

Draft proposals: Heathrow West's request for cost recovery

CAP2387

A large, abstract blue graphic occupies the bottom two-thirds of the page. It features a gradient from light blue to dark blue, with a curved, wave-like shape on the right side that tapers towards the bottom right corner.

Published by the Civil Aviation Authority, 2022

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First published 2022

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Introduction

1. In response to our June 2020 document “Economic regulation of Heathrow: policy update and consultation”,¹ Heathrow West wrote to us requesting² that it be allowed to recover the costs that it had incurred in developing an application for planning consent for its proposal to deliver a terminal as part of the expansion of Heathrow Airport in response to the Airports National Policy Statement (“NPS”) under the Planning Act 2008. Heathrow West considered that the CAA should adopt this approach because it was the only approach compliant with:
 - a. “fairness principles”, since the CAA was consulting on allowing Heathrow Airport Limited (“HAL”) to recover the costs of developing its development consent order (“DCO”);
 - b. the CAA’s duties and powers; and
 - c. Government policy.
2. We consulted stakeholders on Heathrow West’s request in our April 2021 document Consultation on the Way Forward for HAL’s “H7” price control.³
3. Several of the responses to that consultation addressed these issues. We have now considered these responses and made a draft decision. This document sets out a summary of stakeholders’ responses, our views on them, and explains our draft decision on these matters.

Stakeholders’ views

4. We had responses to our consultation from Heathrow West, HAL and airlines. Heathrow West reiterated the views it set out in its original request.
5. Despite remaining supportive of a competitive bid to develop new terminal capacity as part of expansion, airlines considered that it was not appropriate for the costs incurred by Heathrow West to be recovered through HAL’s RAB. Airlines considered that:
 - a. there is currently little prospect of capacity expansion at Heathrow;
 - b. Heathrow West’s proposals were speculative; and
 - c. it is not in the interests of consumers that the costs of Heathrow West’s activities are passed on to them.
6. An airline welcomed the prospect of future terminal competition, suggesting that it would increase efficiencies in capital projects, and it encouraged the CAA to consider further how to capture benefits of competition in future, but it did not support the recovery of Heathrow West’s costs. The AOC/LACC considered that it would be appropriate for Heathrow West to seek to recover its costs from the Government, given that capacity expansion was a Government policy.
7. HAL set out its view that Heathrow West’s request for cost recovery is not meritorious. It also said that the CAA does not have the power to grant Heathrow West’s request within the scope

¹ Available online: <https://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=9669>

² Available online: <https://www.caa.co.uk/media/q2vfyvoh/cap1940-heathrow-west.pdf>

³ Available online: <https://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=10401>

of its current powers under the Civil Aviation Act 2012 and stated that recovery would not be in the consumer interests. HAL addressed the issue of fairness by contending that, while it had invested significant resources in the Airports Commission process, Heathrow West was attempting to “free ride” on HAL’s efforts. HAL also reiterated its view that inter terminal competition was unlikely to be in the interests of consumers. Taking a similar stance to airlines, HAL said that Heathrow West entered the expansion process at its own risk, and without a cost recovery policy in place. HAL noted that if the CAA were to licence a third party operator in future, the CAA could then permit recovery of historical costs.

CAA views

8. Having considered stakeholders’ views carefully alongside our powers, duties and assessment of the interests of consumers, our draft decision is that it would not be in the interests of consumers to allow Heathrow West to recover its costs at this time.
9. As we set out in our April 2021 Consultation on the Way Forward for the H7 price control⁴, Heathrow West’s proposals formed part of a standalone commercial project that it chose to commence at its own risk and without prior agreement with the CAA on how it should be funded. We note the suggestions by Heathrow West that there may be advantages in setting a regulatory precedent in the form of allowing Heathrow West to recover its costs, but are not convinced that this a proportionate approach or targeted on the circumstances that we now find, where the focus is on the operation of a two runway airport rather than capacity expansion.
10. We note Heathrow West’s observations that its approach was supported by airlines, but also observe that such support does not extend to supporting recovery of the costs in the circumstances where capacity expansion is no longer being taken forward. In this context, we consider that there would be the potential for significant consumer detriment were the regulatory regime to be developed in such a way that it provided a means of underwriting the costs of commercial proposals that were being developed outside the established regulatory framework, as there would be a risk of consumers funding wasteful or duplicative spending. We also note the different position of HAL, where the recovery of its costs is subject to the conditions of an economic licence and its rates of return are determined by a price review process. As such, and despite the progress made by Heathrow West, its proposal remains distinct from that developed by HAL.
11. While we note the arguments made by Heathrow West that its approach was in accordance with Government policy, we also note that the statements in the NPS about not specifying the promoter to deliver expansion at Heathrow were designed to ensure that alternative developers were not excluded, rather than implying that any such developer should necessarily benefit from the same treatment as HAL. The treatment that HAL has received in relation to the costs of expansion recognises the arrangements in the price control, including how it recovers its capital investments.

⁴ See CAP2139A “Appendices to Economic regulation on Heathrow Airport Limited: Consultation on the Way Forward” at Appendix O which sets out in more detail issues we have considered in relation to HW’s request.

12. We are also not persuaded by Heathrow West's arguments based on comments made by the Competition Commission in 2009 in relation to terminal competition. The comments referred to were made in the context of a market investigation that did not consider inter-terminal competition in detail and were supported by an Appendix that was relatively equivocal about the benefits and downsides that such competition might bring. As such, we do not consider that that report provides either direct or strong support for Heathrow West's request.
13. Overall, having considered Heathrow West's arguments about the potential and possible benefits that it perceives that it brought to the expansion programme, we consider that Heathrow West has not provided sufficient evidence that its work has delivered benefits to consumers that would justify the CAA taking a decision to allow it to recover the costs it is seeking. Much of Heathrow West's argumentation is based on the general arguments about the benefits of competition, rather than the delivery of tangible and quantifiable benefits to consumers that are proportionate to the size of the request that it is making. In that context, we note that Heathrow West was free to, and did, proceed with its project without having sought or obtained agreement from the CAA that the early costs of its proposal should be borne by consumers irrespective of whether the project was a success.
14. We also note 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. As a result, the CAA had not reached any conclusion on whether Heathrow West's proposals were:
 - a. in fact, in the interests of consumers; or
 - b. likely to deliver specific benefits to them.

Given this, it is not possible for us to conclude now that Heathrow West's proposals were in the interests of consumers, or that its costs in developing its project should be borne by consumers.

15. In coming to this draft decision, we have considered the requirements under the Civil Aviation Act 2012 (CAA12) for us to act transparently, consistently, proportionately and in a way that is targeted at cases where action is needed. As such, we consider:
 - a. it is not clear that cost recovery is needed to further the interests of consumers by promoting competition in the manner contemplated by sections 1(1) and 1(2) CAA12, given Heathrow West brought forward its proposals without prior agreement with the CAA on funding mechanisms;
 - b. there has been little specific and/or quantified evidence of a clear benefit for consumers from Heathrow West's proposals, thus it is not clear that to allow Heathrow West to recover the costs of around £30 million referred to by Heathrow West would be proportionate to any benefit that consumers might have received from that expenditure; and
 - c. given that Heathrow West is not a regulated airport operator and thus is not restricted in how it can fund its activities, it is consistent with the overall scheme of regulation of the operators of dominant airports under CAA12 that the regulatory position in relation to cost recovery by each of HAL and Heathrow West may be different at this time. In this

context, we note that perceived notions of “fairness” do not form part of the matters that the CAA is required to consider under CAA12, save to the extent that similar notions are relevant under its duties, such as those in relation to proportionality and consistency.⁵

16. While we do not consider that it would be reasonable for us to decide that consumers should be exposed to HW's costs at this stage, we are clear that this decision does not set, and should not be seen as setting, a precedent for future decisions. We do not want to set a precedent against cost recovery for potential new providers if that would stifle the emergence of appropriate competition in future.
17. Similarly, this draft decision should not be taken as the CAA expressing a view that the Heathrow West project would not be credible, nor that its promoter is not capable of delivering the project. However, given the wide range of potential developments that could occur, it is not possible for the CAA to provide more certainty on its approach to dealing with the issues raised by alternative terminal operators at this stage, beyond that given in the “Technical Information Note” published by the CAA in August 2018.⁶

Regulatory arrangements

18. In respect of HAL's comments that it would not be within the CAA's powers to ensure that Heathrow West could recover its costs, we note that section 21(1)(b) of the Civil Aviation Act 2012 (“CAA12”) allows a licence to include provisions:

“requiring the holder of the licence to enter into a contract or other arrangement for a purpose specified in a condition and on terms specified in, or indetermined in accordance with, a condition”.

We consider that this provision appears to be broad enough to support the development of a mechanism for the recovery of the costs of other projects in the future, should it be in the interests of consumers for those costs to be recovered.

19. Nonetheless, recognising the position that Heathrow West has taken and the efforts that it has devoted to its project, we consider that this process has identified some challenges with the current regulatory arrangements with regard to introducing competition to the provision of airport infrastructure. For instance, it is not clear that the current statutory framework provides sufficient support for third party proposals for airport infrastructure at dominant airports. If evidence were to emerge in the future (and taking account of evolving circumstances) that these difficulties would likely create significant consumer detriment, then we would consider how they might be reasonably addressed.

⁵ We also note HW's assertion in its response to CAP2139 that the CAA's policy proposals in 2016 gave HW “every indication” that its costs would be recoverable. This statement appeared to be a reference to CAP1469 (footnoted in the same paragraph). However, it is clear that CAP1469 (and CAP1513 which is the CAA's decision on the matters raised in it) relates only HAL's costs. As such, it gave no indication as to how the costs of an alternative developer might be addressed.

⁶ See:

https://www.caa.co.uk/uploadedFiles/CAA/Content/Accordion/Standard_Content/Commercial/Airports/Files/TechnicalInformationNote-HeathrowCapacityExpansion.pdf

20. Please e-mail responses to this draft decision to economicregulation@caa.co.uk by no later than 29 October 2022. We expect to publish the responses we receive on our website as soon as practicable after the period for representations expires. Any material that is regarded as confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to information under section 59 CAA12 and the Freedom of Information Act 2000.