Arora Holdings Limited
World Business Centre 3,
Newall Road, London Heathrow Airport,
Hounslow,T W6 2TA

HEATHROW PRICE CONTROL REVIEW

CAP2387

DRAFT DECISION ON THE COSTS OF THE HEATHROW WEST PROJECT

A. INTRODUCTION AND EXECUTIVE SUMMARY

(1) This is Heathrow West's response to the CAA's consultation on its draft decision regarding its request for cost recovery (CAP2387). This response has been submitted by the extended consultation date of 29 October.

(2) Heathrow West welcomes this opportunity to respond to the CAA's draft decision, on a matter it has been seeking to resolve with the CAA for some time. References to paragraph numbers in this document are to the CAA's draft decision, unless otherwise indicated.

(3) The starting point is that the CAA accepts it has the statutory power to ensure that Heathrow West could recover its costs (paragraph 18 of the draft decision) and has rejected HAL's arguments to the contrary. This was Heathrow West's position and we welcome this statement.

(4) It follows that the question for the CAA is whether it should exercise its statutory power to ensure that Heathrow West recovers its costs. Heathrow West contends that, in deciding not to exercise that power, the CAA has made a number of material errors, in particular:

a. The CAA is fettering its discretion by imposing a threshold that must be reached before it will exercise its power and/or that threshold is unreasonably high;

b. It has made a retrospective assessment of the circumstances, which is unreasonable;

c. The CAA has not requested relevant evidence to enable it properly to consider whether the test it now sets is met nor has it adequately considered existing evidence; and

d. Its approach is inconsistent with its policy in other areas and Government policy.

(5) These errors are explained in more detail below.

B. THE CAA IS PROPOSING TO FETTER ITS DISCRETION BY IMPOSING A THRESHOLD THAT MUST BE SATISFIED AND/OR THE THRESHOLD IS UNREASONABLY HIGH

i. The CAA's approach will fetter its discretion

(6) The statutory power contained in section 21(1)(b) of the Civil Aviation Act 2012 ("**CAA 2012**"), which is the source of the CAA's power to ensure that Heathrow West recovers its costs, is extremely broad. As a public body, the CAA must – when exercising that power in any particular case – take account of all material facts. However, the CAA's draft decision suggests that it will only consider whether to allow Heathrow West to recover its costs if Heathrow West can produce evidence which meets a very high bar, talking in turn about demonstrating '*unambiguous'*,

'*tangible and quantifiable*' benefits to consumers and '*specific and/or quantified evidence of a clear benefit*' (emphasis added) to consumers.

(7) Section 21(1)(b) does not lay down any such threshold and the proposed imposition by the CAA of a threshold that must be met in every case means that it would be fettering its discretion to take account of the individual facts of any particular case. Indeed, as explained further below (in Section C), the imposition of that threshold in the present case would exclude the CAA from taking account of a highly material consideration: Heathrow West's proposals would have conferred clear benefits on consumers had it not been for events outside its control, namely the pausing of Heathrow Airport expansion following the Court of Appeal decision and the start of the pandemic.

ii. The threshold the CAA is imposing is unreasonably high and stifles competition

(8) The threshold that the CAA proposes to set is unreasonably high, unrealistic and inconsistent with the CAA's statutory duties. Section 1 of the CAA 2012 imposes a duty on the CAA to carry out its functions "*in a manner which it considers will promote competition in the provision of airport operation services*". It follows that the CAA must, when exercising its power to ensure recovery of costs, do so in a manner that promotes competition.

(9) An important aspect of promoting competition is the facilitation of market entry by new operators. However, new market entrants who seek, for example as in this case, to operate a terminal at an airport dominated by an incumbent company, will need to invest significant resources in preparing their applications. The application of the threshold proposed by the CAA would act as a strong disincentive to would-be entrants to carry out the necessary investments. It is difficult to understand precisely what a company would need to show in order to demonstrate "*quantified evidence of a clear*" and "*tangible*" benefit to consumers, particularly ahead of such a competing project completing. Presumably, the company would at least need to be successful in its DCO application and be granted permission to enter the market. But if it were the case that only successful applicants were permitted to recover their costs, the consequence would be the suppression rather than promotion of competition as very few companies would be prepared to risk such large sums of money. That is particularly the case in circumstances where their competitor (the incumbent, here HAL) is permitted to recover its costs, even though its applicable for a DCO has not, to date, been submitted.

(10) This point is well illustrated on the facts of the present case. Although the CAA attempts to reserve its position by stating that the draft decision should not be read as setting a precedent for the future, the proposed imposition of a threshold which needs to be met will inevitably affect other cases in the future. Moreover, it is difficult to see how the CAA's decision to refuse the recovery of any of Heathrow West's costs would not operate to dissuade any future proposals to introduce competition. At the point at which the project was paused in the early days of the pandemic, Heathrow West had already incurred £30 million (and it may have incurred fewer costs had HAL not entirely failed to engage with Heathrow West to limit duplication). If the CAA will only consider allowing costs to be recovered if, for example, a DCO application is successful, the introduction of competition will only really be possible if a third party is willing to put at risk tens or hundreds of millions of pounds. That is unlikely, and it therefore follows that the approach of the CAA stifles rather than promotes competition. By way of illustration, Heathrow West considered that a realistic estimate of its costs for a DCO application would have been in the region of £ [excised] in total. HAL's Category B costs amounted to a total of nearly £400 million.[1] Before the Stansted second runway project was cancelled, Stansted had incurred £181 million.[2] In

[1] CAP 2365, Appendix E, table A1.

[2] Stansted Q5, mid Quinquennial review.

its campaign for a second runway, Gatwick was allowed up to £70 million of costs, which would have been recoverable from airlines had permission been granted.[3]

(11) Moreover, the CAA makes two further points regarding its threshold which are liable to further stifle competition.

(12) First, it repeatedly highlights that Heathrow West engaged on a commercial project without prior agreement with the CAA on funding. However, this disregards i) the circumstances in which Heathrow West was operating at the time. Heathrow West was under considerable time pressure to develop a DCO application sufficiently credible and in time to be submitted alongside HAL's (or as soon as possible after) for consideration by the Planning Inspectorate. If Heathrow West had had to wait for CAA agreement as to the recovery of its costs before proceeding with the substantial workstreams needed for its DCO application, it would never have stood a chance of making a successful application and even potentially competing with HAL. This is quite apart from the fact that Heathrow West raised early on with the CAA the possibility of recovering its costs and was largely proceeding on the basis that its costs would be dealt with, particularly given the CAA's comments at the time that Heathrow West's competing plans would be helpful to its ability to benchmark HAL; [4] and (ii) the substantial engagement between the CAA and Heathrow West at the time, including on the development of a regulatory framework to accommodate Heathrow West's proposals. At the time the project was paused, Heathrow West had undertaken a significant amount of work to develop a draft regulatory framework which it had submitted to the CAA for consideration. Both Heathrow West and the CAA were working on the assumption that Heathrow West could be regulated, and Heathrow West was willing to be.[5] Heathrow West was also the only credible competitor to HAL (within the Northwest Runway Scheme) whose proposals the CAA had recognised were sufficiently mature and credible to merit a detailed review.[6]

(13) Heathrow West also notes that HAL spent over £500 million of costs before it received indicative CAA approval regarding cost recovery. Indeed, the CAA consulted multiple times on elements of HAL's costs, such as the wind-down costs and the costs of the Supreme Court action. The CAA first consulted on HAL's costs in 2017 (CAP 1510). These costs consisted of Category B costs (broadly those associated with the DCO process and incurred after Government approval was given) and Category C costs (property purchases and post DCO costs, including early construction costs). In its Final Proposals, published in June 2022 (CAP 2365), the CAA concluded that HAL would be allowed to recover £529 million of Category B and Category C costs.

(14) Second, the CAA's position now is that it would be inappropriate to allow recovery of costs of commercial proposals developed outside the established regulatory framework. Aside from the fact (as noted above) that the CAA and Heathrow West were discussing a possible framework to accommodate Heathrow West's project, this was not its position when it was encouraging alternative delivery mechanisms, where it was referring to the need to adapt the existing regulatory framework accordingly. For example, in CAP 1722 the CAA stated:

> "*If a party other than HAL, such as the Arora Group, applies for, and is granted, a DCO to allow it to develop all or part of Heathrow airport to deliver new capacity, adjustments to the existing regulatory framework both to facilitate and support these alternative*

[3] CAP 1152 would have allowed £10 million for 7 years.

[4] Heathrow West raised the question of costs recovery in the context of an informal meeting with the CAA's former chief executive. Its proposals for a draft regulatory framework were also premised on a RAB which would include any Category B and Category C costs (see Heathrow West's Working paper: A framework for regulation, submitted to the CAA for consideration).

[5] See CAA's Technical Information Note from August 2018 where the CAA recognises its power to licence an alternative terminal operator. See Heathrow West's draft proposals for a regulatory framework.

[6] CAP 1940.

arrangements may be required. As we are currently doing with HAL and its proposals for capacity expansion, it would be important to develop the regulatory framework in a timely way, both to support efficient investment and ensure consumers are properly protected. This could involve very significant work as we may have to address novel issues created by competing applications for development consent and the possibility that the Arora Group could be granted a DCO in relation to the western campus, with HAL continuing to operate and develop the rest of the airport."[7]

(15) Despite the above, the ANPS being specifically amended to allow for more than one promoter, and Arora/Heathrow West's and airlines' multiple calls for the CAA to do so, the CAA had not established a regulatory framework to accommodate competition.[8] The CAA had therefore failed to design a regulatory framework in line with its own and Government policy (as explained in further detail at Section E below). How can competition ever be promoted when the CAA takes such a circular position, that a developer cannot expect cost recovery until it is regulated but cannot be regulated until it has incurred such costs?

C. THE CAA HAS UNREASONABLY TAKEN A RETROSPECTIVE APPROACH

(16) The application by the CAA of its purported threshold requirement of '*tangible and quantifiable benefits to consumers*' is unreasonable and unfair because the key reason for which the CAA has concluded that the threshold was not met is because "*capacity expansion is no longer being taken forward*" (paragraph 10). The decision to pause capacity expansion was mainly taken by HAL, on whose plans Heathrow West depended because its proposals fitted within HAL's project, and therefore entirely outside Heathrow West's control.

(17) The CAA's approach accordingly ignores (i) the fact that Heathrow West's project was anticipated to achieve tangible and quantifiable benefits for consumers, and (ii) the reason why it could not in fact deliver these benefits was because of events which were outside its control and unforeseen at the time it carried out its investments.

(18) As to (i) above, Heathrow West's project was set to deliver demonstrable benefits to consumers, including as a result of the introduction of terminal competition (and was indeed already delivering results):

a. Heathrow West's proposals were anticipated to deliver substantial cost and environmental impact efficiencies compared to HAL's. Heathrow West was looking at integrating existing and new public transport interchanges in a single location to support key modal shift, and its proposal would have reduced land take and its impact, with a positive focus on communities. It also would have delivered lower construction costs, greater design quality and operational efficiency brought about by the Arora Group's extensive experience in airport-based developments and a fully sustainable approach to development and operation. At the time of pausing its project, Heathrow West estimated that its project would have been over £10 billion cheaper than HAL's proposals and been delivered faster;

b. Heathrow West had assessed that it would be more efficient to deliver capacity in two phases. HAL's project was for incremental investment to match the forecast demand for capacity while Heathrow West's project would have delivered capacity ahead of forecast demand. This would have introduced additional terminal capacity earlier than HAL's project, promoting greater competition between airlines and resulting in lower airfares as

[7] CAP 1722, paragraph 3.25.

[8] See for example Arora's responses to CAP 1541, CAP 1610 and CAP1782, and Virgin's response to CAP 1722.

well as allowing the potential for new airlines and new airline models to be introduced at Heathrow;

c. Heathrow West's project would have allowed the Government's affordability challenge (i.e. keeping airport charges flat in real terms when compared to 2016) to be met, in a way that HAL's proposals, if taken forward alone, would not. As Heathrow West has previously noted to the CAA,[9] it had started modelling the implications of its scheme on the overall costs of Heathrow expansion. While this work was at an early stage, Heathrow West had demonstrated to the CAA that the affordability challenge could only have been met with a combination of HAL's and Heathrow West's proposals, and not by HAL alone;

d. Arcadis, which were commissioned to carry out an initial assessment of whether Heathrow West met a series of tests the CAA had set out, concluded that it had "*provided initial evidence of sufficient completeness*" on all tests. This was a detailed and involved process which required Heathrow West to provide evidence relating to a number of matters, including whether the proposals were in the interests of consumers. Arcadis concluded that there was evidence that terminal competition, which Heathrow West was set to introduce, was in the interest of the consumer and that "*it [was] clear that the 'interest of the consumer' is considered a core objective in the delivery Heathrow West's proposals*";[10] and

e. The publication of Heathrow West's schemes in 2017 resulted in HAL immediately cutting its estimate of expansion costs which it had been using in discussions with the Airports Commission by £2.5 billion.

(17) At the time the project was delayed because of the Court of Appeal decision and then the start of the pandemic, Heathrow West had instructed PA Consulting and was working with them on modelling to quantify the benefits of Heathrow West's proposals. This would have included analysis of the likely consumer benefit of the Heathrow West proposals, as well the development of a price control model for submission to the CAA to support the development of a regulatory framework. In addition, Heathrow West was undertaking a significant amount of work to be able to submit its DCO application in Q3 of 2020, following HAL's submission scheduled for Q1 2020.

(18) The CAA's approach now is unreasonable and unfair because it is retrospective in its effect and is apt to stifle the promotion of competition by failing to offer a predictable framework in which a potential market entrant can reliably reach a view as to the prospect that it will be able to recover its costs.

(19) It is also inconsistent with the CAA's approach in other cases where it has rejected 'hindsight regulation' and considered the consumer interest at the time the expenditure was incurred. Indeed, in CAP 1996 the CAA stated that in making the commitments to allow HAL's efficiently incurred costs of capacity expansion to be added to the RAB and recovered as part of the H7 price control:

> *it* "*took the view that developing expansion was in the consumer interest at the time the expenditure was incurred*."
>
> It did "*not consider it is appropriate to revisit this approach in the current changed circumstances, as that would not be consistent with the CAA's established policy and would undermine confidence in the regulatory framework and constitute an undesirable form of*

[9] See response to CAP 2139.

[10] See Arcadis report published alongside CAP 1940.

"hindsight regulation". Such an approach could have the effect of deterring future investment, to the detriment of users of airport service."[11]

The CAA appears to be departing from this approach in relation to Heathrow West.

D. THE CAA HAS NOT ASKED ITSELF THE CORRECT QUESTIONS, REQUESTED RELEVANT EVIDENCE, OR GIVEN PROPER CONSIDERATION TO EXISTING EVIDENCE

i. This is the first time the CAA has required 'specific' and 'quantified' evidence of benefits to consumers

(20) Heathrow West has been asking the CAA formally to consider its request for the recovery of costs since at least February 2020 (as part of the response to CAP 1871) and engaging repeatedly since then with the CAA. The expectation that the regulatory framework would include pre-DCO costs in line with the CAA's policy on HAL costs was included in the submission to the CAA on a regulatory framework in October 2019.[12] Despite this, the CAA has never asked Heathrow West for quantified evidence of consumer benefit. Yet it is now proposing to rule against Heathrow West on the basis that it has not provided evidence of '*tangible and quantifiable*' benefits, '*unambiguous'* benefits and '*specific and/or quantified evidence*' of 'clear' benefits to consumers. At no time from the first submission from Arora in 2017 to the pausing of the programme in March 2020 has the CAA sought this information or suggested that it would be necessary.

(21) Furthermore, the CAA has not even asked for a detailed breakdown of Heathrow West's costs or considered whether they fall within the definition of Category B costs (by contrast to the many consultations on HAL's Category B costs and detailed accounting analysis as to the level of costs claimed by HAL).

(22) The CAA has accordingly failed to take all material factors into account and has failed to take proper steps to acquaint itself with the material it needs in order properly to exercise its discretionary power.

ii. The CAA appears to have largely ignored existing evidence and Heathrow West's previous submissions

(23) Further, the CAA makes no reference to and appears to have entirely ignored (i) the substantial work carried out by Heathrow West and scrutinised closely by Arcadis shortly before the project was paused; and (ii) a material body of evidence demonstrating the benefits of terminal competition.

(24) First, as noted above, the CAA required Heathrow West to undertake substantial work and meet a series of tests before its proposals would be considered in full. Heathrow West duly complied. Arcadis were commissioned to carry out this assessment and consider the Heathrow West project across a range of areas, including safety and security, consumer benefits, deliverability and operability, the proposed regulatory framework and compliance. On each of these topics (and there were several questions on each topic), Heathrow West provided a substantial number of documents and attended numerous working meetings with the Arcadis team, who also consulted the airlines. Other than the proposed regulatory framework which was outside the scope of Arcadis' review, Arcadis concluded that Heathrow West had provided "*initial evidence of sufficient completeness*" on each of the topics reviewed.[13] The CAA concluded that "*the progress made on the tests*

[11] See paragraphs 2.2 and 2.3.

[12] Heathrow West's proposals on the RAB included both Category B and Category C costs.

[13] See Arcadis reviewed published alongside CAP 1940.

alongside other evidence demonstrated that Heathrow West's proposals were reasonably mature and credible, and would likely be sufficient to allow CAA to commence more detailed work on them."[14] This work was paused at that time due to the successful legal challenge to expansion (which was subsequently quashed) and the start of the pandemic. At that time, the CAA was not requiring "*specific and/or quantified evidence of a clear benefit*" to consumers and was satisfied that the proposals were sufficiently credible.

(25) Second, Heathrow West has previously listed a number of reports evidencing that terminal competition is beneficial for passengers, including reports by Walbrook Economics, the Adam Smith Institute, Frontier (for easyJet) and Alix Partners (for Heathrow West).[15] Compass Lexecon came to a similar conclusion.[16] More recently, WPI Economics (commissioned by Virgin Atlantic, British Airways and IATA) recommended that the UK Government consider opening up operational competition at Heathrow to ensure Heathrow works for the benefit of the UK.[17] Moreover, in reviewing the remedies imposed by the Competition Commission following the BAA market investigation, the CMA found that competition had been beneficial for passengers: "*airline competition, facilitated by airport capacity, has been good for passengers. Airport competition, facilitated by the break-up of BAA, has been good for passengers, as the detailed analysis of the CMA concludes*".[18]

(26) The CAA appears to have dismissed out of hand this substantial body of evidence regarding the benefits of terminal competition on the basis that these are "*general arguments about the benefits of competition.*" But this body of evidence (save the May 2022 report) was relevant to Arcadis' assessment of whether there was sufficient evidence that Heathrow West's proposals were in the interest of consumers, which it concluded there was.

(27) The CAA has also largely ignored Heathrow West's response to CAP 2139, which raised a number of points (which are also re-iterated in this response):

a. The CAA had previously been supportive of the concept of competition in the provision of infrastructure;

b. The Competition Commission's comments on terminal competition were not some vague notion. As explained further below, they were substantial enough to be incorporated into the CAA 2012, with specific reference in the ancillary documents issued at the time, which the CAA ignores;

c. In terms of consumer benefit, the CAA ignores the evidence that the affordability challenge would have been met with Heathrow West included, and not if excluded;

d. Other regulators have been promoting infrastructure competition;

e. The CAA dismisses the many reports cited that support terminal competition, including evidence from other countries;

f. The CAA does not explain why cost recovery was permitted for Gatwick and Stansted, but not for Heathrow West;

g. It is clear that a policy set out before Arora began developing its proposals would be focused on HAL's costs, but the CAA does not explain why such a policy cannot be

[14] CAP 1940, Appendix G, paragraph 9.

[15] See responses to CAP 1812 and CAP 2139.

[16] The potential for competition between Heathrow terminals, Compass Lexecon, January 2016.

[17] Clipping Britain's Wings, May 2022.

[18] BAA Airports: Evaluation of the Competition Commission's 2009 market investigation remedies, May 2016.

extended to other parties (noting that other parties costs can already be recovered through the HAL RAB); and

h. The CAA does not explain why HAL, which commenced its expansion project without an agreed method of cost recovery, is treated differently to Heathrow West, which also commenced its expansion project without an agreed method of cost recovery (other than the precedent of HAL's cost recovery). Indeed, the recovery of HAL's costs was only confirmed in 2022, some 5 years after the CAA's initial consultation on the matter.

E. THE CAA'S APPROACH IS INCONSISTENT WITH ITS EARLIER POLICY AND GOVERNMENT POLICY

i. The CAA's position is inconsistent with its own policy on expansion and its other decisions

(28) First, the CAA's current position is inconsistent with the CAA's existing policy on expansion costs. It notes itself that "*the CAA has consistently stated that additional runway capacity in the south east of England will benefit air passengers and cargo owners.*"[19] The CAA developed its policy on expansion costs through multiple consultations dating back to 2016,[20] which include in particular the following decisions:

"*Our final policy decision is that Category B costs should be defined as costs which are directly associated with, and solely for the purposes of, seeking planning consent for the delivery of new runway capacity, including through the Development Consent Order (DCO) process*."

"*Category B costs incurred, including those recovered through the licence modification that we made on 21 December 2016, will be subject to ongoing governance and efficiency tests*."[21]

(29) Heathrow West's costs are direct costs associated with the delivery of new runway capacity (through the provision of terminal capacity). They were solely incurred in pursuance of a DCO. Having seen the direction of travel as outlined in the main CAA consultations on the subject of HAL's early costs, Heathrow West was reasonably entitled to expect that its costs, which fall within the definition of Category B costs as defined above, would be treated reasonably consistently.

(30) It is also clear from the Arora/Heathrow West submissions starting in 2017[22] that Heathrow West was expecting the CAA to come to a view on the regulatory arrangements necessary to support the competition that it was bringing, especially since it was responding to the CAA's repeated comments since 2017 inviting 'alternative delivery mechanisms' at Heathrow. Heathrow West was at least entitled to expect that its costs would not be subject to a separate pre-approval process which the CAA had not outlined; nor that they would be measured against a materially different standard when compared to HAL's.

(31) Moreover, if Heathrow West's costs would have been recoverable in the event of a successful DCO application, it is wrong in principle that its costs should be entirely disallowed where the project was paused for reasons outside of its control.

(32) Second, the CAA's approach to Heathrow West is inconsistent with the approach it has taken in other decisions on cost recovery and/or its approach in other cases when considering the benefit to consumers:

[19] CAP 1871, paragraph 1.

[20] See CAP 1469 and CAP 1513 for example.

[21] CAP 1513, paragraphs 1.11 and 1.14.

[22] See for example Arora's responses to CAP 1541, CAP 1610 and CAP 1782.

a. When Gatwick was developing its proposals for a second runway, the CAA proposed that it be allowed the "*automatic recovery of costs associated with a second runway, up to a maximum of £10 million per year*" to cover the pre-construction costs of the runway (which were essentially pre-DCO and DCO costs). The CAA allowed this cost recovery mechanism to be included in the licence, subject to Government approval of a new runway (at Gatwick) and compliance with CAA guidance.[23] Gatwick was not required to demonstrate *specific and/or quantified evidence of a clear benefit*' in order to recover these costs. This CAA decision was taken under the CAA 2012;

b. When considering Stansted's indicative Q6 price control under the CAA 2012, the CAA acknowledged that the costs of developing proposals for a second runway (which had been developed in line with Government policy) could be included in the Regulatory Asset Base:[24]

"*STAL, consistent with government policy at the time, started to develop a second runway to ensure sufficient capacity going forward. Some of these costs were included in STAL's RAB. While this long-term project has been abandoned, these costs are being recovered through current users of the airport.*"

At the time, Stansted was to be licensed. In the end it was de-regulated, so such cost recovery – allowed in principle – did not occur via the RAB. We note however that at the time that this decision was made, Stansted was an unlicensed operator, with no direct regulatory support for any cost recovery. Stansted was not required to demonstrate a *"specific and/or quantified evidence of a clear benefit*', and there is no indication that it would have been required to do so had the price control been implemented;

c. In respect of HAL, the CAA accepts that the quantification of benefits is difficult and is prepared to consider evidence in the round:

"*The CAA has consistently stated that additional runway capacity in the south east of England will benefit air passengers and cargo owners. The timely delivery of more aviation capacity is required to prevent future consumers experiencing higher airfares, reduced choice and lower service quality. At the same time, we are mindful that the quantification of these benefits is not straightforward and is subject to significant uncertainty*."

"*While our consideration of consumer benefits focuses on congestion pricing, we recognise that there are likely to be other consumer benefits associated with expansion, such as the benefits associated with greater choice of routes or improved resilience at the airport.*";[25] and

d. In its surface access policy, the CAA set out criteria against which it expects HAL to produce evidence in order to recover through airport charges surface access costs, including by other parties, associated with capacity expansion or to enhance the efficient operation of the airport. The criteria include the overall cost benefit to airport users, cost minimisation and an overall holistic approach to consider whether the proposal is the most efficient approach to meeting the requirement for planning consent (among others not applicable here). The standard does not include "*specific and/or quantified evidence of a clear benefit*".

[23] CAP 1152.

[24] CAP 1030.

[25] CAP 1871, Appendix C, paragraphs 3 and 4.

(33) Third, since beginning to develop the regulatory framework for expansion, the CAA has repeatedly stated its willingness to consider, and encouraged third parties to bring forward, alternative proposals to deliver expansion, premised on the idea (which the CAA endorsed) that competitive arrangements could deliver benefits for consumers. For example:

a. In CAP 1510, the first consultation on priorities for developing the regulatory framework for capacity expansion, the CAA noted "*there are advantages in market arrangements that put downward pressure on capital, operating and financing costs" and "we remain open to the idea that certain parts of the programme could be subject to commercial agreements between HAL and the airlines (or other parties). (…) This may include projects such as car parks and possibly the construction of terminal buildings*."

b. CAP 1541: "*We are open to the development of such commercial approaches, and proposals to incentivise such developments. We therefore encourage parties to bring such proposals forward and expect that HAL will actively consider the full range of commercial mechanisms and delivery arrangements to promote efficiency, including those brought to it by third parties and proposals for joint delivery of assets*."

c. CAP 1658: "*In the December 2017 Consultation, we reiterated our long standing position that the CAA is in favour of competitive arrangements where they can be shown to be in the interests of consumers. We confirmed our view that the CAA12 is flexible enough to accommodate a wide range of commercial structures at Heathrow, even if it does not permit the imposition of commercial structures, forced divestment of assets, or the licensing of a new participant without first conducting a market power determination. (…) We confirmed that we are seeking to support and encourage the timely introduction of more competitive arrangements in the interests of consumers." "We have consistently supported the exploration of alternative commercial and delivery arrangements with a view to establishing whether they could be integrated into the overall plans for capacity expansion in a way that would help protect the interests of consumers.*"

d. CAP 1722: "*In previous consultations, we have explained the advantages of HAL exploring alternative commercial and delivery arrangements for capacity expansion at Heathrow airport. Our intention was that HAL should explore a full range of alternative arrangements, such as third parties designing and building significant elements of capacity expansion and/or developing alternative proposals for financing and delivering aspects of the capacity expansion programme. The aim of this approach is for HAL to exploit competitive forces to a greater extent than its business as usual approach to procurement, with these alternative arrangements being demonstrably efficient, delivered in a timely way and consistent with protecting the interests of consumers*."

(34) These statements were repeated often enough that Arora and Heathrow West were justified in expecting that their proposals to introduce terminal competition, as well as the costs incurred in doing so, would be treated fairly and appropriately. This is particularly the case given the amendments to the ANPS and policy initiatives from the Government and regulators to promote infrastructure competition:

a. UK regulators are increasingly promoting infrastructure competition. For instance, Ofgem is seeking to introduce competition in the provision of transmission infrastructure. Ofwat has always allowed competition for the provision of new infrastructure by way of inset appointments. More recently, Ofwat allowed the construction of the Thames Tideway by a company not owned by Thames Water, the incumbent company. Ofcom has allowed competition between telecoms infrastructure companies, as well as competition to part of

the mail delivery network. Competition between infrastructure providers has therefore been found by regulators to be in the interests of end consumers. We see no reason why this would not be the case in airports;

b. In line with recommendations from the National Infrastructure Commission published in 2019, the UK government is reviewing the regulatory framework for economic regulation of the utilities sectors. One of the four areas of focus is allowing greater competition in strategic investment. The policy paper states: "*For the design and delivery of infrastructure, all regulators should harness competition to unlock opportunities for strategic investment.*"

"*To manage the constraints of natural monopolies and encourage investment, sector regulators can open areas of the value chain (such as the delivery, management, and financing of infrastructure) to competition, rather than leaving it to the incumbent. In the National Infrastructure Strategy, the Government stated that competition in this form should be harnessed as the most reliable means of supporting innovation and delivering strategic investments and major projects*."[26] While focused on the energy, water and communications sectors, we see no reason why this policy direction is not relevant to airport infrastructure (particularly given the Government has launched a review of the CAA).[27]

(35) Heathrow West responded to the CAA's call, and given HAL's unwillingness to engage, was compelled to make its own independent DCO application. Despite this, the CAA's position now is not to allow Heathrow West to recover any of its costs for introducing alternative proposals.

(36) Fourth, there were serious questions about whether HAL's proposals would be in the interest of consumers, and therefore would meet the threshold which the CAA has set for Heathrow West. Heathrow West had previously highlighted to the CAA that it was highly unlikely, if not impossible, for HAL to be able to meet the affordability challenge set by the Government[28] and which was a key concern of the Transport Select Committee's inquiry into the ANPS.[29] IAG and Heathrow Hub held similar views. IAG flagged that it had no confidence in HAL's ability to deliver cost-effective expansion, noting that initial construction and planning costs had jumped more than 250% in two years.[30] Heathrow West estimated that HAL's proposals would increase charges by over 50%, which airlines would have had to pass on to consumers.[31] The sizeable increase in estimated Category B and early Category C costs led the CAA itself to request that HAL consider different scenarios including implications for the overall timetable and the consumer interest, suggesting that the CAA itself was concerned about HAL's ability to deliver proposals in line with the interest of consumers.[32] Indeed, the CAA had asked HAL to explore the possibility of delaying the opening of the runway, in order to mitigate the increase in costs.

(37) The CAA has therefore failed to act 'consistently' as it recognises it must under the CAA 2012 statutory framework. Moreover, the CAA's failure to set out a fair and transparent process for the recovery of costs is the reason for this ad hoc consultation (following repeated requests from Heathrow West), and which comes after H7 Final Proposals despite those being the natural way

[26] BEIS, Economic Regulation Policy Paper, January 2022.

[27] Government launches review of Civil Aviation Authority to strengthen regulator for the future - GOV.UK (www.gov.uk)

[28] Heathrow West's responses to CAP 1812 and CAP 1871.

[29] See Report of the Transport Committee on the ANPS, March 2018.

[30] "Heathrow's £3.3 billion expansion heist", IAG, 21 August 2019, https://www.iairgroup.com/~/media/Files/I/IAG/press-releases/english/2019/IAG09.pdf

[31] Heathrow West's response to CAP 1940.

[32] See for example CAP 1819.

for these costs to be properly considered and where the CAA had previously advised Heathrow West they would be dealt with. This suggests the CAA has failed to engage fully with Heathrow West's request and give it proper consideration.

ii. It is also inconsistent with Government policy and the broader regulatory framework

(38) First, as the CAA recognises, in developing the ANPS the Government was keen to ensure that alternative developers were not excluded. The ANPS was specifically amended in October 2017 to clarify that it did not identify any promoter to take forward the scheme and to ensure that more than one promoter could make relevant DCO applications.[33] It was incumbent on the CAA to develop a policy framework which could also accommodate the possibility of multiple promoters. It had the powers to do so, as it recognised in the Technical Information Note published in August 2018, and it had the statutory duty to exercise its powers in a manner which would promote competition. The CAA's failure to do so, and its current position regarding Heathrow West's costs, are inconsistent with Government policy on allowing multiple DCO applications to be taken forward.

(39) Second, the CAA's position is inconsistent with the broader regulatory framework, including the objectives of the CAA 2012. The CAA dismisses (paragraph 12) Heathrow West's reference to the work of the Competition Commission in 2009, failing to acknowledge that it was a primary driver for the substantial reform to the regulatory framework for airports. The conclusions of the Competition Commission's investigation were that powers should be given to the CAA to allow the concept of terminal competition to be considered and, if felt to be in the interests of passengers, to be introduced, with specific reference to a new sixth terminal at Heathrow. In the Decision Document[34] issued by the DfT when deciding to develop the Civil Aviation Bill, the Government stated:

"*Although there are some risks associated with terminal competition, there are also a number of potential benefits. Firstly, it might represent one way of delivering more timely and appropriate investments as development of terminals is a lot less 'lumpy' than the development of new runways. Secondly, it would allow airlines to tailor the services offered at the terminals to their needs which could improve the passenger experience as terminals would better reflect the needs of consumers. Thirdly, this approach may reduce on-going regulatory costs, since where effective terminal competition develops the CAA would only need to regulate runway facilities.*

To summarise, we do not believe that consultation responses have identified any issues which convince us that the new regulatory regime should explicitly preclude the development of terminal competition in the future. As the CAA, in assessing whether terminal competition at a particular airport would be in the interests of passengers, would need to ensure that any potential risks are addressed, we believe the new regulatory regime should not prohibit the development and operation of competing terminals."

(40) The Government's Policy Paper, published in November 2011, confirmed that the genesis of the framework for economic regulation under the CAA 2012 was the Competition Commission's recommendation in the market investigation:

"*2.18 Consistent with the Competition Commission's recommendations, the draft legislation for the airport economic regulation reforms has been carefully designed so that it should not preclude*

[33] See Revised draft Airport National Policy Statement, October 2017.

[34] Reforming the Framework for the Economic Regulation of Airports: Decision Document, DfT, 2009

the development of competition at airports – for example in the form of competition between terminals – in the future."[35]

(41) Once CAA12 was enacted, the Guidance Notes[36] explained:

"*This section introduces the concept of an 'airport area' (and therefore a 'dominant airport area') to allow for the possibility of there being more than one operator at an individual airport. This could be the case, for example, if an airline acquired or leased a terminal building. As there can be more than one 'airport area' at an airport, it follows that there can be more than one 'operator of an airport area' at an airport*."

(42) In fact, given the purpose of the reforms to the CAA 2012, the amendments to the ANPS and the broader regulatory context favouring infrastructure competition, it is remarkable that the CAA had not sought to introduce a competitive process – or at least protect competition – in such a major infrastructure project as Heathrow expansion. At the very least Heathrow West should not be penalised for seeking to challenge the presumption that only HAL could take forward Heathrow expansion.

(43) As a final point, we remain ready to deliver the benefit to passengers that would arise from terminal competition, regardless of whether there is a new runway. That is, we recognise the economic and policy uncertainty over the future of the third runway. Nevertheless, the need for extra terminal capacity at Heathrow remains strong as we would expect passenger throughput to return to previous levels in due course, and then continue to grow as runway and airspace technology improves runway utilisation. Therefore, we consider that this new terminal capacity – perhaps 20mppa – could and should be delivered by a competitor to HAL. This would bring genuine choice to airlines and passengers and move away from the "one size fits all" approach that has to date been adopted by HAL.

Arora Holdings Limited **October 2022**

[35] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/3309/civil-aviation-bill-vol1-policy-paper.pdf

[36] https://www.legislation.gov.uk/ukpga/2012/19/notes/division/4/1/1/3/1, paragraph 45.