

HEATHROW AIRPORT LIMITED

- and -

CIVIL AVIATION AUTHORITY

Decision on Permission to Appeal

1. Heathrow Airport Limited (**the Applicant**), which is referred to below as HAL, has applied to the Competition and Markets Authority (**CMA**) for permission to appeal the Economic regulation of Heathrow Airport: H7 Final Decision CAP2524 of 8 March 2023 (**the Decision**) made by the Civil Aviation Authority (**the Respondent**). The Decision sets the price control and associated regulatory framework that applies to HAL during the H7 price control period (1 January 2022 until 31 December 2026).
2. The Applicant made its application on 17 April 2023, under section 25 of the Civil Aviation Act 2012 as the holder of the licence to which the Decision relates in accordance with section 25(2)(a) of the Civil Aviation Act 2012 (**the Act**) and within the time period allowed by paragraph 1(1) of Schedule 2 to the Act.
3. The Applicant seeks to challenge the Decision on the following grounds:
 - **Ground 1 (RAB Adjustment):** The Respondent has erred in refusing a further adjustment to HAL's Regulated Asset Base (**RAB**) to reflect fully the impact of the Covid-19 pandemic on HAL.
 - **Ground 2 (Cost of Equity):** The Respondent's estimate of the Cost of Equity of 6.97% RPI real is far too low. It implies an unlevered nominal cost of equity that is below HAL's observable cost of debt, which is wrong from first economic principles.
 - **Ground 3 (Embedded Debt):** The Respondent's estimate of HAL's cost of embedded debt of -0.08% RPI real is unreasonably low and fails to provide HAL with an appropriate allowance to service that debt.
 - **Ground 4 (AK-Factor):** The Respondent is wrong to introduce an additional correction factor (AK-factor) in the Decision to claw back what it describes as over-recovered revenues in 2020 and 2021.

- **Ground 5 (Capex Incentives):** The Decision inserts a modified condition into HAL's licence, which introduces an overly complex, disproportionate and inefficient capex incentives regime.
4. Under section 25(5) of the Civil Aviation Act 2012, the CMA may refuse permission to bring an appeal only on one of the following grounds: (a) that the appeal is brought for reasons that are trivial or vexatious; (b) that the appeal has no reasonable prospect of success; or (c) in certain circumstances where a matter has previously been appealed and remitted to the Respondent by the CMA following an earlier appeal.
 5. Under paragraphs 2(3) and 2(4) of Schedule 2 to the Civil Aviation Act 2012 the CMA's grant of permission may be made subject to conditions, which may include:
 - conditions which limit the matters that are to be considered on the appeal;
 - conditions for the purpose of expediting the determination of the appeal; and
 - conditions requiring the appeal to be considered together with other appeals, including appeals relating to different matters or decisions and appeals brought by different persons.
 6. On 2 May 2023, the Respondent notified the CMA that it did not intend to contest the application for permission to bring an appeal.

Grant of permission and conditions

No grounds for refusing permission

7. I consider that the issues raised in the notice of appeal are serious and of genuine concern to the Applicant, so that the appeal is not being brought for reasons that are trivial or vexatious.
8. Each ground raises arguable points of substance which will require detailed consideration and therefore it is not the case that the appeal, in relation to any of the grounds, has no reasonable prospect of success.
9. None of the grounds concern matters previously considered and remitted to the Respondent by the CMA: this is the first occasion on which any appeal has been brought against the Decision.

Conditions applicable to grant of permission

10. I have also considered whether, in granting permission to appeal, any grant of permission should be subject to particular conditions.

11. Permission to appeal the Decision has been sought by HAL and a total of three airlines. At the time of submitting their applications for permission to appeal, the three airlines each requested that their grounds of appeal be heard together, should permission be granted.
12. Having reviewed the four applications for permission to appeal, I note that all four applicants challenge the Decision in relation to the RAB adjustment and in relation to aspects of the Decision concerning HAL's Cost of Capital. In addition, all three airline applicants (but not HAL) challenge the Decision in relation to passenger forecasts. The numbering of the various grounds of appeal on the issues described in this paragraph is set out in the following table:

	HAL	BA¹	Delta²	VAA³
1. RAB adjustment	Ground 1	Ground 2	Ground 3	Ground 3
2. Cost of Capital	Ground 2 (Cost of equity – equity beta) Ground 3 (Cost of debt - embedded debt)	Ground 3 (WACC ⁴)	Ground 2 (WACC)	Ground 2 (WACC)
3. Passenger forecast / forecasting	-N/A-	Ground 1	Ground 1	Ground 1

13. Finally, HAL (but not the airline applicants) challenges the Decision in relation to the AK-Factor (Ground 4) and Capex Incentives (Ground 5).
14. On 27 April 2023, the CMA sought representations from each applicant and from the Respondent in relation to the question of whether certain grounds of appeal of the four appeals should be considered together pursuant to paragraphs 2(3) and 2(4) of Schedule 2 to the Civil Aviation Act 2012. Specifically, the CMA proposed that:
- the RAB adjustment grounds of appeal be considered together as Joined Ground A;
 - the Cost of Capital grounds of appeal be considered together as Joined Ground B; with the following sub-grounds:
 - i. Alleged errors in estimating the asset beta;

¹ British Airways plc.

² Delta Air Lines Inc.

³ Virgin Atlantic Airways Ltd.

⁴ WACC stands for weighted average cost of capital.

- ii. Alleged errors in estimating the cost of debt; and
 - iii. Alleged errors in selecting a point estimate for the WACC;
- the Passenger Forecast / Forecasting grounds of appeal be considered together as Joined Ground C; and
 - HAL's grounds of appeal on AK-Factor and Capex Incentives be considered separately as Grounds D and E, respectively.
15. On 2 May 2023, as well as confirming that it had no representations on the Applicant's application for permission to appeal the Decision, the Respondent stated that it was content with the CMA's proposal to consider the appeals together as described above. On 4 May 2023, the Applicant and the other applicants also confirmed that they were content with the CMA's proposal.

Disposition

16. I have decided to grant the Applicant permission to appeal the Decision on each of the grounds set out in its Notice of Appeal. This grant of permission is conditional upon the following:
- The RAB adjustment ground of appeal of this appeal (Ground 1) shall be considered together with the grounds of appeal identified in row 1 of the table above as '**Joined Ground A**'.
 - HAL's Cost of Equity ground of appeal (Ground 2) and Embedded Debt ground of appeal (Ground 3) shall be considered together with the similar grounds of appeal pleaded by the other applicants identified in row 2 of the table above as '**Joined Ground B**'.
17. I have also decided that the Applicant's AK-Factor ground of appeal (Ground 4) and Capex Incentives ground of appeal (Ground 5) shall be considered separately, as **Ground D** and **Ground E**, respectively.
18. I consider that the above conditions will enable the CMA to dispose of the appeals fairly and efficiently and at proportionate cost.

Kirstin Baker
Authorised Member of the CMA
11 May 2023