



International Airlines Group, S.A. (IAG) Response to CAA's consultation on a shortlist of regulatory models – CAP3251

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Contents

Executive Summary	4
Introduction and overarching position.....	8
Recap of the IAG Proposed Solution submitted in response to CAP3195.....	10
Overall view on the CAP3251 shortlist	12
Section 1: Building on the CAA's shortlisted models	14
1.1 The Capital Investment Committee.....	14
1.1.1 How capital allocation works in disciplined, capital-intensive organisations	14
1.1.2 What disciplined Capital Planning should mean in practice.....	15
1.1.3 Reviewing not just the size, but the composition, of the RAB	16
1.1.4 Appropriate allocation of risk: making the regime meaningful	17
1.1.5 Other CIC design points	18
1.2 Competition	19
1.2.1 Three components of the Heathrow RAB, and how the competition models map to them	19
1.2.2 Model 7b is the right path forward wherever practicable	20
1.2.3 Model 7b applies equally in a three-runway and a two-runway setting.....	20
1.2.4 Model 7b already exists. CAA only needs to ensure it can be established as broadly as possible across the campus.....	22
1.2.5 Model 7b is the most appropriate remedy, and other models are subsets or variations of it	23
1.2.6 Where Model 7b is not feasible: Model 5b and the DPC analogue.....	24
1.2.7 Why a single cross-campus Maximum Allowable Yield is essential for competition to deliver for consumers	25
1.2.8 Protecting the competitive process: realistic assumptions and meaningful penalties	26
1.3 A special case: land acquisition timing and pricing	27
Section 2: The CAA has the legal powers to implement this proposal	29
Section 3: The IAG Proposed Solution keeps investors whole and maintains regulatory certainty.....	30
3.1 Past investments are honoured and future investments earn a regulated return, supporting investor confidence	30
3.2 Ensuring regulatory certainty and investor confidence does not prevent the CAA from reforming economic regulation through a comprehensive consultation process.....	30
3.3 Ownership of components does not affect regulatory certainty	32
Section 4: The IAG Proposed Solution strengthens financeability	34
4.1 Lower quantum is easier to finance	34
4.2 More efficient capex makes airline economics work, which protects the RAB	34
4.3 Multiple balance sheets are easier to finance than one.....	34
4.4 The cost of capital is set by underlying cash flow risk, not by a “competition wedge”. ..	35
Section 5: Competition is fully compatible with operational resilience and safe operations	37

5.1 Heathrow already operates as a multi-operator ecosystem	37
5.2 International evidence supports the compatibility of competition with strong operational performance	38
5.3 British Airways' own experience of operating in multi-operator environments	38
5.4 The relevant safety regulatory framework is unchanged	38
5.5 Coordination overhead is a price worth paying for capex efficiency	38
Conclusion and next steps.....	40
Annex A: International Best Practice in Airline–Airport Capital Collaboration — Lessons from American Airlines and DFW	42
Annex B: Why Model 3 is not the right model to push forward	52
Annex C: T2 Baggage Renewal: an example of failed capital governance	60

Executive Summary

The case for change identified in CAP3251 arises overwhelmingly from the shortcomings of the existing two-runway Heathrow: its position as the world's most expensive major hub airport, persistent service-quality underperformance, and demonstrated capital inefficiency. Regulatory reform should therefore proceed without delay. Adding a £49 billion-plus expansion programme to an unreformed regulatory framework would risk entrenching, on a much larger scale, the very consumer harms that the CAA itself has identified.

International Airlines Group, S. A. (IAG) welcomes the publication of the CAA's shortlist of regulatory models. This response builds directly on IAG's January 2026 response to CAP3195 and should be read alongside that submission, as well as the Heathrow Reimagined CAP3251 response, which IAG has co-authored and endorses.

At the centre of our proposal is an integrated package of reforms (*"the IAG Proposed Solution"*) comprising:

1. a Capital Investment Committee (CIC) with genuine authority over capital planning, budgets and delivery; and
2. competition across the Design-Build-Finance-Operate-Maintain-Own (DBFOMO) value chain.

The submission also explains how a multi-RAB model operating within a single cross-campus Maximum Allowable Yield structure can be used to share the costs of the infrastructure with all users of the Heathrow campus. The application of a multi-RAB model may become more necessary when major developments imply the marginal cost of capacity will significantly exceed the average costs on the campus. For example, the new runway or the central terminal area renewal and expansion.

Together, these reforms would maintain regulatory certainty, preserve investor confidence, honour past investments, support financeability, and remain fully consistent with safety and operational resilience requirements.

A coordinated HMG-CAA effort is required, but the CAA must act in any case

Successful capacity expansion will require coordinated action by the CAA, the Department for Transport (DfT) and HM Government more broadly. The Airports National Policy Statement (ANPS) and the Development Consent Order (DCO) process should enable competition and provide a clear framework for identifying and progressing the most cost-effective combination of schemes through a defined selection process, while preserving genuine scope for promoters to develop alternative ANPS-compliant proposals.

For its part, the CAA must establish a regulatory framework that delivers capital discipline, capital efficiency, affordability for airlines and consumers, and effective competition in the provision of airport operational services. It must do so without yielding to pressure to adopt timescales that are known to be unrealistic. While responsibility for successful expansion is shared with Government, that does not diminish the CAA's own statutory obligation to act now.

A Capital Investment Committee with real authority, not another consultative forum

Models 1a, 2 and 4a provide a sound foundation for establishing the CIC at the heart of the IAG Proposed Solution. However, the CAA must ensure that the CIC possesses genuine decision-making authority. It cannot be another consultative body that HAL can simply navigate and circumvent. The CIC must have the power to approve or reject long-term capital plans that do not align with consumer interests, in the same way that major airlines routinely exercise capital discipline at their respective hubs.

This is not a novel construct. It reflects the operating model of every well-run capital-intensive business and, more directly, of major US hub airports. Annex A provides first-hand evidence from American Airlines of how a negotiated capital envelope, pre-approved capital programme, Majority-in-Interest voting on additions, and multi-layered strategic, project and affordability engagement operate at Dallas-Fort Worth International Airport. The result is the delivery of expansion programmes at materially lower unit cost than HAL's past and current proposals.

Risk allocation must also be appropriate. Management and shareholders should not be rewarded for poor consumer outcomes. The CAA should establish and be prepared to use mechanisms that enable bonuses and dividends to be impacted where appropriate and proportionate.

Competition at the centre of reform, paired with a single cross-campus MAY

Model 7b (direct competition for airport operational services across the value chain) should sit at the centre of the reform package. The rationale for Model 7b applies equally in both a two-runway and three-runway environment. Nor is the model novel at Heathrow. It already exists in practice for ancillary assets, including the Arora-developed Sofitel, British Airways' maintenance hangars and the cargo estate (including IAG's Cargo Terminal: Ascentis), where third parties design, build, finance, operate, maintain and own infrastructure while leasing land from HAL.

The CAA's task is to extend Model 7b to the assets that matter most to consumers: the Central Terminal Area modernisation programme, the medium-term redevelopment of Terminal 4, and new infrastructure associated with a third runway.

Model 7b is not dependent on a DCO-led pathway. It can equally be implemented through contractual arrangements introduced via licence modification under the Civil Aviation Act 2012 (CAA12).

Competition delivers the greatest consumer benefit when paired with a single cross-campus MAY. Without it, more efficient new infrastructure would attract passengers while legacy facilities would be left recovering fixed costs from a shrinking user base, resulting in passengers and airlines with the least choice paying more for objectively worse infrastructure. A single MAY ensures that new capacity is funded fairly across the campus and that efficiency gains are shared by all passengers, not just those using newly competed facilities.

This logic complements the existing benefits of a cross-campus single-till framework, under which non-aeronautical revenues are pooled across the airport estate, reducing aeronautical charges for all passengers rather than allowing those benefits to be retained within individual facilities.

Model 5b is essential where Model 7b cannot be applied to a particular asset. However, tender processes must be managed by the CAA and/or the relevant designated body, not by HAL. Tender specifications and requirements are the principal determinants of value for money; leaving control of the process entirely with the incumbent would undermine the competitive discipline the model is intended to create.

Model 8 (transfer of ownership of an existing asset) should also remain available as a complementary route alongside Model 7b. It should not be ruled out. Model 8 could be implemented either through: (i) a market investigation reference by the CAA to the Competition and Markets Authority (CMA) under CAP1235; or (ii) partial divestment by HAL, with the acquired assets operated by a separately licensed entity under CAA2012. The CAA should ensure both pathways remain available.

The CAA has the powers it needs. Not using them inappropriately fetters its discretion.

The CAA can implement the IAG Proposed Solution through targeted modifications to HAL's existing economic licence under CAA12 sections 18, 21 and 22. The Solution does not require primary legislation, does not require the CAA to transfer or create property interests, and does not require an immediate new Market Power Determination (the 2014 MPD remains in force until and unless the CAA chooses to revisit it).

Reform protects investors and strengthens financeability

The IAG Proposed Solution honours past investment under the Regulatory Asset Base (RAB) and ensures future investment continues to earn a regulated return. However, the right to earn that return on future investment should be earned through competitive discipline rather than granted by default.

The proposed framework strengthens financeability rather than weakens it. A smaller and more efficient investment programme is inherently easier to finance than a £49 billion-plus capital envelope. Multiple balance sheets can attract a broader investor base than a single, highly leveraged balance sheet. More efficient capital expenditure helps maintain affordability, protects the integrity of the RAB, and supports long-term demand. The cost of capital is determined by underlying cash-flow risk, not by the introduction of a “competition wedge”. The CAA's commissioned financeability assessment by Centrus (CAP3251A) supports this conclusion.

Competition is fully compatible with safety and operational resilience

IAG and other airlines would not advocate a framework that compromises safety or operational resilience. Airlines have a greater interest than any other stakeholder in ensuring Heathrow remains both safe and resilient.

The evidence is clear. International experience, including Munich, Atlanta and New York JFK (and Heathrow's own operational reality) demonstrate that competition and operational resilience are compatible. Heathrow already operates in a multi-operator environment involving a range of service providers, including the existing Model 7b-type precedents identified above.

The safety regulatory framework administered by the CAA's safety function and by NATS would remain unchanged under the IAG Proposed Solution.

Suggested approach

IAG remains ready to engage constructively with the CAA, DfT and HM Government to translate these principles into the detailed reform package required to make Heathrow expansion a success. We urge the CAA to use its July 2026 update to:

- (i) confirm Model 7b at the centre of the competition package, applied to new and existing assets alike;
- (ii) confirm that Model 5b tenders will be conducted under CAA or the designated-body oversight rather than left wholly with the incumbent; and
- (iii) establish a CIC with genuine authority to approve or reject capital plans, supported by appropriate risk allocation and enforcement mechanisms; and
- (iv) review the feasibility of Model 8 through a CMA market investigation referral or legislative change.

In our judgement, acting now - with the powers the CAA already holds - is of vital importance.

Introduction and overarching position

International Airlines Group, S.A. (IAG) welcomes the opportunity to respond to CAP3251. This response builds directly on, and should be read together with, our January 2026 response to CAP3195 and the response to CAP3251 submitted by Heathrow Reimagined (which IAG has co-authored and endorses). Where this submission is silent on a particular point covered in those documents, that should not be read as a change of position.

As we set out in our response to CAP3195, the design of an economically viable Heathrow expansion is not a matter for the CAA alone. The success of expansion will be determined jointly by: (i) the regulatory framework established by the CAA; (ii) Government decisions on the Airports National Policy Statement (ANPS), the Development Consent Order (DCO) process, scheme scope, and risk allocation; and (iii) wider HM Government policy levers, including aviation taxation and the broader policy stack borne by airlines and consumers. Reform in any one of these areas, in isolation, will not be sufficient.

IAG agrees with the CAA that delivering capacity expansion at Heathrow successfully will require a coordinated effort between the CAA, the Department for Transport (DfT) and HM Government more broadly. Regulatory reform of Heathrow will also require significant co-ordinated action across government and regulators. The roles of each are distinct but inter-dependent:

- **the ANPS and DCO** must enable competition and provide a clear framework to identify and progress the best value-for-money scheme. As currently structured, there is a gap between the policy stage and the DCO consenting process, with no mechanism to determine which proposal should be taken forward. Accordingly, the ANPS should facilitate a defined process, which enables competing promoter proposals to be assessed on a level playing field against objective criteria and allow the selection of the best value-for-money scheme combination, rather than pre-judging a single promoter. This process ought to operate prior, or as a gateway, to the DCO stage to manage competition between promoters and avoid parallel DCO applications. It should include the establishment of a selection process or body (drawing on the approach previously undertaken by the Airports Commission). The framework should also leave promoters genuine room to develop different schemes while remaining compliant with ANPS objectives. We have set out our detailed proposed amendments to the ANPS in our letter to Hannah Newell dated 15 April 2026 (attached to our email response to the CAA CAP 3251); and
- **the CAA** must establish a regulatory framework that ensures capital control, capital efficiency, affordability for airlines and consumers, and effective use of competition in the provision of airport operation services (AOS). This should be done without undue influence or pressure from HMG on timescales, timescales that are known to be unrealistic under the current plans. While the CAA is not the sole party responsible for the success and viability of expansion, the CAA sharing responsibility with Government in this process does not diminish the CAA's own legal imperative to act now.

Economic reform is critical also in respect of the existing airport campus. The CAA has itself identified a clear case for change in the existing economic regulation of Heathrow, supported by extensive evidence of shortcomings in capital discipline, cost control and the protection of consumer interests. In these circumstances, the CAA must now act within its existing statutory powers to introduce a comprehensive and integrated reform package that addresses these deficiencies at their root. This requires more than incremental adjustments to the current regime. The CAA must exercise its functions under section 1 of the Civil Aviation Act 2012 in a manner that furthers the interests of users of air transport services and, where appropriate, promotes competition in the provision of airport operation services. A failure to implement an effective and coherent package of reforms at this stage would risk leaving known sources of consumer harm unaddressed and would be difficult to reconcile with the CAA's statutory duties.

This document focuses on responding to CAP3251 and, in particular, on how the CAA can build on its proposed shortlist to deliver the regulatory step-change needed to enable a successful Heathrow, in both a 2-runway and a 3-runway setting.

Recap of the IAG Proposed Solution submitted in response to CAP3195

In our response to CAP3195, IAG set out an integrated regulatory solution designed to address the root causes of the consumer harm observed at Heathrow today and to provide the foundation for capacity expansion that is affordable, in the interests of consumers and that can be delivered on time and on budget. The key features of that proposal, referred to in this response as the IAG Proposed Solution, are:

- **A Capital Investment Committee (CIC)** that oversees capital planning, capital approval and capital performance monitoring across the regulated Heathrow campus. The CIC provides the scrutiny, accountability and capital discipline that has been demonstrably absent under the current economic regulation arrangements. We explain in this paper why the CAA must go further than it currently envisages in CAP3251;
- **Competition across the value chain:** specifically across Design, Build, Operate, Finance, Maintain and Own (DBFOMO). Competition should be applied across the value chain, with a focus on major new infrastructure (e.g.: new terminals, redevelopment of existing terminals, baggage systems, etc.), with the right to earn a regulated return on future investments competed for rather than reserved for the incumbent. We explain why model 7b is the most practical approach and should not be restricted to a DCO process;

The submission also explains how a multi-RAB model operating within a single cross-campus Maximum Allowable Yield structure can be used to share the costs of the infrastructure with all users of the Heathrow campus. The application of a multi-RAB model may become more necessary when major developments imply the marginal cost of capacity will significantly exceed the average costs on the campus. For example, the new runway or the central terminal area renewal and expansion.

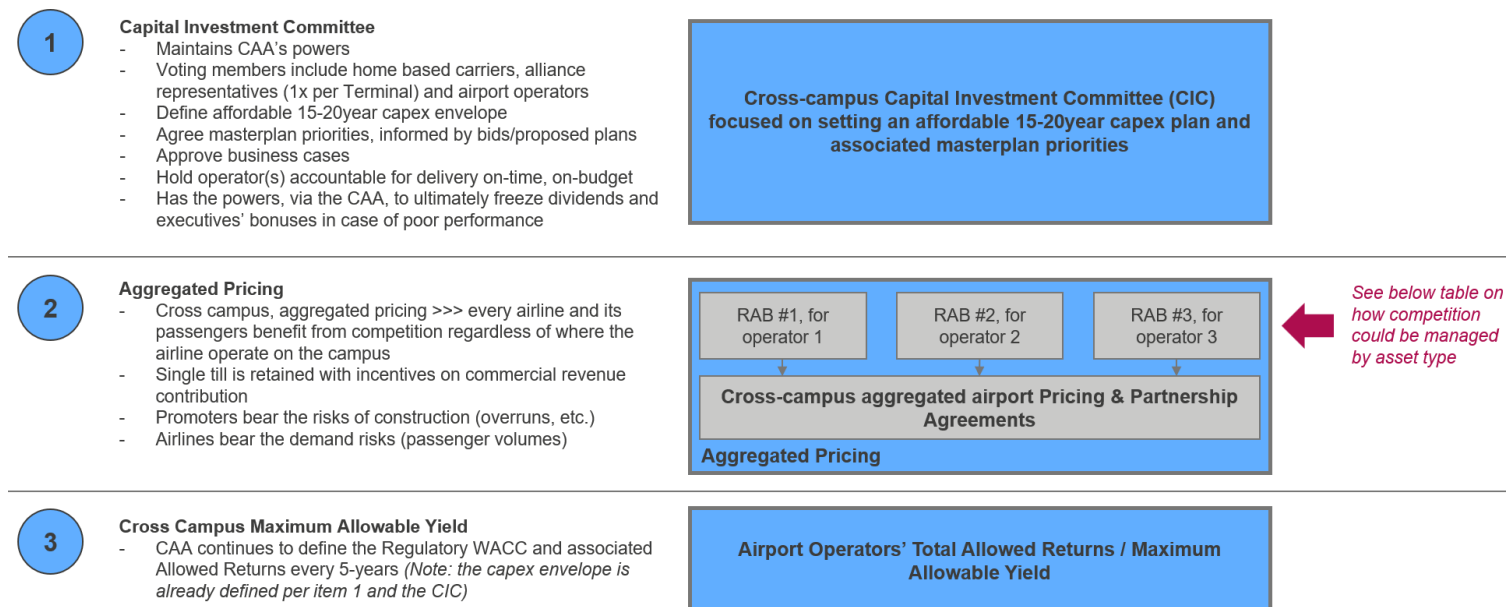
These elements are not alternatives; they are designed to work as a single, integrated package. Removing or substantially diluting any one of them weakens the others. Crucially, the IAG Proposed Solution preserves the RAB-based reward of investments already made and properly approved, so that investors are kept whole and regulatory certainty is maintained, while introducing competitive discipline at the points in the value chain where it can drive value for consumers going forward. No efficiently incurred past investment and associated compensation is being challenged by IAG. However, the right to a return on future investment has to be earned on merits.

Together, these reforms would maintain regulatory certainty, preserve investor confidence, honour past investments, support financeability, and remain fully consistent with safety and operational resilience requirements.

Figure 1 - IAG Proposed Solution

The IAG solution relies on a CIC and also leverages competition with appropriate selection processes based on asset types.

Solution building blocks:



Selection process by asset type – illustrative example of how it could work

Type of Assets	Capacity Expansion: Runway, New Terminals and Existing Terminal Redevelopment			Track-transit systems, Baggage systems, Tunnels and other large projects					Business As Usual projects (Safety, Maintenance, etc.)			
Competitors	1	2	3	A	B	C	D	E	i	ii	iii	iv
Government's role in the selection process	• Establish an ANPS that is objectives-led and provides sufficient flexibility to not pre-judge of the regulatory reform outcomes nor utilise the DCO process in a way it was not designed to operate • Establish a pre-DCO selection framework that enables to select the best value for money packages that deliver against the ANPS objectives (led or materially supported by an independent advisory body) • Consult with the CAA • Consult with the CIC			• n/a					• n/a			
CAA's role in the selection process	• Run the affordability and operability evaluation for the Government and assess its alignment with consumers' interests • Provides visibility on the impact of the projects on charges • Consult with the CIC • Make recommendations to the Government's commission			• Designate the body/party in charge of running the selection process • Provides visibility on the impact of the projects on charges • Consult with the CIC					• n/a			
CIC's role in the selection process	• Assess the fit of the project within the overall capital plan • Evaluate impact of the project on other capital projects and the associated re-prioritisation required • Seek expert advice on the project to evaluate operability and value for money • Make recommendation to the CAA and Government as appropriate (approve the project vs. appeal against the project)								• Assess the recommendation from the airport operator(s) (using expert advice) • Approve the recommendation or appeal the recommendation for CAA's review			

Overall view on the CAP3251 shortlist

IAG agrees with a substantial portion of the CAA's proposed shortlist in CAP3251. We particularly welcome the CAA's recognition that several of the shortlisted models are mutually compatible and that a package of reforms, rather than any single model, is required to address the failings of the current regime. There is no one single solution and the relevant models need to be jointly implemented if the package is to deliver the consumer outcomes the CAA's statutory duties require. In particular, the CAA's primary duty under section 1(1) of CAA12, to further the interests of users of air transport services, mandates a comprehensive approach to reform rather than piecemeal measures. Given the evidence presented, any significant dilution or omission of the core components needed to remedy the current regulatory frameworks deficiencies may fail to satisfy this primary duty. A partial regulatory solution would risk leaving known inefficiencies and consumer detriments unaddressed, which would not meet the statutory requirement to further the interests of consumers. We emphasise that a holistic, integrated package of reforms is legally and operationally necessary to achieve the outcomes that the CAA's statutory duties demand.

In particular:

- Models 1a (changes to capex governance), 2 (targeted adjustments to the existing incentive regime) and 4a (enhanced scrutiny of HAL's approach to procurement) form a sound basis for establishing the CIC and the supporting capital governance regime that sits at the heart of the IAG Proposed Solution. Some key adjustments are needed, which we set out in Section 1 below.
- Model 7b (direct competition for airport operation services) is the primary model to leverage competition and drive value for money for consumers and should sit at the centre of the package. Model 7b should not be restricted to a DCO process as it can also be imposed on HAL via contractual arrangements.
- Model 5b (Design, Build, Operate) is a key model to retain where full competition cannot be established via Model 7b. However, a tender under Model 5b should be managed by the CAA and/or the relevant designated body, not by HAL as the requirements/specifications defined in the tender process are key building blocks for Value for Money solutions.
- Accordingly, the CAA's focus should be on establishing a genuine CIC (not merely a new consultative forum), implementing Model 7b wherever feasible. Where Model 7b cannot be used for a particular asset, Model 5b (a DPC-style competitive delivery) should be used to inject competition.
- The CAA should also ensure Model 8 is fully explored given the possible pathways of:
 - The CAA making a market investigation reference to the CMA, pursuant to CAP 1235 (Guidance on the Application of the CAA's Competition Powers)¹;
 - Legislative change through the Civil Aviation Bill

¹ <https://www.caa.co.uk/publication/download/14993>

This response is structured to address, in turn, the five core questions that follow from this overall position:

- **Section 1:** how the CAA can build on its shortlisted models to deliver a fundamental improvement in regulatory effectiveness and enable Heathrow to succeed in both a two-runway and a three-runway setting;
- **Section 2:** confirming that the CAA has the legal powers under the Civil Aviation Act 2012 (CAA12) to implement this transformational proposal;
- **Section 3:** confirming that the IAG Proposed Solution keeps investors whole and maintains regulatory certainty;
- **Section 4:** confirming that the IAG Proposed Solution strengthens, rather than undermines, the financeability of expansion; and
- **Section 5:** confirming that competition is fully compatible with operational resilience and safe operations.
- **Annex A:** providing a real-life example of how adequate capital governance and collaboration works at DFW, between American Airlines and the airport
- **Annex B:** explaining why Model 3 is not the right model to address the flaws identified in the Case for Change and why it will not reduce consumer harm nor further the interests of consumers
- **Annex C:** explaining how the current capital governance failed in the context of the Terminal 2 baggage system

Section 1: Building on the CAA's shortlisted models

This section sets out how the CAA can build on the shortlisted models to create the fundamental improvement in regulatory effectiveness that is required for Heathrow to succeed in both a two-runway and a three-runway campus. We address the Capital Investment Committee (CIC) first, followed by the use of competition, and then a material and related point on land acquisition and early costs.

1.1 The Capital Investment Committee

Models 1a, 2 and 4a, taken together and with the adjustments described below, provide the foundation for the CIC envisaged in the IAG Proposed Solution. As a starting point, the CIC must be established as a cross-campus body, with oversight of the capital plans of all Heathrow airport licence holders. This is essential to deliver the IAG Proposed Solution and to ensure consistency of treatment across operators. It is also essential in a two-runway environment: the case for change identified in CAP3251 arises overwhelmingly from the existing airport, not from expansion alone, and the CIC must be formed and implemented without delay. It should be noted that until a new Market Power Determination is conducted (if the CAA wishes to conduct a new one), the current MPD remains valid and the relevant part of the campus remain under CAA's regulatory oversight.

1.1.1 *How capital allocation works in disciplined, capital-intensive organisations*

The CIC is not a novel regulatory construct. It is designed to introduce the disciplined capital planning that capital-intensive organisations routinely apply to themselves. The underlying principle is straightforward: where the available capital is finite and the cost of misallocation is high, investment must be planned, justified, prioritised, sequenced and tracked against pre-agreed outcomes. That principle applies to publicly-owned infrastructure and to privately-owned businesses alike. Heathrow should not be an exception.

The clearest direct analogue is how capital allocation works at other major hub airports. In the United States, the negotiation of the capital envelope is a core component of the airline–airport lease (the Airline Use and Lease Agreement, or AULA): it establishes both the scope of the investment to be undertaken and the methodology by which it will be recovered through charges. At Dallas-Fort Worth International Airport (DFW), for example, the lease defines a pre-approved capital programme covering both growth-supporting infrastructure (e.g. terminal redevelopment, new piers, etc.) and asset repair and replacement work that has been jointly validated as necessary. Items outside the pre-approved envelope must run through a separate process (a Majority-in-Interest vote), weighted by the financial exposure each carrier will bear under the rate-setting methodology, with voted (or deemed) approval unless airlines actively disapprove within a defined window. Multi-layered engagement runs in parallel throughout the programme lifecycle: airline corporate-real-estate teams align upstream programme drivers with the airport's executive leadership; airline planners work alongside airport planners on phasing, constructability and prioritisation; airline commercial and airport-affairs teams work alongside airport finance teams on affordability and the projected cost-per-enplanement profile. Phasing and milestones are agreed jointly and tracked, even where ultimate delivery

dates depend on external dependencies such as planning consents. These are not theoretical mechanisms, they are the everyday operating model at DFW and at other major US hubs, and they deliver expansion programmes at materially lower unit cost than HAL's proposals. We develop this evidence in detail in Annex A.

The same underlying disciplines apply to large capital-intensive businesses, not only to airports. Available capital is finite and is managed as such. Operating units or business divisions must put forward specific investment projects and longer-term plans, supported by evidential business cases, expected returns, defined delivery milestones and outcome measures. Capital is then allocated across competing investments over a defined horizon according to strategic fit, affordability, delivery confidence and track-record, and value for money. Disciplined capital planning provides a continuous, group-level view of how investment capital is deployed over the cycle, with rigorous project planning, formal approvals at defined gateways, and accountability for pre-agreed outcomes. Management accountability (including remuneration) is explicitly linked to the delivery of approved plans against budget, schedule and outcomes. This is the operating model in every well-run capital-intensive business listed on a major equity market, and it is the operating model at the major US hub airports we describe above. It is not a novel construct.

This is the rigour and discipline that the CAA needs to replicate at Heathrow through the CIC.

By contrast, HAL has in practice operated with a highly permissive capital framework. While the existing regime includes incentive arrangements and service-quality mechanisms, those mechanisms have not amounted to a hard capital budget over the renewal cycle of the airport or a robust gatekeeping discipline on what enters the RAB. The regime has provided for consultation on expenditure, but with information asymmetries in favour of HAL, and has not prevented over-scoped or poor-value expenditure from being passed through to consumers. Once expenditure is added to the RAB, the default position is that HAL earns a return on it, with only limited and insufficient mechanisms to prevent consumers from bearing the consequences of inefficient or weakly-justified investment. A further weakness in the current process, identified in the report by Dr Mansell, is that HAL is not currently required to produce a long-term capital plan. Replacing the existing regime with the discipline of a CIC, informed by the operating practice at DFW and at other major US hubs, and by the broader operating model of capital-intensive businesses is the single most important capital governance change the CAA can make.

1.1.2 What disciplined Capital Planning should mean in practice

It is important to be precise about what is meant by the disciplined Capital Planning that the CIC will oversee. Disciplined Capital Planning is not a periodic exercise in setting a single headline figure of “capital envelope”. A single figure can be, and has been, poorly anchored to deliverable outcomes and lifecycle impacts on affordability. The CIC must oversee a Capital Planning that is a continuous, portfolio-led framework for shaping, trading-off, sequencing and governing long-term investment across the airport, anchored in a continuously maintained long-term capital plan grounded in the masterplan, affordability, asset condition, renewal cycles and operational requirements. It should have clear traceability from strategic need

through to approved delivery. Annex A clearly demonstrates how this process works between American Airlines and Dallas-Forth-Worth International Airport.

The capital plan should comprise, at a minimum:

- a Capital Strategy linked to the masterplan, asset condition and renewal cycles;
- a prioritised portfolio of near-, medium- and long-term investments with sequencing choices;
- clear allocation principles and trade-offs across competing needs;
- lifecycle costing, affordability and alternative options;
- explicit customer, operational and resilience outcomes – not just outputs;
- reporting supported by asset data, benchmarking and assurance.

Portfolio prioritisation should determine funding for project-level development. Project-level capital planning should define requirements, appraise options, develop whole-life costs and confirm delivery strategies, culminating in a CIC investment decision that approves only sufficiently mature, deliverable and justified projects with clear accountability for scope, cost and outcomes.

The framework should be evidence-led, using asset condition data, whole-life performance information, external benchmarking and independent assurance. The CIC should require a near-term investment plan covering capital expenditure at project-level detail (scope, cost, schedule), alongside a medium-term prioritised pipeline and a 15–20 year² strategic horizon for renewal and capacity assumptions.

This is the minimum level at which the CIC and the CAA can meaningfully oversee efficiency, deliverability and outcomes. Contingent or undefined expenditure will still be required but must remain within the investment framework and allocated by CIC with sufficient evidence provided to assess full trade-offs and impacts. The CAA should set this threshold in licence-based guidance and the CIC should hold operators accountable to it.

1.1.3 Reviewing not just the size, but the composition, of the RAB

One of the less well-understood features of RAB-based regulation, and which existing arrangements do not properly address, is that the owner of a regulated business does not face neutral incentives across different categories of capital expenditure. Different assets in the RAB have very different economic properties for the owner.

Long-lived assets, and in particular land and structures, embed substantially larger "inflation wedges" and "tax wedges" than short-lived assets. They earn an allowed return for many decades, they index broadly with inflation, and, in the case of land they do not depreciate at all. Short-lived assets such as software and rapidly-obsolescing IT have the opposite properties: they earn a return for a short period, they depreciate quickly, and they generate relatively little inflation- and tax-related uplift to the equity value of the business. Commercial property sits between the two: it does not depreciate in the same way as plant and equipment,

² The planning horizon may be longer for some assets linked to expansion

but it requires meaningful cash maintenance, which dampens its asset-class advantage in a single-till framework.

The rational owner of a regulated business therefore has an incentive to bias its capital portfolio towards long-lived assets, and within that, towards land in order to increase their allowable returns through higher airport charges. The composition of the RAB matters as much, and arguably more, to the owner's equity value as its total size. This is a separate point from inefficiency in delivery: a well-delivered, on-budget land purchase or terminal building can still result in capital misallocation if it has been preferred over an equally functional but shorter-lived alternative.

We do not consider that this dynamic is presently appropriately regulated at Heathrow with such incentives resulting in users paying high charges for poor capital investment outcomes. The CIC must therefore have an explicit responsibility, alongside its responsibility to scrutinise the efficiency of individual projects, to scrutinise the composition of the proposed long-term capital plan against the underlying functional requirements of improved airport assets, including specifically:

- whether the proposed mix between land, long-lived structures, medium-lived assets and short-lived assets is genuinely required to deliver the appropriate range and quality of affordable airport operator services, or whether it has been skewed towards long-lived asset categories in order to maximise shareholder return at the expense of consumers;
- whether shorter-lived alternatives, including digital or operational solutions, have been considered and properly tested as alternatives to capital-intensive long-lived solutions; and
- whether the timing of investment in long-lived assets, particularly land, is appropriately calibrated to the underlying requirement (we develop this point further in Section 1.3 below).

Recognising and periodically reviewing and adjusting this asset-mix incentive is particularly important in the context of expansion, where decisions taken now about the composition of the expansion RAB will lock in equity-value distortions for decades. It is also particularly important in the context of any early cost recovery arrangements: early cost recovery for land, in advance of clear evidence of need and price discipline, would be the single most attractive avenue for an owner seeking to grow the long-lived component of the RAB.

1.1.4 Appropriate allocation of risk: making the regime meaningful

A central failing of the current regime, which is recognised in CAP3251 and reinforced in CAP3195, is the absence of any meaningful risk for the operator if it fails to deliver against plan. Detailed plans, robust governance and improved transparency are necessary but not sufficient. If the operator faces no real consequences for failing to deliver on time, on budget and to the required outcomes, the underlying incentives that have produced the world's most expensive airport will persist.

The CAA must therefore exercise its powers, pursuant to sections 18 and 22 of the CAA12, to modify the airport operator's licence to ensure the appropriate allocation of risk by introducing conditions to regulate executive bonuses and to control the payment of dividends should capital projects not be delivered on time, on budget and to the agreed outcomes (other than for clearly identified reasons outside management control).

The CAA's decisions must be driven by the evidence of these regulatory shortcomings and by the statutory mandate to protect consumers' interests. The absence of meaningful risk allocation measures has been clearly identified as an area where the current regime is falling short. Failing to act on this known deficiency would risk the CAA ignoring a highly relevant consideration, leaving consumers exposed to continuing harm and undermining the CAA's ability to discharge its duties under section 1 of CAA12. By using its existing licence modification powers, the CAA can ensure it meets its statutory obligations.

This package of remedies is appropriate, targeted and proportionate. It replicates, in a regulated setting, the discipline that any competitive business faces from its capital markets: persistent failure to deliver against plan has direct, personal consequences for management and direct, financial consequences for shareholders. Without such risk allocation, the CIC risks becoming yet another consultative forum that the operator can game/navigate around replicating, the weaknesses of the existing Capital Governance and Delivery Obligations regimes.

1.1.5 Other CIC design points

Consistent with our response to CAP3195 and the Heathrow Reimagined response, we also note the following points on CIC design which we ask the CAA to reflect in its July update:

- **Independence of chair and advisers.** In order to ensure the independence of, and stakeholder confidence in, the CIC must have an independent chair, appointed by the CAA following consultation with stakeholders and IAG endorses the CAA's proposals in paragraph 4.136 of CAP 3251. Similarly, independent technical advisers supporting the CIC must also be appointed by the CAA, not the airport operator, to avoid conflicts of interest, ensure stakeholder confidence and to avoid undermining of the process.
- **Long-term planning horizon.** The CIC should require a rolling, long-term capital plan (we suggest 15-20+ years³) to be maintained and updated regularly, with the ability to test alternatives.
- **Backward-looking review.** The CIC should undertake structured ex post reviews of completed projects, with the ability to recommend exclusion from the RAB of costs found to be materially inefficient subject to reasonable thresholds and therefore IAG endorses the CAA's proposals in this respect in paragraph 4.146 of CAP 3251.
- **Threshold on oversight.** In line with the CAA's position, IAG agrees that thresholds should be defined to ensure that the oversight is proportionate to the size of the project and that the capital investment governance does not become unnecessarily onerous. However, it has to be acknowledged that overseeing a multi-billion capital investment

³ The planning horizon may be longer for some assets linked to expansion

plan requires reasonable level of resources (the structure described in Annex A requires 5-8 qualified staff).

- **Incentives around the quality and timeliness of information.** In line with the CAA's position, IAG agrees that incentives for HAL on the quality and timeliness of information provided to the CIC should apply. These 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.

1.2 Competition

The CIC is overdue and necessary but not sufficient to address the shortcomings in the current economic regulation regime identified in Heathrow Reimagined's submission to the CAA dated 20 January 2026. Capital regulation alone cannot fully mitigate the harmful incentives created by a monopoly RAB-based regime: it can only aim to control them. Genuine competition, where it can be introduced, resets those incentives at source where feasible. Model 7b is therefore the most important model on the CAP3251 shortlist.

1.2.1 *Three components of the Heathrow RAB, and how the competition models map to them*

It is helpful to think about the Heathrow RAB as comprising three economically distinct components, each of which calls for a different competitive treatment:

- **(i) Core airport infrastructure that cannot be sensibly split.** This includes the existing runways, the principal taxiway system, the airfield navigation infrastructure, and the campus tunnels. These elements form an integrated whole that must be operated under unified control for safety and operational reasons. They will continue to sit within HAL's RAB and to be operated by HAL. For this component, the relevant competition models are limited to procurement-based mechanisms (Models 4a and 4b), supported by the discipline of the CIC. For instance, the 3rd runway could be built by a 3rd party but, ultimately, it will need to be operated by HAL and NATS as the other 2 existing runways.
- **(ii) Major redevelopment of separable existing assets.** Existing terminals are the clearest example. The imminent modernisation of the Central Terminal Area (replacement of Terminal 3, expansion of Terminal 2) is the immediate practical case, and the longer-term redevelopment of Terminal 4 (which will be approximately 60 years old by 2045) is a further example (both developed further below). They are separable in the operational sense and have been operated as semi-autonomous units historically. Competition can be introduced for the operation of, and major redevelopment within, existing terminals through contractual mechanisms inserted into a modified airport operator licence. Models 5b and 7b can be applied in this manner to existing as well as future assets. Model 7b is more relevant as it fully exploits competition. Model 5b would be a step in the right direction so long as the tender process is not controlled by HAL. Model 8 could also introduce competition through divestment.

- **(iii) New growth assets associated with expansion.** Model 7b enables the introduction of competition over the right to design, build, finance, operate, and maintain new terminal capacity and would enable the proper discharge of the CAA's duties for the benefit of consumers.

Recognising these three components separately matters because it counters two flawed assumptions that recur in the current debate. The first assumption is that the Heathrow airport asset base is monolithic thus indivisible. This assumption underpins HAL's position that all parts of the asset base must be owned and operated by HAL and that the RAB must be maintained at the whole-airport level. The second is that introducing competition to any single component somehow destabilises the regulatory treatment of the other components. This proposition does not stand up to scrutiny, as we develop in Section 3.

1.2.2 Model 7b is the right path forward wherever practicable

IAG's position is that Model 7b should be the default approach wherever practical including for any major new development (new infrastructure or redevelopment of existing infrastructure). There is no rationale for reserving the right to earn a return on a major new piece of Heathrow infrastructure to the incumbent with consumer harming incentives. Where it is feasible and beneficial to introduce competition, the CAA must do so pursuant to its duties in section 1 CAA12. The CAA cannot lawfully treat competition as merely optional or ancillary where it is the best means of furthering users' interests; rather, it must give it proper effect in the design of the future regulatory framework.

We have set out in our response to CAP3195 and endorse in the Heathrow Reimagined responses to CAP3195 and CAP3251 why the implementation concerns raised by HAL in respect of Model 7b, relating to fragmentation, operational interfaces, coordination, financeability and resilience, are overstated and manageable, including by reference to comparable airports (Munich, Atlanta, JFK, other US and Asian airports) where airfield and terminal operations are run by separate entities. We do not repeat that analysis here but refer to our and Heathrow Reimagined's previous responses on the point in full.

1.2.3 Model 7b applies equally in a three-runway and a two-runway setting

We believe the case for Model 7b applies with equal force in a two-runway setting.

The case for change set out in CAP3251 arises overwhelmingly from issues with the economic regulation of the existing two-runway airport, not from expansion. Heathrow's position as the world's most expensive major airport, its persistent service-quality underperformance, and the demonstrated capital inefficiency identified in the OGP benchmarking study all predate any expansion-related expenditure. A reform package that confines competition to new infrastructure associated with expansion, while leaving the existing campus untouched, would leave the underlying drivers of the case for change largely unaddressed and would not adequately satisfy the CAA's primary duty.

The most immediate practical illustration of the need for competition in respect of existing terminal assets is the planned modernisation of Heathrow's Central Terminal Area (CTA) with the expansion of Terminal 2 to replace Terminal 3. This is a capital programme of substantial

scale, comparable in magnitude to a significant new-build terminal project, and exactly the kind of investment where the absence of true competitive discipline has driven the cost premium the CAA has identified. There is no credible justification to leave the CTA modernisation outside the application of competition and indeed doing so would not properly discharge the CAA's duties pursuant to section 1 CAA12.

Similarly, Terminal 4, which sits to the south of the airfield and is operated separately from the CTA, will be approximately 60 years old by 2045 and will require either substantial redevelopment or replacement well within the planning horizon of the regulatory framework the CAA is now designing. The case for promoting competition for the right to design, build, finance, operate, maintain and own the redeveloped facility applies.

Given that both projects will require a DCO and DCOs can, and routinely do, confer Compulsory Purchase Order (CPO) powers on the applicant in respect of land and interests required for the project, model 7b can equally apply to these two-runway airport projects. Furthermore, even without a DCO, model 7b can be established through imposing a contractual arrangement on HAL which the CAA can do pursuant to its powers under CAA12.

Where the new CTA or T4 infrastructure are to be owned outright by a new operator (rather than simply operated under contract with HAL), the Planning Act 2008 provides a clear statutory pathway. The Secretary of State can, through a DCO, authorise the compulsory acquisition of HAL's interest in the relevant land and existing structures as needed for the new infrastructure provided the statutory tests are met. In such circumstances, HAL would receive full compensation under the standard CPO compensation framework that applies to all nationally significant infrastructure projects, ensuring that it is not financially disadvantaged. This means HAL would be paid the open-market value of any interest acquired (disregarding an increase or decrease due to the project), as well as statutory compensation for any related losses where the relevant criteria are met, e.g., disturbance costs, severance, injurious affection and appropriate loss payments, plus reimbursement of reasonable professional fees. This planning-led route is entirely separate from the CAA's economic regulatory powers and from the CMA's Enterprise Act 2002 powers. It neither requires a CMA market investigation referral nor forces the CAA to attempt to use a power it does not have. It simply utilises the planning regime to do what that planning regime is designed to do: consent major infrastructure and assemble land in the public interest.

The DCO regime has been used to deliver multiple recent nationally significant infrastructure projects under the Planning Act 2008 including the Thames Tideway Tunnel (DCO granted in 2014); Sizewell C (DCO granted in 2022); the Lower Thames Crossing (DCO granted on 25 March 2025); and, most directly relevant to the present discussion, Gatwick Airport's Northern Runway Project (DCO granted on 21 September 2025). Analogous statutory CPO powers were also conferred on HS2 under the High Speed Rail Acts, by a different statutory route. The Gatwick precedent is particularly instructive: its DCO authorises runway repositioning, taxiway reconfiguration, terminal expansion, new piers and aircraft stands, ancillary facilities and associated highways and surface-access works, which are the precise categories of works contemplated for the CTA modernisation and Terminal 4 redevelopment at Heathrow.

It demonstrates that the DCO regime is operationally and legally adequate to deliver major modernisation of an existing major UK airport.

Similarly, the DCO process is not the only path to Model 7b, contractual arrangements can be imposed by the CAA to ensure a new promoter can design, build, operate, finance an infrastructure on HAL's land without impacting HAL's property and human rights.

Therefore, the CAA ought to design Model 7b so that it can facilitate competitive delivery across all relevant categories: (a) new terminal capacity associated with a three-runway airport; (b) the imminent CTA modernisation; and (c) the redevelopment of Terminal 4 in due course. Together, these three categories represent the overwhelming majority of the projected terminal capital expenditure at Heathrow over the planning horizon of this regulatory review. Applying competitive discipline to all three would vastly increase the share of Heathrow's capital programme delivered under the efficiency pressures and innovation that competition can bring. Conversely, excluding either CTA or T4 from the possible scope of the competition-based model would leave the largest near- and medium-term capital programmes at Heathrow outside the scope of the very reforms the CAA has identified as necessary. **Under this approach, if HAL ultimately offers the best value for money solution, it can still prevail and deliver the project, but critically, HAL would need to compete to earn that right, rather than presuming it by default.**

Crucially, this approach is fully consistent with the regulatory certainty point made in Section 3 below. HAL's interest in the existing CTA and T4 assets is protected at fair value with HAL receiving market-value compensation for any interest it is required to surrender pursuant to a CPO. HAL's existing investment is not retrospectively impaired. What changes is who undertakes and earns the regulated return on the very substantial new investment required to modernise the CTA and to redevelop Terminal 4 going forward, and on what terms. This outcome aligns with the case for change set out in CAP 3251 by introducing competition to ensure that future expansion and upgrade projects are delivered by the best-value promoter, benefitting consumers and the public interest.

1.2.4 Model 7b already exists. CAA only needs to ensure it can be established as broadly as possible across the campus

Model 7b should not be treated as a novel or untested regulatory model at Heathrow: in substance, it already exists in practice today. There are multiple ongoing examples in which a third party other than HAL has designed, built, financed, owns, operates and maintains infrastructure on HAL land, under a contractual arrangement that leaves HAL the freehold:

- The Arora Group designed, built, financed, owns, operates and maintains the Sofitel hotel adjacent to Terminal 5, on land for which HAL retains the freehold on a nominal basis (i.e. HAL receives a nominal ground rent). Arora bears the full design, build, financing, operating and maintenance risks and rewards;
- British Airways designed, built, financed, owns and operates its principal maintenance hangars at Heathrow while it leases the land from HAL;

- The principal cargo site at Heathrow operates under an analogous long- land leasehold structure and a right to extend.
- The SAA and EAA buildings adjacent to Terminal 5 were similarly designed, built and financed by British Airways and remain British Airways-owned while the land is leased from HAL.

These examples demonstrate three things directly relevant to the CAA's assessment of Model 7b. First, the legal mechanism (a contractual arrangement from HAL with the third party taking the full Design, Build, Finance, Operate, Maintain role) already exists at Heathrow, is well-understood by Heathrow's commercial counterparties, and is supported by ordinary property law of England and Wales without any need for new statutory powers, primary legislation or transfer of HAL's underlying freehold. Second, the operational interface between HAL and a third-party operator running the full design–build–finance–operate–maintain chain has not caused safety, resilience or coordination problems in practice: these arrangements have operated successfully for years, and in some cases for decades, under HAL's existing aerodrome operator licence framework and the CAA's safety regulator function. Third, and perhaps most strikingly, the asymmetry in where Model 7b has historically been applied is the wrong way round from a consumer welfare standpoint. It is currently used at Heathrow for ancillary assets (hotels, maintenance hangars, cargo facilities, airline support buildings); that is, precisely the assets where the consumer benefit from introducing competition is comparatively small. The assets to which it is not applied (terminals, central airfield infrastructure and the major capital programmes that will dominate Heathrow expenditure over the next two decades) are precisely those where the consumer benefit of competition would be largest. The CAA's task in this review is therefore not to determine whether Model 7b is operationally or legally workable at Heathrow (it manifestly is as it is the model under which a significant portion of the Heathrow estate already operates), but to extend its application to the assets that actually matter for consumers.

1.2.5 Model 7b is the most appropriate remedy, and other models are subsets or variations of it

We want to be explicit about the relationship between Model 7b and the rest of the competition shortlist, because in our view this is important to the CAA's structuring of the next phase of work. Model 7b, properly implemented, is the key remedy that best resets the incentives a regulated monopoly faces, because it is the only remedy under which the right to invest and to earn a return on that investment, has to be won. All other competition models in the shortlist are, in substance, subsets or variations of Model 7b:

- **Model 4b** (mandated contract for design and build) is Model 7b with operation, maintenance and ownership excluded, preventing competition from extending further down the value chain. Furthermore, the process as set-out by the CAA is CAP3251 is under HAL's control which is a significant flaw as the tender specification/requirements of large investments need to be subject to external oversight;
- **Model 5b** (design, build and operate, in the Direct Procurement for Customers (DPC) mould) is Model 7b akin with the relationship with the end users reserved to the

incumbent, this is valuable where Model 7b cannot be fully established. Also, the selection process should not be controlled by HAL but by the CAA or the body it designates; and

- **Model 8** (transfer of ownership and operation of an existing asset) the CAA has chosen not to shortlist it at this stage, but the contractual-separation extension of Model 7b to existing assets captures most of its consumer benefits without requiring a transfer of property, however a CAA reference to the CMA should not be discounted (acknowledging that Model 7b would help with keeping faster timelines).

If the CAA can implement Model 7b for new development at Heathrow expansion (new development meaning new and replacement infrastructure), it will in substance have developed most of the technical, legal, financial, contractual and operational building blocks needed for the other competition models as well. In other words, Model 7b is not a separate or additional layer work; it is the fullest expression of the same underlying framework.

That matters because the incremental effort required to carry the design work through to a Model 7b capable framework is limited, whereas the cost of stopping short is significant. Stopping at the partial-competition models would mean incurring much of the implementation effort while forgoing the model that most fully resets monopoly incentives and delivers the greatest consumer benefit, in line with CAA's duty to further the interests of consumers. We therefore urge the CAA to keep Model 7b at the centre of its July update and the detailed work that follows.

1.2.6 Where Model 7b is not feasible: Model 5b and the DPC analogue

Where Model 7b is not feasible for a particular asset, for example, if an asset is not sufficiently separable (e.g.: baggage systems, track-transit systems, etc.), the CAA should evaluate a Direct Procurement for Customers-style approach, consistent with Model 5b on the CAA's shortlist. However, it should ensure the selection process is not controlled by HAL but by the CAA or the body it designates.

The Ofwat DPC regime, introduced for large discrete water sector projects, provides a directly applicable template. Under DPC, certain large discrete infrastructure projects are competitively procured by the incumbent appointee from a Competitively Appointed Provider (CAP), which is responsible for designing, building, financing and (in some cases) operating and maintaining the asset. The appointee retains overall regulatory responsibility, but the underlying design, build, finance and operate functions are exposed to competitive tension. The model has been deliberately designed by Ofwat to deliver "significant benefits for customers through promoting innovation and enabling capital and operational cost savings as well as a reduction in financing costs"⁴.

Key features of the Ofwat DPC regime that are directly relevant to Model 5b at Heathrow include:

- **Default application above a financial threshold.** Ofwat applies DPC "by default" to all discrete projects with whole-life totex above £200 million, with appointees required

⁴ See DPC Guidance [here](#)

to assess discreteness and conduct a robust value-for-money assessment. The CAA could apply a directly analogous default test for major Heathrow projects with the threshold itself to be determined by the CAA for the Heathrow context.

- **Implementation through licence modification**, not through primary legislation or transfer of property, Ofwat's regime is built on Condition U-style licence conditions, an Allowed Revenue Direction, and amendments to revenue and interim determination conditions. The CAA has analogous powers to introduce such a condition under its licensing powers in CAA12.
- **Land retained by the incumbent**. With model 5b, land remains in the ownership or control of the appointee, with the CAP granted operational rights through the CAP Agreement (typically by licence). This is applicable to the Heathrow context, in instances where it is beneficial for HAL to retain the freehold of its land but the economic and operational rights can be separated contractually.
- **Independent technical assurance and Ofwat consent at defined gateways**. These provide a model for the CAA's role (or its designated body's role) in approving and overseeing CAP-equivalent procurements at Heathrow.

Importantly, while the Ofwat DPC regime is framed as requiring the appointee's consent to designate a project, the CAA's licensing powers pursuant to CAA12 are extensive and a regime could, and should, be introduced which does not require HAL's consent.

1.2.7 Why a single cross-campus Maximum Allowable Yield is essential for competition to deliver for consumers

The IAG Proposed Solution advocates for a single cross-campus Maximum Allowable Yield (MAY): the single MAY is what allows a competition-led framework to deliver good consumer outcomes in practice. That logic goes hand-in-hand with the benefits of a cross-campus single-till which benefits all passengers. There are three reasons:

- First, a single MAY ensures that the cost of major new shared infrastructure — a new runway, a new terminal area, large surface-access works — is recovered fairly across the airport's entire customer base, rather than being loaded onto the smaller number of passengers who happen to use the new facility in its early years. New capacity benefits the airport as a whole and should be funded by the airport as a whole.
- Second, a single MAY ensures that the capital and operational efficiencies generated by competition flow to all passengers, not only those flying through the particular facility where competition has been introduced. If a competitively-procured new terminal delivers a more efficient cost base, that efficiency should be reflected in lower charges across the campus through a reduction in the cross-campus yield, rather than ring-fenced as a charge differential for the small subset of passengers who happen to use it.
- Third, a cross-campus approach is also consistent with the logic of single-till regulation: pooling non-aeronautical revenues across the campus helps lower the aeronautical

charge for all passengers, rather than allowing those benefits to be retained or localised within particular facilities.

The CAA's primary duty is to the airport's users generally, and the framework must operationalise that duty in its pricing architecture.

The alternative, competition without a single cross-campus yield, produces a perverse outcome that should be expressly avoided. In that scenario, a more efficient new terminal would attract passengers and airlines, while the legacy terminals would remain on the existing RAB with fixed costs that have to be recovered from a shrinking passenger base. Allowed revenue divided by fewer passengers means higher unit charges at the legacy terminals; higher unit charges drive further migration to the new terminal; and the passengers who, for connectivity, scheduling or carrier-choice reasons, cannot easily move end up paying more for objectively worse infrastructure. A single cross-campus MAY prevents that outcome by preserving the discipline of competition at the operator level while ensuring that consumer-facing pricing remains coherent and fair across the airport as a whole.

1.2.8 Protecting the competitive process: realistic assumptions and meaningful penalties

For any competition model to deliver value for consumers, the design of the competitive process itself must be robust. We are particularly concerned to guard against two failure modes that are common in regulated competition and that, if unaddressed, would substantially erode the benefits the CAA expects from these models:

- **Asymmetric optimism in bid assumptions.** The CAA, supported by the CIC and by independent technical advisers, must set common, realistic assumption frameworks against which all bidders are evaluated, and must have powers to reject bids that fail to use those frameworks. Where there is genuine uncertainty (for example, on demand or on construction cost inflation), the framework should require bidders to bear that risk rather than passing it back to consumers.
- **Inadequate risk allocation for non-delivery.** A competition in which the winning bidder (whether the incumbent or a new promoter) can depart materially from the assumptions on which it won, without real downside exposure, is not genuine competition. In line with any supplier contract worldwide, the winning bidder must be exposed to the adequate risk allocation and associated meaningful penalties if it fails to deliver against the bid on which it was selected including, but not limited to, exposure to overrun costs outside defined parameters, reductions in its allowed return, and in an extreme case, loss of the right to continue operating the asset or service. This risk allocation and the associated penalties must apply equally to the incumbent and to new entrants.

These design safeguards are not a reason to delay the introduction of competition. They are part of what makes it effective and consistent with the CAA's duty to further the interests of users. The international precedents referred to elsewhere in this response including the JFK multi-terminal redevelopment programme, demonstrate that these design challenges are well-

understood and capable of being addressed through established procurement and regulatory mechanisms.

1.3 A special case: land acquisition timing and pricing

The discussion in Section 1.1 of the inflation and tax-wedge incentive to overcapitalise in long-lived assets has a particularly important practical application: land. Land does not depreciate; it earns an allowed return indefinitely once in the RAB; and its market value is intrinsically difficult to verify and can be influenced by the prospect of acquisition itself. The owner of a regulated business has a strong rational incentive to bring land into the RAB early, in large quantities, and at the highest plausible price. Of all categories of capital expenditure, land is therefore the one that most warrants targeted protection within the regulatory framework.

We are particularly concerned about this in the context of any early cost recovery arrangements for expansion. The CAA has begun to consider early cost recovery reflected, for example, in its draft decision on Heathrow expansion early costs recovery published in April 2026. We recognise the need to enable some early activity, however, the framework needs to actively guard against the use of early cost recovery as a vehicle for accelerated, inflated land acquisition. We therefore propose that, within the framework of the CIC, protections need be applied specifically to land, including:

- **Full detailed property cost estimate** should be provided with an independently appointed assurer scrutinising the details including valuations, compensation and required timing to establish an up-to-date baseline.
- **Independent market valuation.** Any land brought into the RAB should be priced at independently verified market value at the time of acquisition, with the CAA having the ability to disallow the difference between acquisition cost and independently verified market value.
- **Protection against bidding-up.** HAL is in a position to materially influence the market for land in its immediate vicinity through its own behaviour and that of any agents acting on its behalf. The CIC should oversee land assembly activity and require transparency on negotiating tactics and market signalling to prevent the market value from being manipulated upwards by the acquisition process itself.
- **Just-in-time acquisition.** Land should be acquired as late as is consistent with delivery of the construction programme on the required timetable. Pre-emptive accumulation of land far in advance of need, justified by reference to optionality or future flexibility, should be treated with particular scepticism because of the asymmetric benefit it provides to the equity owner relative to the consumer. Where feasible, less committal alternatives (such as options or staged acquisition structures) should be preferred in order to preserve flexibility pending greater scheme certainty.
- **Separate identification within the RAB.** Land should be separately identified within the RAB so that its evolution over time, and its contribution to allowed revenue, can be tracked and challenged by the CIC and by stakeholders. This is consistent with the general principle that the composition of the RAB matters as much as its overall size.

- **Avoidance of asymmetric risk transfer.** The framework should prevent outcomes in which consumers fund land acquisition risk while the operator retains the benefit of any subsequent uplift in value, including through changes to regulatory boundaries or alternative uses. Both downside risk and upside value should be aligned in a manner consistent with the CAA's consumer protection duties.
- **Preservation of competitive optionality.** Land acquisition should not be undertaken in a manner that forecloses alternative developers or delivery models. The CIC should ensure that land assembly strategies preserve, rather than constrain, the ability to introduce competition, including by ensuring that land can be transferred on fair and transparent terms where required.

The CAA's decision-making must take into account this identified risk. Given the evidence that land acquisition and early costs involve unique incentives for distortion, it would be irrational and contrary to proper regulatory practice for the CAA to omit targeted land protections. To do so would mean failing to consider a critically relevant factor in its decision-making, the need to safeguard consumers from the risk of early, overpriced land inflating the RAB, and therefore risk rendering the decision legally unsound. Conversely, incorporating specific land protections demonstrates that the CAA has acted on the evidence in line with its duties to protect consumers and secure efficient investment.

These protections are not anti-investor. They are anti-distortion. They protect both consumers and the broader investor community by ensuring that the assets that enter the RAB do so on terms that the CAA, the CIC and stakeholders can defend. They are also fully implementable within the licence-based framework that we have set out elsewhere in this response.

Section 2: The CAA has the legal powers to implement this proposal

The CAA has power under CAA12 to implement the IAG Proposed Solution as an integrated package through modifications to HAL's existing economic licence

Section 18 CAA12 confers broad powers to introduce licence conditions, and section 21 CAA12 provides specific (non-exhaustive) examples of matters that may be addressed through licence conditions, including in particular section 21(1)(b) expressly permits the CAA to introduce conditions requiring the licence holder to enter into a contract or other arrangement for a specified purpose on specified terms. Other elements of section 21 expressly contemplate decision-making by other specified persons under defined mechanisms, which provides the statutory underpinning for a CIC-type body.

The IAG Proposed Solution operates within those powers. It relies on the imposition of contractual arrangements through licence modification and does not involve the CAA transferring or creating any property rights, such as a transfer of freehold or the grant of a long lease, which fall outside the CAA's powers under CAA12. Property transfers would occur solely through a DCO with CPO process.

The decision whether, and when, to make a new market power determination (MPD) is at the CAA's discretion. Given the existing 2014 MPD, and absent a material change in circumstances such as a form of competition being introduced at Heathrow, a further determination is not a pre-condition to implementation of the Proposed IAG Solution. Under section 7 CAA12, the timing of any further determination is a matter for the CAA's discretion, while sections 18, 21 and 22 confer broad powers to impose and modify licence conditions. This enables licence-based interventions to be introduced in advance of, or independently from, any reassessment of market power, with licensing requirements for any third-party operator addressed within that framework.

In summary, the IAG Proposed Solution does not require primary legislation, the creation or transfer of property interests by the CAA or an immediate new market power determination. It can be implemented through targeted, well-evidenced modifications to HAL's existing economic licence, supplemented by separate licences for third-party operators where required.

In line with its statutory duties, the CAA may confidently deploy its powers pursuant to sections 18, 21 and 22 to implement this evidence-backed solution. Failing to use existing powers to further consumer interests, or misdirecting itself as to the scope of those powers, would pose legal risk to the robustness of the CAA's final decision.

Section 3: The IAG Proposed Solution keeps investors whole and maintains regulatory certainty

A frequent objection by HAL to fundamental reform of the Heathrow regulatory framework is that it would undermine regulatory certainty and damage investor confidence. We address that concern directly here. The IAG Proposed Solution is expressly designed to keep investors whole and to preserve regulatory certainty.

3.1 Past investments are honoured and future investments earn a regulated return, supporting investor confidence

Two propositions sit at the heart of this:

- **Past investments are honoured.** Any past investments that have been properly made under the RAB model will continue to be remunerated under the RAB model. This is not a proposal to write down the existing RAB or to alter retrospectively the basis on which investors have committed capital to date. The IAG Proposed Solution is a forward-looking architecture: it determines how new investments are commissioned, owned, financed and remunerated, not how past investments are treated.
- **Future investments earn a regulated return.** Any future investments would continue to earn a regulated return under the RAB model assuming a continuing MPD. Investors who bid and win competitive tenders for new infrastructure under Model 7b, or who deliver projects through a Model 5b / DPC-style structure, will hold a regulated asset base and earn an allowed return on that asset base in the same way that HAL does today on its existing RAB.

The architectural change is therefore not about removing the RAB, it is about who holds different parts of it, and how the right to add to it is allocated. Investors who deliver value for consumers continue to be properly remunerated. What is removed is the implicit and unjustified assumption that all future investment must be made by, and remunerated through, the existing incumbent's RAB, regardless of efficiency, value for money or whether other parties would deliver a better outcome for consumers.

3.2 Ensuring regulatory certainty and investor confidence does not prevent the CAA from reforming economic regulation through a comprehensive consultation process

Pursuant to section 1(3)(a) CAA12, when exercising its duties the CAA must have regard to the need to secure that HAL is able to finance its provision of airport operation services in the area for which the licence is granted. It is worth being precise about what level of investor confidence is reasonable for so-called 'regulatory certainty' to protect. In our view, a recurring source of confusion in the debate around Heathrow regulatory reform has been the failure to distinguish between capital committed to the RAB and secondary-market premia on equity transactions.

- **Protecting the agreed return on capital committed to the RAB is reasonable.** A lender who lends to HAL against the RAB, lends against the regulated cash flows

associated with that RAB. It expects certainty that those cash flows, once assessed as proper and efficient, will not be retrospectively undermined. The IAG Proposed Solution preserves that certainty. By the same logic, equity capital committed to the current RAB at the point of acquisition, and the continuing exposure to subsequent additions to the RAB, is entitled to a fair return on that capital.

- **Claiming ‘regulatory certainty’ is required to protect investor confidence in secondary-market premia on equity transactions is unreasonable and would go beyond the CAA’s duties.** There is an important distinction between equity committed based on the RAB at acquisition, with continuing exposure to subsequent additions to the RAB, and the price paid in an equity transaction in excess of the RAB. The fair-return principle that anchors regulatory certainty extends to the former; it does not, and should not, extend to the latter. The CAA has no duty to underwrite a premium paid in a secondary market transaction in order to validate that purchaser's investment thesis, just as it would have no duty to support a lender who had paid an above-par price to buy a loan in the secondary market.

This distinction matters because, in practice, the equity value of Heathrow already trades materially above the regulated value of the underlying RAB. The Ferrovial-led transactions completed in December 2024 valued Heathrow's equity at approximately £8.7 billion⁵. Combined with Heathrow's net debt of approximately £16.6⁶ billion at the time, this implies an enterprise value of approximately £25.3 billion, against a 2024 year-end RAB of approximately £20.4 billion, with an enterprise-value-to-RAB ratio in the region of 1.24x⁷. That premium does not reflect a regulatory entitlement to outperformance; it reflects investors' belief in their ability to:

- beat the short-term operational and capital efficiency targets that the CAA sets through the price control;
- raise leverage above the notional capital structure assumed by the CAA in setting prices;
- benefit from the inflation- and tax-wedge characteristics of the portfolio of assets in the RAB, and to influence the composition of that portfolio over time; and
- derive additional value from the cash-flow profile required to maintain the underlying infrastructure.

These are legitimate sources of equity value to the extent they reflect genuine management skill and efficient capital structure and risk decisions. But they are not regulatory entitlements that the CAA has a duty to ensure. The IAG Proposed Solution does not remove them - management can still outperform CAA targets under a reformed regime; leverage can still be optimised; portfolio composition can still be managed. What changes is that the operator no

⁵ Equity Value: Ferrovial et al sold 37.62% of HAHL for 3,259 in 2024. This equates to equity value £8.662bn. (<https://www.cnmv.es/web/services/verdocumento/ver?t=%7B7ddfd9d7-de96-4185-9639-de4c18b0dbd9%7D>)

⁶ As per FGP Topco 2024 Annual report filed at companies house. Gross Debt was (15123+3029+394+98) = £18,644. (P185 of Annual report). Cash and Cash Equivalents + term deposits = (1500+525) = £2,025. This gives us net debt of £16,619.

⁷ Enterprise Value = Equity + Net Debt (assuming no minority interest) = 8.662+16.619 = 25.281. FGP TopCo Annual report states 2024 RAB at 20.422 (P 176 of AR), and implies EV-to-RAB at 25.281/20.422 = 1.237x

longer enjoys an unchallenged right to expand the RAB unilaterally and to capture the equity uplift that flows from that expansion.

The implication is straightforward: anyone who has paid a secondary-market premium in an equity transaction on the implicit assumption that the current regulatory framework would be preserved unchanged, and that the operator's ability to grow the RAB unilaterally would be protected, has taken a view on regulatory risk that the regulatory framework itself does not underwrite.

As the consultation makes clear, in exercising its statutory functions the CAA is required to undertake a balancing exercise between potentially competing considerations and has expressly rejected approaches which would prioritise any single factor, including financeability or investor confidence. Placing disproportionate weight on financeability or investor confidence would be inconsistent with its statutory duties, as it risks subordinating the protection of consumers.

Properly understood, therefore, the duty in section 1(3)(a) CAA12 to have regard to financeability does not confer any entitlement for investor interests to be treated as determinative. Rather, it is one consideration to be weighed as part of an evaluative judgment directed to the overarching objective of furthering the interests of consumers.

Any approach which elevates 'regulatory certainty' or investor expectations, whether in respect of RAB recovery or secondary market premia, into a dominant or outcome-determinative consideration would amount to an unlawful fettering or misdirection in the exercise of the CAA's statutory discretion.

3.3 Ownership of components does not affect regulatory certainty

A related concern that has been raised is that splitting the Heathrow RAB across multiple licensed operators could itself undermine regulatory certainty. We do not consider that this concern stands up to either theoretical or practical scrutiny.

From a financial-economic perspective, the regulatory certainty associated with a RAB derives from three features: (i) the existence of a clear definition of the assets added to the RAB; (ii) a defined methodology for setting the allowed return on those assets; and (iii) a credible mechanism for recovering that allowed return through regulated charges. None of these features is dependent on the entirety of the RAB being held by a single owner. So long as each segmented-RAB is clearly defined, each is governed by a defined return methodology, and each licensed operator has a clear route to recovery of its allowed return (whether directly through wholesale-type charges to other operators, or indirectly through a single cross-campus Maximum Allowable Yield collected from airlines and remitted to the relevant operators), the regulatory certainty available to investors in each segmented-RAB is functionally equivalent to the certainty available to investors in the current single RAB.

The Thames Tideway Tunnel under the Specified Infrastructure Projects regime provides a direct empirical demonstration. The Tideway project sits within a separately licensed Infrastructure Provider, with a separate RAB, separate allowed return and a defined revenue

arrangement with Thames Water. Investors in Tideway did not require, and do not have, the protection of the wider Thames Water RAB; the regulatory certainty of the project rests on the integrity of its own RAB framework. The same logic can and should be applied to a multi-RAB Heathrow (if it is the retained model). The CAA's task in implementing the IAG Proposed Solution is to make sure each segmented-RAB (if the chosen path to implement the multi-operator model with CIC oversight) is well-defined and properly regulated; it is not to preserve a single unified RAB for its own sake.

We recognise, of course, that practical implementation requires careful work on the boundaries between the segmented-RABs, the treatment of shared costs and infrastructure, and the management of any cross-subsidy risks. These are not novel problems and have been solved in other regulated sectors with multi-licensed regimes, including telecoms and water. They are amenable to the same kind of analytical treatment by the CAA, supported by the CIC, that has been applied in those sectors. They are not a reason to leave the existing single-RAB structure unchanged.

The overall conclusion is that the IAG Proposed Solution is, in fact, an enhancement of regulatory certainty for the broader investor community. Today, the framework is regularly subject to escalating tension precisely because the existing arrangements are visibly failing consumers. CAP3195 and CAP3251 are themselves evidence of that. A regime that is unable to deliver acceptable outcomes for consumers is not stable in the long run; it is exposed to far more comprehensive interventions further down the line. The IAG Proposed Solution, by addressing the root causes of consumer harm in a structured and proportionate way, creates the foundation for a long-term, durable regulatory settlement that the global investor community can plan against with confidence.

Section 4: The IAG Proposed Solution strengthens financeability

A further objection sometimes raised against fundamental reform is that it would weaken the financeability of expansion. The evidence and the underlying economics point firmly in the opposite direction: under the IAG Proposed Solution, the financeability of expansion is materially strengthened. There are four reasons for this.

4.1 Lower quantum is easier to finance

The first and most important driver of financeability is simply the scale and risk of the expenditure that needs to be financed. As we set out in our response to CAP3195, HAL's current expansion and masterplan renewal proposals, at a cost of at least £49 billion (and likely materially more), are not financeable in any meaningful sense, because they are not affordable for airlines or for passengers. The IAG Proposed Solution is designed around a hard. A smaller programme is, by definition, easier to finance than a £49 billion-plus programme, all else equal. The capital discipline introduced by the CIC and by competition is what makes that lower envelope deliverable.

4.2 More efficient capex makes airline economics work, which protects the RAB

The second driver is the relationship between capex efficiency, airline economics and the integrity of the RAB itself. As IAG set out in detail in CAP3195, airline affordability is the binding constraint on the success of expansion. If aeronautical charges rise to the levels implied by HAL's current £49 billion-plus envelope, which we estimate would require approximately £3 billion per year of additional aeronautical charges in real terms, airlines simply will not be able to deploy the c. £65 billion of new and replacement aircraft capital required to fill expansion capacity over the 2026-2045 period. The result is a self-reinforcing contraction in which under-utilised infrastructure drives higher unit charges, which drives further contraction. Conversely, a fundamentally strong business case will attract financing.

4.3 Multiple balance sheets are easier to finance than one

The third driver is the architecture of the financing itself. Under the current regime, all expansion-related expenditure is layered onto a single, already highly-leveraged balance sheet. As IAG noted in CAP3195, HAL is already among the largest issuers in the Sterling market⁸, and a £49 billion-plus expansion would place HAL in the top five of the Sterling market alongside major state-backed entities⁹. The concentration of a programme of this scale on a single balance sheet is itself a major financeability risk.

Under a multi-RAB structure, different elements of the expansion are held and financed by different licensed operators, each of whom can attract capital on the strength of its own balance sheet, its own project economics and its own risk profile. The investor base broadens materially, and the risk associated with any single point of failure in the financing chain is reduced. The Thames Tideway Tunnel, financed under the Specified Infrastructure Projects

⁸ Page 17, [iag-response-to-cao-working-paper-on-regulatory-models-cap-3195-vpublic.pdf](#)

⁹ Page 17, [iag-response-to-cao-working-paper-on-regulatory-models-cap-3195-vpublic.pdf](#)

regime through a separate licensed Infrastructure Provider, is a clear example of how a project-specific financing structure can broaden the capital pool and de-risk delivery. The JFK New Terminal One redevelopment provides a further international example.

In other words, financeability under the current model is not really a question of the operator's ability to issue debt, it is a question of whether the business case for the proposal is robust which is evidenced by whether the underlying customer base (airlines and their passengers) can pay the charges that service that debt. If the operator cannot collect the charges, the RAB cannot be remunerated, and the RAB framework itself is undermined. By contrast, under the IAG Proposed Solution, capex is materially more efficient, charges are kept close to today's real-terms levels, and airlines can afford to deploy the capacity needed to fill an expanded Heathrow. The risk of airlines being unable to pay the RAB obligations owed to operators is therefore materially reduced. This is the strongest possible form of financeability protection: it is the protection that arises from a business model that actually works.

4.4 The cost of capital is set by underlying cash flow risk, not by a “competition wedge”

Fourth, and importantly, we need to address head-on the argument raised by HAL and its advisers, that introducing competition into Heathrow's regulatory framework will mechanically raise its cost of capital and therefore damage financeability. That argument should be treated with significant caution and, in our view, does not stand up to scrutiny.

The cost of equity for any business is set by reference to the risk of its underlying cash flows compared to the risk of alternative investments available to investors. In standard finance theory, this is captured through the equity beta, which measures the co-variance of those cash flows with the broader market. The relevant betas applied to regulated infrastructure are drawn from a comparator set that consists overwhelmingly of businesses that face competition for their customers: the vast majority of commercial businesses do not enjoy a guaranteed forever contract with their customers, and instead have to win and re-win the right to continue to serve them. In other words, the comparators against which Heathrow's cost of capital is calibrated already reflect a world in which businesses face competitive pressure. Introducing competition at Heathrow brings the regulated cash flows closer to, not further from, the cash-flow risk profile that the comparator set assumes.

Moreover, under the IAG Proposed Solution the cash-flow risk associated with the asset base in many respects goes down rather than up. There is less capital expenditure to be funded, so there is less construction risk. The capital required to deliver the same airport capability is lower, so the gearing required is lower. The customer base is more able to afford the resulting charges, so the demand risk is lower. The reduction in these underlying risks puts downward, not upward, pressure on the cost of capital.

To the extent that incumbents argue that the cost of capital should be adjusted upwards on the introduction of competition, the burden of evidence sits with HAL. We note that the CAA's own commissioned financeability assessment by Centrus (CAP3251A) concluded that competition models could improve, or at any rate not worsen, the financeability of expansion, including by broadening the equity investor base and reducing HAL's exposure to construction

and delivery risk. This is consistent with the analysis IAG has set out throughout CAP3195 and reinforces here. Conversely, claims that competition would damage the cost of capital should be evaluated against the counterfactual of an unfinanceable £49 billion-plus expansion under an unreformed regime.

For the CAA, a legally robust decision must follow the evidence. Any conclusion that competition harms financeability, if not supported by compelling evidence, would be irrational, particularly given the CAA's own independent analysis suggesting the opposite. We urge the CAA to expressly address this evidence in its final decision and not to rely on unsubstantiated assertions by HAL that are inconsistent with analysis.

Section 5: Competition is fully compatible with operational resilience and safe operations

The final concern that has been raised against the use of competition at Heathrow is that it would damage operational resilience or compromise safety. We address this directly here because, in our view, it is a particularly important point to be clear on.

Airlines, perhaps more than any other stakeholder in the system, need a safe, secure and operationally resilient Heathrow. A poorly run airport is a problem for airlines first and foremost: it disrupts our operations, damages our customer experience, costs us money, damages our and the UK's ability to compete on the world stage, and undermines the trust on which our businesses depend. IAG would not advocate for any reform that we believed risked undermining safety or resilience at the UK's only hub airport.

Against that background, it is concerning to see any suggestion by HAL, the CAA or others that the proposals being put forward by airlines could be portrayed as detrimental to safety or operational resilience. The reality is the opposite: competition is a powerful driver of resilience because operators competing for users have a strong incentive to invest in resilience, to learn lessons from incidents quickly, and to differentiate themselves on the quality and reliability of their operations. There are several reasons why this is so.

Given that neither CAP3251 nor any evidence shows a genuine safety operational resilience risk from well-designed competition, the CAA should take care not to let unsubstantiated concerns about operational complexity distract from the statutory focus on delivering consumer benefits. To rely on hypothetical safety or resilience concerns as a reason to reject or dilute competition, without evidence, would be to give weight to an irrelevant consideration. By contrast, an approach that remains evidence-based and within the scope of the CAA's duties (noting that safety regulation is unaffected by these economic measures) will be on solid ground. The CAA should ensure that any decision to limit competition is justified by concrete evidence, or it risks being seen as unreasonable for disregarding the proven benefits and the presumption in favour of competition under CAA12.

5.1 Heathrow already operates as a multi-operator ecosystem

First, Heathrow is already a multi-operator environment. Hundreds of separate companies provide services at the airport today, including catering, refuelling, de-icing, car parking, retail, passenger assistance, ground handling, baggage handling and cargo operations. NATS operates air traffic control. Independent terminal operators already run dedicated terminals at Heathrow today (for example, the cargo terminals). British Airways already manages many aspects of the day-to-day operation of Terminal 5 independently of HAL. None of this has compromised safety; the relevant coordination protocols are well-established and operate effectively under the oversight of NATS, DfT and the CAA's safety regulator function and the relevant statutory framework.

5.2 International evidence supports the compatibility of competition with strong operational performance

Second, the international evidence is clear that airports with separate airfield and terminal operators, or with multiple licensed operators across different parts of the airport, can and do deliver strong operational performance. Munich is an instructive example: it is widely regarded as one of the best-performing hub airports in Europe on resilience, punctuality and passenger experience, and it operates under a structure in which different parts of the airport are run by distinct entities. Atlanta, the world's largest airport by passenger volume, operates with a similar multi-operator structure. JFK is currently delivering a major redevelopment programme: JFK New Terminal One, involving multiple distinct entities, on a project that is proceeding on time, on budget and at a substantially lower unit cost than HAL's plans for Heathrow. Several major hub airports in Asia and the Middle East follow comparable models.

5.3 British Airways' own experience of operating in multi-operator environments

Third, IAG's own experience as a major airline group reinforces the point.

For decades, British Airways has operated independently at JFK. British Airways operates its own lounges, gates and handling arrangements at JFK in a multi-operator terminal environment alongside other airlines and other ground services providers. We coordinate every day with our ramp area and Port Authority (airfield operator). As and when required operationally we also coordinate and communicate with the other terminal operators and ground handlers. The system works. There is no reason in principle why an equivalent or better outcome cannot be designed for Heathrow.

5.4 The relevant safety regulatory framework is unchanged

Fourth, and importantly, the IAG Proposed Solution does not propose any change to the safety regulatory framework. Safety regulation of Heathrow will continue to be administered by the CAA's safety regulator function, by NATS, and by the existing aerodrome operator licence regime. Any third-party operator licensed under CAA12 would be required to comply, in the same way that HAL is today, with the full suite of safety obligations. The CAA's safety oversight is independent of, and unaffected by, the choice of economic regulatory model.

5.5 Coordination overhead is a price worth paying for capex efficiency

Finally, we recognise that introducing competition does require investment in the systems, protocols and oversight needed to coordinate across multiple operators. We do not dismiss this. But the question for the CAA is not whether there is any coordination cost, there clearly is some, but whether that coordination cost is more than offset by the savings made possible by competitive capital efficiency and overwhelming benefits to consumers this would bring. On the evidence available, including from comparable airports and from the CAA's own analysis of efficiency gaps under the current regime, this test is comfortably met. The coordination overhead required to manage a multi-operator Heathrow is small in absolute terms relative to the scale of inefficiency in the current single-operator model, and it would in any event be borne by the operators themselves rather than directly by consumers. What the consumer

sees, on the other side of that coordination overhead, is materially lower charges and materially better service.

In summary: airlines need a safe, resilient and operationally efficient Heathrow. Competition, properly designed and implemented, is consistent with and, a materially positive contributor to those outcomes. The proposition that fundamental economic regulatory reform is in tension with safety or resilience is not supported by the international evidence, by the operational reality of Heathrow today, or by the design of the IAG Proposed Solution itself.

Conclusion and next steps

CAP3251 represents an important step in the CAA's review of the regulatory framework at Heathrow. IAG welcomes the proposed shortlist and, in particular, the inclusion of Models 1a, 2, 4a, 4b, 5b and 7b. **Taken together, and with the key adjustments and emphasis we have set out in this response, these models can be combined into the integrated package set out in the IAG Proposed Solution;** a package that delivers a Capital Investment Committee with real teeth and competition wherever it is practicable across the DBFOMO value chain. These reforms would maintain regulatory certainty, preserve investor confidence, honour past investments, support financeability, and remain fully consistent with safety and operational resilience requirements.

Crucially, this package is implementable in time. The CAA has the legal powers it needs under CAA12. The IAG Proposed Solution keeps investors whole and reinforces, rather than undermines, regulatory certainty — while not extending that certainty further than the regulatory framework was ever designed to extend it. It strengthens financeability rather than weakens it. It is fully compatible with, and supportive of, operational resilience and safe operations at the UK's only hub airport. It is also anchored in the right conceptual frame: value for money for consumers.

What is required of the CAA now is to follow through on the case for change it has itself identified and to combine the shortlisted models into an integrated reform package that genuinely delivers for consumers, with Model 7b at its centre (applied not only to new terminal capacity associated with expansion, but also to the major modernisation of the existing campus, of which the imminent CTA redevelopment) is the most material near-term example and the Terminal 4 redevelopment is a further significant programme within the planning horizon of this review (see the overall capital outlook at Heathrow¹⁰).

In delivering this outcome, the CAA must keep its focus firmly on its statutory obligations. As we emphasised in our CAP3195 response, short-term expedience, even to meet external schedules or pressures, cannot be pursued at the expense of the CAA's primary duty to consumers, and any decision to compromise in that way would be wrong in law. Equally, having undertaken consultation and identified the need for fundamental change, the CAA must ensure its final decisions are transparently reasoned and demonstrably take into account the evidence and responses received. Not only does this reflect good regulatory practice, it is also a requirement of a fair consultation process that the CAA consider stakeholders' representations conscientiously and explain how it has reached its conclusions. If, despite recognising the case for change, the CAA were to shrink from implementing an effective integrated package, or if it failed to provide cogent reasons for its choices, that would raise questions as to whether it had properly discharged its duties and met the standards of consultation fairness.

What is required of Government, in parallel, is to ensure that the revised ANPS is objective-led and sufficiently flexible, that there is a process for promoter selection to prevent the DCO process from disincentivising anyone but the incumbent from applying, and that the wider

¹⁰ [Heathrow Airport Limited's 20-year spending plans](#)

policy stack supports an affordable expansion. IAG has set out our detailed positions on those points in our 15 April 2026 letter to Hannah Newell (attached).

IAG remains ready to engage constructively with the CAA, DfT and other departments across HM Government to translate the principles set out in this response into the detailed reform package required to make Heathrow expansion a success. We would welcome the opportunity to take the CAA through any aspect of the IAG Proposed Solution in further detail, including the underlying analysis on airline affordability, capex efficiency, the inflation- and tax-wedge incentive on long-lived assets, and the legal and financeability analyses that underpin our position.

Annex A: International Best Practice in Airline–Airport Capital Collaboration — Lessons from American Airlines and DFW

1. Purpose of this Annex

This Annex is submitted by International Airlines Group, S.A. (IAG) in support of its response to CAP3251 — *Heathrow capacity expansion: consultation on a shortlist of regulatory models* (the “Consultation”). It supplements the analysis and proposals already set out by IAG in its response to CAP3195 (the November 2025 Working Paper) and aligns with the Heathrow Reimagined response to both consultations.

The Consultation indicates that the CAA is minded to take forward a combined package of regulatory models 1a, 2 and 4a — comprising enhanced capex governance, targeted adjustments to incentives, and strengthened scrutiny of HAL’s approach to procurement (see CAP3251, paragraphs 1.30 to 1.37). The CAA also signals that it intends to commission further expert advice on the design of these arrangements, including the various tools and mechanisms it could deploy and the roles of different stakeholder parties.

IAG welcomes this direction of travel. As set out in IAG’s CAP3195 response, the existing capital governance framework at Heathrow has placed the burden of scrutiny on airlines while granting them only superficial approval rights, with HAL retaining control of information, scope, programme and the approvals process itself. The Consultation rightly identifies the need to address this asymmetry.

To assist the CAA in calibrating the proposed Capital Committee and the supporting governance, incentive and procurement arrangements, this Annex presents detailed first-hand evidence from American Airlines on how airlines and airports collaborate on capital expenditure. American Airlines has shared this material with IAG for the purpose of supporting the Consultation. It draws principally on American’s experience at Dallas/Fort Worth International Airport (DFW), American’s largest hub, where the airline and the airport work together to deliver one of the largest live airport capital programmes in the world.

The US evidence is directly relevant to the Consultation because it demonstrates, in operating practice today, that the regulatory and contractual mechanisms IAG has proposed in its CAP3195 response — including a Capital Investment Committee, capital envelope controls, airline voting rights, mandatory competitive procurement where appropriate and multi-layered engagement throughout the capex lifecycle — are not novel or untested. They are the everyday operating model at major US hub airports and have been shown to deliver expansion programmes at materially lower unit cost than HAL’s proposals (CAP3195 response, Section C, paragraphs 9 to 10).

There is one important threshold point. In the United States, most airport infrastructure is financed through tax-exempt municipal bonds rather than private equity and corporate debt, and US airports are operated under public, not-for-profit governance models. The funding model therefore differs from Heathrow. However, the governance architecture that surrounds the deployment of that capital — capital envelope negotiation, pre-approved capital

programmes, Majority-in-Interest voting, integrated planner-to-planner engagement and disciplined milestone management — is independent of the funding source and is directly transposable into the Heathrow regulatory framework. Indeed, several of the elements set out below are already echoed in the package the CAA has shortlisted under CAP3251.

2. Executive summary

American Airlines' practice at DFW provides operational validation for the key elements of IAG's proposed Capital Investment Committee (CIC) and for the CAA's package of regulatory models 1a, 2 and 4a. The principal findings are:

- **The capital envelope is negotiated, not unilaterally set.** In US airport agreements, the negotiation of the capital envelope is a core component of the airport-airline lease. It establishes both the scope of investment to be undertaken and the methodology for recovering operating expenses and debt service. By contrast, at Heathrow capex is in practice driven by HAL with limited countervailing discipline.
- **Capital is pre-approved in defined programmes, paired with rights of use.** At DFW, the lease includes upfront approval of a defined capital programme covering growth-supporting infrastructure (terminal redevelopment, new piers, Terminal F), validated repair and replacement activity (e.g. airfield rehabilitation) and is paired with agreed gate allocation. This binds investment, payment obligations and operating rights together in a single coherent package.
- **Additional capex is subject to a Majority-in-Interest (MII) vote, weighted by financial responsibility.** Where new projects emerge during the term, airlines vote on them, with voting weighted by the share of cost each carrier will ultimately bear. MII is strongly preferred by airlines: in its absence, airlines have far fewer mechanisms to control capital spend and are forced into lobbying and informal channels.
- **Engagement is multi-layered and runs end-to-end.** On the airline side, Corporate Real Estate aligns inputs across the carrier and provides a single concise airline position; airline planners work directly with airport planners on programme phasing, constructability and prioritisation; and Airport Affairs engages with the airport's finance team on the affordability and cost per enplanement profile. Incentives are not always aligned, but trade-offs and negotiations consistently find middle ground.
- **Timeline and delivery are defined jointly.** The lease defines or at minimum frames the timeline and delivery commitments. Where external factors (governmental or environmental approvals) intervene, phasing and milestone delivery are agreed and tracked.

Each of these features maps directly onto the package the CAA has shortlisted under CAP3251 (models 1a, 2 and 4a) and onto the CIC that IAG has proposed. Section 8 of this Annex sets out specific recommendations for translating the US practice into the Heathrow regulatory framework.

3. The US airport–airline capital framework

3.1 The lease as the foundation

In the United States, the airport-airline relationship is governed by a long-form lease (often referred to as an Airline Use and Lease Agreement, or AULA) negotiated between the airport and its signatory carriers. The lease is the document in which the capital envelope is negotiated. As American Airlines explains:

“Negotiating the capital envelope is a core component of our airport agreements. It underpins how projects are financed as the lease establishes the methodology for recovering operating expenses and debt service.”

This is materially different from the Heathrow framework, in which capital programmes are advanced by HAL through the gateway process, with airlines providing input on HAL’s timetable and on HAL’s terms (see IAG’s CAP3195 response, paragraphs 10 to 11). In the US, the airlines that will pay for the infrastructure are at the table when the envelope is set. This is the conceptual equivalent of what the CAA describes in CAP3251 (paragraph 1.32) as a Capital Committee, but with two additional and important features that IAG considers essential and which are addressed below: (i) airlines are not merely consulted but vote in proportion to their financial exposure; and (ii) the capital envelope is set as a ceiling, not an aspiration.

3.2 A note on funding model

As noted in paragraph 6, US airports are typically financed through municipal bonds rather than private capital, and they operate on a not-for-profit, cost-recovery basis. Heathrow is a privately financed, equity-backed asset operating under RAB-based regulation. The funding architecture is therefore different.

This difference is sometimes used to suggest that US governance practice cannot be transposed to Heathrow. IAG respectfully disagrees. The source of capital is logically separable from the discipline applied to its deployment. The mechanisms described in the rest of this Annex — capital envelope negotiation, MII voting, pre-approved programmes paired with gate rights, integrated planner-to-planner engagement, and disciplined milestone tracking — would function in essentially the same way under a regulated private model as they do under a municipal bond model. They have no inherent dependency on the source of funds.

Indeed, the case for transposing these mechanisms is stronger at Heathrow than at a typical US hub, because the RAB-based incentive to inflate the asset base (CAP3251, paragraph 2.6) is absent at a non-profit, municipally-funded airport. Heathrow needs the additional governance discipline that US carriers obtain through their leases precisely because the underlying incentive structure pushes harder against the consumer interest than the structure of a US municipal airport does.

4. Pre-approved capital programmes

4.1 The DFW example

At DFW, American Airlines and the airport have negotiated upfront approvals for a defined capital programme that covers both growth-supporting infrastructure and validated asset repair and replacement. American Airlines describes this as follows:

“We negotiate upfront approvals for a defined capital program covering both infrastructure to support growth and asset repair/replacement. At DFW, this includes terminal redevelopment, new piers, and Terminal F. These approvals are paired with agreed gate allocation (rights of use). We also included other work that has been validated (e.g. airfield rehab and/or other repair and replace that we are all aligned on).”

Three features of this approach are particularly important for the CAA’s shortlist:

- **Scope clarity at the outset.** The lease binds both parties to a defined programme. Neither side can unilaterally expand the perimeter of the programme without going through the additional approval process described in Section 5 below. This addresses one of the issues IAG identified in its CAP3195 response (paragraph 91, Heathrow Reimagined response, cited at IAG response paragraph 11) — namely, that under the current Heathrow framework HAL is able to adjust project parameters after the gateway-3 approval point.
- **Coupling capital with rights of use.** Approvals are paired with agreed gate allocation. This ensures the carrier paying for the infrastructure has secure access to use it. This is conceptually similar to the airline-led capacity deployment risk IAG identified in its CAP3195 response (paragraphs 5 to 9, 24 to 28): airlines are required to invest substantial capital in fleet and crew to fill expansion capacity, and they need certainty that the infrastructure they have helped to fund will be available to them on agreed terms.
- **Validated repair and replacement.** Only repair and replacement work for which there is documented agreement between the airline and the airport is included in the pre-approved envelope. Items that do not meet the validation test are excluded and must run through the additional approval process. This provides a structural answer to the issue identified by Heathrow Reimagined and by the CAA itself in CAP3251 (paragraphs 2.107 and 2.108): that capital costs have been the principal driver of charge increases at Heathrow over a decade with no major capital development.

4.2 Relevance for CAP3251

The CAA’s shortlisted package (1a/2/4a) and the proposed Senior Capital Committee (CAP3251, paragraphs 1.32 to 1.36) implicitly require some mechanism for pre-approving the body of work that the committee will hold HAL accountable to. The DFW model provides a concrete template. IAG’s recommendation, set out in Section 8 below, is that the CAA require HAL to bring forward a pre-approved capital programme for the expansion and masterplan

renewal period, agreed with the airline community through the CIC, paired with gate allocation commitments, and operating as a hard envelope rather than an indicative budget.

5. The Majority-in-Interest (MII) framework

5.1 How MII works

Pre-approved capital programmes alone are not sufficient. Long-life airport infrastructure programmes inevitably generate additional capital requests during the term: scope changes, new projects, unforeseen replacements. To handle these, US airport leases routinely include a Majority-in-Interest (MII) process. American Airlines describes this as follows:

“At DFW, the lease also defines how additional capital is approved through a ‘majority-in-interest’ (MII) process. Airlines vote on projects, with voting weighted by financial responsibility. Projects require airlines’ vote of approval or disapproval within a defined period with failure to vote considered approval. This lease structure is not unique to DFW with similar examples at DTW and ATL.”

The defining features of MII are:

- **Voting rights, not consultation rights.** Airlines hold a substantive vote on whether the project proceeds at the airport’s cost, not merely a right to provide input. This is the central distinction between MII and the Heathrow gateway-3 mechanism, which IAG (CAP3195 response, paragraph 11) characterised as “superficial ... largely consultative ... HAL retains ultimate control over ... project scope, delivery approaches, and the approvals process.”
- **Weighting by financial responsibility.** The weight of each airline’s vote is set by the share of cost that airline will ultimately bear under the rate-setting methodology. This ties governance authority to economic exposure — the airline taking the largest commercial risk has the largest voice. It also creates a natural counterbalance: airlines that would benefit from a project pay more attention and weight than airlines that are indifferent.
- **Required approval or disapproval of projects.** Projects require airlines to vote on approval or disapproval within a defined window with non-response deemed as approval. This is a deliberately balanced design: it prevents passive obstruction by inattentive carriers while still giving carriers a real lever to prioritise projects that are in the best interest of their passengers.

5.2 Why airlines strongly prefer MII

American Airlines is clear on why MII is strongly preferred by airlines and what happens in its absence:

“While MII is not universal across airport leases, MII is strongly preferred by airlines. If MII is not established in the lease, airlines have fewer mechanisms to control capital spend, making proactive engagement and lobbying even more critical.”

This is precisely the position airlines find themselves in at Heathrow today. Because the gateway approval process at Heathrow does not confer a real economic veto, the only effective mechanism available to airlines has been the formal regulatory channel — submissions, consultation responses, CMA appeals — and collective lobbying of HAL’s management. Both are necessary but neither is sufficient for the disciplined management of a £49 billion capital programme.

5.3 Relevance for CAP3251

The CAA has shortlisted regulatory model 2 (targeted adjustments to the existing incentive regime) and has indicated that it does not propose to give the Senior Capital Committee a veto over HAL’s capital plans (CAP3251, paragraph 1.34). However, the CAA does propose that “HAL would need to explain clearly to the committee where it chooses to deviate from the advice that the committee and its experts provide,” and that “there would need to be protections in place where HAL under-delivers against the required standards,” including new incentive arrangements and longer-term caps and budgets.

IAG submits that the MII model provides the missing operational bridge between “committee advice without veto” and “effective protection against under-delivery.” An MII-style mechanism would:

- **Preserve HAL’s status as the licence-holder and ultimate decision-maker on operational matters**, consistent with the CAA’s position in CAP3251 paragraph 1.34, while introducing a real economic constraint on capex above the pre-approved envelope.
- **Align governance with financial exposure**, consistent with the CAA’s primary duty (CAA12) and with the principle that those who bear the cost should have a meaningful voice in how the cost is incurred and the ability to ensure rigorous and meaningful Value for Money testing. This addresses the asymmetry the CAA identifies in CAP3251 paragraph 1.32, where “the existing approach to governance ... relies heavily on airlines to provide ongoing scrutiny of capex plans and does not provide independent assurance across some aspects of capital governance.”
- **Operate within the CAA’s existing licence-modification powers** and would not require primary legislation. Licence conditions can require HAL to put additional capex above the pre-approved envelope to an MII-style vote of signatory airlines, with the CAA as ultimate arbiter where disputes arise.
- **Have a working track record at airports comparable in scale and complexity to Heathrow**, including DFW, Atlanta and others.

6. Multi-layered engagement

6.1 The American Airlines engagement model

Effective capex governance at DFW depends on multi-layered engagement between airline and airport teams. American Airlines describes this as follows:

“From an involvement standpoint, Corporate Real Estate works to align inputs across the airline to validate program drivers and provide a concise airline position to the airport. Then we work with the airport, with our planners working with the airport planners on the program itself, including phasing, constructability, and prioritization. In parallel, the Airport Affairs team works with the airport’s finance team to support the effort balancing affordability and providing clarity on the overall financial plan (projected cost per enplanement). It is a multi-layer process as incentives are not always aligned, but with trade-offs and negotiations, we are often able to find middle ground.”

Three layers of engagement operate in parallel:

Layer	Airline function	Counterpart at the airport
Strategic alignment	Corporate Real Estate (CRE) — aligns inputs across the airline, validates programme drivers, presents a single concise airline position. The CRE team includes technical subject matter experts from Airport Affairs and the technical teams (airport planners, design and construction).	Airport corporate / executive leadership.
Programme delivery	Airline planners — work directly with airport planners on phasing, constructability, prioritisation, and operational impacts.	Airport planning, design, and construction teams.
Affordability and finance	Airport Affairs — supports the financial plan balancing affordability and providing clarity on the projected cost per enplanement.	Airport finance and treasury teams.

6.2 Why three layers matter

The three-layer structure recognises that a single airline-airport interface cannot do justice to the breadth of issues that a major capital programme generates. Strategic-level alignment on programme drivers (does the airport need this asset at all?) is a different conversation from constructability and phasing (can this asset be built without unacceptable operational disruption?), which is in turn different from the affordability conversation (does the resulting cost-per-enplanement profile leave headroom for airline investment in fleet and routes?).

American Airlines is candid that this is not a frictionless process: *“incentives are not always aligned, but with trade-offs and negotiations, we are often able to find middle ground.”* The relevant point for the Consultation is not that engagement is easy, but that the **structures** exist to enable productive negotiation between the parties. At Heathrow today, those

structures are either absent (no equivalent of MII) or operate without adequate information access on the airline side (gateway-3 process).

6.3 Relevance for CAP3251

The CAA has indicated that the Senior Capital Committee “would be attended by senior representatives from HAL and airlines” and that the CAA would “also consider whether there should be attendees from other stakeholders, including consumer representatives” (CAP3251, paragraph 1.33). It also notes that the committee “would be supported by independent technical experts in planning, procurement and delivery of major infrastructure projects.”

IAG submits that the US three-layer model offers a useful template for the architecture beneath the Senior Capital Committee. The Committee itself can sit at the strategic level. Two additional structured working groups — one for programme delivery (airline planners with HAL planners, supported by the CAA’s independent technical experts) and one for affordability and finance (airline finance and commercial teams with HAL finance) — would mirror the structures that operate at DFW today and would ensure that the right conversations happen at the right level. The CIC framework proposed in IAG’s CAP3195 response (Annex A) is fully consistent with this architecture.

7. Timeline and delivery

Finally, American Airlines’ practice underlines the importance of agreeing timeline and delivery commitments jointly. American Airlines describes this as follows:

“On timeline and delivery, we aim to define both, though execution can be impacted by external factors such as governmental or environmental approvals. At a minimum, we agree on the phasing of programs and milestones to be delivered.”

Two features are noteworthy:

- **Realism about external dependencies.** American Airlines and DFW recognise that not every delivery date can be guaranteed because external factors (governmental approvals, environmental clearances, planning consents) sit outside both parties’ control. This is consistent with the CAA’s observation in CAP3251 paragraph 3.38 that “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.”
- **A minimum standard of agreed phasing and milestones.** Even where the ultimate delivery date is uncertain, the parties commit to an agreed phasing and to milestones that can be tracked. This is the practical mechanism that makes capex delivery accountable in the absence of fixed end dates.

This is directly relevant to CAP3251’s treatment of timeliness (paragraphs 1.23 to 1.24). The CAA has rightly rejected HAL’s proposed pass/fail test on timeliness, on the ground that this would risk prioritising speed over the effectiveness of the regulatory model in protecting consumers. The American Airlines / DFW approach demonstrates the workable alternative: define the phasing and milestones jointly, hold the parties accountable to those milestones,

and treat the ultimate completion date as a target rather than as a binding deadline irrespective of cost.

8. Implications for CAP3251 and recommendations to the CAA

8.1 Summary of read-across to the shortlisted models

The American Airlines / DFW evidence supports and operationalises each of the elements the CAA has shortlisted under CAP3251. The table below summarises the mapping.

CAP3251 shortlisted element	Corresponding US practice (American Airlines / DFW)
Model 1a — changes to capex governance processes; Senior Capital Committee (CAP3251 paras 1.31–1.34).	Negotiated capital envelope; multi-layered engagement (strategic, programme, finance); CIC-style architecture beneath the Committee.
Model 2 — targeted adjustments to the existing incentive regime (CAP3251 paras 1.35, 4.79 onwards).	Pre-approved capital programme paired with gate-allocation rights; MII vote on additions to the envelope; deemed approval with active disapproval as the lever.
Model 4a — enhanced scrutiny of HAL's approach to procurement (CAP3251 paras 4.82–4.84).	Airport-airline joint validation of repair and replacement scope; independent technical scrutiny of programme phasing and constructability; affordability tested against cost-per-enplanement profile.
Model 4b / 5b — mandatory competitive procurement for design-and-build / design, build and operate (CAP3251 paras 1.44–1.51).	US airports routinely use competitive procurement at the package level; this is integrated into the capital approval workflow rather than bolted on as a separate regulatory mandate.

8.2 Specific recommendations to the CAA

On the basis of the evidence in this Annex and IAG's wider response to CAP3251, IAG sets out the following recommendations to the CAA:

- **Recommendation 1 — Pre-approved capital programme.** Require HAL, in consultation with the airline community, to bring forward a pre-approved capital programme for expansion and masterplan renewal, structured as a hard capital envelope and paired with the relevant rights of use (e.g. terminal and pier allocation). Items within the envelope are deemed approved at the start of the period; items outside the envelope must run through Recommendation 2.
- **Recommendation 2 — MII-style vote for additions to the envelope.** Establish, by licence modification, an MII-style mechanism by which additions to the pre-approved envelope require a vote of signatory airlines, weighted by financial exposure, with

deemed approval if the airlines do not actively disapprove within a defined window. The CAA retains the role of ultimate arbiter where disputes arise. This sits comfortably alongside, and reinforces, the Capital Committee architecture in CAP3251 paragraph 1.32.

- **Recommendation 3 — Three-layer engagement architecture.** Structure engagement on the model used at DFW: a strategic-level Capital Investment Committee (per IAG's CAP3195 response, Annex A), a programme-delivery working group (airline planners with HAL planners, supported by independent experts), and an affordability and finance working group (airline finance and commercial with HAL finance). Each layer to meet on a defined cadence and to report into the CIC.
- **Recommendation 4 — Phased delivery against agreed milestones.** Adopt the US approach of agreeing phasing and milestones jointly, holding the parties accountable to those milestones, and treating the ultimate completion date as a target subject to external dependencies (planning, environmental, governmental approvals). This is consistent with the CAA's rejection of HAL's proposed pass/fail timeliness test in CAP3251 paragraph 1.23.
- **Recommendation 5 — Information access on the airline side.** As a precondition for the above to function, ensure that airlines have the information access enjoyed by US carriers under their leases — including transparent cost breakdowns, procurement strategies, contracting terms for outsourced activities, contingency allowances and benchmarking data. This addresses the information-asymmetry problem identified in IAG's CAP3195 response (paragraphs 10 to 11) and in the Heathrow Reimagined response and is essential to any committee or vote-based mechanism functioning as intended.

IAG would welcome the opportunity to discuss this Annex with the CAA, and is willing to facilitate further engagement between the CAA, American Airlines and other US carriers operating at Heathrow with first-hand experience of these mechanisms. American Airlines, as a member of the Atlantic Joint Business and a signatory carrier at multiple US hubs, has indicated its willingness to support such engagement.

Annex B – Why Model 3 is not the right model to push forward

1. Summary

The CAA has shortlisted, as Model 3, a long-term regulatory framework under which Heathrow Airport Limited (HAL) would receive a committed allowed cost of capital (and, in some variants, related parameters) over a period materially longer than the standard five-year price control. The stated attraction is financeability. This annex explains why Model 3 is inadequate and should not be relied upon as part of the CAA's package of reforms.

The argument is straightforward. Model 3 does not address any of the root causes of the poor consumer outcomes the CAA has identified in the case for reform. Its only claimed benefit – financeability – is narrow, heavily conditional and cannot, on its own, justify the model. And, decisively, a long-term locked-in return would **entrench HAL's ability to game the regulatory system**. Because the CAA's secondary financeability duty can be invoked to lever returns up but is then converted into a shield against bringing returns down, a long-term regulatory commitment can only lead to asymmetric outcomes for consumers. A mechanism with that property cannot, by construction, further the interests of consumers. It is an unnecessary and one-sided constraint on the CAA's decision making.

The CAA appears to assume that the overall package of models comprising the expansion regulatory framework would mitigate this risk by applying appropriate incentives on efficient delivery. It is unclear how it has reached this conclusion. The only models that would materially support the CAA's ability to implement Model 3 are those in which competition for expansion finance provides a credible evidence base as to the cost of capital for expansion.

More generally, the CAA has not clearly articulated the problem that Model 3 is intended to address. The consultation appears to assume that HAL will require a significant construction premium in its allowed return for Heathrow's expansion, together with stronger regulatory commitments to support financeability, but provides limited evidence that such a commitment problem exists or that such a premium is warranted. In addition, the proposals for Model 3, particularly the cap-and-collar variant, are not sufficiently developed to enable stakeholders to fully assess the CAA's reasoning or the merits of the approach. As a result, stakeholders are being asked to comment on an option whose key features and practical implications remain unclear.

This annex builds on Heathrow Reimagined's consultation responses on Model 3 to the CAA's regulatory reform consultation to which IAG contributed. It provides additional analysis on why Model 3 is not a justified course of regulatory action and is not in consumers' interests. This response should be read alongside Heathrow Reimagined's response to CAP3251, which raises similar concerns about the CAA's proposals for Model 3.

2. What Model 3 is, and where it comes from

In its November 2025 Working Paper (CAP3195), the CAA set out the case for change and a long-list of regulatory models.¹¹ In the Spring 2026 Consultation (CAP3251), it narrowed that

¹¹CAA, CAP3195, Working Paper on regulatory models for Heathrow, November 2025. The Working Paper set out the case for change, an evaluation framework, and a long-list of possible regulatory models.

long-list to a shortlist.¹² Model 3 sits in that shortlist as the “long-term regulatory framework”. In substance it would replace the regulator’s periodic reset of the allowed return with a multi-period commitment, through one of several sub-options: a combined long-term cost of capital across business-as-usual (BAU) and expansion (Option 3.1a); a long-term cost of capital for a separate expansion RAB only (Option 3.1b); a formal lengthening of HAL’s price control period (Option 3.2); or a cap-and-collar mechanism on returns (Option 3.3).

As a preliminary point, it is important to note that Model 3, as a potential regulatory reform for Heathrow, has been primarily advocated by HAL and its advisers. Given the incentives and rationale for reform set out by the CAA in Chapter 2 of CAP3251, the CAA should exercise caution in considering the model and carefully assess whether the outcomes sought by its principal proponent are aligned with consumers’ interests.

UK economic regulation across water (Ofwat), energy networks (Ofgem) and aviation (the CAA) is built on RAB-based controls reset every five years. The periodic reset is not an administrative inconvenience; it is one of the regulator’s most important protections for consumers and investors. It is the mechanism by which allowed returns are recalibrated to new evidence and changed market conditions, and through which the regulator retains the discretion to introduce, extend or recalibrate other reforms. **Model 3 proposes to surrender that discretion for a decade or more. The case for doing so has not been made.**

As noted above, a core concern with the CAA’s short-listing of Model 3 is also that it does not clearly articulate the problem the model is intended to solve, or how key elements of the proposal, such as a cap and collar, would operate in practice. The long-term regulatory commitment underpinning Model 3 appears closely linked to an expectation that expansion, particularly during the construction period, would require a premium in HAL’s allowed cost of capital. However, this is not clearly recognised in the CAA’s reasoning. As a result, stakeholders cannot readily assess the merits of the proposal or meaningfully engage with its underlying rationale. The CAA has not provided evidence on the scale of any uplift to the cost of capital that it envisages may be required to support expansion, and therefore the scale of the issue that Model 3, through a long-term regulatory commitment, is intended to address.

3. Model 3 does not address the root causes of poor outcomes

The CAA’s own case for change locates the harm at Heathrow in HAL’s harmful incentives (the product of monopoly market power and a regulatory model that rewards higher capital spend rather than higher consumer value) compounded by the limits of existing regulatory tools in the face of HAL’s information advantage. These are problems of incentive and of competition. A commitment to a particular cost of capital over a longer period does nothing to change HAL’s incentive to inflate the RAB, nothing to expose HAL to competitive discipline, and nothing to close the information asymmetry the CAA must work against.

This is reflected in the CAA’s own scoring. As recorded in Table 5.1 of CAP3251, Model 3 has no direct positive impact on five of the six evaluation criteria (avoiding delay and disruption, promoting efficient costs, promoting competition, promoting service quality and practicality). It is scored positively on one criterion only: raising sufficient finance. None of the dimensions most directly tied to the CAA’s primary duty is advanced by the model. The CAA appears to

¹²CAA, CAP3251, Spring 2026 Consultation. Model 3 is the long-term regulatory framework option. See in particular Table 5.1 and the discussion at paragraphs 5.29 to 5.35.

set aside concerns over trade-offs between these criteria by assuming that it achieves this positive impact by delivering a lower cost of capital than under the counterfactual. But it has not clearly defined this counterfactual; the CAA's analysis is incomplete. It has not engaged with the possibility that supporting the raising of finance may come at an inflated cost to consumers, because there is no robust evidence on which to assess the supposed expansion premium.

4. The financeability case cannot carry the model

The single positive score is, on inspection, fragile. The CAA's financeability analysis is conditional throughout: the benefit depends on the precise design of the mechanism and on the broader package of reforms. The CAA's adviser, Centrus, scored Model 3 positively on financeability but was explicit that its report addresses financeability *only*, and does not opine on the rest of the evaluation framework.¹³ Centrus itself observed that the precise mechanic matters less than reopeners, the charges and cash-flow profile, and risk allocation. This is precisely to say that the consumer interest is determined by the conditions of implementation, not by the headline label of a long-term commitment.

Centrus' assessment of the benefits of Model 3 and its variants is also highly qualified. While Centrus conclude that the long-term regulatory commitment embodied in Model 3 may support financing, its assessment of the benefits appears relatively modest. In particular, Centrus states that Model 3 may increase competition and reduce the cost of capital, while any improvement in HAL's credit rating is expected to be only marginal and the cost of debt is "not expected to reduce significantly".¹⁴ This further highlights that, while Model 3 may create significant risks of consumer harm (as discussed below), there remains considerable uncertainty regarding the scale of the benefits (if any) it is expected to deliver.

There is also a deeper point. Model 3 does not reduce the underlying risks of expansion; it reallocates them. If a long-term commitment improves HAL's financeability, it can only be because it reduces the risk borne by HAL's investors or increases the returns they expect – relative to other models. Either way, more risk or more cost is transferred to consumers. Any financeability benefit from a lower cost of capital is therefore offset by greater protections or payments funded by users. A positive financeability score is one criterion among several, and cannot outweigh a model that is, at best, neutral and, at worst, harmful on everything that matters most to consumers.

5. A long-term WACC entrenches HAL's ability to game the system

This is the decisive objection. A long-term commitment to the allowed return interacts with the CAA's secondary financeability duty to create a one-way ratchet that operates entirely in HAL's favour. The asymmetry works through two mechanisms:

- **If the committed WACC proves too low**, HAL can invoke the CAA's financeability duty to press for the settlement to be revised upwards. That lever is made more potent by HAL's elevated gearing – sitting materially above the notional structure – where the CAA has itself recognised that strict enforcement could threaten HAL's ability to meet its

¹³Centrus financeability assessment commissioned by the CAA, as summarised in CAP3251. Centrus is explicit that its report addresses financeability only and does not comment on other aspects of the CAA's evaluation framework.

¹⁴ Centrus (2026): 'Financeability assessment of regulatory models for Heathrow Airport', p. 17

obligations. The pressure to ‘aim up’ to avoid a financeability problem is immediate, visible and politically salient.

- **If the committed WACC proves too high**, the commitment itself disables correction. Once HAL has raised finance against the committed return, any attempt by the CAA to bring returns back down can be resisted on the very ground that financing was secured in reliance on the commitment. A regulator that has made a genuine multi-period ‘commitment’ has, by definition, fettered its discretion to intervene.

The financing duty therefore arms HAL on the upside and shields it on the downside. The gradual harm to consumers from an over-generous return accumulates quietly over the whole commitment period, while the risks of an under-generous return (ratings pressure, financeability concerns, political intervention) are sharp and visible. To set a return over a longer horizon, the CAA must forecast across a wider range of outcomes and, consistent with the “aiming up” principle endorsed by the CMA in its 2026 PR24 redeterminations,¹⁵ apply a larger margin to avoid setting returns too low. That margin grows with the length of the commitment. The CAA therefore cannot assume that a longer-term commitment will reduce charges; the more likely effect is to raise the allowed WACC and lock the higher figure in.

The track record reinforces the concern. HAL earned in the region of £1.6 billion above its allowed return between 2014 and 2023 – and it did so under a five-year cycle, with far less forecast-error risk than a decade-long commitment would carry.¹⁶ Extending the commitment period multiplies the scope for that kind of systematic over-recovery, and removes the periodic reset that is the CAA’s principal means of correcting it. A cap-and-collar mechanism (Option 3.3) does not cure this: it simply moves the same information asymmetries and financing-duty pressures to the setting of the cap and collar bounds, where HAL retains the same advantages.

The conclusion is unavoidable: **a mechanism that can only move consumer charges in one direction cannot further the interests of consumers.**

6. HAL is already overcompensated – there is no case for locking in returns

The premise behind Model 3 (HAL needs locked-in or premium returns to make expansion financeable) should be rejected at the outset. HAL is already among the most extensively protected regulated entities in the UK. The regulatory package layers multiple, overlapping protections that insulate HAL from the very risks a long-term return commitment would purport to compensate.¹⁷ These protections include:

- the indexation of the RAB to outturn inflation, which has allowed HAL to pass inflation shocks through to consumers and has driven substantial RAB growth from indexation alone;

¹⁵CMA, PR24 redeterminations, March 2026, which concluded that a modest degree of aiming up can, overall, benefit customers.

¹⁶Heathrow Reimagined response to CAP3251, drawing on H8 responses. HAL earned in the region of £1.6 billion above its allowed return between 2014 and 2023, under a five-year regulatory cycle with materially less forecast-error risk than a long-term commitment would carry.

¹⁷British Airways response to CAP3232 (CAA H8 Initial Proposals), Section 12 (Cost of Capital), “HAL’s layers of overcompensation under the regulatory package and proposed remedies”.

- the pass-through of HAL's actual, rather than notional, cost of debt, transferring the cost of HAL's own financing choices to users;
- the traffic risk-sharing mechanism and a separate traffic shock factor, both of which allocate demand risk away from HAL and onto consumers;
- an asymmetric risk allowance funded by users against extreme demand shocks;
- a pre-tax cost of capital allowance; pension deficit recovery; broad cost pass-throughs; and the ability to flex the capex envelope.

A regime that already shields HAL against traffic, inflation, financing, input-cost and investment-volume risk does not also require the CAA to surrender, for a decade or more, its ability to reset the allowed return. The case for locking returns has not been made. The evidence points the other way: the CAA should preserve, not fetter, its ability to correct returns as risk and market conditions evolve.

7. A premium return on expansion would compound overcompensation and invite gaming

Variants of Model 3 contemplate a separate expansion RAB carrying a higher allowed cost of capital than the BAU RAB. This should be rejected for two reasons. First, any premium would sit on top of the already-generous return and the multi-layered protections described above; it would compound existing overcompensation rather than fill any genuine gap in HAL's risk exposure. Expansion expenditure delivered under a regime that preserves those protections and backed by the CAA's financeability duty already enjoys significant risk mitigations. No evidence has been presented that, with these protections in place, expansion warrants a premium relative to BAU investment; still less that a premium would be necessary over the current BAU return.

Second, a premium creates a direct gaming incentive. Where the return on the expansion RAB exceeds the BAU return, HAL has every incentive to maximise the proportion of expenditure classified as expansion. In practice this would generate disputes over asset boundaries, project scope and expenditure categorisation (contests HAL is well placed to win given its information advantage and control over baseline assumptions). Contributing to the frequency and intensity of such disputes would risk going against the CAA's criteria to avoid undue delay and disruption. This is the same dynamic that regulators elsewhere have recognised: the French ART, in its 2026 opinion on the Aéroports de Paris regulation agreement, found that the WACC cannot be assessed independently of the actual risk-sharing arrangements and must remain proportionate to the risk the operator actually bears.¹⁸ A premium untethered from a genuine increase in risk fails that test.

8. Model 3 cannot be thought of independently of models promoting competition

The competition models the CAA has rightly shortlisted (and direct terminal competition in particular) are the reforms that genuinely address HAL's incentives. The CAA should not

¹⁸French ART, opinion on the Aéroports de Paris Economic Regulation Agreement 2027–2034, April 2026. The ART found that the WACC cannot be assessed independently of the actual risk-sharing arrangements and must remain proportionate to the risk borne by the operator.

prioritise Model 3 or think of it as a substitute for models that will deliver better outcomes for consumers.

In some respects, competitive models are complementary to Model 3 in that they could help mitigate the risk of forecast error. The CAA's case for Model 3 appears to rest on the presumption that the expansion cost of capital will differ from BAU, and that it will not be possible to commit to allowing that difference over investors' time horizons.

Conceived as an independent option, Model 3 would rely on an estimate of the expansion cost of capital. Although HAL and the CAA refer consistently to an expansion premium, there is no robust evidence with which to size it. Our primary concern is that, given the regulatory protections in place, any premium would be over-estimated. Model 3 would lock in that over-estimate.

A competition for financing expansion is the only way to address that weakness in the evidence base. In principle, competitive models can be used to generate evidence on efficient financing costs, provided the allocation of risk is transparent and appropriate. Only with this kind of direct evidence in place could Model 3 have sufficiently robust underpinnings to fit with the CAA's duties and evaluation criteria.

There may also be a risk that Model 3, if implemented independently, could impinge on the future application of competitive models. A long-term commitment carries a structural cost: a formal lengthening of the price control period (Option 3.2) would reduce the frequency with which the CAA can introduce, extend or recalibrate competition arrangements in light of evidence, and would entrench HAL's monopoly position over a longer horizon. Even the narrower sub-options risk path dependency: long-term investor protections, once designed around HAL financing and delivering expansion assets, can pre-empt or constrain the later introduction of competition for those assets.

The CAA should not allow Model 3 to preclude or constrain the future application of models that would deliver better outcomes for consumers.

9. The sub-options do not rescue the model – and highlight shortcomings in the CAA's consultation process

We have found it challenging to appraise each of the sub-options, as the proposal as currently described does not provide sufficient clarity on the nature of the risk it is seeking to address or how the proposed framework would operate in practice. Our comments on the sub-options should be read in the context of this overarching issue.

Overall, the consultation does not yet establish a clear case for departing from a conventional five-year price control framework. The CAA has not clearly identified the specific risk that Model 3 is intended to address, demonstrated why existing regulatory mechanisms are insufficient, or explained how the proposed arrangements (in particular the cap-and-collar) would operate in practice.

Indeed, the proposal appears to contain an inherent tension. While Model 3 is presented as providing greater long-term certainty, the introduction of cap-and-collar, gain-sharing and other risk-sharing mechanisms suggests that significant regulatory discretion would remain. It is therefore unclear what additional certainty the model would provide relative to a

conventional price review framework, or why the benefits would outweigh the loss of periodic reassessment and scrutiny that accompanies five-year controls.

In the absence of a clearer articulation of both the problem and the proposed solution, IAG does not consider that the CAA has established a sufficient basis for shortlisting Model 3 as a credible alternative regulatory framework.

None of the design variants resolves the core defects. Option 3.1a (a combined long-term cost of capital across BAU and expansion) is the most harmful: it would lock in returns on the entire existing asset base and maximise exposure to the asymmetry and forecast-error risks above; the CAA has rightly declined to pursue it. Although Option 3.1b (a long-term cost of capital for a separate expansion RAB, with BAU redetermined every five years) should in theory limit harms to expansion assets, this is subject to gaming risk over the boundary between expansion and other assets. Even here the Portsmouth Water / Havant Thicket precedent shows only that tight scoping and reopener discipline are the *minimum* required if the CAA proceeds, not that a long-term commitment is desirable.¹⁹ Option 3.2 (lengthening the price control period) should be ruled out definitively, a conclusion reinforced by credit-rating considerations and the foreclosure of competition. Option 3.3 (cap and collar) relocates the asymmetry rather than removing it.

One of the principal concerns previously identified by Heathrow Reimagined was the risk of forecast error. The CAA appears to now position the cap and collar variant of Model 3 as a potential response to this concern.

The CAA's consultation does not elaborate on how this variant would be expected to work, and indeed highlights the potential complexity of the model. For example, paragraph 5.46 notes that, if returns were to fall outside the cap-and-collar range, additional risk-sharing arrangements could apply, and that the mechanism could potentially include a gain-share arrangement. Such features introduce further layers of design complexity and implementation risk. They would also inevitably become the subject of regulatory debate and lobbying, reducing the predictability and simplicity that appear to be among the primary objectives of the proposal.

More fundamentally, the cap-and-collar construct again raises questions about the specific problem the CAA is seeking to solve. If the CAA is comfortable allowing realised returns to vary within a specified range, it is not clear what risks it believes would otherwise justify revisiting the allowed return under a conventional five-year price control framework. The consultation is also unclear as to whether the proposed cap and collar would apply solely to the allowed cost of capital, or more broadly to realised returns after taking account of other drivers such as demand, expenditure and operational performance.

This distinction is important, as the rationale and implications of the mechanism differ significantly depending on its intended scope.

There appear to be three broad categories of forecast error that could potentially motivate the proposal:

- First, there may be concerns regarding forecast errors in WACC parameters, such as the risk-free rate or cost of debt. However, this is a familiar feature of RAB regulation

¹⁹The Portsmouth Water / Havant Thicket Reservoir precedent cited by Centrus: a bespoke higher project WACC alongside the standard BAU WACC, paired with cost-adjustment mechanisms for unforeseen costs.

and one that is routinely managed within conventional five-year price controls. Moreover, any plausible forecasting errors are likely to fall well within the range of a cap-and-collar mechanism, limiting the practical value of a long-term commitment.

- Second, the CAA may be concerned about the risk of incorrectly calibrating any premium associated with expansion. However, if the relevant premium is measured in only a small number of percentage points, again it is difficult to see why a long-term commitment mechanism would be necessary, given that any reasonable variation would likely fall within the proposed corridor.
- Third, the CAA may be seeking to address uncertainty regarding future demand outcomes. This is perhaps the most plausible rationale for a cap-and-collar approach, as demand shocks could have a material impact on realised returns. However, if this is the intended objective, important questions remain unanswered. In particular, it is unclear how losses below the collar would be funded and how risks would ultimately be allocated between HAL and consumers.

The existence of diverse sub-options, and in particular the cap-and-collar variant, therefore exposes a lack of clarity in the CAA's consultation on the problem it is seeking to address.

10. Conclusion and recommendation

Model 3 fails the test the CAA has set itself. It does not address the root causes of poor outcomes; it scores positively on one conditional criterion only; and it would entrench HAL's ability to game the system by converting the CAA's financeability duty into a one-way ratchet that can raise returns but not lower them. It rests on a premise (HAL needs locked-in or premium returns) that the evidence on HAL's existing protections does not support.

The CAA should therefore **not rely on Model 3 as part of its package of reforms**. Its energies are far better directed at the reforms that genuinely reset HAL's incentives: a step-change in capital governance and, above all, the introduction of competition – including direct terminal competition extended across the existing estate. If the CAA nevertheless proceeds with any element of Model 3, it should be confined to a separate expansion RAB (Option 3.1b), tightly scoped, time-limited, paired with robust reopeners and cost-adjustment mechanisms, and designed to be complemented and supported by the introduction of competition. A long-term commitment to HAL's returns is not a reform that furthers the interests of consumers; the CAA's most valuable protection for consumers is the very discretion that Model 3 would ask it to give away.

Annex C – T2 Baggage Renewal: an example of failed capital governance

1. EXECUTIVE SUMMARY

1.1 Overview

The programme for the replacement of the baggage system that serves airlines in Terminal 2 shows that, despite extensive activity, Heathrow's current capital governance framework does not provide sufficient assurance that major investments are prioritised, developed and approved within a coherent and controlled capital planning process.

The replacement of the c.25-year-old²⁰ baggage system still housed in Terminal 1 and serving Terminal 2 airlines is a long-recognised renewal need, yet it has not translated into a timely and stable investment plan. The programme has developed through deferral, prolongation and cost escalation alongside a deteriorating product and service.

The wider T2 Baggage Programme now approaches £1 billion on a whole-programme basis, while the G3 request for the T2 baggage system itself is £552 million. The quantified benefits are comparatively narrow and are largely protective rather than transformational. The programme is framed around maintaining existing 2019 Terminal 2 capacity and service levels, reducing the likelihood of failure associated with ageing Terminal 1 infrastructure and protecting future optionality for growth, but it does not itself provide growth.

The business case is principally based on continuity, resilience and risk reduction. It does not bring together in a single decision-grade presentation the impact on charges, asset life, whole-life costs and the cost of prolonged reliance on ageing infrastructure. The £900 million for Terminal 2 baggage over an estimated 20 years is expected to cost airlines £64 million pa²¹, while the business case identifies a £6 million pa reduction in Other Regulated Charges ("ORCs") to airlines.

The cost forecast has continued to rise over time. In 2007, the Q5 submission identified a new baggage handling system in Terminal 2 at a cost of £339 million, however the scope was excluded from Terminal 2 development. Since the programme was reinitiated, costs have escalated from an initial view of £574 million to £897 million, with an upper bound expressed as £1 billion²².

In the meantime, over the last decade significant capex has been spent patching and maintaining the Terminal 1 system and facilities to serve passengers in Terminal 2²³. However, despite the investment, the system and facilities are deemed obsolete and the incidence of failure has been increasing. Customers face the prospect of bags not being loaded. Airlines have had to undertake service recovery and pay the cost of compensating passengers. Most summers since T2 opened, airlines have faced at least one major system outage. Handling around 30,000 bags daily for c. 20 million passengers, each 1,000 bags not loaded is

²⁰ CAA, Price control proposals for Heathrow and Gatwick airports, November 2007, Supporting Paper I/II, Review of Heathrow Airport capital investment plan for Q5, Currie & Brown Final Report, 20 November 2007, section 5.2 / "HET Baggage Handling System", p.29

²¹ Higher on a nominal basis. Real terms calculation based on H7 WACC of 4.01%, straight line depreciation for an assumed life of 20 years

²² IFS PMAC Presentation for B7233: T2 Baggage Programme P2 Gateway, £999.9m upper bound, 4 April 2023

²³ CAA CAP1103 Final Proposals: £220m for enhancements to the T1 baggage system only.

estimated to cost airlines around £100k. The cost impact on airlines of deterioration runs into millions of pounds. Consumers and airlines would reasonably expect better service outcomes for this level of airport investment.

The result is continued reliance on an ageing system that is failing consumers, with baggage renewal for one terminal only being delivered towards the end of the decade.

1.2 Context

The T2 Baggage Programme has moved from a known renewal issue identified in 2007 into a major capital investment expected to deliver towards 2030, while remaining anchored to historic 2019 capacity assumptions.

Over this period, Terminal 2 operations have continued to rely on a baggage system originally intended as an interim solution. That system has been extended well beyond its initial planning horizon and is associated with recurring operational disruption. These disruptions require workarounds such as rehandling and manual intervention, resulting in additional operating costs for airlines and ground handlers. These costs are not reflected in the capital value of the programme but form part of its overall economic impact.

Heathrow also worked extensively with airlines, ground handlers and subject matter experts to develop the operating concept, requirements, logistics principles and related design inputs. That collaboration was necessary and relevant to defining the operational solution and testing practical deliverability. It did not, however, remove the need for separate governance and scrutiny of the investment case, including independent challenge of scope, maturity, cost, assumptions, exclusions and value for money.

Despite extensive consultation and formal governance processes, costs increased materially and scope evolved over time. Airlines and handlers were extensively engaged in requirement development and operational design, but that engagement did not provide equivalent control over approval, scope or timing. When considered on a whole-life basis, including both capital and operating impacts, the value-for-money case is not demonstrated.

The case illustrates a recurrent governance risk, where long-known infrastructure needs are deferred, the eventual programme becomes larger, later and more constrained, while the cost of interim deterioration is borne through additional capital spend to avoid the worst deterioration, operational inefficiency and consumer harm. In such circumstances, formal consultation and gateway compliance are not sufficient indicators of effective capital governance.

1.3 Implications for CAP3251 and regulatory reform

This case study shows how Heathrow's capital governance framework operates in practice and raises material doubt as to whether it provides sufficient assurance that major investments are planned, challenged, approved and controlled in a way that protects consumers from inefficient or poorly timed expenditure.

The case study supports a strengthened framework centred on earlier control, independent decision-making and whole-life value assessment. This includes an independent Capital Investment Committee, a requirement that approval precedes material contractual commitment, stronger independent assurance of business cases and options, improved

information rights for users, and a more systematic approach to benchmarking, option testing and ex post accountability. The case study supports the introduction of competition for semi-separable assets to drive up innovation and drive down cost.

2. T2 BAGGAGE PROGRAMME

2.1 Long-standing infrastructure renewal need

The requirement for a permanent Terminal 2 baggage solution has been recognised since the Q5 planning process in 2007 and was further identified during Q6 as an operational risk. The reliance on Terminal 1 infrastructure, including a transfer sorter identified as a single point of failure, was clearly understood.

The approach adopted at that time relied on an interim solution, with the expectation that a permanent system would be delivered at a later stage. In practice, that has now been extended over a prolonged period. The permanent solution was deferred across successive regulatory periods. The long-term infrastructure requirement was identified but not translated into a timely and stable investment plan with understood and traceable impacts.

2.2 Cost development and output proposition

The programme's cost trajectory is a central feature of the case study.

Stage	Cost
Q5 (2007) ²⁴	£339m
H7 Revised Business Plan (2021) ²⁵	£574m
H7 Business Plan (2022) ²⁶	£645m
P1 Gateway (2022) ²⁷	£695m
P2 Gateway (2023) ²⁸	£787m
G3 Gateway (held since Sept 2025) ²⁹	£897m

Note: costs exclude additional costs for prolongation and the additional airline operating costs for a deteriorating product.

Approaching £1 billion for the programme, excluding the previously incurred spend prolong the system and facility, the programme is approximately 56% more than the original H7 Revised Business Plan estimate and around three times higher than the original concept in 2007.

Yet at this cost level, the programme only aims to maintain Terminal 2 throughput and performance levels as at 2019, despite operations starting at the end of the 2020s. The limited quantified benefits provided are concentrated on resilience, continuity, opex savings and performance protection, with further improvement claims often qualitative, modelled or contingent on future operating conditions.

²⁴ Review of Heathrow Airport capital investment plan for Q5, Currie & Brown Final Report, 20 November 2007, Appendix F

²⁵ CAA/HAL H7 T2 Baggage Programme Appendix A3

²⁶ Arcadis RBP Update 2 review, 29 June 2022

²⁷ HAL P1 FPG pack, May 2022

²⁸ HAL P2 CPB pack, April 2023

²⁹ HAL T2 Baggage Programme G3 Investment Decision, September 2025 CPB pack, Document Number: 12142-XX-RG-301-100003

For an investment of this scale, the case should demonstrate clearly why this level of expenditure represents the best available whole-life solution. The available information does not show that this case was established with sufficient clarity and rigour.

2.3 The business case and benefit proposition

The business case is not presented as a growth or transformation case. It is a resilience, obsolescence and continuity case. The core rationale for the investment is that Heathrow must reduce dependence on ageing Terminal 1 baggage and supporting infrastructure to avoid further deterioration in service, reliability and operational resilience.

For a programme of this scale, justified primarily on avoided failure and the maintenance of existing service, the discipline around option assessment, whole-life cost appraisal and benefit substantiation needs to be correspondingly stronger.

Quantification in the business case is limited. The future capex requirements of the system are not brought together in a whole-life presentation, asset life is not presented clearly in decision capable form and the impact on charges is not presented as part of an integrated whole-life view. Assuming a 20-year life, and excluding the additional increase from inflation, the impact for airlines is estimated to be £64 million pa³⁰.

The tracked benefits are narrowly framed around maintaining existing capacity and misconnect performance, reducing risk likelihood, lowering Heathrow/ORC opex and enabling future flexibility. Important value dimensions, including airline and handler impacts and some future carbon effects, are either treated qualitatively, identified for later development or not fully integrated into the core investment case.

The benefits shown are a limited mix of direct, quantified benefits and benefits that are qualitative, modelled or dependent on future operating conditions. Direct benefits given are £6.2 million pa ORC opex saving and the removal of a red operational risk, against substantially higher capital cost. Other benefits, including reduced reliance on T1, safety improvement, airline savings, timely delivery improvement and resilience-related bag outcomes, are either qualitative, modelled or contingent on operational adoption and commercial arrangements.

The financial case is presented, but not as a complete whole-life view of cost, committed benefits and residual risk. Against an average cost to airlines of £64 million pa for 20 years (excluding inflation), the savings are meagre and do not offset the material increase of cost, even when taking account that most of the existing asset is fully depreciated.

Furthermore, reference class benchmarking³¹ evidence indicates that Heathrow baggage investments are positioned³² above the 95th percentile of the comparator set, including comparisons with Gatwick and Stansted on a cost-per-unit-of-capacity basis.

³⁰ Higher on a nominal basis. Real terms calculation based on H7 WACC of 4.01%, straight line depreciation for an assumed life of 20 years

³¹ Oxford Global Projects (OGP), Heathrow Benchmark Report, November 2025

³² 20 years is an assumed average life of the asset.

The result is weaker assurance that the programme has been advanced on the basis of a complete and stable value-for-money case, rather than as a necessary but only partially quantified response to long-deferred infrastructure risk.

2.4 Asset condition and operating impacts

Terminal 2 operations continue to depend on a baggage system originally intended as an interim solution and now extended over a prolonged period. The system is operating beyond its initial planning horizon and is subject to reliability and obsolescence risks.

Consumers and airlines continue to experience the effects of a baggage operation serving Terminal 2 from ageing infrastructure located in Terminal 1. Operationally the system experiences recurring disruption events, including significant outages at peak travel periods of summer and Christmas. These events require workarounds such as rehandling, manual intervention and contingency routing. As a result, airlines incur additional operating costs, including handling costs, repatriation, staffing impacts, passenger compensation.

Since T2 opened, airlines have faced at least one major system outage in the summer. With the system handling around 30,000 bags daily, each 1,000 bags not loaded is estimated to cost airlines around £100,000, costing the airlines millions of pounds in additional operating costs. Consumers and airlines would reasonably expect better service outcomes for this level of airport investment.

This pattern is longstanding and the system has experienced outages during every summer holiday period, typically at the start of peak summer travel, and has also been prone to intermittent failures during other high-demand periods such as Christmas and Easter. The duration of these outages has varied according to the nature and severity of the issue. In the most severe case, the system was out of service for three days, resulting in more than 10,000 bags failing to travel with their owners and causing disruption on a mass scale.

Costs have been borne by airlines through additional operating expenses as well as substantial maintenance capex being passed on through the RAB into charges. These impacts are not reflected in the cumulative decisions on the replacement of the system. Whole-life value, including the cost of deferral and ongoing operational inefficiency, was not fully integrated into or tracked through the investment decision-making framework. The costs of deferral have been borne over time through operational inefficiency, disruption risk and additional user cost, without those effects being transparently incorporated into the capital decision framework.

2.5. Governance and decision-making control

Airlines, ground handlers and subject matter experts have worked with Heathrow to develop the operating concept, requirements, logistics principles and related design inputs. That collaboration was necessary and relevant to defining the operational solution and testing practical deliverability. However, the governance and scrutiny of the proposition and investment case, including independent challenge of scope, maturity, cost, assumptions, exclusions and value for money did not enable robust decision-making for a £1 billion investment.

The programme progressed through formal governance steps, including consultation, gateway review and certain assurance under the scope of the jointly appointed Independent

Fund Surveyor. However, effective contractual commitments brought forward the approval process and removed true decision-making choice. Conditional, time-limited contract terms were agreed ahead of the approval process thus removing the practical ability of airlines to reject or materially reshape the decision without severe time and cost penalty according to HAL.

The programme documentation³³ shows that, at G3, a number of important delivery and operational matters were still being carried forward rather than closed. The solution is described as being at RIBA Stage 4ii, with further design development to 4iii still to follow; the HBS machine tender outcome and resulting screening-room impacts are excluded from G3 and deferred to later change control; and parts of the operating framework, including KPI development, are stated to be completed in the next design stage. For a programme of this scale, these are material areas of maturity that would ordinarily be expected either to be resolved before approval or to be subject to clear and explicit approval conditions.

Formal governance conformance did not ensure effective decision-making control. Passing through a stage-gate where the consequences of rejection were materially constrained did not amount to effective ex ante control.

2.6 Business case quality and governance maturity

The maturity and strength of the business case raises governance concerns. The document at the G3 spend commitment gateway relies in several areas on scope assumptions, later design development, future procurement outcomes and subsequent operational implementation to resolve material matters. For a programme of this scale, readiness for gateway decision-making and the robustness of the underlying assurance process should be greater. A delivery-led positioning, without a sufficiently integrated financial and strategic review, weakens decision-making, increases risk and harms efficiency.

The programme is structured across multiple tranches and future phases, with different levels of maturity and definition across the overall package. Some elements of the wider end-state solution sit outside the current project scope or depend on later stages, further design development or subsequent commercial processes. The business case is heavily assumption dependent. Key assumptions relate to operational transition, tie-in sequencing, training and readiness, continued availability of existing systems during implementation, stakeholder compliance with the new operating model, and the ability of suppliers and support functions to deliver to plan.

For a programme of this scale, unresolved assumptions of this kind require strong ownership, sensitivity analysis and clear contingency planning. The available material does not demonstrate those disciplines in a consolidated way.

The £552 million G3 request reflects the approved project scope only. It does not capture the full cost exposure associated with delivery and operation of the solution, as a number of foreseeable items remain outside the project baseline. These include elements of transition support, external stakeholder training release, operational resource requirements, accommodation and facilities dependencies, selected fire and MEP matters, HBS tender

³³ HAL T2 Baggage Programme G3 Investment Decision, September 2025 CPB pack, Document Number: 12142-XX-RG-301-100003

outcome impacts, and downstream works in Terminal 1 and elsewhere³⁴. The document does not present a whole-cost view showing the extent to which cost sits within the project, elsewhere in the programme, in operations, or with airlines and handlers.

At G3, a number of material uncertainties remained open, including the HBS machine tender outcome and associated screening-room impacts, completion of design development from RIBA 4ii to 4iii, readiness of airlines and handlers to implement the operating model, and the extent to which excluded items may crystallise through delivery. These matters remained open at G3 and were to be managed through subsequent stages, change control or implementation governance.

3. IMPLICATIONS FOR THE CURRENT GOVERNANCE FRAMEWORK

The current Heathrow framework relies on consultation, gateway processes and independent assurance to provide discipline over capital investment decisions.

The experience of the T2 Baggage Programme shows that these mechanisms do not provide effective control in practice where the regulated company retains control over timing, scope and commitments and where information asymmetry persists.

In this context, airlines are able to provide challenge but do not have the ability to control outcomes. Consumers are therefore exposed to the costs of major investments without equivalent influence over key decisions.

The prolonged reliance on ageing infrastructure has also resulted in ongoing inefficiencies and additional costs, which are not transparently captured within the capital framework but are relevant to overall consumer impact.

Large defensive or resilience-led investments also present a wider governance issue. Where a programme is justified mainly by the need to avoid future failure, the absence of transparent whole-life appraisal, mature assumptions, clear benefit ownership and robust ex ante approval controls creates a material risk that consumers are exposed to high expenditure without equivalent assurance that the chosen scope, timing and option represent the most efficient response.

4. KEY FINDINGS FOR REGULATORY REFORM

The case study supports a reform package focused on strengthening ex ante control over capital investment, particularly for large programmes justified on resilience or continuity grounds rather than clearly monetised output gains. Capital planning with genuinely independent, multi-disciplined assurance, stronger business case challenge and explicit whole-life value testing are especially important.

An independent Capital Investment Committee would separate capital planning for the portfolio from project development and approval and ensure that major decisions are taken within a structured and evidence-based framework.

³⁴ HAL T2 Baggage Programme G3 Investment Decision, September 2025 CPB pack, Document Number: 12142-XX-RG-301-100003

Stronger independent assurance of business cases, including option development, benchmarking and whole-life cost analysis, would improve the quality of evidence supporting investment decisions. Improved assurance of contractual commitments compared with maturity and value-for-money is also required. Enhanced information rights would reduce asymmetry and support more effective user challenge.

Earlier and more structured option assessment, including consideration of alternative delivery models, would strengthen value-for-money discipline. Where assets or services are semi-separable, the framework should also test whether competition could provide a more efficient delivery model than integrated airport-led provision. This is particularly relevant where the investment supports identifiable user groups, operationally distinct services or facilities that do not need to remain fully bundled within the airport's wider capital programme. In such cases, competitive delivery or operation can provide a stronger discipline on cost, scope and service outcomes than reliance on internal approval and consultation processes alone.

Stronger ex-post accountability would ensure that outcomes, including cost, performance and operational impacts, are assessed against expectations established at approval.