its aeronautical revenue and suggested this helps explain Oslo Airport's relatively low charges.

Our assessment

- C4 Available evidence supports elements of this position but also indicates that the Oslo/Avinor example can be misinterpreted if the distinction between Oslo Airport as a single asset and the wider Avinor group is not maintained.
- C5 The relative scale of Oslo Airport's aeronautical charges presented by HAL is consistent with published benchmarking. Jacobs' Review of Airport Charges 2024⁴⁵ (baseline aircraft mix) reports 11.92 SDRs⁴⁶ per passenger for Oslo compared with 68.22 SDRs for Heathrow, implying that Oslo's charges are approximately 17% of HAL's.
- C6 HAL's observation that Avinor's government grant income exceeded its aeronautical revenues in 2020 and 2021 is supported by Avinor's reporting. Group-level government grants amounted to NOK 3,600.2m (2020) and NOK 3,800.0m (2021), compared with traffic income of NOK 2,247.4m (2020) and NOK 2,922.9m (2021).⁴⁷ These grants were exceptional and related to pandemic-era measures rather than the group's steady-state operating model.

⁴⁵ https://www.jacobs.com/sites/default/files/2025-07/Airport%20Charges%20bespoke%20analysis%20-%20Final%20Report_0.pdf

⁴⁶ SDRs refer to Special Drawing Rights, which are an international reserve asset created by the International Monetary Fund (IMF) in 1969 to supplement its member countries' official reserves.

⁴⁷ https://live.euronext.com/sites/default/files/company_press_releases/attachments_oslo/2022/04/04/558493_Avinor%20Annual%20and%20Sustainability%20report%202021.pdf

- C7 For 2024, the evidence indicates a materially different position. Avinor's 2024 Annual and Sustainability Report records traffic income of NOK 5,754m and total operating income of NOK 12,110m, with only NOK 46.4m of government grants or refunds recognised within "other income" representing less than 1% of operating income.⁴⁸ The higher figures cited by HAL (around 40% of aeronautical revenue) appear instead to relate to capital investment grants for the New Airport Bodø and New Airport Mo i Rana projects, with recognised grants of NOK 862.5m and NOK 1,201.2m respectively in 2024. Together, these capital grants are equivalent to roughly 36% of Avinor's 2024 traffic income (NOK 5,754m) and approximately 17% of operating income (12,110m). As these grants relate to individual projects elsewhere in the Avinor system, their relevance to Oslo's aeronautical charges is indirect and operates through group-wide financing rather than as a direct subsidy to Oslo Airport. Nonetheless, Oslo Airport is not included in the charges benchmarking exercise.
- C8 Evidence from a sample of EU comparator airports used in the benchmarking (Dublin, Frankfurt, Amsterdam), provides limited support for the idea that direct, recurring operating subsidies (government support) materially influence aeronautical charge levels in normal trading conditions.
- C9 daa plc, operator of Dublin Airport, reported no government grant income in 2024 apart from small capital-related grants (for example, €1.3m linked to SESAR⁴⁹/CINEA⁵⁰).⁵¹
- C10 In Frankfurt's case, Fraport received approximately €160 million from the German federal government and the State of Hesse in 2021 as compensation for uncovered costs incurred in maintaining operational readiness during the first Covid-19 lockdown in 2020.⁵² Frankfurt's approximately €160 million Covid compensation is best understood as a one-off crisis measure. Spread across Frankfurt Airport's passenger throughput over the 2021–2024 recovery period

⁴⁸ https://om.avinor.no/siteassets/om-avinor/finansielle-rapporter/avinor_annual-and-sustainability-report_2024.pdf

⁴⁹ SESAR refers to the Single European Sky ATM Research 3 Joint Undertaking, which is an institutionalised European public-private partnership, established in 2021, to accelerate through research and development the delivery of the Digital European Sky, as part of the SESAR project.

⁵⁰ CINEA refers to the European Climate, Environment and Infrastructure Executive Agency, which is the European Commission agency which manages decarbonisation and sustainable growth. It is the successor organisation of the Innovation and Networks Executive Agency.

⁵¹ <https://www.daa.ie/wp-content/uploads/2025/05/daa-Annual-Report-2024-ENG-Web.pdf>

⁵² Fraport AG, Press Release (July 2021): <https://www.fraport.com/en/newsroom/press-releases/2021/q3-2021/fraport-receives-pandemic-compensation-for-maintaining-operation.html>

(approximately 195 million passengers), this equates to around €0.8 per passenger over that period.⁵³

- C11 In Amsterdam's case, Royal Schiphol Group's financial reporting does not indicate material recurring operating subsidies. Schiphol is majority state-owned but operates on a commercial basis and has historically paid dividends to public shareholders, with recent increases in aeronautical charges reflecting recovery of pandemic losses and there is no evidence of recovery by subsidy.⁵⁴
- C12 As such, limited evidence has been identified that disclosed government support is a material explanation for lower aero charges at these comparator airports. The caveat is that this conclusion is strongest for observable grants/subsidies in the accounts.
- C13 On borrowing costs, EU state aid rules and the Market Economy Operator Principle ("MEOP") do not support an assumption that public ownership automatically leads to lower borrowing costs. The Commission's guidance makes clear that public guarantees or loans that provide financing on terms more favourable than market conditions confer an advantage and may constitute state aid. Assessment therefore requires comparison of the total financing cost, including any guarantee premium, with the terms of an equivalent market transaction.⁵⁵
- C14 Overall, we do not consider that government support represents a clear driver of differences in aeronautical charges between the comparator airports and HAL.

⁵³ [Fraport AG traffic statistics](#): 24.8 million passengers (2021), 48.9 million (2022), 59.4 million (2023), 61.6 million (2024)

⁵⁴ https://downloads.ctfassets.net/biom0eqyiyi6b/4dK3ANlSkFq31RXtEu9oyP/1a9b38969bfac5a5bd75bd0c1f7d839/Schiphol_Group_Annual_Report_2024.pdf

⁵⁵ [27]

APPENDIX D

Summary of key additional stakeholder submissions

D1 Several stakeholders provided documents commissioned from third parties in support of their submissions. In this Appendix, we summarise those documents which most directly related to our regulatory models as well as explaining our view of their contents. We cover the following four documents which were most relevant for informing our analysis and conclusions:

- *The Mansell report*, commissioned by Heathrow Reimagined from Green Impact;
- Heathrow expansion: capital governance framework, commissioned by HAL from Jacobs;
- Heathrow capital efficiency: best practice review, commissioned by HAL from Amey; and
- *Multi operator airports*, commissioned by HAL from Mott MacDonald.

The Mansell report, Green Impact

D2 Heathrow Reimagined commissioned Green Impact to assess the capital governance and delivery processes followed by HAL and the airlines at Heathrow. Heathrow Reimagined submitted the report, produced by Dr Paul Mansell, as supplementary evidence to its response.

D3 The Mansell report considered that the governance protocols in place should lead to good outcomes, but that this was not the case in practice, even when accounting for the complex operational environment. Three reasons for this underachievement were identified:

- The current governance protocols do not address the disconnect between regulatory periods and asset lifecycles. This leaves airlines “blind” on agreeing priorities over the cycle and making trade-offs;
- The current framework generates a large volume of selective, static information presented at airlines but is insufficient for robust decision making resulting in inadequate oversight of key projects; and

- Trust and collaboration have been eroded as the effort expended by all parties is high yet the basis for and confidence in decision making is low.⁵⁶

D4 The report made 20 recommendations split into three categories: critical (do now); critical (do by); and recommended. The author states that these recommendations are interlinked and cannot be chosen piecemeal. Of these, the first is an “overarching recommendation”, recognising the need for an in depth review to better understand problems with the current governance and decision making. Other recommendations were:

“Critical (do now)” recommendations

1. Conduct a deeper review of HAL’s capital governance that has access to HAL’s senior leadership and project professionals.
2. Ensure earlier, more meaningful engagement with airlines in the design of the portfolio and establish a Capital Investment Group.
3. Take steps to restore trust between stakeholders.
4. Implement a new, less complicated, governance process with fewer layers and crystal clear accountabilities.
5. Learn from existing mega projects to ensure that HAL inserts more realism into cost and schedule estimates.
6. The assurance framework needs revisiting to better understand who the ‘independent assurance’ teams report to, who directs their activity and assesses their competence and success.

“Critical (do by)” recommendations

7. Develop and agree a robust benefits model that clearly defines and agrees value for money for all elements of the capacity expansion programme and for H8.
8. Increase the point at which a project is subject to the capital governance processes from £1m to £5-10m.
9. The role and focus of independent oversight and assurance functions needs to be more independent, more proactive and with an increased remit to access the critical issues early enough to give stakeholders reasonable time to jointly consider their options.
10. Streamline and clarify risk and issue reporting across the Heathrow capital portfolio to ensure transparency and consistency.

⁵⁶ Independent Assurance of Governance for Heathrow Airport’s Expanding Capital Expenditure Plans, Green Impact, December 2025

11. The CAA should closely monitor how risk is allocated, ensuring visibility of when HAL shifts risk onto the supply chain to ensure this does not drive up costs or compromise quality.
12. More should be done to ensure clarity of decisions at key decision points, especially for the top 20% strategically important projects.
13. The increased scale of expansion requires new thinking to identify a better balance of risk and reward within delivery obligations to achieve challenging schedule, cost and benefit targets.
14. The information requirements for individual projects need reviewing. The key tests of the information provision should be whether it is timely, relevant, manageable and enables effective decision making.
15. Change requests should be subject to transparent, independent scrutiny to ensure that adjustments are justified by genuine project needs.

“Recommended” recommendations

16. To improve decision making, collaboration, buy-in and assurance of proposals, decisions and plans, a fundamental restructure of when and how engagement and decision making occurs needs to take place.
17. HAL should look to learn lessons from HS2’s supply chain failings as they are likely to rely on many of the same firms.
18. Simple, plain English guides are required to increase understanding of the core components of HAL’s capital governance protocols.
19. An escalation route through mid-management should be implemented to address issues and risks across the portfolio in a more timely, less senior route.
20. There is a need for more transparency and information sharing of post-project reviews.

Our views

- D5 We agree with the overarching recommendation of the Mansell report that a deeper review of current governance arrangements is required and we have proposed that we will commence such a review with the support of external expertise.
- D6 We believe that the Mansell report provides interesting insight into governance at Heathrow and contains several useful recommendations, both for the governance of expansion as well as HAL’s business-as-usual capex programme. We will further consider these as part of our subsequent review and development of the governance framework. Some of these we highlight in our proposals for packaging regulatory models 1a, 2 and 4. These include, learning lessons from

other mega projects, strengthening of independent assurance, earlier engagement of stakeholders in the planning cycle, and the importance of a proportionate approach.

Heathrow expansion: capital governance framework, Jacobs

- D7 HAL commissioned Jacobs to assess the suitability of the current capital governance framework for delivering expansion and whether the framework requires strengthening. Jacob's assessment was informed by a review of ten case studies across UK mega infrastructure projects (Crossrail, High Speed 2, Sizewell C, and United Utilities Haweswater Aqueduct Resilience Programme) and international airport projects (in Heathrow [T2 and T5 projects], Dublin, Frankfurt, Chicago, and Western Sydney).
- D8 Jacobs says the existing H7 capital governance framework is unlikely to be fit to deliver expansion, which requires a different set of principles that can be informed by lessons from mega projects. Jacobs identified a range of lessons from their case studies across guidance, governance, the role of stakeholders, and the setting of incentives. These included:
- general good governance principles are assurance, transparency and clearly defined roles;
 - governance structure must be tailored to each mega project's unique context, scale and complexity;
 - effective governance should be underpinned by robust assurance, clear accountability and monitoring;
 - governance models should evolve throughout the project lifecycle as complexity and risks change;
 - early definition of stakeholder roles and responsibilities mitigate risks through the project lifecycle;
 - proportionate and targeted stakeholder involvement can help drive successful airport programmes; and
 - independent third parties can strengthen governance by providing impartial oversight and assurance.
- D9 Jacobs concluded that expansion requires bespoke, flexible governance, including independent programme specific assurance, tailored CAA and airline involvement, and clear baselines and change control mechanisms. Specific recommendations were:
- expansion should have a bespoke capital governance framework that is consistent with good practice from comparable projects;

- CAA should adopt a multi-control period funding envelope, with flexibility for scope changes;
- programme-specific independent assurance framework, appointed by HAL, is required;
- CAA and airlines should have a “less intrusive role” for BAU projects during delivery;
- the extent of CAA and airline involvement should vary according to the projects within the programme;
- output, cost, and schedule baselines should be set proportionately at appropriate governance checkpoints; and
- changes to the baseline should be subject to explicit change control processes and approval by CAA.

Our views

- D10 We agree with Jacobs’ conclusion that the H7 governance is unlikely to be fit to accommodate expansion and that changes would be required to protect consumers. This view is reflected in our proposal to shortlist regulatory model 1a.
- D11 We also agree with the importance of incorporating into any future governance framework best practice and lessons learnt from existing guidance and relevant mega projects. We have been mindful of these in developing our proposals for a regulatory model packaging aspects of models 1a, 2 and 4. We expect that lessons from other mega projects will feature as part of our future work to develop an appropriate approach to governance and incentives.
- D12 In our work to develop a new framework we will assess the merits of a range of options, including recommendations such as those Jacobs have made. Several of these already feature in our proposals in this document, including the importance of a tailored and flexible approach, the significant role for assurance, and flexibility in setting baselines. However, we have concerns over some aspects of Jacobs’ recommendations. For example, we are not convinced by the merit of HAL appointing the independent assurer(s), something HAL themselves recognise in their proposals for appointment jointly with airlines (and approved by CAA). Separately, we are also unclear of the merit of the CAA being the approver of change requests as this could create a conflict if the issue were to be escalated to us. Instead, our proposed new, independently chaired capital committee could be the approver.

Heathrow capital efficiency: best practice review, Amey

- D13 HAL commissioned Amey to review the efficiency of the H7 capital framework against construction and infrastructure industry best practice, with a view to

informing changes ahead of H8. The review compares the CAA's H7 regulatory framework with Heathrow's Capital Governance Handbook ("CGH") and assesses their alignment with industry best practice. HAL submitted the report as supplementary evidence to its response.

D14 The review concludes that HAL's approach as outlined in its CGH broadly aligns with best practice, but that the CAA's H7 framework materially constrains HAL's ability to deliver efficiency, especially for large, complex projects.

D15 In particular, the report highlights five areas of principle where the CAA framework does not support alignment with industry best practice:

- "One size fits all" assumption: The application of a single delivery and governance model across all projects introduces inefficiency and risk, particularly for larger and more complex schemes.
- Insufficient flexibility to manage complexity: The current regulatory framework constrains HAL's ability to tailor delivery approaches to project complexity, reducing efficiency and adaptability.
- Approach to contracts: One size fits all approach encourages fixed-price contracts which conflict with best practice for complex projects, leading to risk premiums, supplier reluctance or inefficient risk transfer.
- Risk management: Early fixing of cost, scope and time for projects limits effective risk allocation and increases HAL's exposure to unquantified risks.
- Delays caused by administrative burden: Burdensome governance, change process and compliance requirements risk delaying projects, escalating costs and distracting management effort from delivery.

D16 Generally, the report identifies a "one size fits all" approach in the existing regulatory framework as the core problem, with a resulting lack of flexibility and proportionality. It makes the following recommendations:

- Apply tailored governance and delivery approaches for large, complex and digital projects rather than a single uniform framework.
- Move to a programme basis for larger, complex projects.
- Identify a risk range at G3 and proceed within this rather than a fixed price.
- Quantify the impact of risks where they are being internalised from the supply chain.
- Maximise time and resources allocated to planning and design to reduce change during construction.
- For IT and digital investments, allow agile, iterative delivery models rather than a linear approach.

- Systematically reconcile HAL's CGH with H7 framework requirements in order to identify areas of flexibility consistent with best practice.
- Establish clear criteria for identifying large or complex projects so proportionate governance and flexibility can be applied.

Our views

- D17 We agree with aspects of Amey's recommendations, as reflected in in chapter 4 and our proposals for further developing an approach that packages aspects of our regulatory models 1a, 2 and 4. This includes in relation to tailored, proportionate and flexible governance, which will we further consider and develop as part of our next steps.
- D18 In our future work to develop an approach, we see merit in further considering how projects could be categorised for the purposes of governance and incentives, such as size and complexity, while noting that our existing guidance already expressly allows for projects to be considered in tranches under a programmatic approach. We also see merit in revisiting how cost incentives could operate, particularly for expansion. However, without pre-judging our future work, we are not convinced of the merits of Amey's proposal for setting a range for costs at G3, which would appear to introduce a significant deadband on HAL's incentives to control costs.
- D19 As already stated, in our work to develop a new framework we will assess the merits of a range of options, including those such as Amey have made that are relevant to CAA (rather than HAL).

Multi operator airports- Mott MacDonald

- D20 HAL commissioned Mott MacDonald to carry out comparative analysis of Heathrow Airport, a single operator airport, and two examples of US multi-operator airports – John F. Kennedy (JFK) International Airport and Los Angeles International Airport (LAX). These airports were chosen as they represent different variants of the multi-operator model. HAL submitted the report as supplementary evidence to its response to our Working Paper on regulatory models.⁵⁷
- D21 The report investigated five main hypotheses related to the performance of Heathrow and the two comparator multi-operator airports across a number of dimensions:
- (1) Efficient Use of Capacity;
 - (2) Cost and Revenues;

⁵⁷ [Multi-Operator Airports – Mott MacDonald. Report prepared for HAL, January 2026.](#)

- (3) Quality of Service;
- (4) Governance and Coordination Challenges; and
- (5) Competition and Market Access.

D22 Below we report findings with respect to each of the hypotheses tested.

Efficient use of capacity

D23 Mott MacDonald found that traffic was distributed more efficiently and capacity was utilised more effectively at Heathrow compared with JFK and LAX. The difference was not explained by differences in the traffic mix at the airports but appeared to be a function of better traffic distribution and allocation of facilities at Heathrow.

Cost and revenues

D24 Mott MacDonald found limited evidence to support or challenge the hypothesis that multi-operator airports had higher operating and capital expenditure, and greater commercial risks compared to single-operator airports. It stated that the more efficient use of capacity at Heathrow would translate into lower capital costs (or a higher throughput for a footprint-constrained airport) but that like-for-like comparison of commercial metrics was challenging given JFK and LAX do not have consolidated accounts for the entire airport. It considered that operational costs for multi-operator airports will be higher due to multiple operations centres and a significant number of additional interfaces.

Quality of Service:

D25 A range of ASQ attributes were analysed and Mott MacDonald concluded that overall Heathrow consistently delivered higher airport service quality than JFK and LAX with less variance in performance between terminals.

Governance and coordination challenges

D26 Mott MacDonald found that multi-operator airports required an overall airport operator responsible for core safety, security, landside and airside operations. Each independent terminal operator would have their own management team and control centre, to manage their own operation. Multi-operator airports required significant contractual governance and procedures to deliver a reasonable level of resilience.

D27 This additional governance required resources to monitor, manage and respond to the contractual requirements. Due to operational fragmentation and a lack of common systems, there was less interoperability between terminals when a single terminal was unexpectedly closed or where an overall downturn shock occurred. For hub airports operating at near-capacity, performance during irregular operations was a central performance metric. The ability of the airport

operator to have overall control with access to integrated and interoperable systems across the whole operational asset materially reduced the impact on the consumer and all stakeholders.

Competition and market access

- D28 Mott MacDonald said that in the context of the expansion, terminal and apron capacity limitations were likely to be the primary constraint on airport and market access following the opening of a third runway. It considered that incumbent airlines had the incentive and ability to limit new entry and growth of other airlines in favour of using new runway capacity for slot retimes and punctuality/resilience improvements and that this was evidenced by the lower gate utilisation achieved at JFK and LAX than Heathrow. It concluded that multi-operator airports may require more regulation by the CAA rather than less.

Our views

- D29 We agree with some of the findings from the Mott MacDonald report, as reflected in our discussion of model 7b in Chapter 6 and our minded to decision to shortlist it and seek further inputs from stakeholders.
- D30 Specifically, we agree with Mott MacDonald that operational fragmentation and lack of common systems at multi-operator airports create the need for additional governance requirements to manage interfaces; and might also impact the efficient use of gate capacity and staff resources. We acknowledge both these points in Chapter 6.
- D31 We also agree with Mott MacDonald that independently governed terminal systems operating alongside a unified airfield operator during construction and operation could create variability in passenger experience across the entire journey and by terminal.
- D32 As for competition and market access, we acknowledge the concerns raised by Mott MacDonald on the potential for the owner and operator of the new terminal to act in a manner that would limit the effectiveness of terminal competition. However, we consider that further information is needed before we can reach a definitive view on the impact of model 7b on competition.