

# **Heathrow Capacity Expansion – consultation on regulatory policy on early costs (CAP 3149)**

Response from Heathrow Airport Limited

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## Introduction

We welcome the opportunity to respond to the CAA's consultation CAP 3149 on early expansion costs at Heathrow. We appreciate the CAA's timely engagement, the assurance that efficiently incurred costs should be recoverable, and the commitment to provide a decision on this consultation by September 2025.

Following the Government's endorsement of Heathrow Expansion (Expansion), we submitted a comprehensive proposal in July outlining how a third runway can be operational within a decade. Our scheme builds on prior work from 2016–2020, aligned with the Airports National Policy Statement (ANPS), and avoids duplicative or wasteful efforts – as evidenced by our 1<sup>st</sup> of September submission of a scoping addendum to our Environmental Impact Assessment (EIA) to the Planning Inspectorate (PINS), instead of redoing a full EIA.

Alongside our proposal to Government, we have requested the CAA agree a £320m (2024p) increase to the H7 capital envelope, to enable time critical investment in 2025 and 2026 to mobilise teams, engage suppliers, and prepare our DCO application, keeping us on track for a DCO application in late 2026/early 2027 and consent by 2029.

## Summary of Heathrow response

### Guiding Principles:

Consumer interests should shape the approach to recovery of early costs. We agree that this is best achieved through timely and efficient delivery of Expansion. This requires a framework guided by proportionality and certainty, building on regulatory precedent.

Timely and efficient delivery of Expansion will unlock enormous benefits for consumers through lower ticket prices and greater connectivity. Delays in agreeing the cost recovery framework risks significant consumer harm. A one-year delay could result in passengers missing out on savings linked to the congestion premium of £3.5 billion annually.<sup>1</sup>

We further agree with the importance of a robust regulatory process to support efficiency. The approach to cost recovery needs to be pragmatic to avoid consumers funding significant and unnecessary duplicate or wasteful planning or early construction costs.

To align pace and appropriate oversight, we encourage the CAA to adopt a proportionate approach setting out regulatory arrangements for Heathrow's early costs covering both 2025 and 2026. Clarity and certainty for this initial stage of Expansion is essential to

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<sup>1</sup> Heathrow Expansion CBA Frontier Economics, 2025. Available at <https://www.frontier-economics.com/media/uelp153a/heathrow-expansion-cost-benefit-analysis.pdf>

support momentum. Heathrow will continue to engage with the CAA to develop a regime for recovery of early costs to be incurred after this initial stage, i.e., from 2027 until DCO consent. This later stage is when the bulk of early costs will be incurred and the recovery framework could build on more mature cost and timescale estimates, and more advanced discussions with Government.

#### Heathrow's Proposed Approach:

We agree with CAA's initial view to allow the recovery of Heathrow's costs through a regulatory arrangement which is suitable for the early costs of Expansion, as outlined in Option 1b in CAP3149. However, this depends on careful application of the guiding principles set out above.

CAP3149 is right that recovery of early costs in 2025 and 2026 should build on existing frameworks. Creating a different approach model would not be proportionate, and prone to be inefficient and risk delays, undermining consumer benefits.

While some elements of the previous expansion framework – *specifically ex-post efficiency reviews* – are useful, the entire framework as set at that time is too complex to support the treatment of early costs in 2025 and 2026. More extensive engagement on different aspects of that approach would be appropriate for consideration when defining the recovery of the much more substantial early costs post-2026.

Instead, a *pragmatic adjustment to the existing H7 regulatory framework* would offer a proportionate approach for the time-critical investments needed in the short-term. These adjustments should be targeted, reducing complexity and enabling pace by tackling only those specific elements in the framework that the CAA rightly points out as problematic – *specifically ex-ante review, delivery obligations and requirement for airline agreement to progress with projects*.

We are seeking a clear policy decision from the CAA supporting the following:

- The regulatory treatment for the first stage of Heathrow's early costs for Expansion should be applicable to early costs incurred in both 2025 and the full year of 2026. This is key to provide all stakeholders with clarity and certainty, allowing us to keep momentum.
- Heathrow is allowed to proceed with an additional spend of up to £320m (2024p) for the remainder of 2025 and during 2026. This can be implemented by permitting Heathrow to adjust its expected forecast for capex investments in the remainder of 2025 and during 2026.
- This is in line with existing Licence conditions, avoiding the requirement for lengthy statutory consultations. A full Licence modification and appeal procedure could take three to ten months which is irreconcilable with the pace required to meet the 2029 DCO goal.

- The return on £320m can be recovered through aeronautical charges similarly to regular capex investments i.e., return on the expenditure to be added to the 2026 aeronautical charges and any deviation on actual spend to be adjusted through the K Factor in 2028.
- Efficiently incurred costs will be added to the Regulatory Asset Base (RAB) with cost oversight and scrutiny through *ex-post reviews* by the CAA.
- The capital governance process should support timely delivery of Expansion and therefore its benefits to consumers. Heathrow will continue engaging with airlines on investment plans, but airline agreement should *not* be required for early costs in 2025 and 2026. If the CAA considers airline agreement necessary for specific elements, a fast-track escalation process should be introduced. This would allow the CAA to quickly endorse or reject Heathrow's proposals in case of disagreement. This could be implemented by ensuring that a CAA representative is party to key Expansion costs discussions between Heathrow and airlines.

Below we comment on the options outlined in CAP3149 – with a primary focus on Options 1(b) and (3), which the CAA has indicated as likely to be their preferred choice.

#### **Option 1a: Allow recovery of Heathrow's efficient costs under the existing H7 framework**

We agree with the CAA that a simple replication of the existing H7 regime in its entirety, *including an ex-ante review with delivery obligations and requirement for airline agreement to progress with projects*, is not the right approach to treat the recovery of early Expansion costs in 2025 and 2026, given the characteristics of these costs and potential implementation challenges.

As set out in CAP3149, ex-ante or delivery obligations (DO) are not an effective approach to early costs. Experience so far shows that a consequence of the DOs has been delays in project timelines, particularly in achieving Gateway 3 milestones. Work commissioned from KPMG and submitted with our H8 Business Plan estimates these delays to be of at least two months.<sup>2</sup> The DO framework has fostered a more intensive approach to project management and stakeholder engagement, especially during early stages of development, which tends to come at the expense of expediency, with implications for project costs, efficiency, and delivery schedules. This is particularly concerning in the context of Expansion early costs and the tight timescales against which we need to deliver.

Similarly, we agree that the current H7 governance process between Heathrow and airlines is not fit for purpose as an approach to early costs. As noted in CAP3149, the attempt to agree with airlines on the initial mobilisation costs for Expansion was

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<sup>2</sup> H7 Capex Delivery Obligations Framework - Lessons Learnt. KPMG, 2025.

unsuccessful, resulting a decision to escalate the decision to the CAA. This is not compatible with the Expansion timescales set by Government.

However, we do not think that the existing H7 framework should be completely discarded. Resorting to a well-known and tested approach provides the proportionate solution needed now. Limited targeted adjustments to include a backwards-looking review of the efficiency of costs and appropriate governance engagement with airlines can help address the specific challenges identified.

### **Option 1b: Allow recovery of Heathrow's efficient costs under a new framework**

We agree with the CAA that a bespoke approach could be utilised for the recovery of Expansion early costs. This should be proportionate, crafted on the basis of the principles of timely and efficient delivery of Expansion, building on regulatory precedent to provide clarity and certainty to stakeholders.

Developing an entirely new set of rules to treat cost recovery for this element of Expansion would not be proportionate, and would introduce unnecessary complexity, therefore is not in the interests of consumers. The approach for this initial phase of early costs needs to build on existing models and precedent, offering stakeholders a pragmatic and credible solution.

While some elements of the previous expansion framework – *specifically ex-post efficiency reviews* – are useful, elements like incentives and cap mechanisms would not be proportionate for the treatment of early costs in 2025 and 2026. Early costs to be incurred in this early phase are key to enable the critical path work required to allow a DCO consent by 2029 and thus demand a targeted approach that allows pace. A regime for the bulk of early costs, to be incurred from 2027 onwards, could then further consider more complex mechanisms, building on more mature cost and timescale estimates, and more advanced discussions with Government.

For early costs in 2025 and 2026, a *pragmatic adjustment to the existing H7 regulatory framework* is the best way to support pace while also ensuring adequate cost oversight and scrutiny. This approach would follow key elements of the existing H7 framework complemented by focused adjustments. This has a number of advantages, mainly by providing a quick and robust solution that has been tested, is currently in use, and is well understood by all stakeholders.

Two specific elements need to be reviewed to make the H7 framework suitable for the early costs of Expansion in 2025 and 2026.

1. Ex-post review of costs: we agree with the CAA that it may be advantageous to bring forward a framework allowing for a proportionate backwards-looking (ex-post) review of the efficiency of costs, rather than a forward looking (ex-ante) approach; and

2. Airline engagement: the framework for early costs in 2025 and 2026 needs to ensure that capital governance supports timely delivery of Expansion. While Heathrow should continue to consult and seek agreement with airlines, to maintain a pragmatic approach and pace, their full agreement should not be a requirement to proceed in the case of early Expansion costs. Alternatively, if the CAA considers that airline agreement remains appropriate for certain types of Expansion-related elements where airline knowledge could be directly relevant, then a fast-track escalation process needs to be put in place. For these cases, the CAA would need to commit to deciding on Heathrow's proposed costs within short period of notification to the CAA of any airline disagreement. A suitable engagement framework for the early costs to be incurred from 2027 onwards should be explored in greater depth once a decision has been reached on the appropriate treatment of costs incurred during 2025 and 2026.

It is important that the framework provides certainty by incorporating the treatment of early costs until the end of 2026. A clear and stable policy for this entire critical period is essential to allow us to plan ahead, secure efficient contracts, and mobilise teams to maintain the pace required to support our DCO submission in late 2026/early 2027 and meet the 2029 consent goal.

**Option 2: Allow recovery of efficient costs only for alternative promoters with credible and appropriately mature proposals**

We agree with the CAA in discarding this alternative.

Heathrow has a robust, credible, mature proposal for Expansion, built on years of extensive work and significant engagement and investment. Our commitment to meeting current Government's timescales further testifies to our ability to quickly mobilise and deliver Expansion, especially as our proposed scheme builds on previous scrutiny and is fully aligned with the current ANPS.

Critically, we believe that not allowing Heathrow to recover efficiently incurred costs would be a significant departure from established regulatory principles. This could undermine the Government's Expansion ambitions and risk setting a precedent that is unhelpful for future infrastructure investment in the UK.

**Option 3: Allow recovery of efficient costs for both Heathrow and alternative promoters with credible and appropriately mature proposals**

We welcome the CAA's reaffirmation of the principle that regulated entities should generally recover their efficiently incurred costs. Heathrow supports this principle, which underpins the aviation price control framework.

We are strongly opposed to any proposal amending our Licence to require Heathrow to recover costs from airlines and consumers on behalf any alternative promoter(s). This

proposal falls outside the scope of the powers granted to the CAA by the Civil Aviation Act 2012 (CAA12), lacks demonstrated consumer benefit, has no proper UK regulatory precedent, and introduces significant legal and timetable risks.

This option is inconsistent with the purpose of the licencing and price control regime set out in CAA12, which is to control risks of airport charges exceeding efficiently incurred costs and/or the potential abuse of substantial market power (SMP). The only costs which should be addressed by the Licence are Heathrow's costs, incurred as the regulated entity. The statutory framework does not empower price control conditions being imposed with the objective of recovering costs of entirely separate third parties that are not licensed airport operators and that are not engaged in providing any services to users of the airport, nor does it contemplate the CAA requiring Heathrow to act as a form of tax collector on behalf of rivals. Such costs are not relevant to Heathrow's Licence, the potential risks of SMP, and are not otherwise supported by CAA12. It is our view that establishing such a novel approach would be inappropriate, beyond the scope of the regulatory framework and would require additional legislation from Parliament.

It is unclear how the recovery mechanism and Licence modification suggested in Option 3 could be consistent with the CAA's general duty to further the interests of air transport users nor that it would be a proportionate or consistent exercise of regulatory powers. Licence conditions may only be imposed where necessary or expedient to manage the risk of excessive pricing/abuse of SMP (subject to the limits of what may be included in a price control condition) or to further the interests of users of air transport services. Imposing a condition on Heathrow to recover the costs of any alternative promoter(s) does not appear to meet either of these tests. There is no evidence of any material consumer benefit, and such a condition would bear no relation to the risk of abuse of SMP. The imposition of a third-party cost recovery fund is not the type of arrangement that falls within the scope of the applicable framework. For comparison, the CAA has previously concluded that it does not have the power to force Heathrow to enter into commercial arrangements to promote competition in delivering expansion, and there is no basis to reach any different conclusion in relation to an arrangement for cost recovery for third party proposals.

The CAA has previously recognised that costs incurred by alternative promoters relate to standalone commercial projects, undertaken by non-regulated entities at their own commercial risk. Unlike unregulated entities, Heathrow is restricted in how to finance its business as well as subject to extensive capital governance procedures and regulatory oversight. It is therefore not obvious that the costs treatment of regulated versus unregulated parties should be the same nor that using Heathrow's Licence is the right mechanism to manage this.



The CAA would need to provide credible evidence of any consumer benefits that it believes might arise from the recovery mechanism and Licence modification suggested in Option 3. Adopting these proposals could result in consumer detriment from using an aviation price control condition as a means of supporting unregulated commercial entities with their commercial endeavours in promoting alternative expansion schemes.

If this precedent is set, it would be important for the CAA to consider such risks very carefully in view of the substantial financing requirements required for airport development programmes. There is no guaranteed benefit to airlines and consumers of this proposal, but there would be a certain impact on airlines and consumers through higher aeronautical charges. Using the price control framework to support such schemes would be a novel and unjustified regulatory intervention. Timely and efficient delivery of Expansion would likely outweigh any potential benefits in this early phase.

Indeed, there is no direct precedent in UK regulation for requiring a regulated entity to recover the costs of a rival new entrant through regulated charges. Where somewhat comparable mechanisms have been used, they have been backed by express legislation and safeguards. The CAA's proposal lacks such a framework on which to rely, and there are other alternatives which the CAA could pursue – using Heathrow's Licence is not the proper avenue.

The CAA's proposals would also expose Heathrow to additional administrative costs (also required to be charged to airlines/consumers) as well as legal, bad debt and litigation risks by being required to act as a middleman between airlines and any relevant alternative promoter(s). This is fundamentally unrelated to Heathrow's price control, disproportionate, and no information has been provided as to how such risks could be accounted for or appropriately managed. Furthermore, some of the CAA's proposals, such as those set out in paragraph 1.23 of CAP3149, may be difficult to implement, requiring more consideration of possible competition law implications.

Finally, implementing the recovery mechanism suggested in Option 3 would require a complex and lengthy process, including Licence modification, consultation, and potential appeals. This would threaten Government's timetable, increase uncertainty, and would not support the CAA's general duty nor the timely and effective development of DCO proposals. Such approach is neither supported by sufficient evidence of consumer benefit to be proportionate nor otherwise justified, and we urge the CAA to discard this option.

#### **Option 4: Do not allow recovery of costs**

We agree with the CAA in discarding this alternative.

The assurance provided by cost recovery allows Heathrow to invest confidently, quickly and with a lower cost of financing than would otherwise be the case. Consequently, this



also enables Heathrow to support the Government's wider economic growth ambitions and to enable the significant benefits to passengers brought by Expansion.

Not allowing cost recovery would be irreconcilable with fundamental regulatory principles and detrimental to Government's Expansion plans.

### Proposed Approach

We support the CAA's position that a bespoke approach rooted in established models and precedent is appropriate for recovering Expansion early costs in 2025 and 2026. Utilising an *adjusted version of the H7 framework* would offer a proportionate mechanism to support pace and appropriate oversight of costs, which is ultimately in the interest of consumers.

To enable this, we are seeking a clear policy decision from the CAA that supports Heathrow to progress with an investment of up to additional £320m (2024p) for the period through to the end of 2026. This would allow us to efficiently mobilise our teams and engage suppliers in preparation for our DCO application in the timescales set by Government. To implement this, we propose that the CAA permit Heathrow to adjust its expected forecast for capex investment in the remainder of 2025 and during 2026.

We propose that the CAA's oversight of these efficiently incurred costs in 2025 and 2026 is conducted through a proportionate ex-post review, which would be more suitable for this type of expenditure than a prescriptive, upfront review. The efficiently incurred costs would be capitalised and added to the RAB, and the return on the capital invested would be recovered through aeronautical charges.

Whilst we will continue to engage with our airline partners on this project, there is a need for a pragmatic approach for early costs incurred during 2025 and 2026. We do not believe final agreement from airlines should be required for these early Expansion costs.

The proposed approach provides the necessary balance between regulatory oversight and the agility required to deliver Expansion. By using the existing licence and avoiding the need for a new statutory consultation, this approach ensures a timely and efficient path forward for all stakeholders. We will continue to support the CAA to develop a regime for the bulk of early costs, to be incurred from 2027 onwards.