

18 July 2025

## Statement on scope and process for CAA's review of the regulatory approach to capacity expansion at Heathrow airport

### Introduction

1. On 29th January the Chancellor issued a statement setting out Government support for the development of a 3rd runway and capacity expansion at Heathrow airport. The CAA recognises the government's ambitions – including the public commitments to have planning permission by the end of this Parliament and a 3rd runway operational by 2035 – and acknowledges the importance of the efficient and effective expansion of capacity at Heathrow airport to the wider economy, airlines and consumers.
2. Expanding capacity at Heathrow airport would be one of the largest capital expenditure programmes in the UK. We need to ensure that we develop regulatory arrangements that deal with the associated challenges, supports capacity expansion in a timely and efficient and effective way, which furthers the interests of consumers.
3. On 26 March 2025, we published a letter to industry, which set out our intention to review the framework for economic regulation for capacity expansion at Heathrow, alongside our work on the H8 price control.<sup>1</sup> Heathrow Airport Limited ("HAL"), airlines and the "Heathrow Reimagined" group have all asked us to review the framework for the economic regulation of Heathrow.
4. In that letter, we said that we will examine options to ensure the regulatory framework provides strong incentives for the efficient delivery of the substantial costs involved in expansion and will consider the potential impact on the regulated asset base ("RAB") and airport charges.
5. Since then, we have been working with the Department for Transport to develop a plan to complete this review consistent with the ambitious timetable set by the Government for delivery of capacity expansion. We have also started to consider the submissions and evidence that we have received to date from stakeholders on these matters.
6. This statement sets out the scope of the review and our plans for 2025 and 2026. Nonetheless, our approach may need to evolve to take account of new information, including on the Government's plans for developing an updated Airports National Policy Statement ("ANPS") and the details of the expansion plans due to be submitted to the Government later in the summer of 2025.

## Scope of our review

7. The context of our work on capacity expansion has changed significantly since our earlier work programmes on these matters. This work primarily took place between 2017 and 2020, but was halted after Heathrow paused its work on capacity expansion at that time.
8. Recent developments on capacity expansion at Heathrow include:
  - the Government has set out its ambitions for capacity expansion and challenging targets for its timely delivery;
  - we understand that interested parties are working on plans for capacity expansion for submission to HM Government in summer 2025;
  - airlines have expressed strong reservations about the potential cost estimates from HAL and are seeking regulatory reform, noting that the overall programme no longer has the previous objective expressed by the then Government of “no significant real-terms increase in airport charges”; and
  - HAL has said the regulatory framework should be reformed to better support capacity expansion at Heathrow.
9. In the light of this evolving context, our review will focus on how we can best protect consumers in a way consistent with our statutory duties. Both our work to assess regulatory models for capacity expansion at Heathrow and our work to develop the existing regulatory framework will be guided by these duties.
10. Given that Heathrow airport is currently subject to capacity constraints in term of the number of flights that use Heathrow, its runways, and terminal capacity, then the timely expansion of capacity would be in the interests of consumers. This would allow the airport to serve a greater range of destinations and there would be scope for more competition between airlines. Nonetheless, to ensure that consumers can benefit the most from capacity expansion then it needs to be carried out as efficiently and effectively as practicable. This should ensure that airport charges do not increase unnecessarily, as this would reduce the benefits to consumers, and ultimately large and undue increases in airport charges could jeopardise the benefits of capacity expansion.
11. Where it is appropriate to do so we will also take account of the lessons learnt exercise that we conducted in 2024 on our approach to setting price controls, but we note we did not consider capacity expansion at Heathrow airport in any detail as part of that review and said that the H8 price control review would focus on the operation of the two-runway airport, with any matters relating to capacity expansion dealt with separately.
12. Bearing all of the above in mind we expect to work at pace and to deploy the necessary and appropriate level of resources to deliver this review. The scope of the review will cover the following broad areas.

## ***The case for changing the current framework to further the interests of consumers***

13. Our work on considering the case for change will cover both the performance of the existing framework and whether it is suited to deal with all the challenges associated with capacity expansion. This work will:

- assess the main characteristics of the current regulatory framework, noting that it has evolved considerably over time;
- examine how the current regulatory framework has performed in terms of outcomes that matter to consumers, including airport charges and service quality – both over time and compared with other airports that are subject to a greater degree of competition;
- consider, to the extent it is practical to do so, the drivers of observed outcomes; for example, whether there are Heathrow-specific factors that are largely outside the control of management that could result in higher costs, different levels of service and charges compared with other airports;
- examine the available evidence on the incentives the framework places on HAL to deliver capital projects in a cost-efficient manner and provide the best outcome for consumers; and
- consider whether there are characteristics of major capital projects in general that could limit the effectiveness of the current regulatory framework.

### ***The evaluation of credible alternatives***

14. This work will:

- set out what the possible alternatives are to the current regulatory model, drawing upon UK and international precedents and first-principles assessment. This would include examination of regulatory models involving the introduction of competition at various stages of project development and the ongoing provision of airport services, alongside consideration of characteristics that would lead to a project or service being more or less suited to competition. It would also consider regulatory models that could be applied more broadly to the airport as a whole;
- consider whether the current regulatory framework could be adapted and refined to better protect the interests of consumers and incentivise timely delivery in the context of capacity expansion. For example, alternative arrangements that would provide better incentives and governance processes in respect of capital expenditure; and
- narrow the range of alternatives based on the application of evaluation criteria driven by our duties under CAA12, including our primary duty to further the interests of users of air transport services, which will involve considering how different arrangements would incentivise the timely and efficient delivery of capacity expansion. Based on this assessment, we will present a proposed set of recommendations for the regulatory model to be applied at Heathrow airport.

### ***Analysis of the impact of capacity expansion at Heathrow on airport charges***

15. This will consider the impact of charges under the plans submitted to Government in the summer, on the assumption that incentive-based price controls using a RAB are in place at Heathrow airport. This will be based on the same price control model as was used for H7, updated to reflect actual data for recent years in addition to the latest view on forecasts and scheme proposals. As we consider and develop any alternative regulatory models, we will also assess the likely impact on charges.

## ***Assessment of financeability***

16. Our initial assessment will be based on the financial metrics and other factors that are considered by credit rating agencies on the assumption that HAL continues to be regulated under a RAB-based framework. This will also include qualitative factors such as regulatory stability and predictability, though we note that this will involve a degree of subjective assessment. We will also consider the financeability of any other plans put forward to Government in the summer, and any alternative regulatory models, as we consider and develop these models.

## ***A technical assessment of the plans submitted by potential promoters in the summer of 2025***

17. We would expect to support the DfT in its examination of the plans submitted by potential promoters. We would expect this to cover the feasibility, reasonableness, and deliverability of the plans and whether the estimates of costs are credible, well-evidenced and reflect an efficient level of costs.
18. Our programme of work on capacity expansion will also include consideration of other policy areas, such as recovery of planning costs and assessment of surface access schemes.

## **Next steps**

19. As a next step, we plan to publish a working paper on the review of regulatory models for consultation in the Autumn of 2025, though this timetable may need to evolve as we gain further clarity on the Government's timetable for developing the ANPS.
20. We expect this working paper to:
  - set out our initial analysis of the case for changing the current regulatory framework;
  - present a "long list" of possible alternative regulatory models and how these models might, in principle, apply to capacity expansion at Heathrow airport; and
  - set out criteria that we could use to evaluate whether different regulatory models would be likely to further the interest of consumers.
21. We provide illustrative examples of regulatory models in Appendix 1. This includes the alternative models and potential options to strengthen the current regulatory model that we are considering as part of our long list for the working paper.
22. Alongside the working paper we intend to publish in the autumn, we will publish stakeholder materials that we have received that have informed our work, redacting confidential information as appropriate. In any event, we request that stakeholders make this information publicly available as early as possible to facilitate open and transparent engagement by all parties.
23. In late 2025 (or early 2026 if we require further information on the plans submitted in the summer), we also plan to publish the initial views from our technical assessment of expansion plans submitted to the Government, as well as our assessment of the impact of capacity expansion on HAL's airport charges and financeability. We will also consider

the impact on charges and financeability of any other plans and any alternative regulatory models, although this work may be completed over longer timescales.

24. During 2025 and 2026, we will work closely with the Department for Transport to align appropriately with its timetable for preparation of the ANPS. We would expect subsequent steps in our process to include:
- consultation on our evaluation of different regulatory models and the CAA's statutory powers, with a proposed set of recommendations for the regulatory model to be applied at Heathrow airport; and
  - our final report and conclusions on regulatory models.

## **The H8 price control review**

25. We indicated in the letter accompanying our H8 Method Statement that we plan to continue our work in respect of the H8 price control process so that there are appropriate protections in place for consumers during this period.
26. Our work in respect of regulatory models and capacity expansion requires significant work and is being done at its own pace, separately to the H8 process. There is a real risk of significant consumer detriment if we were to pause or delay the H8 price control process until this process is completed. Doing so could lead to delays in undertaking capex and asset maintenance activities which could have negative consequences for consumers in terms of service quality, resilience and capacity. We also note that stakeholders have asked us to set out a timetable for the H8 price control process and to adhere to this process. To depart from this approach now would create undue uncertainty and inconsistency.
27. We therefore intend to retain the timetable set out in the H8 Method Statement, but will keep this under review to ensure that the timetable for the H8 review remains in the interests of consumers.
28. While the review of regulatory models to support capacity expansion and the H8 price review will each be conducted to its own timetable, they remain in essence complementary. For instance, the assessment of capex efficiency across both programmes will inform decision making on both the H8 price control and the work on future regulatory models. Improvements in capex governance that result from the H8 price control may help with delivering capacity expansion efficiently. If a different regulatory model is found to be appropriate for expansion this would inform or change the context for our work on the "business as usual" price controls for the H9 price control period and beyond.
29. We also note that work to improve capex governance should be relevant to both programmes as this has the potential to improve the current regulatory model in the H8 price control period, and we would urge stakeholders to engage with these issues as our H8 review continues.

## **Conclusion**

30. We have set out a programme of work to review the current regulatory arrangements at Heathrow airport that is consistent with the ambitious timetable set by the Government

for delivery of capacity expansion, although the content and timing of this work may need to evolve to reflect new developments and information. Throughout this process, we will carry out our assessment in a manner that we consider will best protect the interests of consumers.

31. If you have any queries or questions on this update, please contact [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk).

## **Appendix 1 – Illustrative examples of regulatory models**

1. Below we present some illustrative examples of the regulatory models that could, in principle, be included in the long list we will set out in the Autumn 2025 working paper. In practice these models are not necessarily mutually exclusive, and some could be combined together to create an overall framework for capacity expansion. Issues around the implementation of these models (including consistency with our existing statutory powers) will be considered subsequently as part of the evaluation of these models and the development of a short list.
2. Our work on regulatory models will not focus on the fundamental question of whether Heathrow airport should be regulated. The CAA made a market power determination in respect of Heathrow airport under section 7 of the Civil Aviation Act 2012 (“CAA12”) in January 2014, and we have not seen evidence that suggests we should revisit this determination.
3. The focus of our work on regulatory models will be arrangements that are consistent with the scope of our current powers under CAA12. To the extent that we identify arrangements that appear to have significant advantages to consumers but lie outside the scope of our current powers we would need to consider what next steps might be appropriate (in the context of the advantages of the timely, efficient and effective delivery of capacity expansion) and would discuss these matters further with the Department for Transport.
4. This approach should help ensure that a reasonably full suite of regulatory models is given due consideration, and that decisions on the short list are systematically and clearly explained.

### **Regulatory model 1: Asset competition**

5. Features of this model could include:
  - Two or more promoters submit alternative DCO applications for capacity expansion at Heathrow.
  - A DCO is granted both to HAL and to an alternative promoter, with the alternative provider delivering aspects of capacity expansion, such as a new terminal.
  - The alternative promoter would acquire land and build, own and operate the asset.
  - There would need to be appropriate interconnection and coordination with the rest of Heathrow airport operations, through licence obligations on HAL and possibly the alternative provider.
  - Where there was scope for competition, new assets would compete directly with aspects of HAL’s own assets.
  - The revenues and charges would be collected separately to HAL.

### **Regulatory model 2: DPC model**

6. This model is based on features of the Direct Procurement for Customers (“DPC”) approach applied by Ofwat in the context of major projects in the water sector.
7. Features of this model could include:

- The separation of one or more discrete projects within the broader capacity expansion plan, such as a new terminal.
- HAL or another party would be required to carry out a competitive procurement exercise at an early stage of the project development: for example, after HAL had completed the initial design of the project.
- The successful bidder would then undertake the detailed design of the project, and would then build, own and operate the asset.
- Bidders would be asked to submit bids for the revenue stream that they would require.
- The successful bidder would be selected based on the lowest bid revenue stream.
- The required revenues would be collected from HAL, and then recovered from consumers through a pass-through component of airport charges.
- The allocation of risks, obligations and responsibilities would be governed by a contract that HAL would be required to enter into with the successful bidder and approved by the CAA.
- As a contractor to HAL in the provision of airport operation services, the successful bidder would not be subject to a separate economic licence.

### **Regulatory model 3: Long lease contract for asset operation**

8. Features of this model could include the following:

- A discrete asset, such as a terminal, would be identified and designated by the CAA as being subject to competition. This could include assets that are built as part of HAL's capacity expansion plan or assets that exist prior to the commencement of capacity expansion.
- CAA would determine the efficient costs attributable to the asset. These would be deducted from HAL's allowed revenues to avoid double-recovery of these costs.
- HAL or another party would be required to carry out a competitive procurement exercise whereby the successful bidder would win the right to operate the asset.
- Ownership of the asset would remain with HAL throughout the duration of the contract, and the asset would remain in HAL's RAB.
- HAL would be required to enter into a contract with the successful bidder under which the successful bidder would receive a revenue stream from HAL that would be recovered through a pass-through charge to consumers.
- The successful bidder would be chosen based on the lowest bid revenue stream.
- The rights, responsibilities and obligations of the successful bidder and HAL would be governed under the contract.
- As a contractor to HAL, the successful bidder would not be subject to an economic licence.

### **Regulatory model 4: price benchmarking**

9. This model would be based on our broad understanding of some of the commercial and regulatory arrangements in place at Changi Airport in Singapore. The CAA would set maximum allowed charges based on a basket of charges levied at comparable hub airports.

### **Regulatory model 5: amended capex governance arrangements**



10. CAA would strengthen the current capex governance arrangements that are in place at Heathrow airport, for example in respect of:

- Control of key aspects of decision making on the capex programme.
- Procurement and tendering strategies, potentially allowing a much greater role for competition in the building and operation of new assets.
- Dispute resolution procedures.
- Information provision.
- The scope and remit of independent assurers such as the current “Independent Funds Surveyor”.

**Regulatory model 6: strengthening the existing incentive-based price controls with targeted adjustments**

11. Under this approach:

- HAL would have new incentives for the timely delivery of capacity expansion.
- There would be an early adjustment of its price control to allow for the recovery of efficiently incurred early costs, such as scheme development and planning costs.
- The profile of airport charges would be set to best support the efficient financing of capacity expansion.
- The framework for setting the allowed return would be amended to take account of capacity expansion (for example, in terms of the treatment of construction risk, allowing for a greater level of working capital and how expansion might affect the notional debt structure).
- The current system of delivery obligations under the capex incentives framework would be augmented to include a system of bonuses and penalties to further incentivise timely delivery of new capacity.