

Heathrow Capacity Expansion – consultation on regulatory policy on early costs

CAP 3149

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Chapter 1

Introduction and Summary

Background

- 1.1 Under the Civil Aviation Act 2012 (“CAA12”), operators of airports that have substantial market power are subject to economic regulation by the CAA. These include Heathrow Airport Limited (“HAL”). The CAA’s primary tool for the economic regulation of HAL is through a licence granted under CAA12 (“the Licence”).
- 1.2 Heathrow airport is operating close to its maximum capacity. To significantly increase this capacity in the future would require the development of important new infrastructure, including a new runway, additional terminal capacity and surface access infrastructure.
- 1.3 In January 2025, the Government announced its support for capacity expansion at Heathrow airport¹ and asked interested parties to bring forward proposals by the end of July 2025. We have agreed to work closely with the Government (especially the Department for Transport (“DfT”)) on the timely, efficient and effective expansion of capacity at Heathrow airport, consistent with our statutory duty under CAA12 to further the interests of consumers.
- 1.4 The proposals for capacity expansion at Heathrow airport involve very significant capital expenditure (“capex”) to provide the new infrastructure outlined above. Interested parties have now provided a range of different plans for expansion at Heathrow airport. Even the most mature of these proposals are at a relatively early stage of development and will require a considerable amount of further work before they could form the basis for an application for a Development Consent Order (“DCO”) under the Planning Act 2008. A DCO would be needed to provide planning and other necessary consents that would allow any promoter of new capacity to proceed with expansion.
- 1.5 HAL’s capex is a key element used by the CAA to set the level of airport charges that HAL is permitted to recover under the Licence. Under the present regulatory framework, this expenditure feeds through to form part of HAL’s regulatory asset base (“RAB”) and so (through a regulated return on, and depreciation of, the capital invested) into airport charges. While we are in the process of reviewing the regulatory framework for expansion, it is reasonable to expect that any approach that we adopt will involve the costs of capacity expansion being recovered through airport charges over time. So, it is essential that such

¹ In this consultation, we refer to this as “expansion”.

investment, including any early costs incurred on expansion, is undertaken efficiently to protect the interests of consumers.

- 1.6 In our work to support capacity expansion at Heathrow airport, one of the key issues we need to consider is the approach to recovery of the early costs of expansion. In this document, we define early costs to mean expansion costs that are incurred by potential promoters before the Government takes a decision on whether to grant a DCO for capacity expansion at Heathrow airport.
- 1.7 Two potential promoters of capacity expansion at Heathrow have made representations to us on the treatment of early costs. Both of them (as well as other potential promoters) may incur early costs in preparing DCO applications. The parties who have made representations to us are:
- HAL, which has asked that it should be allowed to recover £71 million in 2025, including an initial £20 million for the period up to the end of September 2025, and a further £249 million in 2026, making £320 million in total (in 2024 prices) up to the end of 2026; and
 - the Arora Group, which has asked for its costs to be treated in an equivalent way to those of HAL. It has said that its early costs are expected to be around £3.5 to £4.0 million in 2025, including £2.5 million up to the end of July 2025 and a further £1 to £1.5 million to the end of 2025. We do not at this stage have information on the Arora Group's expected costs beyond 2025, nor the early costs of other potential promoters.
- 1.8 We considered similar questions in the context of the capacity expansion process prior to 2020. At that time, we developed a detailed policy for the recovery of the early costs that HAL incurred between 2017 and 2020. The Arora Group's proposals were, at that time, less mature than those of HAL. It was only in early 2020, just before the capacity expansion programme was paused, that we decided there was sufficient evidence to consider that the plans of the Arora Group (termed "Heathrow West") were reasonably mature and credible.²
- 1.9 Once expansion had been paused and the focus had returned to a "two runway" airport, we decided that there was not a compelling case in the interests of consumers for us to take action to support the recovery from consumers of the early costs that the Arora Group had incurred at that time. While we did not consider that it would be reasonable for us to decide that consumers should be exposed to Heathrow West's costs at that stage, we were clear that, our decision did not set, and should not be seen as setting, a precedent for future decisions.

² See "Economic regulation of Heathrow: policy update and consultation", CAP1940, June 2020, page 117

We did not want to set a precedent against cost recovery for potential new providers if that would stifle the emergence of appropriate competition in future.³

- 1.10 Circumstances have changed significantly since 2020 and we understand that both HAL and the Arora Group have been working broadly in parallel on proposals for capacity since the Government announcement in January 2025. The Government has also received proposals from other parties. This raises new and different issues for the regulatory treatment of early costs and these matters are explored further in this consultation.
- 1.11 We are consulting interested parties on the recovery of early costs incurred:
- until September 2025, when the DfT intends to take an initial decision on whether the proposals of potential promoters meet the conditions set out in the Government's letter of 30 June 2025;⁴ and
 - for the period immediately afterwards and until the end of 2026.
- 1.12 Our approach to these matters is guided by our statutory duties, particularly our "primary" duty to further the interests of present and future consumers. A summary of our statutory duties is set out in Appendix D. Our starting point, as with our previous consideration of expansion prior to 2020, is that the timely, efficient and effective expansion of capacity at Heathrow airport would be in the interests of consumers and we are working alongside the DfT and Government to promote these objectives.

Summary of issues and options

- 1.13 There are a number of considerations in developing our approach to the regulatory treatment of early costs that we consider to be important in delivering our primary duty to further the interests of consumers. While our broad approach to the regulation of expansion should encourage the consideration and assessment of a wide range of options, the following issues appear particularly relevant to our assessment of early costs:
- supporting the timely and effective development of credible and appropriately mature proposals for expansion, for which we will provide reasonable certainty over the recovery of efficiently incurred early costs;
 - our approach should encourage an appropriate degree of competition in the infrastructure for and provision of airport operation services to drive more efficient costs, innovation and better service quality;

³ See "Heathrow West's request for cost recovery: decision", CAP2524H at paragraph 33.
www.caa.co.uk/CAP2524H

⁴ [Letter to potential promoters of Heathrow expansion – GOV.UK](https://www.gov.uk/government/consultations/letter-to-potential-promoters-of-heathrow-expansion)

- at the same time, our approach should avoid consumers funding significant and unnecessary duplicate or wasteful planning or early construction costs, provide incentives for efficiency, and seek to ensure that any recovery of costs is reasonably smooth over time to avoid any undue increase in airport charges; and
- supporting and complementing Government policy where appropriate, so that there is an appropriately coordinated, efficient and effective approach to these matters, consistent with our statutory duties.

- 1.14 The intention behind this broad approach is not to exclude any proposals from consideration, but to recognise that once a proposal is credible and appropriately mature there are likely to be benefits to consumers that the rivalry between such proposals will create. In these circumstances, there may be benefits in allowing for the recovery of early costs provided that such costs are efficient and avoid any duplicate or unnecessary activity. We are also seeking to develop these arrangements in a timely way, to both further the interests of consumers and support the Government's timetable for the delivery of expansion.
- 1.15 Our views on the credibility and maturity of proposals will be informed by our technical assessment of proposals that were provided at the end July. We will also take into account any assessment of those proposals by the DfT.
- 1.16 Chapter 2 describes the initial information provided by HAL and Arora on early costs and discusses the key issues that we need to address in developing our policy towards early costs to further the interests of consumers. Key issues include the mechanisms for cost recovery, the identification of efficient costs, and the treatment of costs incurred by potential promoters other than HAL. We will also consider the costs of other promoters, if we assess their proposals as credible and appropriately mature.
- 1.17 Chapter 3 considers a range of options for the treatment of early expansion costs at Heathrow airport, including those of both HAL and other promoters with credible and appropriately mature proposals. These options are summarised below.
- Option 1: allow recovery of HAL's efficient costs: (a) either under the existing H7 capital governance and incentive framework, or (b) a new framework;
 - Option 2: allow recovery of efficient costs for alternative promoters only with credible and appropriately mature proposals;
 - Option 3: allow recovery of efficient costs for both HAL and alternative promoters with credible and appropriately mature proposals; and
 - Option 4: do not allow the recovery of early costs.

Our initial views

- 1.18 The broad approach to economic regulation in the UK is that licensees, including HAL, should expect (but are not guaranteed) to recover efficiently incurred costs. This suggests that there is a strong case to allow HAL to recover both the efficient early costs that it has incurred to date and the efficient costs it is likely to incur over the remainder of this year, while the DfT, supported by the CAA, makes an initial assessment of its proposals.
- 1.19 Other promoters are in a significantly different position to HAL, as they do not have an economic licence or a mechanism to recover their costs. At this stage, we are assessing the proposals that were submitted to the Government at the end of July 2025 and so it is too early to reach a final view on whether the proposals submitted are credible and appropriately mature. Nonetheless, we will aim to reach a view on these matters as soon as is practicable, working closely with the DfT. In this context, we note that we assessed the Arora Group's earlier plans as reasonably mature and credible in 2020.
- 1.20 Our initial view is that there are likely to be advantages to consumers in supporting the recovery of initial early costs (that is, at least over the remainder of 2025) of other promoters with credible and appropriately mature proposals. Having a degree of rivalry between promoters provides advantages to consumers in that it should promote efficiency and the thorough evaluation of a wide range of expansion options. This is particularly important given the size and complexity of the capacity expansion programme.
- 1.21 Given this, we are exploring whether it is practicable to create a mechanism that would allow proposals assessed as credible and appropriately mature to recover efficiently incurred early costs. One such approach would be to bring forward a modification to HAL's licence for HAL to create a fund to recover its efficiently incurred early costs together with those of any promoter with a credible and appropriately mature proposal, through the charges HAL levies on airlines. This would require HAL to administer and make appropriate payments to the other promoters. We welcome the views of respondents on these matters.
- 1.22 While we have a clear initial view, as outlined above, as to how early costs should be treated for the initial period and the remainder of 2025, the appropriate position for the medium-term (that is, after 2025) will require more consideration. While there are advantages to consumers in competitive rivalry between promoters when early costs are of limited materiality, the balance between the benefits of competition and its costs changes once costs start increasing significantly ahead of DCO submission. This is compounded by the potential for significant and unnecessary duplication of planning and/or early construction costs (including land purchases and site preparation). We will want to consider whether it would be appropriate (that is in the interests of consumers) to take a

different approach to the recovery of costs from the start of 2026, including whether it is possible to put arrangements in place to ensure that the applications were complementary and did not involve duplicate and unnecessary costs.

- 1.23 How these matters might be best resolved is a key issue. Our initial view is that consumers' interests are likely to be best served by an agreed and coordinated approach to making DCO application(s), for example to avoid duplicate and unnecessary early costs for land purchase and site preparation to meet the construction timetable, which could still leave open final decisions on which party could be responsible for the development of certain aspects of the infrastructure at Heathrow airport. We will want to consider these issues further alongside our work on reviewing the wider regulatory framework for capacity expansion at Heathrow airport: we intend to publish a further consultation on these matters in the autumn of 2025.

Next steps and views invited

- 1.24 We are seeking views from stakeholders on this consultation and, in particular, on:
- the key issues identified in this chapter and in chapter 2;
 - the options and initial views set out in chapter 3; and
 - any other relevant issues and options that we should consider.
- 1.25 Given the clear advantages of the timely resolution of the issues identified in this consultation and the importance of giving careful consideration to the views of stakeholders, we are seeking views on this consultation by 17:00 on 10 September 2025. Responses to this consultation should be sent to economicregulation@caa.co.uk. We do not envisage being in a position to give any extensions to the deadline for responses, given the importance of making timely progress with decisions on these pressing matters.
- 1.26 We expect to publish the submissions we receive on our website as soon as practicable after the consultation period ends. Any material that is regarded as confidential should be clearly marked as such, with an explanation of why the information is confidential, and included in a separate annex. We have powers and duties with respect to the disclosure of information under Schedule 9 of the TA00, Section 59 of CAA12 and the Freedom of Information Act 2000 and it may be necessary to disclose information consistent with these requirements.
- 1.27 Following consideration of responses, we expect to publish our decision on the principles and approach to the recovery of early planning costs by HAL by the end of September 2025. We will also expect to set out our view on the timetable for future work and decisions on planning and early construction costs and provide our updated view on recovery of costs by other promoters with credible

and appropriately mature proposals. Given the need to assess which proposals are credible and appropriately mature, and potential issues around the duplication of planning and early construction costs, we expect a decision on these matters to follow later in 2025.

- 1.28 Subsequent to this, we will develop the detailed policy and approach to implementation. For any modifications to HAL's licence that we might need to make, we will need to follow the statutory process for consulting on licence modifications, which, under CAA12, can be subject to appeal by certain parties to the Competition and Markets Authority ("CMA").
- 1.29 Any questions related to this consultation should be sent to economicregulation@caa.co.uk.

Chapter 2

Key issues for early costs

Introduction

- 2.1 Policy around the recovery of early expansion costs should be developed and subsequently implemented in a way that furthers the interests of consumers, including in respect of facilitating the timely and efficient delivery of expansion. In this chapter we consider:
- the initial representations and information we have received from HAL and the Arora Group on early costs;
 - regulatory mechanisms and incentives for early costs;
 - regulatory treatment of HAL's capex;
 - mechanisms that would allow other promoters with credible and appropriately mature proposals to recover costs; and
 - key issues for consultation.

The initial submissions from HAL and the Arora Group

Requests from HAL and the Arora Group

- 2.2 HAL wrote to us on 26 June 2025 outlining the steps it is taking to meet the Government's goal of securing a DCO by 2029. It said that, to achieve this, it will require additional expenditure during the remaining two years of its H7 price control (2025 and 2026) and beyond including:
- £10 million up to the submission of its expansion proposal to Government at the end of July 2025; and
 - another £10 million up to the end of September 2025 ahead of agreeing a Memorandum of Understanding ("MoU") with Government on expansion.
- 2.3 HAL requested assurance from us that we consider that the activity associated with the £20 million that it expects to incur up to the end of September 2025 is in the interest of consumers and that HAL should be able to anticipate appropriate recovery of efficient costs. HAL also noted that airlines had not agreed to the initial £10 million of these costs as part of the H7 capex governance arrangements and that this would be escalated to the CAA.
- 2.4 We also received a letter from the Arora Group dated 4 July 2025 setting out its expectations on future engagement with the CAA on expansion matters. The

Arora Group said that it will be committing significant resource and time to develop its proposals for expansion and requested assurance from us that it will be placed on “a level playing field” and treated in the same manner as HAL, including how the costs that it has incurred to develop its proposals are recovered.

Our response

- 2.5 We responded to HAL’s initial request on 14 July 2025. We said that we would need to consult on our approach for the recovery of early costs incurred during the H7 period and that this should take place as soon as reasonably practicable. We outlined further information that we would need from HAL in relation to the £20 million cost estimate it had submitted, including;
- a more detailed breakdown of expenditure and what outputs are expected to be delivered as a result; and
 - evidence that this expenditure has been efficiently and effectively incurred and is genuinely incremental to the costs that were allowed as part of the H7 price control.
- 2.6 We also set out the information that HAL will need to provide to support its request to increase the H7 capex envelope. We said that HAL should separately identify capex increases driven by early expansion costs from other capex and set out how any additional capex compares to the capex allowances for H7, and capex incurred by HAL during that period to date.
- 2.7 We replied to the Arora Group on 21 July 2025 to outline our plans for consulting on early expansion costs in the first half of August 2025. We said that this consultation will consider the recovery of costs incurred by HAL and any other potential promoters that may emerge in response to the Government’s invitation for proposals.
- 2.8 We said that to support this process, it would be helpful for the Arora Group also to provide us with information on costs related to capacity expansion that it has incurred since the Government’s announcement in January 2025, and costs that it expects to incur over the remainder of 2025.

Information submissions from HAL and Arora

- 2.9 We received information from HAL on 17 July 2025 on the £20 million that it expects to incur up to September 2025. HAL provided a breakdown of the expenditure with commentary to explain the different categories of costs, including work on consents, programme management and development of business cases. We summarise this breakdown of costs in Appendix C.
- 2.10 HAL said that it does not consider that a detailed review and consultation on these early costs is necessary given the compressed timeline and because it

was seeking “assurance in principle” for the recovery of appropriate efficient costs.

- 2.11 We replied to HAL on 22 July 2025 that this consultation will reflect the established practice in economic regulation in the UK, that a licensee subject to economic regulation should expect to be able to recover efficiently incurred costs, either through regulatory cost allowances or the operation of a “fair bet” incentive regime.
- 2.12 On 31 July 2025, HAL submitted a further request that identified £71 million of early costs in 2025 (including the £20 million in its June 2025 submission for costs to September 2025) and £249 million in 2026: making £320 million in total over H7. HAL said that we should raise the H7 capex ceiling (that was established as part of the H7 price review and included in the Licence in 2023) to allow for the recovery of these extra costs. HAL has requested that we review and consult on our approach to these additional costs before the end of September 2025, to support its efforts to make a timely DCO application.
- 2.13 On 30 July 2025, the Arora Group informed us that it had incurred early costs of around £2.5 million from the date of the Chancellor’s announcement to the end of July 2025 and that it expected to incur a further £1 to 1.5 million of costs up to the end of December 2025: around £3.5 to £4.0 million in total in 2025. We do not at this stage have information on the Arora Group’s expected costs beyond 2025, nor the early costs of other potential promoters.

Regulatory mechanisms and incentives for early costs

- 2.14 In view of our statutory duties, it is important that early expansion costs are efficiently incurred and lead to a high quality DCO application if they are to be recovered from airport users. In considering such matters, we will be guided by the established practice in economic regulation in the UK that a licensee subject to economic regulation should expect (but is not guaranteed) to be able to recover efficiently incurred costs, either through regulatory cost allowances or the operation of a “fair bet” incentive regime.
- 2.15 Our previous policy towards early costs developed prior to 2020 included several features designed to incentivise this. It is for consideration as to what features of the previous arrangements could be used in any new arrangements, for example:

- previous policy involved not allowing costs prior to the Government identifying the preferred location of a new runway in the south east of England in 2017 (these were called “Category A” costs). As we explain in Appendix B, one of the considerations underlying this decision was that these early costs were considered lobbying costs and so it was not considered appropriate that these should be recovered from consumers. One equivalent approach would be to ensure that only the costs associated with the genuine development of plans would be recoverable and to exclude any costs associated with lobbying and/or publicity;
- previous policy did not allow recovery of early costs for the Arora Group’s proposals, where we had not yet reached a conclusion that the proposals were in the interests of consumers or were likely to deliver specific benefits to them. A similar approach here would be to consider cost recovery for alternative promoters where their proposals are considered credible and appropriately mature, and the competition between proposals is shown to deliver benefits for consumers;
- an incentive on cost recovery linked to a successful DCO outcome. Previous costs associated with seeking planning consent through the DCO process (known as “Category B” costs at the time) were subject to risk sharing. Had a DCO application been made by HAL and been successful, HAL would have been allowed to recover 105% of its efficient costs of preparing that application. However, were the DCO application to have been unsuccessful, HAL would have been allowed to recover only 85% of its efficient costs. The cost sharing mechanism was introduced to incentivise the development of a high quality application to increase the likelihood of its success and to share the risk of a failed application between HAL and consumers;
- an overall recovery cap to protect consumers in the event of escalating planning cost forecasts and to incentivise HAL to deliver its planning application in line with its forecasts. Previously, we had introduced a cap and said that, if there was a material change in circumstances, we would consider a request for adjusting the recovery cap, provided HAL could demonstrate that increasing expenditure was in the interest of consumers, and that it had been discussed with airlines;
- providing regular independent scrutiny of costs. Previously, planning costs were subject to annual review and scrutiny by an Independent Planning Cost Reviewer. This review included considering whether there was evidence that the costs had been incurred, whether the costs had been appropriately categorised and whether costs had been efficiently incurred;
- enhanced reporting requirements. We had previously introduced quarterly reporting of actual expenditure compared to budget/forecasts, and six-monthly updates of forecasts; and

- a backwards looking review of HAL's planning costs and consultation on the level of efficient costs to be added to HAL's RAB, to provide an incentive that only efficient costs would be added to the RAB. Our previous policy was for allowed expansion costs to be capitalised and added to RAB, to be recovered through charges once the outcome of the DCO was known.

2.16 We would welcome views on which approaches to incentivise and limit early costs to efficient levels (including from those set out above or others) may be most suitable to the current circumstances.

Regulatory treatment of HAL's capex

- 2.17 As part of the H7 price control review, we introduced new arrangements for the regulation of HAL's capex. It is for consideration as to whether these arrangements could be used to provide appropriate allowances for HAL's early costs.
- 2.18 The new approach is based on forwards looking ("*ex ante*") incentives for capex and replaces the previous backwards looking reviews of capex. The new arrangements provide HAL with a financial incentive to outperform against project-level budgets within an overall capex envelope set for the price control review period by the CAA. The project-level budgets are agreed through a capex governance process involving airlines. Once the project-level budget is agreed, HAL bears a proportion of the risk of any under-spends or over-spends against the budget, which provides the incentive for it to minimise the cost subject to it delivering agreed outputs (known as "delivery obligations"). This proportion is set at 25% for H7.
- 2.19 In principle, the governance processes associated with the forwards looking approach could provide a process for allowing HAL to recover its early expansion costs, although it would likely require HAL to apply for (and the CAA to agree to) an increase in the H7 capex envelope (using the process set out in the Licence known as the "uncertainty mechanism"⁵). Furthermore, the Licence requires the CAA's consent in writing before HAL can make an application to increase the H7 capex envelope outside of two application periods specified in the licence (1 February 2024 to 31 March 2024, and 1 February 2025 to 31 March 2025) and requires the CAA to consult on its proposed decision in respect of any such application.
- 2.20 We note that the H7 price control, including the uncertainty mechanism described above, was expressly developed in the context of a "two runway" airport. So, while we consider the forwards looking approach and associated capital governance process is appropriate for HAL's "business as usual" capex

⁵ See Condition C1.12ff of the Licence.

during a price control period, it seems less suitable for expansion planning costs where it is more difficult to specify outputs and delivery obligations to confirm that the capex has delivered the outputs expected. We will take this into account in assessing the appropriate approach to addressing the issues raised by HAL's submission and we welcome stakeholders' views on these matters.

The recovery of the efficient costs for other promoters with credible and appropriately mature proposals

- 2.21 In chapter 3 we assess different options for the recovery of early costs, including options that would allow promoters with credible and appropriately mature proposals to recover their costs. Below we explore whether there are mechanisms that could be developed to allow promoters other than HAL to recover their costs, bearing in mind that other promoters do not currently have an economic licence for the provision of airport operator services at Heathrow airport or commercial or other mechanisms for recovering such costs from consumers.
- 2.22 One potential approach would be to bring forward a modification to the Licence for HAL to create a fund to recover its efficiently incurred early costs together with those of any promoter with a credible and appropriately mature proposal, through the charges HAL levies on airlines. This would require HAL to administer and make appropriate payments to the other promoters.
- 2.23 Any such modification would need to specify the approach to recovery of early costs, any associated incentives, and additional reporting and assurance requirements to ensure the appropriateness, accuracy and transparency of the relevant costs.

Key issues for consultation

- 2.24 We welcome stakeholders' views on any issues raised in relation to these matters and in particular on:
- the initial cost estimates provided by those parties (HAL and the Arora Group) that have made representations to us on this matter;
 - whether there are elements of the previous arrangements for the recovery of HAL's costs that we should build into any arrangements for the recovery of early costs for 2025 and 2026;
 - our initial view that the existing forwards looking capex incentives and uncertainty mechanism are unlikely to be suitable for the recovery of HAL's early costs; and

- our initial view that if we decide to allow the recovery of early costs by other promoters with credible and appropriately mature proposals, then one approach to this would be to make modifications to the Licence to implement the policy. Any proposed modification to the Licence would be subject to the statutory process for consultation and potential appeals to the CMA.

Chapter 3

Options for recovery of early expansion costs

Introduction

- 3.1 In this chapter we examine four different options in relation to recovery of early expansion costs. These are:
1. to allow recovery of HAL's efficient costs: either (a) under the existing H7 capital governance and incentive framework, or (b) under a new framework;
 2. to allow recovery of efficient costs for alternative promoters with credible and appropriately mature proposals only;
 3. to allow recovery of efficient costs for both HAL and alternative promoters with credible and appropriately mature proposals; and
 4. not allow the recovery of early costs.
- 3.2 We describe each option and set out our initial views on whether the option would be consistent with our primary duty to further the interests of consumers. In particular, we consider whether the options would support the timely and effective development of DCO proposals by:
- supporting the timely and effective development of proposals for expansion, for which we will provide reasonable certainty over the recovery of efficiently incurred early costs;
 - our approach should encourage an appropriate degree of competition in the infrastructure for and provision of airport operation services to drive more efficient costs, innovation and better service quality;
 - at the same time, our approach should avoid consumers funding significant and unnecessary duplicate or wasteful planning or early construction costs, provide incentives for efficiency, and seek to ensure that any recovery of costs is reasonably smooth over time to avoid any undue increase in airport charges; and
 - supporting and complementing Government policy where appropriate, so that there is an appropriately coordinated, efficient and effective approach to these matters, consistent with our statutory duties.

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

- 3.3 Under this option we would allow HAL to recover efficient early costs under the current H7 framework. This would involve reviewing HAL's suggestion for uplifting the H7 capex envelope for the early planning costs incurred up to the end of H7 (including the £20 million of early costs that HAL expects to incur up to September 2025), following an assessment of the efficiency of these costs. HAL would then bear a proportion of the risk for under or overspend against this allowance.
- 3.4 While this approach would provide certainty for HAL in the recovery of costs incurred in H7 (with the opportunity to review how it is working at the end of 2026), this approach may face a number of practical difficulties. For example, early costs will depend on the UK Government's review and planning process, so will be uncertain and difficult to forecast. We may also not be able to set suitable delivery obligations to secure that the capex is incurred appropriately to deliver benefits to consumers. Moreover, these costs may also not be suitable for the normal governance process between HAL and airlines. For instance, we understand that at the June 2025 Joint Steering Board (which is part of the governance arrangements for HAL's capex), HAL and airlines agreed to escalate the recovery of the initial portion of these costs to the CAA.
- 3.5 The process for considering requests by HAL to increase H7 capex allowances is addressed by Conditions C1.12 to C1.15 of HAL's licence. For such an approach to be adopted, the CAA would need to give its consent in writing for HAL to make such an application, as we are outside of the two time windows specified in the licence. The CAA would then need to publish relevant information to be submitted by HAL as specified in the licence and consult on its proposed decision in respect of HAL's application. As noted in chapter 2, these arrangements were developed in the context of a price control for a "two runway" airport and we are considering whether they are suitable for the treatment of costs related to expansion.

Option 1b: Allow recovery of HAL's efficient costs under a new framework

- 3.6 As an alternative, we could allow the recovery of HAL's costs through a new set of regulatory arrangements, designed specifically to:
- suit the characteristics of the early costs of expansion; and
 - support the timely delivery of capacity expansion.
- 3.7 The approach that we used for early costs incurred prior to the "pausing" of expansion in March 2020, which involved separate categories of costs (as

explained further in Appendix B) and different incentives arrangements (as explained further in chapter 2) was an example of the sorts of arrangements that we might develop for these costs now. That said, circumstances have now changed and it is not clear that breaking early costs down into different categories would be needed. However, as we explained in chapter 2, there may be certain aspects of the previous framework that it would be advantageous to bring forward into new arrangements, including:

- allowing for a proportionate backwards looking review of the efficiency of costs and making sure they relate to expansion and are not “double counted” with HAL’s price control allowances for costs;
- providing an incentive for timely and successful DCO application. This could be in the form of a top-down incentive similar to our approach prior to March 2020 (under which HAL would have been able to recover 85% of costs should its DCO application have been unsuccessful and 105% of costs should its DCO application have been successful); and
- providing some protection to avoid very significant and unexpected changes in costs and charges. To that end, we could define a minimum threshold for recovery of costs (where only costs above the threshold would be recoverable) and place an overall cap on costs to be allowed within the current price control period. We could also treat costs as recoverable from the RAB, to reduce the impact on charges within a price control period.

3.8 We would welcome views on the potential design of the bespoke approach to recovery of these costs.

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

- 3.9 In the scenario where one or a number of alternative promoters are assessed to have submitted credible and appropriately mature proposals for expansion, we could allow the recovery of early costs for those alternative promoters alone.
- 3.10 Similar to option 1(b), we could carry out a backwards looking efficiency review of costs, provide incentives on the alternative promoters to make sure the planning is timely and high quality and leads to a successful outcome to the DCO process, and provide protection to consumers from significant and unexpected changes in charges.
- 3.11 We would need to consider the practical approach to recovery of costs for the alternative promoters, as they will not have their own economic licence or commercial relationships with airlines that would enable them to recover the costs in questions from consumers. We discuss a possible means of addressing this in chapter 2.

- 3.12 However, as HAL is expected to have developed a credible and appropriately mature proposal for expansion, such an approach may not be consistent with the established practice in economic regulation in the UK, that a licensee subject to economic regulation should expect to be able to recover efficiently incurred costs, either through regulatory cost allowances or the operation of a “fair bet” incentive regime.

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

- 3.13 Where both HAL and alternative promoters are assessed to have developed credible and appropriately mature proposals, we could adopt an approach to allow the recovery of both of their efficient planning costs.
- 3.14 Similar to options (1b) and (2), we could develop an approach to assess cost efficiency and consider how to provide reasonable incentives around timely and effective planning and a successful DCO application process. This approach could provide a level playing field between parties, consistent with encouraging competition between rival promoters.
- 3.15 Nonetheless, the potential for unnecessary duplication of effort and costs by separate potential promoters also needs to be considered. The submissions from HAL and the Arora Group suggest limited duplication in planning costs in 2025 given that the initial estimates of costs to be incurred by HAL and the Arora Group are relatively modest in this period (HAL estimates its 2025 costs to be £71 million and the Arora Group estimates its 2025 costs to be around £4 million). However, the increase in HAL’s estimated early costs in 2026 (£249 million) suggests the recovery of duplicate costs from 2026 onwards would appear to be capable of having a significant impact on the airport charges which, if they were to be recoverable, would need to bring proportionate offsetting benefits to consumers in order to be in their interests.
- 3.16 We also note there are likely to be significant benefits in rivalry during the planning stage for capacity expansion, as there are significant advantages to consumers in the thorough investigation of options and the exploration of more efficient approaches for the delivery of what will be a very large and complex capex programme.
- 3.17 Nonetheless, as the proposals progress, the costs of pursuing a DCO application are likely to be substantial and it will be appropriate to protect consumers from bearing unnecessary and duplicate costs, as the balance between the benefits of competition and its costs changes once costs start increasing significantly ahead of DCO submission. This is compounded by the potential for significant and

unnecessary duplication of planning and/or early construction costs (including land purchases and site preparation).

- 3.18 This is a key issue that will require further consideration. For example, we could consider an approach where a greater proportion of the early planning costs are at risk should proposals be withdrawn or the DCO process not be successful for that promoter. This could encourage the potential promoters to consider the appropriate approach to planning and potentially collaborating on the design of expansion works so as to avoid unnecessary and costly duplication of significant planning costs.
- 3.19 Similar to option (2), we would need to consider the practical approach to recovery of costs for any alternative promoters.

Option 4: Do not allow recovery of costs

- 3.20 Given the issue identified above around the risk of duplication of significant costs, another option to create a consistent approach across all potential promoters would be to not allow any early planning costs at this stage prior to assessment of proposals or not allow any costs prior to a successful DCO acceptance.
- 3.21 However, as set out under option 2, such an approach may not be consistent with the established practice in economic regulation in the UK, that a licensee subject to economic regulation should expect to be able to recover efficiently incurred costs, either through regulatory cost allowances or the operation of a “fair bet” incentive regime. We would also be concerned that disallowing these early costs would have the unintended consequence of promoters abandoning capacity expansion, slowing down the planning process or reducing the quality of planning work. This is unlikely to be in the interests of consumers.

Our initial views

- 3.22 Our initial view is that it would be in the interests of consumers to adopt an approach that is consistent with recovery of efficient costs where this provides clear benefits to consumers by delivering a successful and timely DCO process.
- 3.23 This would support an approach consistent with options (1b) or (3), dependent on which of the promoters’ proposals are assessed to be credible and appropriately mature and in the interests of consumers. In practice, it seems relatively likely that HAL will produce a credible and appropriately mature proposal for capacity expansion, bearing in mind the significant amount of work it undertook on these matters between 2017 and 2020 and the further engagement it has undertaken with the airline community in 2025.

- 3.24 Our views on the credibility and maturity of proposals will be informed by our technical assessment of proposals that were provided at the end July. We will also take into account any assessment of those proposals by the DfT.
- 3.25 If we decide that HAL and/or any other promoters have brought forward credible and appropriately mature proposals, there would be significant advantages in option (3), at least in the short-term, as it would support the competitive development of proposals. Nonetheless, there could be greater difficulties with this option in the medium-term, and we would need to consider the potential for significant and unnecessary duplication of planning costs. To protect the interests of consumers, we would welcome views on the appropriate approach to address this concern. This could involve either regulatory arrangements that would not allow the recovery of duplicate costs or incentives based on a successful outcome to the DCO application made by the promoter in question.

Key issues for consultation

- 3.26 We welcome the views of respondents on any issues raised in relation to these matters and in particular on:
- the four options we have identified above;
 - our initial views on each option and whether there are additional issues we need to consider;
 - our initial view that we should focus on options (1b) and (3), depending on which of the promoters' proposals are assessed to be credible and appropriately mature; and
 - how we make sure our approach addresses the potential for significant and unnecessary duplication of planning costs to be recovered through airport charges.

APPENDIX A

Glossary

A1 The terms used in this consultation have the meanings set out below.

AOS	Airport operation services, as defined in section 68 CAA12
CAA, “we”, “us”, “our”	The Civil Aviation Authority
CAA12	The Civil Aviation Act 2012
Capex	Capital expenditure
Category A (Cat A)	Our previous policy for expansion costs included Category A costs which were Airports Commission-related and associated lobbying costs incurred by the airport operator. In general, these were costs that were incurred before a Government policy decision on the location of capacity expansion was made (either at Heathrow or Gatwick).
Category B (Cat B)	Our previous policy for expansion costs included Category B costs which were costs directly connected with, and solely for the purposes of, seeking planning consent through the DCO process.
Category C (Cat C)	Our previous policy for expansion costs included Category C costs which were costs to be incurred by an airport operator, typically after planning permission is granted, in connection with implementation and construction of new capacity, up to entry-into-operation.
Consumers	We use this term to cover the “users” of airport operation services as defined in section 69 CAA12 as passengers and those with “a right in property” (cargo) carried by air transport services and includes future users.
CPI	The Consumer Prices Index, a measure of price inflation calculated by the Office for National Statistics
CMA	Competition and Markets Authority
DCO	Development Consent Order granted under the Planning Act 2008

Delivery obligations	Outputs to be delivered agreed as part of forwards looking capex incentives
DfT	Department for Transport
Early Category C costs	Our previous policy for expansion costs included early Category C costs which covered early works which would need to take place before the outcome of the DCO was known and included commercial compensation costs, certain residential compensation costs and the costs of other enabling work such as ground surveys and initial design.
Expansion	Capacity expansion at Heathrow airport including building a third runway
H7	Heathrow Price Control 2022-2026
H8	Heathrow Price Control 2027-2031
HAL	Heathrow Airport Limited, the operator of Heathrow airport
Heathrow West	The capacity expansion plans of the Arora Group before the capacity expansion programme was paused in early 2020
IFS	Independent Fund Surveyor
IPCR	Independent Planning Cost Reviewer
The Licence	The licence granted to HAL under CAA12
MoU	Memorandum of Understanding
NERL	NATS (En Route) plc
Opex	Operating expenditure
RAB	Regulatory Asset Base
Uncertainty mechanism	The process in HAL's licence (Condition C1.12ff) for HAL to apply for (and the CAA to agree to) an increase in the H7 capex envelope

APPENDIX B

Summary of policy on early costs incurred up to March 2020

Introduction

- B1 Previously, our overarching approach was to allow HAL to recover planning and early construction costs, where they were efficiently incurred.
- B2 Our policies on how HAL should be allowed to recover these costs evolved between 2016-2019 as HAL made progress towards submitting its application for a DCO, and new information was presented to us.

Category A costs

- B3 The Airports Commission had been set up in 2012 by Government to advise on the location of new runway capacity in the south east of England. It considered around 50 different options before drawing up a short list of schemes that included two proposals at Heathrow airport and one at Gatwick airport.
- B4 Category A costs were the costs that the promoters of those schemes incurred in Airports Commission-related activities, including lobbying costs and further engagement with the Department for Transport. In general, these were costs that were incurred before the Government's policy decision on the location of capacity expansion was made.
- B5 Paragraph 9 of our March 2015 policy statement on these matters noted the following:

“For Category A, recovery of most costs will not be permitted. We do not consider that lobbying costs to influence Government policy or other stakeholders are part of the costs of constructing new capacity, nor part of the planning process. We consider that these costs should be borne by the relevant proposer (airport operator or HHL⁶). However, we do accept that some Category A costs could be viewed as the costs of seeking planning permission. Our policy for these costs is that we will allow them to be re-categorised as Category B provided that the airport operator makes a strong and clear case that the information submitted for planning is not materially different to that submitted to the Airports Commission”.

⁶ Heathrow Hub Limited, the promoter of an alternative proposal for expanding Heathrow airport

Category B costs

- B6 Category B costs were costs directly connected with, and solely for the purposes of, seeking planning consent through the DCO process for example:
- planning advice and consultants for master planning;
 - environmental and sustainability advisory and consultancy;
 - legal and professional advice;
 - architectural, structural and engineering design;
 - surveys on land, surface access and the environment;
 - public consultations for the NPS and DCP processes; and
 - costs incurred by the Independent Fund surveyor (“IFS”) in relation to planning matters CAA Treatment
- B7 Our previous policy on the recovery of Category B costs was developed between 2014 and 2019. Our final policy had the following features:
- The first £10 million incurred each year was to be recovered from airport charges through an adjustment to the licence formula (that is treated like an operating cost pass through, sometimes described as “fast money”). This policy was in place for 6 years up to 2021.
 - Costs above £10 million each year and up to £265 million in total (in 2014 prices) were capitalised and added to RAB (“slow money”) but only after the outcome of the DCO application process was known. These costs were subject to risk-sharing: if HAL’s DCO was successful (unsuccessful), it would recover 105% (85%) of its efficient costs. The cost sharing mechanism was introduced to incentivise a successful planning application and to share the risk between HAL and consumers of a failed application.
 - We also set a policy around ‘interest during construction’ which costs would earn from the date incurred until the date they are added to RAB. From 2020 there were different rates of return applied depending on whether the DCO was successful or unsuccessful.
 - We said that we reserved the right to decide whether HAL would be able to recover less than 85% of all its Category B costs (including those costs more than £265 million) if there was “clear and compelling evidence” that HAL had unilaterally withdrawn from the planning process. We said that we would not expect to reduce recovery below 85% where HAL could demonstrate that it had used all reasonable endeavours to continue with the capacity expansion.

- An overall recovery cap was set at £500m, costs above £500m were not added to the RAB. The cap was introduced to protect consumers in response to HAL's escalating planning cost forecasts and to incentivise HAL to deliver its planning application in line with its forecasts of Category B costs. We said that if there was a material change in circumstances, we would consider a request for adjusting the recovery cap provided HAL could demonstrate that increasing expenditure was in the interest of consumers, and that it had been discussed with airlines.
- Enhanced reporting requirements were introduced which included quarterly reporting of actual expenditure compared to budget/forecasts, and six-monthly updates of forecasts.
- Planning costs were subject to annual review and scrutiny by an Independent Planning Cost Reviewer ("IPCR"). This included whether there was evidence to support the costs, whether costs had been appropriately categorised as category B costs and whether costs had been efficiently incurred.
- We would carry out a backwards looking review of HAL's planning costs and consult on the level of efficient costs to be added to HAL's RAB.⁷

Early Category C costs

- B8 Category C costs were costs to be incurred by an airport operator, typically after planning permission is granted, in connection with implementation and construction of new capacity, up to entry into operation.
- B9 Early Category C covered early works which would need to take place before the outcome of the DCO was known and included commercial compensation costs, certain residential compensation costs and the costs of other enabling work such as ground surveys and initial design.
- B10 Our policy on early Category C costs was similar to our approach for Category B costs, except that efficiently incurred costs would all be recovered through the RAB (rather than a bespoke addition to annual airport charges), with no risk-sharing, and the level of the any cap on the level of recoverable expenditure had not been determined.

Outcome of previous policy on HAL's early costs

- B11 In practice, the capacity expansion plan was paused in March 2020 for reasons outside of HAL's control. So, we did not apply the risk-sharing mechanism for Category B costs. Instead, the CAA made a determination of the level of efficiently incurred Category B and early Category C costs which HAL should be

⁷ We said that we would consider appointing the IPCR to conduct an overarching review of total Category B costs incurred, following the outcome of the DCO process.

allowed to recover through the RAB. In broad terms, the CAA allowed about £490m of HAL's expansion costs to be recovered, which included 'wind-down' costs to pause and demobilise the programme.⁸

Other promoters' costs

- B12 Before work on capacity expansion was paused in March 2020, Heathrow West (a company set up by the Arora Group) had been proposing to make a planning application to build a new terminal at Heathrow airport. In June 2020, Heathrow West wrote to the CAA requesting that it be allowed to recover the costs that it had incurred in developing that project.
- B13 In our decision dated March 2023, we said that, considering its statutory duties and the specific circumstances of the case, we did not consider that it was appropriate to allow the recovery of those costs.⁹ Paragraph 30 noted that:
- “the expansion programme, and Heathrow West’s proposals for a new terminal, were paused at a relatively early stage and before unambiguous benefits to consumers of the competition to HAL’s proposals it would provide could be clearly evidenced. Indeed, our reviews of Heathrow West’s proposals had only reached the stage of determining that they were worthy of more detailed work”.*
- B14 We made it clear that our decision did not set a precedent for how we might act in the future, nor should it be taken as the CAA expressing a view that the Heathrow West project would not have been credible or that its promoter would not have been capable of delivering it.

⁸ See CAP2365 Appendix E

⁹ See CAP2524H

APPENDIX C

Early costs submissions from HAL and Arora

HAL submissions

- C1 We received information from HAL on 17 July 2025 on the £20 million of costs that it expects to incur up to September 2025. HAL provided a breakdown of the expenditure with commentary to explain the different categories of spend, which we have summarised in Table C1.

Table C1: Breakdown of HAL's costs up to September 2025

Types of costs	Expenditure up to Jul-25 (£m)	Expenditure up to Sept-25 (£m)	Total (£m)	% of total
Consents ¹	4.1	8.3	12.3	63%
Programme	1.9	0.0	1.9	10%
Business case / finance	1.4	0.0	1.4	7%
Airspace	0.6	0.5	1.1	5%
Land and property	0.0	1.0	1.0	5%
Programme coordination	0.5	0.0	0.5	2%
ANPS four tests	0.4	0.0	0.4	2%
Policy	0.4	0.0	0.4	2%
Aviation	0.2	0.0	0.2	1%
Surface access	0.2	0.0	0.2	1%
Property	0.1	0.0	0.1	1%
Total	9.8	9.7	19.5	100%

Source: CAA analysis of Heathrow submission on Early Costs for Expanding Heathrow, 17 July 2025

Notes: ¹ Includes cost associated with consents for various activities including environmental and planning support, land referencing and acquisition strategy, town planning, Masterplanning, design & engineering, delivery planning.

- C2 On 31 July 2025 we received further information from HAL requesting an increase of £320 million (2024 prices) to the H7 capital cap in Condition C of HAL's licence, for expansion related costs. This included the £20 million of costs up to September 2025.

C3 HAL said that its H7 capital plan was forecast to cover the full H7 allowance of £4.7 billion in its licence and so the uplift in the cap is required for HAL to be able to make the necessary investments in gaining planning permission during H7.

C4 HAL provides a breakdown of the £320 million cost, which we show in Table C2.

Table C2: Breakdown of HAL's cost estimates for 2025 and 2026

Types of costs	Expenditure in 2025 (£m, 2024 prices)	Expenditure in 2026 (£m, 2024 prices)	Total in H7 (£m, 2024 prices)
Programme Management	8	36	44
Development Consent Order	44	92	136
Premobilisation phase	10	0	10
Property	4	80	84
Deliver the capacity	5	41	46
Total	71	249	320

Source: CAA analysis of Heathrow application to increase the H7 capex allowance, 31 July 2025

Arora Group submissions

C5 We received information from the Arora Group on 30 July 2025 on its early costs. Arora said that it had spent around £2.5 million from the Government announcement on expansion at the end of January 2205 to submission of its proposal to Government on 31 July 2025. It estimated that it expected to incur costs of around £1 to £1.5 million to 31 December 2025.

APPENDIX D

Our duties

- D1 The CAA is an independent economic regulator. Our duties in relation to the economic regulation of airport operation services (“AOS”), including capacity expansion, are set out in the CAA12.
- D2 CAA12 gives the CAA a general (“primary”) duty, to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of AOS.
- D3 CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of “consumers”.
- D4 The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.
- D5 In discharging this primary duty, the CAA must also have regard to a range of other matters specified in the CAA12. These include:
- the need to secure that each licensee is able to finance its licensed activities;
 - the need to secure that all reasonable demands for AOS are met;
 - the need to promote economy and efficiency on the part of licensees in the provision of AOS;
 - the need to secure that the licensee is able to take reasonable measures to reduce, control and/or mitigate adverse environmental effects;
 - any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
 - the principles of transparency, accountability, proportionality and consistency and that regulatory activities should be targeted only at cases where action is needed.
- D6 In relation to the capacity expansion at Heathrow, these duties relate to the CAA’s functions concerning the activities of HAL as the operator at Heathrow.
- D7 CAA12 also sets out the circumstances in which we can regulate airport operators through an economic licence. In particular, airport operators must be subject to economic regulation where they fulfil the Market Power Test as set out in CAA12. Airport operators that do not fulfil the Test are not subject to economic

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

- D8 We are only required to update these determinations if we are requested to do so and there has been a material change in circumstances since the most recent determination. We may also undertake a market power determination whenever we consider it appropriate to do so.