



## **CAP2387 – Draft proposals: Heathrow West’s request for cost recovery**

13<sup>th</sup> September 2022

This response to the consultation is submitted by Heathrow Hub Ltd/Runway Innovations Ltd. (HHL), promoters of the Heathrow Extended Northern Runway (ENR) scheme.

### **1.0 Stakeholders’ views**

- 1.1 We note the consultation confirms an airline *“welcomed the prospect of future terminal competition,”* agreed *“it would increase efficiencies in capital projects”* and requested the CAA should *“consider further how to capture benefits of competition in future.”*
- 1.2 We also note Heathrow Airport Ltd. (HAL) acknowledged that *“if the CAA were to licence a third party operator in future, the CAA could then permit recovery of historical costs”* but also *“reiterated its view that inter-terminal competition was unlikely to be in the interests of consumers.”*

### **2.0 Our comments on the consultation**

- 2.1 We make no comment on the specific issue of Heathrow West’s claim. However, we believe it is a positive and timely contribution to the fundamental question of competition in the provision of airport infrastructure at Heathrow.
- 2.2 Both our own and other consultees’ responses to the CAA’s previous consultations provide clear evidence of gross inefficiencies in HAL’s capital programme - e.g.: our response to CAP1964 - and HAL’s apparent presumption that the *“CAA has duty (sic) to ensure Heathrow can finance its activities.”*<sup>1</sup>
- 2.3 Without the introduction of competition to remove or limit what have proved to be perverse inherent incentives in the RAB based regulation of its monopoly, HAL will continue to believe itself, and may in fact be, effectively immune from the market forces that are fundamental to the viability and performance of other airports.
- 2.4 The most recent increase of c.£1bn from December 2021<sup>2</sup> has resulted in Heathrow’s RAB reaching £18.43bn by 30<sup>th</sup> June 2022. The continuing increases in charges, already the highest of any comparable airport, threaten the UK’s national competitiveness and connectivity. However, HAL still maintains further increases are justified and necessary.<sup>3</sup>

---

<sup>1</sup> Investors and Insurers Update, HAL January 2021

<sup>2</sup> P.9, Heathrow (SP) Ltd, Results to 30<sup>th</sup> June 2022

<sup>3</sup> *“Our RBP2 set out a £41.95 (£2018p) charge to deliver for passengers in H7 in contrast to the CAA’s Initial Proposals charge c.£22.94 - £32.19 (2018p)”* and *“calling for the CAA to recognise the need for a RAB adjustment following the impact of COVID-19, to implement forward looking risk sharing to prevent the type of impact seen from COVID-19 happening again and to set a WACC of 8.5% for the H7 period”* – Investor Report, HAL June 2022

- 2.5 The CAA's concerns over ten years ago have proved to be justified, for example:
- *"The CAA recognises the potential for a regulatory asset base (RAB) approach to price regulation to distort investment incentives and competition. Expectations regarding regulation can have a significant effect on the behaviour of market participants, perhaps prejudicing nascent competition, or distorting investment decisions."*<sup>4</sup>
- 2.6 We therefore believe the introduction of competition must now be considered.
- 2.7 The consultation refers to the Competition Commission's 2009 market investigation, and what is said to have been its *"relatively equivocal"* conclusion *"about the benefits and downsides"* of inter-terminal competition.
- 2.8 The consultation notes the Commission's final report *"did not consider inter-terminal competition in detail"* and was *"supported by an Appendix that was relatively equivocal about the benefits and downsides that such competition might bring."*
- 2.9 However, it is relevant and important that the investigation was carried out in the specific, and highly controversial, context of Ferrovial's acquisition of Heathrow and six of the UK's other principal airports. As the Commission's final report concluded:
- *"The separation of terminal ownership or operation from the ownership and operation of the airfield has been adopted in certain countries as a path to privatization. In the UK, the decision was taken to privatise each airport as a whole. The evolution of the airport sector and the legislation underpinning it reflect this political choice."*<sup>5</sup>
- 2.10 It is also relevant that the Commission were mindful of the legislative framework then applicable:
- *"Under the Airports Act and other legislation relevant to the safe operation of airports, there are severe limitations to the ability of a company to operate terminal facilities within an airport, independently from the operator of the airfield."*
- 2.11 However, even recognising those limitations and the political choices that influenced the then current Airports Act 1986, the Commission concluded:
- *"In our view, significant benefits could be derived from introducing terminal competition, particularly at airports that are under weak competitive constraints from other airports, either because of their isolated geographical position or because of some other unique characteristic which confers substantial market power on them;*
  - *As explained in Appendix 10.11, we recognize that there can be operational and planning issues associated with STOD and that a careful assessment of the particular circumstances of an airport would need to be carried out, before introducing terminal competition;"*

---

<sup>4</sup> Preparing for a more competitive airports sector - Objectives and processes, CAA February 2010  
<https://www.iata.org/en/iata-repository/publications/economic-reports/preparing-for-a-more-competitive-airports-sector/>

<sup>5</sup> BAA airports market investigation - A report on the supply of airport services by BAA in the UK, March 2009  
[http://www.competition-commission.org.uk/rep\\_pub/reports/2009/fulltext/545.pdf](http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/545.pdf)

- *Given that a reform of the economic regulation of airports is under way, it seems to us that the legislation should now be amended to allow for terminals to be developed or redeveloped and to be operated separately from runway facilities, where appropriate.”*

2.12 Subsequently, the Airports Act 1986 was replaced by the Civil Aviation Act 2012, the preceding decision document noting:

- *“Although there are some risks associated with terminal competition, there are also a number of potential benefits;*
  - *Firstly, it might represent one way of delivering more timely and appropriate investments as development of terminals is a lot less ‘lumpy’ than the development of new runways;*
  - *Secondly, it would allow airlines to tailor the services offered at the terminals to their needs which could improve the passenger experience as terminals would better reflect the needs of consumers;*
  - *Thirdly, this approach may reduce on-going regulatory costs, since where effective terminal competition develops, the CAA would only need to regulate runway facilities.”<sup>6</sup>*

2.13 The CAA subsequently confirmed:

- *“In the UK, there is currently no example of different parties operating terminals (or runways) at the same airport. Prior to the Act, it was unclear whether such arrangements would have been possible. However, the Act removed this uncertainty and terminal competition is now a possibility;”<sup>7</sup>*

2.14 We do not therefore believe the CAA, in considering competition, should rely on selective statements made in the principal context of the privatisation and subsequent sale of many of the UK’s airport principal airports, including the two largest, and when subsequent events have more than justified the CAA’s concerns over regulation *“prejudicing nascent competition, or distorting investment decisions.”*

2.15 The consultation’s assumptions in any case appear inconsistent with the CAA’s statements even prior to the current Act, for example in 2001:

- *“Although competition could theoretically be introduced into a number of different levels of infrastructure, the most significant gains could be made in the provision of terminal facilities. Competition between terminals could be granted via a contractual arrangement to operate a terminal facility, or through the outright sale of assets. A short-term management contract or lease solely for the right to operate a terminal facility would be the closest to the current situation. More far-reaching consequences would result from a longer term lease agreement with facility development rights or the outright sale of assets.”<sup>8</sup>*

---

<sup>6</sup> Reforming the Framework for the Economic Regulation of Airports: Decision Document, DfT 2009

<https://webarchive.nationalarchives.gov.uk/ukgwa/+http://www.dft.gov.uk/pgr/aviation/airports/reviewregulationairports/decisiondocument/pdf/decisiondocument.pdf>

<sup>7</sup> Discussion paper on the regulatory treatment of issues associated with airport capacity expansion, CAP1195 June 2014  
<https://publicapps.caa.co.uk/docs/33/CAP%201195%20regulatory%20paper.pdf>

<sup>8</sup> Competitive provision of infrastructure and services within airports, February 2001

<https://webarchive.nationalarchives.gov.uk/20131205124245/https://www.caa.co.uk/docs/5/ergdocs/competitionwithinairportsfeb01.pdf>

- 2.16 To its credit, HAL has been clear and consistent in its objectives, for example the “*ambition is to continue to own and operate the hub airport as a single entity.*”<sup>9</sup> Indeed, any other approach would fundamentally conflict with its fiduciary duty to shareholders.
- 2.17 The issue we believe must now be addressed is whether HAL’s commercial interests have diverged to such an extent from consumers’ and the national interests as to justify a fundamental review of competition.
- 2.18 We are aware there have been and remain fundamental differences as to the practicality and desirability of terminal competition. For example, Frontier Economics have made the case both for and against competition in reports produced for easyJet and HAL respectively.<sup>10</sup>
- 2.19 However, most recently, and undermining any argument that competition would inevitably favour a dominant incumbent carrier, BA, Virgin Atlantic and IATA (the trade association for the world’s airlines, representing some 290 airlines or 83% of total air traffic) jointly state:
- *“Bolder moves could see the Government considering different regulatory options to open up competition at Heathrow. These include requiring the breaking up of the HAL monopoly at Heathrow, thereby allowing other operators to enter as service providers, such as operating terminals. This would provide incentives to increase efficiency and keep airport charges in check as terminals would be competing for airlines and their passengers. It would also have the additional benefit of ensuring no one operator of the airport is “too big to fail”.*<sup>11</sup>
- 2.20 Considering all current circumstances, we suggest there is now an unarguable case for a presumption in favour of competition, and particularly having regard to the CAA’s powers and duties:
- *“We act to encourage choice and value to consumers. In doing this, our approach is guided by our statutory duty to promote competition as far as appropriate. Experience has demonstrated that with only a few exceptions, a market based approach, where providers compete with each other on the merits of their offering, across the aviation value chain, has delivered major benefits to consumers;”*<sup>12</sup>
  - *“The CAA must carry out its functions ... in a manner which it considers will promote competition in the provision of airport operation services.”*<sup>13</sup>
- 2.21 Competition would also be clearly consistent with the CAA’s strategic objective to “*improve choice and value for aviation consumers now and in the future by promoting competitive*

---

<sup>9</sup> Response to CAP1658, HAL July 2018 <https://www.caa.co.uk/media/zvfbe4fz/cap1658-heathrow-response-final.pdf>

<sup>10</sup> It should be terminal, Frontier Economics for easyjet March 2009 <https://www.frontier-economics.com/media/2773/competition-between-airports-final4-24-02-09.pdf>

Economic Regulation of Terminal Expansion, Frontier Economics for HAL December 2018

<https://www.caa.co.uk/media/oy0prgl3/caa-h7-230-annex-1-frontier-economics-economic-regulation-of-terminal-expansion-december-2018.pdf>

<sup>11</sup> Clipping Britain’s Wings, WPI Economics May 2022 <http://wpieconomics.com/site/wp-content/uploads/2022/05/Clipping-Britains-Wings-Web.pdf>

<sup>12</sup> Guidance on the application of the CAA’s Competition Powers – CAP1235 May 2015 <https://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=6485>

<sup>13</sup> Para. 2, Civil Aviation Act 2012 [https://www.legislation.gov.uk/ukpga/2012/19/pdfs/ukpga\\_20120019\\_en.pdf](https://www.legislation.gov.uk/ukpga/2012/19/pdfs/ukpga_20120019_en.pdf)

*markets, contributing to consumers' ability to make informed decisions and protecting them where appropriate,"*<sup>14</sup>

- 2.22 The potential benefits of lighter regulation, not only to consumers but also to HAL, are also a relevant consideration.
- 2.23 Gatwick demonstrates that airlines, acting, albeit imperfectly, as a proxy for airport customers, are able to agree a number of regulatory building blocks direct with the infrastructure provider. Regulation is effectively limited to a back stop, with credible sanctions if parties cannot agree.
- 2.24 Furthermore, as Heathrow West noted, *"terminal competition will increase the effectiveness of regulation of HAL by adding a competitive benchmark. It will also offer the possibility of lifting the regulatory burden on HAL itself from a strict RAB based regulation to looser safeguarding and monitoring regime – providing HAL with greater flexibility to respond to customer preferences and market trends."*<sup>15</sup>

### **3.0 Our conclusions**

- 3.1 In considering how competition might be introduced at Heathrow, the CAA has previously confirmed:
- *"Some of the issues that the CAA would need to consider include:*
    - *the market power of the existing airport operator, including any changes to critical loss analysis and how it may change going forward;*
    - *the competitive position of other airports now and going forward; the CAA's duty to ensure that licensed operators can finance their activities; and*
    - *the framework of economic regulation at the airport. For example, whether the new terminal operator required a RAB for the terminal, and how, if at all, the use of the common assets, such as surface access or runways, might be regulated."*<sup>16</sup>
- 3.2 We note the consultation refers to the CAA's August 2018 'Technical Information Note.' However, its scope is restricted to dealing with licensing issues raised by potential alternative developers of new capacity at Heathrow Airport, and in the specific context of what was expected to be a DCO application consistent with the designated Airports National Policy Statement (ANPS).
- 3.3 We note this is only of relevance to Heathrow West's claim, and therefore welcome the consultation recognises that *"it is not clear that the current statutory framework provides sufficient support for third party proposals for airport infrastructure at dominant airports."*
- 3.4 As the CAA will be aware from our previous submissions, Heathrow Hub Ltd. intends to bring forward proposals for new airport infrastructure which is lower cost and more deliverable

---

<sup>14</sup> Para. 5 Memorandum of Understanding between the Competition and Markets Authority and the Civil Aviation Authority on the use of concurrent powers under consumer protection legislation, CMA June 2015

<sup>15</sup> Terminal Competition at Heathrow Airport, Alix Partners for Heathrow West Ltd. October 2019  
[https://heathrow-westconsultation.com/wp-content/uploads/sites/78/2019/11/Terminal-Competition-at-Heathrow-Airport\\_AlixPartners.pdf](https://heathrow-westconsultation.com/wp-content/uploads/sites/78/2019/11/Terminal-Competition-at-Heathrow-Airport_AlixPartners.pdf)

<sup>16</sup> Discussion paper on the regulatory treatment of issues associated with airport capacity expansion, CAP1195 June 2014

than HAL's, now dormant, NWR proposal and for which policy support, through the ANPS, has now effectively lapsed.

- 3.5 However the consultation appears to conclude that any further review of competitive procurement, delivery or operation of infrastructure at Heathrow must await evidence *"to emerge in the future (taking account of evolving circumstances)."*
- 3.6 We believe there are already compelling grounds for such a review, for example:
- The clear and unequivocal evidence of HAL's inefficiencies (e.g.: as set out in our response to the CAP1964 consultation);
  - Continued substantial increases in the RAB, benefiting only HAL's shareholders, are clearly unsustainable but we are not aware of any analysis by the CAA to determine the point, (if not already reached), at which fundamental regulatory change is needed to prevent further consumer detriment and even greater harm to the UK's wider economic interests;
  - The CAA agreement to HAL recovering over £0.5bn of Category B & C, wind-down and legal costs despite our responses (e.g.: to CAP1819/1825, CAP1940 and CAP1964 consultations) showing the scheme to be entirely unaffordable and undeliverable, and where our detailed assessments remain unchallenged;
  - Government's decision to adopt NWR as its preferred scheme for Heathrow expansion over Heathrow Hub's directly resulted from HAL's refusal to provide the Secretary of State with *"the certainty that it would be built and adopted by Heathrow airport, if we opted for it"*<sup>17</sup> - a clear breach of the (then operative) Article 2 TFEU Treaty barring *"exclusionary conduct by dominant undertakings, i.e. conduct which aims to deliberately exclude actual competitors from expanding, or prevent potential competitors from entering a market."*<sup>18</sup>
- 3.7 These issues alone have resulted in *"significant consumer detriment"* and we believe are more than sufficient to justify a fundamental review of competition, even without considering any further *"evolving circumstances."*
- 3.8 We therefore suggest the CAA should now commit to a fundamental review of competition at Heathrow and suggest a call for evidence as a first step to ensure a robust and current evidence base for decision making.
- 3.9 The consultation's consideration of issues raised by the specific Heathrow West proposal is helpful in identifying some of the principles that a review should consider, for example:
- *"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."*
    - We therefore suggest the CAA set out the process by which an alternative scheme promoter would seek such prior agreement, and the evidence that the CAA would require in order to reach a decision.

---

<sup>17</sup> Rt. Hon. Chris Grayling, Secretary of State for Transport, Column 179, Hansard 25<sup>th</sup> October 2016

<sup>18</sup> Article 102 TFEU Treaty on the Functioning of the European Union, formerly Article 82

<http://www.ffw.com/publications/all/articles/transport-competition-law.aspx>

- *“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.”*
  - We therefore suggest the CAA set out the process by which an alternative scheme promoter would demonstrate the consumer benefit from competition and the evidence that the CAA would require in order to reach a decision.
- *“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.”*
  - We therefore suggest the CAA set out the process by which an alternative scheme promoter, in developing its proposals, might be considered for regulatory purposes in a manner consistent with an existing regulated airport operator.
- *“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.”*
  - We therefore suggest the CAA set out the process by which alternative scheme promoters’ proposals could be considered for cost recovery.

3.10 We look forward to the CAA’s next steps and would be pleased to meet to discuss the points raised in this response.