Heathrow capacity expansion – update on the approach to the regulatory framework

CAP 3286

Published by the Civil Aviation Authority 2026

Civil Aviation Authority
Aviation House
Beehive Ring Road
Crawley
West Sussex
RH6 0YR

First published July 2026

Enquiries regarding the content of this publication should be addressed to: economicregulation@caa.co.uk

The latest version of this document is available in electronic format at: www.caa.co.uk/CAP3286

Contents

CHAPTER 1

Introduction

1.1 In January 2025, the Government announced its support for the development of a third runway and capacity expansion at Heathrow Airport (collectively, "expansion"). It said expansion would provide significant benefits to consumers (through lower fares and greater connectivity) and to economic growth. The Government reviewed proposals for expansion that emerged in response to its January 2025 announcement and, in November 2025, announced that the Northwest Runway scheme proposed by Heathrow Airport Limited ("HAL") would be used to inform the Government's review of the Airports National Policy Statement. In June 2026 the Government published for consultation its draft revision to the Airports National Policy Statement (now known as the Heathrow Expansion National Policy Statement, or "HENPS").[1]

1.2 In April 2026, we published an initial assessment of both HAL's proposals and those of a potential alternative provider, Heathrow West Limited ("HWL"). That assessment showed the very significant costs of expansion.[2] While the scope and scale of the scheme will be determined by the HENPS and planning process, it will be important that the regulatory framework is designed to incentivise the efficient delivery of expansion and ensure that consumers are protected from the consequences of expansion leading to excessive costs in the short and longer term.

1.3 In May 2026 we published a consultation on a shortlist of regulatory models for expansion (the "Shortlist Consultation"). We concluded that there is a case for changing the current regulatory framework and shortlisted the following regulatory models to take forward for more detailed development:

- a package of enhanced capital governance, incentives for capital efficiency and oversight of HAL's procurement processes (regulatory models 1a, 2 and 4a);
- a longer-term framework for the cost of capital (regulatory model 3);

1 National Policy Statements are statements of planning policy in relation to nationally significant infrastructure produced by the Government.

2 Our advisors, Steer, estimated a scheme cost range of £33 to £52 billion for HAL's proposal and £27 to £43 billion for HWL's proposal, in 2024 CPI prices. This excludes the costs of other works to expand capacity at the airport, such as replacement of existing terminals (Steer, Initial technical and cost efficiency assessment of capex expansion plans for Heathrow Airport, April 2026)

- mandating competitive tendering by HAL for the design and build (and potentially operation) of assets (regulatory models 4b and 5b); and
- direct competition between HAL and an alternative developer, for instance in the circumstances where an alternative developer was to be awarded a Development Consent Order ("DCO") to develop a new terminal and/or other infrastructure at Heathrow Airport (regulatory model 7b).

1.4 The Shortlist Consultation said that we would publish this high-level update on our recommendations on the strategy and approach to regulatory models for expansion in July 2026. In this document we set out our current thinking and updated views on the regulatory framework for expansion and the next steps to implement the framework. In developing this current thinking, we have considered the responses to the Shortlist Consultation as well as the draft HENPS published by Government. We plan to publish a more detailed document that expands on this high-level summary in September 2026, after fuller consideration of both stakeholders' responses and the HENPS.

1.5 Having received responses from stakeholders on the Shortlist Consultation, and set out our updated views on the shortlist of models, we now invite views from stakeholders on the next steps in implementing the regulatory framework set out in chapter 5 by 5pm on 13th August. We want to understand views on our proposed work areas and whether there are additional pieces of analysis we should be undertaking. This will be used to inform a more detailed work plan, on which we will provide an update in the document we intend to publish in September 2026. The work plan will include development of the parts of the regulatory framework we intend to take forward and implement (which includes regulatory models 1, 2, 3, 4a, 4b and 5b) as well as parts of the framework that may be required (regulatory model 7b), which we will progress so we are prepared in the event, for example, that a third party successfully obtains planning consent through the DCO process.

1.6 Alongside our work on regulatory models, we are continuing to develop our policy on the recovery of the early costs of expansion that are incurred before the Government makes any decision on whether to grant a DCO for expansion. We intend to set out our final decision on the recovery of HAL's early costs incurred in 2025 and 2026 and those of HWL until November 2025 later in July 2026, and to publish a consultation in October 2026 on the recovery of early costs from 2027 to DCO decision. These will include an update on our views of the overall costs and benefits of expansion for consumers.

1.7 We also plan to publish the final proposals for the next Heathrow price control (covering the period of "H8", namely 2027 to 2031) in November 2026 and we will discuss overlapping issues in our final proposals for H8 and as part of our work to implement the regulatory framework for expansion.

1.8 This document has been developed in the light of the CAA's duties under the Civil Aviation Act 2012 ("CAA12"). A summary of our duties is set out in Annex B.

1.9 The remainder of document has the following structure.

- Chapter 2: the case for change, which considers the case for further developing the existing regulatory framework for Heathrow to meet the challenges of expansion.
- Chapter 3: the evaluation framework, which discusses the criteria we have used in shortlisting and selecting regulatory models for further development.
- Chapter 4: regulatory models, which summarises our current thinking on the regulatory models discussed in the Shortlist Consultation.
- Chapter 5: next steps, which discusses our next steps in respect of the development and implementation of the new regulatory framework for Heathrow Airport and seeks views from stakeholders on these matters by 5pm on 13th August 2026.
- Annex A: provides a list of abbreviations.
- Annex B: provides a summary of the CAA's statutory duties.

1.10 We have also published with this document, reports by our advisors Centrus[3] and Steer[4], including their responses to stakeholders' views and updates on their assessment of the regulatory models. These are updates to the financial assessment report by Centrus and the technical assessment report by Steer that we published in May 2026 with the Shortlist Consultation.

1.11 Responses to this consultation on next steps in chapter 5 should be sent by 5pm on 13 August 2026 to economicregulation@caa.co.uk. 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.

[3] Centrus, Centrus response to CAP3251 Consultation Responses, July 2026

[4] Steer, Update on technical assessment of the CAA regulatory models for Heathrow expansion, July 2026

CHAPTER 2

Case for change

Introduction and stakeholder views

2.1 In our Shortlist Consultation, we said that there remains a strong case to revisit the current regulatory framework to determine whether it can be improved and whether an alternative approach would be expected to better serve the interests of consumers. This was based on our updated findings that:

- after adjusting for factors outside of HAL's direct control and other factors that make the underlying level of airport charges more comparable, HAL's aeronautical charges per passenger are high relative to the average adjusted charges for comparator airports and this difference is likely to grow in the future due to the relatively high costs of expansion;
- while there have been recent improvements in HAL's quality of service it remains below its pre-pandemic level and appears to lag certain other airports; and
- although we have not concluded that specific capital projects have been inefficient, capital expenditure has been a primary driver of HAL's high charges, which may suggest a degree of inefficiency.

2.2 HAL said in its response that we had overstated the case for change. It restated its views and provided evidence on its strong recent service quality performance (in the context of strong traffic recovery and high capital utilisation), the external factors that explain its relatively high charges and its capital efficiency. Nevertheless, HAL agrees that there is a case for changing the current regulatory framework given the context of expansion.

2.3 Heathrow Reimagined and airlines broadly supported our conclusions on the case for change, although some stakeholders said that we had understated the case and relied too heavily on what they described as a structurally biased analysis of airport charges. Several stakeholders also restated that the case for changing the regulatory framework applies to the whole airport, not just expansion.

Our updated views

2.4 We remain of the view that there is a strong case for changing the current regulatory framework for expansion, not least because the existing framework has been designed in the context of the business-as-usual operation of a two-runway airport. We do not currently consider that the additional submissions from stakeholders include compelling new evidence or arguments that means we should take a different view or do further work on the case for change, although we will take account of new information as we develop further the regulatory framework for Heathrow Airport.

2.5 Consistent with the approach set out in the Shortlist Consultation, we now intend to focus on developing and implementing the shortlisted regulatory models as part of the regulatory framework for expansion. We will also consider which parts of the new framework should be applied in due course to the business-as-usual price control arrangements.

CHAPTER 3

Evaluation Framework

Introduction and stakeholder views

3.1 In the Shortlist Consultation we set out six criteria based on our statutory duties that we would use to evaluate each regulatory model, namely that models should:

- avoid delay and disruption;
- promote efficient costs;
- allow raising sufficient finance;
- be practical to implement;
- promote competition; and
- promote service quality.

3.2 HAL broadly accepted our approach. It emphasised that any new regulatory framework must not damage its existing financing or the future financing of expansion.

3.3 Some airlines raised concerns that:

- affordability of expansion for airport users and consumers should be an explicit criterion in the evaluation framework; and
- we had over-weighted implementation considerations, which can be overcome, and we should instead prioritise outcomes that reflect our statutory duties to consumers and not readily dismiss more complex models.

3.4 The New Economics Foundation said the two main tests for the regulatory models should be whether they ensure:

- the scheme only proceeds if it is cost-effective and commercially viable; and
- risks and benefits are allocated fairly, between investors and consumers and between users and non-users of the new infrastructure. It further notes that we have not addressed what would happen if demand for new capacity is much lower than forecast.

Our views

3.5 As we explained in the Shortlist Consultation, it is in the interests of consumers that a scheme is "affordable" to airlines such that it is consistent with the increase in passenger demand, connectivity, frequency and route choice required to fill the significant new expansion capacity. We are considering these matters further as part of our work on the early costs of expansion and this work should encompass the broad issues raised by airlines and the New Economic Foundation on affordability. The regulatory framework should then provide effective incentives for costs to be incurred efficiently, which is part of our evaluation framework.

3.6 The risks and issues around implementation of the regulatory framework remain an important practical consideration. This includes those issues raised around allocation of risks and benefits and the treatment of demand risks. We will take account of ways in which these risks can be mitigated and addressed in a proportionate way, alongside considering the longer-term benefits that changes to the regulatory framework are expected to bring.

3.7 Bearing the above in mind, we intend to retain the evaluation framework set out in the Shortlist Consultation. Our intention is that our forward work programme will move on from assessing individual models to ensuring that the models are integrated together into an effective overall framework for the regulation of Heathrow Airport.

CHAPTER 4

Regulatory framework

Introduction

4.1 In this chapter we summarise our current thinking on the regulatory models discussed in the Shortlist Consultation. We have a particular focus on the models that were shortlisted and where there is most disagreement from stakeholders on the most appropriate way forward.

4.2 We then summarise, at a high level, our reasons for taking forward particular models as part of the overall regulatory framework for expansion at Heathrow. We explain how these models should work together to form a coherent framework that will further the interests of consumers, where appropriate by promoting competition in the provision of airport operator services.

4.3 In May 2026, in support of our work on regulatory models, we published reports from our advisors, Centrus and Steer. The Centrus report was a financial assessment, while Steer's report was a technical assessment of the regulatory models. We have published updated reports from Centrus[5] and Steer[6], including their responses to stakeholders' views and updates on their assessment of the regulatory models.

4.4 We will set out further detail on stakeholders' views and our responses to them in the document we intend to publish in September 2026.

Stakeholders' views on the shortlisted models

4.5 Stakeholders generally agreed that:

- there is a need for stronger capital governance frameworks, incentives and procurement oversight (models 1a, 2 and 4a);
- some form of competitive procurement may be appropriate (models 4b and 5b); and
- a number of other models should not be taken forward for more detailed consideration, including models 1b, 5a, 6, 7a and 9.

4.6 Given the broad stakeholder agreement with our proposals, we currently intend to take forward models 1a, 2, 4a, 4b and 5b for further development and implementation as part of the overall regulatory framework. There are different

5 Centrus, Centrus response to CAP3251 Consultation Responses, July 2026

6 Steer, Update on technical assessment of the CAA regulatory models for Heathrow expansion, July 2026

views from stakeholders on how these models should be implemented, which we discuss below and will consider further as part of our work on implementation.

4.7 There were significant disagreements with our broad proposals in relation to three models:

- a number of airlines said we should not take forward the longer-term framework for the cost of capital (regulatory model 3);
- HAL and certain other stakeholders said we should not take forward direct competition between HAL and an alternative developer (regulatory model 7b); and
- a number of airlines said we should take forward the transfer of existing assets from HAL to an alternative provider (regulatory model 8).

4.8 We provide below our current views on these three areas of disagreement and we will provide more detailed responses in the document we intend to publish in September 2026.

Our views on the areas of disagreement between stakeholders

Long term frameworks (regulatory model 3)

4.9 Our shortlist included two preferred options for a longer-term framework for expansion:

- 3.1b: a long-term cost of capital determination for expansion applied to a separate “expansion RAB”, with redeterminations of the business-as-usual cost of capital every five years; and
- 3.3: a “cap and collar” mechanism on returns.

4.10 We discussed consideration of other options for this model in the Shortlist Consultation. This included “option 3.2”, the formal lengthening of the price control period, although we considered this would also involve amending the current approach of setting five-year price control determinations for business-as-usual activities, which credit rating agencies may view cautiously. We did not receive any new evidence from stakeholders supporting option 3.2 and we do not propose to consider this option further.

4.11 Further options we discussed included:

- “option 3.1a”, setting a long-term combined cost of capital for business-as-usual and expansion activities; and

- “option 3.1c”, setting a long-term “cost of capital premium” that would be fixed over a longer period than the five-year cost of capital resets covering expansion and business-as-usual activities, such as over the construction period.

While our Shortlist Consultation did not focus on these options, we also do not propose to rule out these options at this stage and intend to do further work to develop the model options and assess their relative benefits to consumers.

4.12 For option 3.1a, we identified potential issues with setting a longer-term cost of capital for business-as-usual capex, although we could consider whether there are mechanisms that could significantly mitigate these risks, such as indexation. For option 3.1c, we are considering further the merits of adopting a single RAB for business-as-usual and expansion capex and whether this option could provide greater financing certainty during the construction phase to benefit consumers.

4.13 Airlines were concerned that the long-term framework model did not address the flaws in the current framework and raised a number of concerns that:

- a long term framework would reallocate risk from HAL to consumers;
- there is a risk of asymmetrically locking in higher returns;
- the CAA’s regulatory discretion to intervene would be reduced; and
- a separate expansion RAB could create gaming incentives to allocate capex to expansion to take advantage of higher allowed returns.

4.14 HAL, the Heathrow Passenger Forum and other stakeholders supported having a long-term cost of capital for expansion and five-year business-as-usual cost of capital, but with a single RAB. HAL highlighted concerns with an “expansion only RAB”, specifically around the corporate, legal and structural implications of implementing this approach. HAL is in favour of fixing the cost of equity over a 10-to-15-year construction period at a higher level to reflect greenfield/construction risk, while retaining periodic, market-based resets for the cost of debt, supported by clear reopener mechanisms. HAL did not support a cap and collar approach, noting it is unlikely to improve on a well-designed regulatory incentive and cost of capital framework, while introducing significant complexity and uncertainty in design.

4.15 We remain of the view that a longer-term framework could provide benefits to consumers through enabling expansion to be financed at a lower overall cost. By providing certainty that the framework will not be inappropriately amended once capital is committed, investors may require less compensation for bearing risk over the expansion construction period. Nonetheless, airlines have raised reasonable concerns over the risks that a longer-term framework could provide HAL with opportunities to benefit in a way that inappropriately allocates risks to consumers, while reducing regulatory oversight and our ability to intervene (if needed) to ensure adequate protections for consumers. Bearing the above in mind, any approach to a longer-term framework will require careful design and calibration to mitigate such risks. This work would need to be in parallel with the development of mechanisms to identify efficient costs, to provide reasonable protections for consumers against cost escalation.

4.16 We propose to continue development of options for the longer-term framework, including:

- the setting of a longer-term cost of capital premium or longer-term cost of capital;
- addressing whether there should be a separate expansion RAB, taking account of the concerns raised around ensuring a robust approach to cost allocation; and
- whether there should be a cap and collar and/or other re-opener mechanisms and protections in the event of significant deviation from forecasts.

4.17 We will undertake further analysis of stakeholder's views and provide an update on our work plan and steps to decide on the final form of the longer-term framework in the document we intend to publish in September 2026.

Direct competition (regulatory model 7b)

4.18 Under this model, a third party would need to receive planning consent to provide all or part of the Heathrow expansion and associated infrastructure, such as a new terminal building. The third party would then provide services to airport users and recover its required revenues from them directly, in competition with HAL. To facilitate this model, it may be necessary to require HAL to develop a wholesale product (which we expect would be subject to price control arrangements) for other aspects of airport operations which could not be provided by the third party. Any regulation of the third party would be subject to market power and airport operator assessments.

4.19 A number of stakeholders did not support model 7b and said that it is unlikely to deliver effective competition between airport operators and could lead to significant disruption to Heathrow expansion and airport operations. HAL raised concerns that this model would result in a duopoly within the airport that would not result in consumer benefits. Stakeholders also pointed to difficulties in implementing the model, concerns around whole-system financeability and increased risk to consumers. Delta Air Lines indicated that its experience of JFK airport suggests that models where multiple entities operate assets within an airfield may not be effective in generating competition.

4.20 Other airline stakeholders (including IAG and Heathrow Reimagined) considered that model 7b is essential to address the issues raised in the case for change. They stated that many of the concerns raised about disruption and fragmentation can be overcome. They also said that international evidence supports the compatibility of competition with strong operational performance, including at Heathrow Airport, which already operates as a multi-operator ecosystem. They also indicated that any additional costs from coordination would be offset by improvements in capital efficiency from competition.

4.21 Heathrow Reimagined also stated that there would not need to be a large degree of spare capacity to get the benefits of competition given the long tail of airlines operating limited services to Heathrow. IAG proposed that the CAA introduce a single cross-campus Maximum Allowable Yield to ensure that the costs of expansion are recovered fairly across the airport's entire customer base, not just those using new facilities.

4.22 Our interpretation of the Government's now published draft HENPS is that it allows a third party to bring forward an application for a DCO for the full scheme. How and whether such proposals would comply with the requirements of the draft HENPS would be a matter for the third party and for the planning regime to consider.

4.23 In order to appropriately protect consumers, the regulatory framework for expansion needs to be sufficiently flexible to accommodate a full range of plausible outcomes from the planning process, including the possibility of a third party submitting an application for and being granted a DCO. Therefore, we remain of the view that model 7b should be developed in a way such that it could be applied to any new infrastructure that forms part of any DCO that is granted to a third party.

Transfer of ownership and operation of an existing asset (regulatory model 8)

4.24 Under this model, HAL would be required to transfer ownership and operation of an existing asset to a third party. Since the asset would already be built and owned by HAL, the scope of the third party's activities would not be construction but rather any redevelopment, operation and maintenance of the asset.

4.25 IAG, Heathrow Reimagined and other airline stakeholders said that model 8 should be retained on the shortlist as it allows for the greatest use of competition within the airport to drive significant consumer benefits. They say that the CAA should seek the powers to implement this model, either through a referral to the CMA under the Enterprise Act 2002 or through primary legislation. They also argued that this model could be implemented in a manner that avoids undue distraction to capacity expansion or material operational or financeability issues.

4.26 In the Shortlist Consultation we said that, on the basis of the information that was available, we did not support doing further work on this model (including seeking legislative changes to enable the CAA to implement it). Nonetheless, we note that a market investigation reference under the Enterprise Act 2002 could result in remedies which included such a model. Having considered airline's further views on these matters we are not convinced, on the basis of the information provided and available to date, that we should change our assessment. It is not clear that this model offers material advantages over the other models we have shortlisted. We also consider that the outcome of any process under the Enterprise Act 2002 is a matter that the CAA does not control, the procedures are lengthy and resource intensive and the outcome would not be certain.

4.27 That said, we are open to considering this model further in future if there is a material change in circumstances or substantial new evidence, including, for example, if HAL was to seek to divest itself of an asset.

4.28 We note that Heathrow Reimagined and IAG also suggest that the CAA has the powers under the Civil Aviation Act 2012 to force contractual separation, which could leave HAL as a freeholder and independent third parties (without the need to acquire a DCO) could for instance operate and redevelop an existing terminal. We will consider these representations further but note that the redevelopment of a terminal may require planning consent. More broadly we are not clear there would be significant advantages in such arrangements, bearing in mind the flexibilities that would already be provided by models 5b and 7b.

New regulatory framework

The new regulatory framework for expansion

4.29 We have explained above that there is a degree of stakeholder consensus around:

- there being a need for stronger capital governance frameworks, incentives and procurement oversight (models 1a, 2 and 4a); and
- some form of competitive procurement being appropriate (models 4b and 5b).

4.30 The Shortlist Consultation set out our evaluation of these models and explained that they should further the interests of consumers, where appropriate, by promoting competition in the provision of airport operator services. The updated assessments by our advisors, Centrus and Steer, also continue to support development of these models as part of the overall framework as providing potential benefits for consumers. Bearing all of the above in mind, we intend to pursue the development of these models.

4.31 Our present view is that these models would be usefully supplemented by further exploration of whether a longer-term framework for the cost of capital could be added to the regulatory arrangements for HAL. This would have the potential to mitigate any undue increases in the financing costs of expansion and support a lower level of airport charges than would otherwise be the case, and so further the interests of consumers.

4.32 We are also of the view that arrangements for direct competition (regulatory model 7b) should be developed so that it can be applied in the event that a third party is granted a DCO for all or part of the infrastructure required for expansion under the draft HENPS.

4.33 Our initial view is that all these models are complementary and can be developed together to help form an overall regulatory framework for Heathrow Airport that would further the interests of consumers, where appropriate by promoting competition in the provision of airport operation services. In particular, new arrangements for capital governance and incentives should sharpen the efficient delivery of enhancement capital spending efficiency, while greater focus on procurement should ensure competitive forces are relied upon to help drive further efficiencies. The longer-term framework for returns would then support the efficient financing of this capital expenditure and the arrangements for direct competition would ensure the regulatory framework could encompass an appropriate range of outcomes arising from the planning process.

4.34 Therefore, our current thinking is that we should implement a new regulatory framework for Heathrow that combines models 1a, 2, 3, 4a, 4b and 5b into a coherent whole that furthers the interests of consumers. Model 7b could also be applied in the event that, for example, a third party is successful in securing DCO approval.

Developing this new regulatory framework

4.35 We consider the new approach to capital governance and incentives should initially focus on expansion activities, but over time should be developed to cover both expansion and business-as-usual capex. It will be appropriate to take an incremental approach to implementing new governance structures, and our initial priority will be to ensure that effective governance is in place for major elements of the expansion programme. A central part of this will be a new capital committee, with input from, but also an appropriate degree of independence from, HAL. Such a committee would oversee the governance of capital planning and investment decisions, and its work would be informed by independent technical advice. This approach would need to be suitably tailored to expansion and the lessons from other major capital projects.

4.36 The new capital governance framework would need to include independent scrutiny of costs and clear escalation routes where issues could not be reasonably resolved. However, we continue to consider that the committee should not have veto powers over HAL’s expenditure decisions, as HAL should continue to have a clear responsibility to deliver the investment needed to maintain the safe and secure operation of the airport. We would want a clear process where serious concerns can be escalated in a timely way to the CAA and ultimately we would decide whether capex should be eligible for inclusion in HAL's RAB (which is used to set its price control). In making our decisions, we would take account of the advice from the committee, any independent assurance and stakeholder representation in reaching our decisions. We will work with stakeholders to develop the detail of this approach as well as the incentive arrangements, which could include an overall cap or other incentives designed to encourage cost efficiency and reasonableness.

4.37 This committee would also scrutinise HAL's procurement activities, which we consider should form a key input into our views on where competitive procurement approaches should be applied. We would expect HAL to:

- take due account of the views of the committee and independent technical experts in setting out its procurement plans; and
- have a clear rationale where it decided not to follow their views.

4.38 We would set up the committee to act in a way that furthers the overall interests of consumers at the airport by providing scrutiny to make sure capital investment is appropriate and efficient, without unduly delaying necessary investment.

4.39 In terms of the longer-term framework for returns we will continue to explore:

- whether this should be through HAL's existing RAB or a development of these arrangements;
- the approach to setting a longer term cost of capital; and
- the additional protections required for the interests of consumers.

4.40 HAL has said that mandating competitive procurement should only be used for separable, lower-risk packages of work and not applied broadly to core operational assets. Our current view is that competitive procurement should be considered to apply to a broader range of infrastructure assets owned by HAL, with the operational issues mitigated through effective contract management. We will need to consider the appropriate allocation of revenue risks as part of the development of these models. We will seek further expert advice and engage with HAL and stakeholders on these matters as we develop them further.

4.41 We will continue to develop model 7b to ensure that, if a third party is successful in securing a DCO for expansion, this can be integrated into the regulatory framework. This work is needed to ensure that we can further the interests of consumers and adapt and accommodate the issues that will likely arise if these circumstances materialise.

4.42 As we further refine the new regulatory framework, we will continue to assess the framework against our evaluation criteria and our duties under CAA12 generally, to make sure the framework furthers the interests of consumers, where appropriate, by promoting effective competition in the provision of airport operator services. This will include providing effective incentives for cost efficiency and service quality and developing arrangements in a timely way. We discuss next steps in the next chapter and will set out further detail on our approach in the document we intend to publish in September 2026.

CHAPTER 5

Next Steps

Introduction

5.1 In this chapter we set out our current views on the priority work areas we would need to address to implement changes to the regulatory framework in a timely way. We have not set out a timetable for these work areas in this document, as they require detailed planning work that we are carrying out during the summer of 2026 and some work areas will require detailed plans from HAL and any third party providers. We recognise there will be considerable work required to implement the models and we will consult further with stakeholders on how we should implement the changes to the regulatory framework. This work will also be coordinated with our work on early costs, the H8 price control review and any developments in Government policy or the planning process.

5.2 We invite views from stakeholders on the issues raised in this chapter by 5pm on 13th August. We want to understand views on our proposed next steps and whether there are additional pieces of analysis we should be undertaking. We also request that HAL and any third party providers provide a timetable, either with their responses or earlier where possible, that sets out when detailed information will be available to the CAA on their infrastructure, cost and funding plans, which we will use to develop the regulatory models. The responses and timetables will be used to inform a more detailed work plan, which we will provide an update on in the document we intend to publish in September 2026.

Enhanced capital governance and incentives

5.3 We will work on the design and implementation of changes to capital governance and incentives over the remainder of 2026, although full implementation will likely require a phased approach over several years, to include both expansion and, in due course, business-as-usual capex. We will engage with stakeholders throughout this process.

5.4 The current approach to capital governance and any changes set out as part of the H8 price control review should continue to operate during this process, to avoid undue delays in important capital investment by HAL.

5.5 The next steps we plan to take are summarised below.

- Establish whether there are elements of the expansion programme which could be used to help develop and test new governance arrangements.

- Work with HAL and airlines on the approach to the independent assurance of expansion costs, including early costs, to best support the governance of overall expansion and business-as-usual capex.
- Consider incremental changes to the current approach to capital governance and incentives for business-as-usual capex as part of the H8 price control review. We will consider further phased changes to the business-as-usual arrangements during the H8 period to ensure a coherent framework with changes to the governance of expansion capex.
- Commission an expert review to advise us on the practical design of the capital governance for expansion and major capital projects. We will consult HAL and airlines on the scope of the review. This will likely include:
    - undertaking a review of how capital governance at Heathrow currently works in practice, identifying opportunities for enhancement to business-as-usual capex and learning points for expansion;
    - establishing the best practice approach taken by other major projects, including reviewing the evidence submitted by stakeholders, and how to tailor these lessons for capex at Heathrow, taking account of the characteristics of expansion and the learning from the operation of the existing governance arrangements;
    - developing the terms of reference and guidelines for a new capital committee and supporting governance, taking account of the existing programme and working groups; and
    - developing other governance documents as appropriate, such as guidance, template documents and minimum information standards.
- Develop our approach to setting strong, tailored incentives on capital efficiency and to protect consumers from cost escalation. We will publish a plan for this work in our September 2026 document, which could include:
    - requesting further information from HAL on its capex plans and types of costs;
    - commissioning our technical advisors to review how HAL’s costs could be categorised in order to best support a tailored approach to capital incentives;
    - developing and modelling options for how capital incentives could be adapted and tailored, and consulting on these options; and
    - developing possible approaches to setting an overall cap for expansion costs and how this could be credibly enforced, for consultation.

Long term framework

5.6 The next steps to develop the longer-term framework include:

- further consideration of setting a separate expansion RAB and analysis of the implementation issues, including the concerns raised by HAL over the legal and financial implications and the issues raised by Heathrow Reimagined on cost allocation;
- considering different methods for estimating the cost of capital for expansion, including how we would ensure that we retain appropriate consumer protections, drawing on analysis that the CAA carried out prior to covid-19 and further information on the types of costs and risks from the current Heathrow expansion proposals;
- identifying options for setting caps and collars on overall returns where this approach can be implemented in a way that is credible and workable in practice;
- considering the use of re-openers and indexation mechanisms to ensure appropriate risk allocation and benefits to consumers; and
- identifying and analysing precedents for risk sharing for other major UK infrastructure projects in energy, water, rail and telecoms, to shape future implementation policy proposals.

5.7 We recognise HAL is seeking this clarity as soon as practicable on key aspects of the regulatory framework, including any longer-term elements. We will seek to make progress on these arrangements in a timely way and provide such clarity as we reasonably can, but this is likely to be a relatively challenging area to develop policy. In particular, it will be important to address the legitimate concerns that stakeholders have expressed that there need to be clear benefits from these arrangements for consumers, rather than an undue focus on simply protecting HAL from risks.

Mandating competitive tendering

5.8 The next steps for implementation of competitive procurement models will likely include the following steps:

- defining information requirements for HAL to demonstrate in its procurement plans;
- developing our approach to assessing HAL’s plans and how this draws on the views of the capital committee and independent assurance. We consider this will require a framework for selecting assets that are appropriate for competitive procurement. We note HAL has provided initial views in its response on which assets might be suitable for competitive procurement;

- considering the approach to enforcing competitive approaches where we assess this would be in the interests of consumers; and
- developing the appropriate design of the competitive approaches, which will look to draw on best practice from competitive models and regulatory precedent.

5.9 We expect to commission external advice on these issues and will provide further details of our work plans in the consultation we intend to publish in September 2026.

Direct competition

5.10 As noted above, direct competition at Heathrow airport for the provision of airport operator services may come about if a third party is successful in securing planning permission to deliver part or all of the expansion programme. We expect to progress work before and during any relevant DCO process in order to ensure that the regulatory framework is sufficiently flexible to accommodate these possible outcomes and would further the interests of consumers in these circumstances.

5.11 Bearing the above in mind we are intending to take the following steps:

- a more detailed assessment of the potential for competition and fragmentation issues that could arise. HAL and other stakeholders have very different views on the materiality of these issues. Our consultants Steer have also expressed concerns about potential fragmentation issues. We plan to commission external advice to review these issues and look at international precedents where there are multiple operators in further detail, including to understand how any operational issues at Heathrow Airport could be mitigated;
- developing a broad view on the approach to the regulation of any wholesale services that HAL may be required to provide to support these arrangements and outcomes;
- further work to understand the potential benefits and risks of direct competition; and
- reviewing of the steps that would be required to introduce any form of regulation for a third party, including market power and operator assessments. This would not pre-judge the outcome of any such assessment and whether any form of regulation might be needed.

ANNEX A
Abbreviations

CAA	Civil Aviation Authority
CAA12	Civil Aviation Act 2012
capex	capital expenditure
CMA	Competition and Markets Authority
DCO	Development Consent Order
GAL	Gatwick Airport Limited
H8	Heathrow price control for 2027 to 2031
HAL	Heathrow Airport Limited
HENPS	Heathrow Expansion National Policy Statement
HWL	Heathrow West Limited
IAG	International Airlines Group
RAB	Regulatory Asset Base

ANNEX B

Our duties

1. 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.

2. 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.

3. 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".

4. The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.

5. 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.

6. 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.

7. 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.

8. 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.