

BEFORE THE COMPETITION AND MARKETS AUTHORITY

**IN THE MATTER OF AN APPEAL UNDER SECTION 25 OF THE CIVIL AVIATION
ACT 2012**

BETWEEN

BRITISH AIRWAYS PLC

DELTA AIR LINES, INC.

VIRGIN ATLANTIC AIRWAYS LIMITED

Appellants

and

THE CIVIL AVIATION AUTHORITY

Respondent

and

HEATHROW AIRPORT LIMITED

Prospective Intervener

**APPLICATION FOR PERMISSION TO INTERVENE
IN AIRPORT LICENCE CONDITION APPEAL**



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CONFIDENTIALITY NOTICE

Information that is confidential to Heathrow is highlighted in yellow, information that is confidential to BA's is highlighted in blue, information that is confidential to VAA is highlighted in grey, information that is confidential to Delta's is highlighted in pink, information that is confidential to relating to the Airline Appellants, collectively, is highlighted in green, information that is confidential to airlines who are not Airline Appellants is highlighted in dark yellow.

STATEMENT OF TRUTH

I believe that the facts stated in this Application for Permission to Intervene are true. I understand that proceedings for contempt of court may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief in its truth.

Signed:

Name: [✂]

A. INTRODUCTION AND SUMMARY OF APPLICATION TO INTERVENE

A(1) Introduction

1. By this Notice, Heathrow Airport Limited (“**Heathrow**” or “**HAL**”) applies to the Competition and Markets Authority (“**CMA**”) pursuant to Rule 8.1 of the Airport Licence Condition Appeals Rules 2022 for permission to intervene in the appeals brought by British Airways Plc (“**BA**”), Delta Air Lines Inc (“**Delta**”) and Virgin Atlantic Airways Limited (“**VAA**”) (together, the “**Airline Appeals**” brought by the “**Airline Appellants**”) against the decision of the Civil Aviation Authority (“**CAA**”) of 8 March 2023 to modify the price control terms of Heathrow’s licence (the “**Decision**”).
2. In particular, Heathrow seeks permission to intervene in relation to the following Grounds of the Airline Appeals, which raise broadly similar arguments:
 - 2.1. The Passenger Forecasting Grounds. Grounds 1 of the BA, Delta and VAA NoAs.¹
 - 2.2. The RAB Adjustment Grounds. Ground 2 of the BA Notice of Appeal (“**NoA**”); Ground 3 of the Delta NoA; Ground 3 of the VAA NoA.²
 - 2.3. The Cost of Capital Grounds. Ground 3 of the BA NoA; Ground 2 of the Delta NoA; Ground 2 of the VAA NoA.³
3. Heathrow is materially interested in the outcome of the Airline Appeals:
 - 3.1. The Airline Appeals relate to Heathrow’s own licence which is modified by the Decision and to a price control on Heathrow’s own business.
 - 3.2. As the holder of the licence which is modified by the Decision, Heathrow is well-placed to assist the CMA, through submissions, in evaluating (i) the Grounds raised by the Airline Appeals insofar as they rely on characterisations of Heathrow’s own

¹ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, section 3, pages 26 – 61, Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, section 4, pages 21 – 42, and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, part 4, pages 23 – 49.

² BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, section 4, pages 62 – 95, Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, section 6, pages 62 – 91, and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, part 6, pages 69 – 97.

³ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, section 5, pages 96 – 125, Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, section 5, pages 43 – 61, and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, part 5, pages 50 – 68.

operations, and (ii) the impact that the relief sought in the Airline Appeals would have on Heathrow, were it to be granted in part or in full.

- 3.3. Heathrow has brought its own appeal against the Decision. It has already been granted permission to appeal by the CMA in relation to its own RAB Adjustment Ground (Ground 1 of the Heathrow NoA) and Cost of Capital Grounds (Grounds 2 and 3 of the Heathrow NoA).⁴ The issues raised by Heathrow’s appeal broadly overlap with the issues on which it now seeks permission to intervene in respect of these grounds.
4. When granting permission, the CMA joined Heathrow and the Airline Appellants’ RAB Adjustment Grounds into “**Joined Ground A**” for appeal management purposes, and Heathrow and the Airline Appellants’ Cost of Capital Grounds into “**Joined Ground B**”, with sub-grounds concerning Asset Beta (“**Joined Sub-ground B(i)**”), Cost of Debt (“**Joined Sub-ground B(ii)**”) and Selecting a Point Estimate for the WACC (“**Joined Sub-ground B(iii)**”). The CMA also joined the Airline Appellants’ grounds on passenger forecasts into “**Joined Ground C**”.
5. Heathrow opposes the Airlines’ positions on each of these designated Joined Grounds (and, where relevant, Joined Sub-grounds) which are addressed in turn below. The Airline Appellants also each argue that the CAA has erred in its specification of the asymmetric risk allowance. This is addressed by BA as part of its Cost of Capital Ground and by Delta and VAA as part of their Passenger Forecasting Grounds. It is addressed separately below.

A(2) Supporting evidence⁵

6. In support of its application for permission to intervene in the Airline Appeals, Heathrow relies on the following witness statements of fact:

⁴ See the CMA’s [Decision on Permission to Appeal – Heathrow Airport Limited](#), dated 11 May 2023.

⁵ All of the evidence relied on by Heathrow in support of its application for permission to intervene is responsive to the evidence adduced by the Airline Appellants in their applications for permission to appeal. As such, Heathrow’s evidence could not reasonably have been put before the CAA prior to the Airline Appellants’ appeals. Heathrow considers that its evidence will have an important effect on the outcome of the appeals and would be happy to make further representations to the CAA on the relevance and importance of its evidence should the CAA request further explanation.

- 6.1. First witness statement of Claire Elizabeth Berridge, Director of Masterplanning, Capacity and Forecasting at Heathrow (“**1st Berridge**”) [Intv/7] and Exhibit (“**CEB1**”).
- 6.2. First witness statement of Mark Powell, Director of Operational Planning at Heathrow (“**1st Powell**”) [Intv/8] and Exhibit (“**MP1**”).
- 6.3. Second Witness Statement of Michael King, Director of Regulation and Economics at Heathrow (“**2nd King**”) [Intv/4] and Exhibit (“**MK2**”).
- 6.4. Second Witness Statement of Lucy Squire, Head of Regulatory Strategy at Heathrow (“**2nd Squire**”) [Intv/2] and Exhibit (“**LS2**”).
- 6.5. Second Witness Statement of Sally Ding, Director of Business Planning and Treasury at Heathrow (“**2nd Ding**”) [Intv/5] and Exhibit (“**SD2**”).
7. Heathrow also relies on the following reports by expert economists:
 - 7.1. First Expert Witness Statement of David Jevons, Partner at Oxera Consulting LLP (“**Oxera**”) (“**1st Jevons**”) [Intv/9] and Exhibit (“**DJ1**”).
 - 7.2. Second Expert Witness Statement of Dr Matt Firla-Cuchra, expert economist at KPMG (“**2nd Cuchra**”) [Intv/3] and Exhibit (“**MFC2**”).
 - 7.3. Second Expert Witness Statement of Peter Hope, expert economist at Oxera (“**2nd Hope**”) [Intv/6] and Exhibit (“**PH2**”).
8. The above-mentioned evidence supports Heathrow’s submissions in relation to the CMA’s designated Joined Grounds and Joined Sub-grounds in the manner set out in Table 1 below.

Table 1: Joined Grounds and Joined Sub-grounds alongside supporting evidence

Ground	Supporting evidence
Joined Ground C: Passenger Forecasts	<i>Factual evidence:</i> 1 st Berridge; 1 st Powell <i>Expert evidence:</i> 1 st Jevons

Ground	Supporting evidence
Joined Ground A: RAB Adjustment	<i>Factual evidence:</i> 2 nd Squire <i>Expert evidence:</i> 2 nd Cuchra
Joined Ground B: Cost of Capital	
Joined Sub-ground B(i): Asset Beta	<i>Factual evidence:</i> 2 nd King (Sections 3 to 5) <i>Expert evidence:</i> 2 nd Hope (Sections 2B to 2E)
Joined Sub-ground B(ii): Cost of Debt	<i>Factual evidence:</i> 2 nd Ding
Joined Sub-ground B(iii): Selecting a Point Estimate for the WACC	<i>Factual evidence:</i> 2 nd King (Section 6) <i>Expert evidence:</i> 2 nd Hope (Section 2F)
Asymmetric Risk Allowance	<i>Factual evidence:</i> 2 nd King (Section 7)

Note: References to this evidence and other documentation referred to in this NOI are to Heathrow’s Intervention bundle in the format “[Intv/Tab/Page Number]”. References to documents filed with the original appeal applications by the various parties follow the format used in those filings.

9. Heathrow respectfully submits that it meets the statutory test for intervention⁶ because it is necessary and desirable that Heathrow be involved in the resolution of the Airline Appeals. Heathrow is the regulated entity concerned in the Airline Appeals against the CAA’s Decision and its interests stand to be materially affected by the outcome. Heathrow has itself appealed the CAA’s Decision on the RAB Adjustment and the Cost of Capital and, in relation to Joined Ground C regarding the CAA’s passenger forecasts (which Heathrow did not appeal), Heathrow is well placed to provide input and assistance to the CMA in resolving the Airline Appeals given its experience and expertise in aviation forecasting matters at its own airport. In particular, Heathrow is uniquely placed to assist the CMA in relation to the evidence of Heathrow’s own approach to passenger forecasting. Therefore, it is necessary and desirable that Heathrow be involved as an intervener in all the Airline Appeals going forward.

⁶ Civil Aviation Act 2012, Schedule 2, clause 5(2). [Auth/1/104]

B. JOINED GROUND C: PASSENGER FORECASTS

B(1) Summary of Heathrow's submissions regarding Airline Appeals on passenger forecasts

10. The three Airline Appellants have appealed against the CAA's Decision in respect of passenger forecasts for the H7 period. It is the first ground of each of their appeals.⁷
11. The Airline Appellants make three overarching arguments in support of their appeals on this ground.⁸ In short, they say:
 - 11.1. it was an error of fact (or law or in the exercise of its discretion) for the CAA to base its passenger forecasts on Heathrow's forecasting methodology, which produced a forecast that was too low;⁹
 - 11.2. the various step adjustments made by the CAA to its passenger forecasts in the Decision reflected errors of fact / law / in the exercise of the CAA's discretion;¹⁰ and
 - 11.3. it was an error of law (or an error in the exercise of the CAA's discretion) for the CAA to base its forecasts on Heathrow's methodology without sharing Heathrow's models with airlines in a manner that would permit them to engage meaningfully during the consultation phases.¹¹

⁷ See: VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.1 et seq, page 23; BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.1 et seq, page 26; and Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.1 et seq, page 21.

⁸ See: VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.126, page 47; BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraphs 3.7.2 and 3.11.1, pages 36 and 44; and Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.104, page 40.

⁹ Delta and VAA plead this as an alleged error of fact but also law (see: Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, Annex 1, page 101; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, Annex 4, page 106. BA pleads this as an alleged error of fact but also an error in the exercise of the CAA's discretion: see BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.6.7(a), page 32.

¹⁰ See: Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, Annex 1, pages 102 to 113; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, Annex 4, pages 107 to 119.

¹¹ Delta and BA plead this as an alleged error of law but also an error in the exercise of the CAA's discretion (see: Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, Annex 1, page 100; and BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.6.7(a), page 32). Whereas VAA only pleads this as an alleged error of law (see VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, Annex 4, page 106).

12. The Airline Appellants contend that these errors have resulted in the CAA understating the level of passenger forecasts over the H7 period. They would have the CMA substitute the CAA's forecast of 375.5m passengers with the Airline Appellants' own forecast of 392.5m passengers.¹².
13. Both the CAA's and the Airline Appellants' forecasts are higher than Heathrow's latest December 2022 forecast of 346.1m.¹³ The impact of the orders sought by the Airline Appellants' would be to reduce Heathrow's average maximum yield per passenger over the H7 period from £23.22¹⁴ to £21.90.¹⁵ The financial impact on Heathrow would be significant. Heathrow estimates it would result in approximately £0.5 billion¹⁶ less for Heathrow in aeronautical revenue alone over H7.
14. None of the Airline Appellants' arguments has any merit. The CAA's passenger forecasts in the Decision, which are more stretching than Heathrow's own forecasts, do not reflect errors of law, fact or discretion. Heathrow's submissions in response to the Airline Appellants' arguments outlined above are as follows:
 - 14.1. The CAA did not place exclusive and uncritical reliance on Heathrow's passenger forecast model (even as a starting point) but applied its own judgment, departing from Heathrow's methodology in a number of ways. It utilised other sources, including booking data and external forecasts, and made a series of significant "adjustments" to Heathrow's model, leading to a challenging passenger forecast which in no way represents a material under-estimation (section B(2)).
 - 14.2. In any event, to the extent that the CAA did take Heathrow's model into account as part of the evidence it considered before reaching its decision on passenger numbers, it cannot be characterised as wrong to have done so because Heathrow's

¹² CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, table 16, page 20 [Supp/2/49], see: BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, table 1, page 28; see Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.105, page 41, see VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.6(a), page 24.

¹³ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.68 [Supp/2/49].

¹⁴ See CAA CAP2524A: [H7 Final Decision Summary](#), 8 March 2023, table 7, page 17 [Supp/1/22]; BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, table 3, page 60.

¹⁵ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, table 3, page 60.

¹⁶ This calculation is set out in 1st Berridge, paragraph 8.5.2. [Intv/7/224]

model is robust, reflects best practice and has been independently verified (section B(3)).

14.3. The Airline Appellants have failed to identify any errors of fact, law or discretion in the adjustments made by the CAA to its forecasts in the Decision (section B(4)).

In particular:

14.3.1. the Airline Appellants' submission that the CAA should have ignored the Local Rule A capacity cap in summer 2022¹⁷ when setting its forecasts for that year is unjustified and would unfairly penalise Heathrow; on the contrary, the CAA would have been wrong to fail to take Local Rule A into account in its Decision;

14.3.2. the CAA was not wrong to forecast 2023 passenger numbers at 92% of 2019 numbers;

14.3.3. it was not wrong, or otherwise inappropriate for the CAA to make a downwards adjustment to its passenger forecasts in light of updated macroeconomic forecast data, and to make no further uplifts having taken account of external aviation forecasts; and

14.3.4. the application by the CAA of the 0.87% shock factor was entirely appropriate in the context of constructing accurate and fair passenger forecasts based on historic experience of events which have impacted passenger numbers over the past 30 years.

14.4. Furthermore, the Decision is not undermined by any error of law in relation to the procedure followed by the CAA (section B(5)). The Airline Appellants were consulted thoroughly and extensively on the CAA's approach to passenger forecasting at each stage of the CAA's process and made detailed submissions to the CAA. They had sufficient information on which to base their submissions, which were carefully considered by the CAA in arriving at its Decision. In any event, Heathrow's original model was only one source of evidence informing the CAA's assessment. Insofar as there were any defects in the CAA's process, these

¹⁷ The Local Rule A capacity cap was in place at Heathrow between July and October 2022 involving a daily cap on passenger volumes.

were not so serious as to leave the correctness of the CAA’s passenger forecasts in any doubt.

14.5. In reality, the Airline Appellants simply disagree with the CAA’s decision on passenger forecasts in their own commercial interests, but have failed to adduce any evidence that comes close to demonstrating that the CAA’s Decision is vitiated by any error of law, fact or discretion.

14.6. In the circumstances, Heathrow invites the CMA to reject each of the Airline Appellants’ arguments and to confirm the passenger forecasts adopted by the CAA in its Decision.

14.7. This section of the Notice of Intervention is supported by:

14.7.1. a witness statement from Claire Berridge, hereafter referred to as “**1st Berridge**”, the Director of Masterplanning, Capacity and Forecasting at Heathrow, which addresses Heathrow’s approach to passenger forecasting, comments on Heathrow’s engagement with the CAA and airline stakeholders during the process leading to the H7 Decision, and outlines the flaws in the Airline Appellants’ forecasting methodologies;

14.7.2. a witness statement from Mark Powell, hereafter referred to as “**1st Powell**”, the Director of Operational Planning at Heathrow, which explains the reasons for, and impact of, the Local Rule A capacity cap in 2022, and why the CAA was not wrong to have taken account of this in its Decision; and

14.7.3. an expert report from David Jevons, Partner at Oxera, hereafter referred to as “**1st Jevons**”, which provides an expert economic assessment of Heathrow’s forecasting model, the differences between Heathrow’s and the CAA’s forecasts, and the reasons the Airline Appellants’ criticisms of the specific adjustments made by the CAA in the Decision are without foundation.

B(2) Heathrow’s model was not relied on exclusively and uncritically by the CAA, which took a number of other factors and forecasts into account and made various adjustments to Heathrow’s forecasts

15. The Airline Appellants argue that the CAA erred by relying on Heathrow’s passenger forecast model. Heathrow submits this claim cannot succeed in circumstances where the CAA did not rely exclusively or uncritically on Heathrow’s methodology, but instead had regard to a wide range of other information (including the forecasts provided by airlines during the consultation process) and applied its own judgment to come to its passenger forecasts, which are materially higher than Heathrow’s own forecasts as a result.

16. In this section, Heathrow submits that:

16.1. the CAA had regard to a wide range of information in its modelling: it did not rely exclusively on Heathrow’s model (section (I));

16.2. the CAA’s approach to setting passenger numbers in the Decision differed materially from Heathrow’s forecasting methodology (section (II)); and

16.3. as a result of these different approaches, the CAA’s passenger forecasts for H7 are expected to be stretching for Heathrow over the course of H7 (section (III)).

(I) The CAA had regard to a wide range of information in its modelling: it did not rely exclusively on Heathrow’s model

17. Heathrow’s passenger forecasting methodology underpinned its submissions to the CAA throughout the H7 price control consultation process and is described in detail in 1st Berridge.¹⁸ In short:

17.1. Heathrow generates passenger forecasts using three different core “modules” based on (i) total market demand for direct and transfer passengers, (ii) Heathrow-specific supply factors based on assumptions about airline capacity, and (iii) potentially applicable traffic restrictions for the time period in question.

¹⁸ See 1st Berridge, paragraphs 4.1 to 4.30 [Intv/7/188-197]. See also the CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraph 2.17 et seq. [Supp/25/1139].

- 17.2. Next, Heathrow applies the forecasts generated by those modules to four reference “scenarios” to reflect different potential developments over the relevant period (ranging from optimistic scenarios in which passenger numbers will be higher to pessimistic scenarios in which passenger numbers will be lower).
- 17.3. Heathrow then applies a Monte Carlo simulation to these scenario-specific forecasts to reflect the inherent uncertainty in the input assumptions used to generate the forecasts. A Monte Carlo simulation is a mathematical technique used to predict the probability of a variety of outcomes when the potential for uncertain variables is present. The Monte Carlo results from the four reference scenarios are then weighted by the assumed probability of each scenario occurring to generate a “low” forecast, a “mid” forecast and a “high” forecast.¹⁹
- 17.4. Finally, a shock factor applies a downwards adjustment to each of those forecasts to take account of additional, asymmetric, non-economic downside risks (such as unpredictable falls in demand that have been seen following certain international conflicts, major weather events, terrorist attacks, health pandemics, or other developments which reduce demand for air travel).
18. Ultimately, this process produces Heathrow’s low, mid and high passenger forecasts for the given time period. This is a highly sophisticated and detailed model. It takes account of a number of Heathrow-specific factors as well as a range of economic and wider factors that impact passenger numbers, and it produces reliable, robust forecasts on which Heathrow’s business relies.²⁰
19. Throughout the H7 price control exercise, Heathrow has maintained that its forecasting methodology should be used by the CAA to generate its passenger forecasts for the price control. However, the CAA disagreed. While it had regard to Heathrow’s methodology in formulating its own predictions at the Initial Proposals stage, from that point on

¹⁹ The “mid” forecast reflects the scenario where there is a 50% chance of being higher, and a 50% chance of being lower than this number; the “low” forecast reflects the scenario at which there is a 10% chance of being below this number, and 90% chance of being higher; the “high” reflects the scenario at which there is a 90% chance of being below this number, and 10% chance of being higher.

²⁰ 1st Berridge, paragraph 4.2. [Intv/7/188]

Heathrow’s methodology was just one of numerous inputs considered by the CAA in preparing its own forecasts.

20. In this respect, the CAA’s position evolved over the course of the H7 decision-making process:

20.1. **Initial Proposals:** In its Initial Proposals, the CAA explained that it had decided to use Heathrow’s models “*as the basis for our passenger forecast*”, with adjustments made “*where our views have differed from [Heathrow’s]*”.²¹ (Those adjustments are outlined in further detail at paragraph 68 below.)

20.2. **Final Proposals:** In the Final Proposals, the CAA explained that it had taken the amended version of Heathrow’s forecast that it used in the Initial Proposals and made a number of further adjustments to it (again, these further adjustments are outlined in further detail at paragraph 68 below).²² The CAA said that Heathrow’s models remained the starting point for its own forecasts,²³ but that it now had regard to “*a much wider range of information*”,²⁴ including a range of traffic forecasts, inputs from stakeholders during engagement, macroeconomic forecasts, updated actual passenger data, and other assessments of the challenges facing the aviation industry.²⁵ As a result, the CAA said Heathrow’s “*forecast and forecasting method has been given less weight in the development of our forecast, as it has become one of a number of forecasts that we have considered*”.²⁶

20.3. **Decision:** In the Decision, the CAA confirmed its view from the Final Proposals that it was appropriate to take account of the Heathrow-specific and risk-weighted aspects of Heathrow’s models, while making its own amendments to certain inputs

²¹ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraph 2.24 et seq. [Supp/25/1141].

²² CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.42 [Supp/13/507].

²³ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.20 [Supp/13/500].

²⁴ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.18 [Supp/13/500].

²⁵ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.18 [Supp/13/499].

²⁶ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.18 [Supp/13/500].

and assumptions, and also taking appropriate account of independent external forecasts.²⁷ It then made a series of further tweaks to its forecasts from the Final Proposals.²⁸

21. The overarching point is that Heathrow’s passenger forecast methodology was not as influential in the CAA’s decision-making as the Airline Appellants suggest (or as Heathrow had hoped it would be during the H7 consultation). In fact, Heathrow’s models really only formed the basis of the CAA’s forecasts at the Initial Proposals stage. From then on, the CAA decided to use its own forecasts from the preceding price control consultation stage as the base for each of its subsequent forecast updates (i.e. for the Final Proposals it used the Initial Proposals, for the Decision it used the Final Proposals).

(II) Heathrow’s forecasting methodology differs materially from the CAA’s approach

22. As referred to above, the CAA’s approach to forecasting passenger numbers departed from Heathrow’s in a number of ways. These differences in approach are discussed in further detail in 1st Berridge.²⁹ The key differences identified by Ms Berridge include:

- 22.1. **Impact of Heathrow’s binding air traffic movements (ATM) cap:**³⁰ ATMs are calculated as the number of flights that take off and land at Heathrow per annum. Heathrow’s legally binding ATM cap means its ATMs per annum will never exceed 480,000. Heathrow reflects this cap in its forecast methodology. However, there is nothing (in the model or in practice) to prevent annual ATMs being much lower than the legal cap, as the experience of Covid-19 reflected. As a result, applying the cap in the methodology produces a downward skew to the outputs, known as “asymmetric distribution”. Heathrow considers this adjustment to its model reflects the reality of the capacity constraints at the airport. However, at the Initial Proposals stage, the CAA adjusted Heathrow’s model to remove the asymmetric distribution in its forecasts, notwithstanding that it acknowledges its

²⁷ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.49 [Supp/2/43].

²⁸ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraphs 1.53 to 1.67 [Supp/2/44-49].

²⁹ 1st Berridge, section 5 [Intv/7/197].

³⁰ 1st Berridge, paragraphs 5.7 to 5.13. [Intv/7/199-200]

adjustments “could lead to a forecast that could only be practically achieved by [Heathrow] breaching a constraint”.³¹

22.2. **Business travel impact:**³² Heathrow considers that the CAA has not taken sufficient account of the full impact of the ongoing reduction in business travel on Heathrow’s future passenger numbers due to factors such as high air fares, flexible working and climate change concerns.³³ While the CAA accepts that there will be a long-term, permanent reduction in business travel, in the Final Proposals, the CAA amended Heathrow’s model to change the impact of the long-term reduction in business travel from 20% to 10% for the most likely scenario.³⁴ Heathrow disagrees with this change and, in particular, notes that evidence indicates business travel recovery is still a significant way behind even 80% of 2019 levels, and is yet to show a continual improvement trend.³⁵

22.3. **London market share:**³⁶ Low-cost carriers are growing at a faster rate than mainline carriers. Those low-cost carriers have concentrated their operations at other London airports – most notably, Luton, Stansted and Gatwick (none of which have legal caps on their ATMs), rather than Heathrow (which does).³⁷ Heathrow is therefore not benefiting from the growth in low-cost airlines to the same extent as its competitors – and its share of the London market is declining as a result. Accordingly Heathrow’s forecast model assumes that Heathrow’s market share will not exceed 2019 levels going forward. The CAA does not accept this assumption, so adjusted Heathrow’s model to remove its effect on the forecasts. As a result, Heathrow considers that the CAA has not taken sufficient account of

³¹ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraph 2.26 [Supp/25/1141].

³² 1st Berridge, paragraphs 5.14 to 5.21 [Intv/7/200-203].

³³ Similarly, the Financial Times reported in April 2023 that “[b]usiness travel has not bounced back – and there is no guarantee that it will”, with high air fares, flexible working patterns and climate change concerns continuing to affect business-related air traffic. See Financial Times: [Business travel has not bounced back – and there is no guarantee it will](#), 23 April 2023 [CEB1/15/160-162].

³⁴ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.46 [Supp/13/508].

³⁵ 1st Berridge, paragraph 5.19. [Intv/7/201]

³⁶ 1st Berridge, paragraphs 5.22 to 5.28 [Intv/7/203-204].

³⁷ HAL CAP2365: [Economic regulation of Heathrow Airport Limited: H7 Final Proposals – Heathrow response](#), 9 August 2022, Chapter 2, paragraphs 2.4.39 et seq. [CEB1/13/140].

recent and ongoing changes in market share attributable to growth in low-cost airlines.

- 22.4. **Carbon prices:**³⁸ Heathrow considers that the CAA has not sufficiently considered the consequences of the likely rise in airfares due to carbon prices for air traffic over the H7 period.
23. In addition, as is set out in the Decision,³⁹ the CAA made a number of further adjustments to its forecasting approach, some of which reflect further departures from Heathrow’s methodology. Those changes were set out by the CAA in four steps:
- 23.1. **Step 1:** The CAA first replaced its forecasts for 2022 with actual passenger data for that year, and adjusted its forecasts for 2023–2026 in light of up-to-date forward booking data for 2023.⁴⁰
- 23.2. **Step 2:** Next, the CAA updated its forecasts in light of recent economic outlook forecasts, resulting in a modest downward adjustment.⁴¹
- 23.3. **Step 3:** The CAA then validated its updated forecasts against various external traffic forecasts, and decided that no further changes to its forecasts were required in light of those more recent external forecasts.⁴²
- 23.4. **Step 4:** Finally, the CAA applied a shock factor to its forecasts for 2023–2026, explaining its view that “*this improves forecast accuracy for the period as a whole by taking account of asymmetric non-economic downside risks (due to events such as adverse weather, volcanic eruptions, terrorism or strike action)*”.⁴³

³⁸ 1st Berridge, paragraph 5.29 [Intv/7/204].

³⁹ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraphs 1.49 to 1.67 [Supp/2/43-49].

⁴⁰ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraphs 1.53 to 1.57 [Supp/2/44-45].

⁴¹ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraphs 1.58 to 1.60 [Supp/2/45-46].

⁴² CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraphs 1.61 to 1.65 [Supp/2/46-48].

⁴³ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.66 [Supp/2/48].

24. In short, the Airline Appellants’ arguments that the CAA erred by relying on Heathrow’s passenger forecast model are simply untenable in circumstances where the CAA’s final forecasting methodology in its Decision had significantly departed from Heathrow’s methodology in a number of ways and drew on a range of other sources, including external forecasts and the forecasts put forward by airlines themselves.

(III) As a result of these different approaches, the CAA’s passenger forecasts for H7 are expected to be stretching for Heathrow over the course of H7

25. The differences outlined above are reflected in the difference between the CAA’s passenger forecasts and the estimates generated by Heathrow’s own model. Those forecasts compare to the CAA’s (and Airline Appellants’) predictions as follows:

	2022	2023	2024	2025	2026	Total
Heathrow (low)⁴⁴	59.2m	57.7m	61.7m	66.5m	69.2m	314.3m
Heathrow (mid)⁴⁵	60.7m	66.6m	69.8m	73.4m	75.6m	346.1m
Heathrow (high)⁴⁶	61.6m	73.0m	76.8m	79.8m	81.5m	372.7m
CAA⁴⁷	61.6m	73.0m	78.9m	80.7m	81.3m	375.5m
Airlines⁴⁸	64.3m	77.6m	82.0m	83.6m	85.0m	392.5m

26. The CAA’s passenger forecast in its Decision of 375.5 million for the H7 period is 8.5% higher than Heathrow’s mid-range forecast of 346.1 million, and slightly above Heathrow’s high forecast (as at December 2022).⁴⁹ Therefore, in Heathrow’s view, the suggestion from Airline Appellants that the CAA’s view represents a material under-estimation of passenger forecasts is not justified.

⁴⁴ As at December 2022.

⁴⁵ As at December 2022.

⁴⁶ As at December 2022.

⁴⁷ These figures are the “mid” (shocked) forecasts contained in the CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.67, table 1.6 [Supp/2/48-49].

⁴⁸ See: BA: *1st Molloy*, 18 April 2023, page 4; Delta: *1st Walker*, 18 April 2023, paragraph 95, page 30; and VAA: *1st Webster*, 18 April 2023, paragraph 166, page 60.

⁴⁹ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.68 [Supp/2/49].

B(3) The CAA cannot be characterised as wrong to the extent that it took Heathrow’s model into account as a starting point for its own forecast

27. The Airline Appellants argue the CAA erred by relying on Heathrow’s passenger forecast model as its starting point, which the airlines say was an “*evidentially erroneous input*”.⁵⁰ As outlined above, Heathrow submits that its model was just one input considered by the CAA. But, in any event, to the extent Heathrow’s model was taken into account as a starting point, Heathrow rejects the Airline Appellants’ arguments that the CAA was wrong to do so. Heathrow says there was no error of law, fact or discretion to the extent that the CAA took account of Heathrow’s model among the evidence that it considered in reaching its Decision.
28. In this section, Heathrow submits that the Airline Appellants are wrong to say the CAA should not have had regard to its passenger forecasting methodology because:
- 28.1. Heathrow’s model is robust, accurate, in line with best practice, and verified by independent experts (section (I));
- 28.2. Heathrow is experienced and an expert at forecasting passenger numbers at its own airport (section (II)); and
- 28.3. the criticisms made by the Airline Appellants of Heathrow’s passenger forecast methodology are misguided (section (III)).

(I) Heathrow’s passenger forecast model is robust, accurate and independently verified

29. First, Heathrow says that – to the extent the CAA did have regard to Heathrow’s passenger forecast model as a starting point – it was not wrong to do so since Heathrow’s model is reliable and has been verified by independent experts.
30. The passenger forecast methodology used by Heathrow across its business is described at paragraph 17 above and in further detail in 1st Berridge.⁵¹ It is a sophisticated model, which produces reliable forecasts utilised by various Heathrow business groups in their day-to-day functions. For example, as 1st Berridge explains, the passenger forecasts

⁵⁰ VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.86, page 38.

⁵¹ 1st Berridge, paragraph 4.2 et seq. [Intv/7/188]

produced by Heathrow’s model are used to assist operational decision-making regarding:⁵²

- 30.1. financial budgets and forecasts for upcoming periods;
 - 30.2. capital projects;
 - 30.3. supply chain resourcing matters; and
 - 30.4. internal resourcing matters, such as staffing airport security and cleaning operations.
31. In Heathrow’s experience, its model generates accurate and useful forecasts.⁵³ However, given its importance right across the business, Heathrow also seeks independent expertise on its model to verify the reliability of its forecasts. For example, in early 2022, Steer Group, a commercial, economic and planning consultancy, was engaged by Heathrow to carry out an independent review of Heathrow’s passenger forecasting methodology and an audit of the corresponding air traffic forecast models.⁵⁴
32. Steer took into account approaches to air traffic forecasts used elsewhere in the industry, as well as the recent complexities presented by Covid-19, and identified six different features that it considered an airport traffic forecast methodology would need to have to be effective. Those were:⁵⁵
- 32.1. a robust and up-to-date series of historical data;
 - 32.2. appropriate market granularity and responsiveness to individual market segments;
 - 32.3. a “top down” forecast of potential traffic demand alongside a “bottom up” forecast of likely airline supply of capacity;

⁵² 1st Berridge, paragraph 3.6. [Intv/7/185]

⁵³ 1st Berridge, paragraph 4.2. [Intv/7/188]

⁵⁴ See: Steer: *Heathrow Airport – Review of Air Traffic Forecast Methodology*, H7, February 2022 [CEB1/9/59].

⁵⁵ Steer: *Heathrow Airport – Review of Air Traffic Forecast Methodology*, H7, February 2022, page iv [CEB1/9/67].

- 32.4. an appropriate means of modelling the prospective traffic recovery path from Covid-19;
- 32.5. an appropriate means for factoring in other potential market impacts; and
- 32.6. a scenario analysis to assess the wide variety of different possible developments in the aviation industry.
33. Steer’s analysis found that “[Heathrow’s] traffic forecast modelling suite incorporates each of these features”.⁵⁶ It came to the following conclusion:⁵⁷

In summary we assess that HAL has developed a sophisticated air traffic forecast modelling suite which is appropriate for use for the H7 period where it is impacted by the COVID-19 pandemic.

34. Even more recently, for the purposes of this appeal, Oxera has carried out a further review of Heathrow’s methodology (see 1st Jevons). Oxera’s conclusion is as follows:⁵⁸

We consider that Heathrow’s approach to forecasting passenger levels is reasonable and appropriate. It is consistent with international best practice and controls for a wide range of potential factors that influence passenger levels as well as Heathrow-specific factors.

35. The Airline Appellants variously describe Heathrow’s passenger forecast model as being patently inaccurate,⁵⁹ an “*evidentially erroneous input*”,⁶⁰ and producing “*a flawed output*”.⁶¹ These allegations are debunked by the independent assessments provided by Steer and Oxera.

⁵⁶ Steer: *Heathrow Airport – Review of Air Traffic Forecast Methodology, H7*, February 2022, page ii [CEB1/9/65].

⁵⁷ Steer: *Heathrow Airport – Review of Air Traffic Forecast Methodology, H7*, February 2022, page iv [CEB1/9/67].

⁵⁸ 1st Jevons, paragraph 3.5. [Intv/9/274]

⁵⁹ See for example BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.9.3, page 41.

⁶⁰ See for example BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.9.6, page 42.

⁶¹ See for example BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.9, page 40.

(II) Heathrow is experienced and the expert at producing passenger forecasts for its own airport

36. Second, Heathrow says it is entirely appropriate that the CAA sought and obtained relevant evidence on passenger forecasts from Heathrow, being the airport to which the passenger forecasts apply and the party most expert and experienced in producing Heathrow-specific passenger forecasts.
37. In support of this submission, Heathrow makes two points:
- 37.1. First, Heathrow has a more detailed and in-depth knowledge of its own business than the CAA or any of the airlines could have. It also has access to a wide range of information to inform its forecasting, including for example information across all of the airlines (which any given individual airline is not privy to).
- 37.2. Second, it is consistent with standard practice elsewhere in the aviation industry for the CAA as the regulator to have regard to Heathrow's own forecasts as the regulated entity. For example, 1st Jevons explains that the regulator of Brussels Airport generally adopts that airport's own forecasting methodology, making adjustments after consulting with relevant stakeholders.⁶² Similarly, the regulator of the Aena airports in Spain bases its own forecasts on Aena's model, adjusting to reflect external evidence where appropriate.⁶³

(III) The Airline Appellants' arguments criticising Heathrow's methodology are unsustainable

38. Third, Heathrow rejects each of the arguments made by the Airline Appellants alleging that Heathrow's passenger forecast methodology is flawed.
39. **Allegations of bias:** The Airline Appellants claim that Heathrow's "*clear incentive to underestimate the passenger forecasts so as to increase passenger charges*" means the CAA was wrong to rely on Heathrow's model.⁶⁴ Heathrow categorically refutes any allegation that its passenger forecast was biased or prepared other than in good faith.

⁶² 1st Jevons, paragraph 4.14 [Intv/9/290].

⁶³ 1st Jevons, paragraph 4.14 [Intv/9/290].

⁶⁴ See: Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.59, page 31; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.76, page 36.

- 39.1. First, as explained at paragraph 30 above, Heathrow’s passenger model is used for business and financial planning purposes beyond simply its price control forecasts; it would not be in Heathrow’s interests for it to underplay the passenger forecasts that it uses for these multiple purposes.⁶⁵
- 39.2. Second, Heathrow maintains that its methodology reflects a sophisticated, accurate and fit-for-purpose means for forecasting passenger numbers for H7 – and, as explained above, it notes that its models were recently reviewed and approved of by independent consultants.
- 39.3. Third, while Heathrow accepts that it has a commercial interest in the CAA’s price control decision, it should be noted that the airlines have a similar commercial interest in the passenger forecast to Heathrow: the higher passenger forecast advocated for by the Airline Appellants would be to the commercial benefit of them and their shareholders.
40. **Changes to forecasts:** The Airline Appellants criticise Heathrow for “*repeatedly adjust[ing] its 2022 passenger forecast*”.⁶⁶ This criticism is not justified. Given the very uncertain economic climate and the effects of the pandemic on travel, Heathrow regularly updates its model to reflect changing circumstances,⁶⁷ including to take account of the regularly changing information provided to it by airlines, such as forward booking data. Far from undermining Heathrow’s information, these updates were appropriate, responsible and in line with forecasting best practice.⁶⁸ Heathrow cannot possibly be criticised for continuing to provide updated forecasting information throughout the price control consultation period, during a period of volatility and uncertainty, including up until December 2022.⁶⁹
41. **Outdated version of forecast model:** The Airline Appellants suggest that the CAA based its Decision on an outdated version of Heathrow’s model, which they say Heathrow

⁶⁵ 1st Berridge, paragraphs 3.10 and 3.11. [Intv/7/186]

⁶⁶ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.9.2(b), page 41. See also Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.62, page 31; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.81 and footnote 206, page 37.

⁶⁷ 1st Berridge, paragraph 4.13. [Intv/7/191]

⁶⁸ See 1st Jevons, paragraph 1.14. [Intv/9/263]

⁶⁹ As set out in 1st Berridge, Appendix 2, [Intv/7/228] Heathrow has provided updated passenger forecast information to the CAA on numerous occasions throughout the H7 consultation process.

knew was wrong.⁷⁰ In particular, BA accuses Heathrow of refusing to provide the latest version of its model in December 2022 – while maintaining that the CAA ought to use its unadjusted and out-of-date model, which BA says could lead one to infer that Heathrow’s data no longer supported the forecast it was urging the CAA to adopt.⁷¹ This criticism is unjustified:

41.1. First, Heathrow continued to provide its passenger forecasts throughout the consultation period, up to and including until December 2022, as explained above. Its latest forecast figures were available to the CAA when making its Decision (as published in the Decision⁷²) and there is simply no factual basis for any suggestion that Heathrow was refusing to provide updated data to the CAA before the Decision.

41.2. Second, and in any event, Heathrow’s model was not the basis of the CAA’s Decision. The Airline Appellants’ suggestion that Heathrow’s model formed the basis of the CAA’s forecasts at the time of the Decision appears to reflect a fundamental misunderstanding of the way the CAA’s forecasts were constructed. As explained at paragraphs 20 and 21 above, the CAA used Heathrow’s model as the starting point for its forecasts in the Initial Proposals, but from then on its starting point at each subsequent stage (i.e., the Final Proposals and the Decision) was its own previous forecast.

42. **Comparisons with actuals:** The Airline Appellants argue that the difference between Heathrow’s passenger forecasts for 2022 (issued in December 2021, then updated in June 2022 and again in December 2022) and actual passenger numbers data for 2022 demonstrates that Heathrow’s models are not fit-for-purpose, so the CAA should not have had regard to them.⁷³ Heathrow rejects this argument. The forecasts made by the CAA, Heathrow and the Airline Appellants throughout the price control consultation

⁷⁰ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.8.6, page 38; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.64, page 34.

⁷¹ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.9.4, page 41; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.82, page 38.

⁷² CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, table 1.1 [Supp/2/37].

⁷³ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.9.2, page 40; Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.61 to 4.62, page 31; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraphs 4.78 to 4.79, page 36.

period in 2021 and 2022 were being made during a period of considerable change and uncertainty in the aviation industry. It is unsurprising that there are differences between forecasts made (in December 2021 and August 2022) and actuals for 2022 given the fast-changing nature of the past and present operating climate. As noted above, Heathrow regularly updated its forecasts in order to reflect this changing climate. In any event, the relevant delta for the CMA's purposes is not that between actual passenger figures and *Heathrow's* forecasts, but that between actuals and the *CAA's* forecasts, which were adopted in the Decision.

43. **Heathrow's alleged lack of transparency:** Finally, Delta goes as far as to argue that, because Heathrow did not share its passenger forecast models with the airlines, it was wrong for the CAA "*to place any reliance on the [Heathrow] model*" at all.⁷⁴ Heathrow rejects the allegation that it did not engage in a transparent manner and, more importantly for the purposes of the Airline Appellants' appeals, Heathrow maintains that the airlines had sufficient information regarding the CAA's approach to passenger forecasting to provide properly informed input to the CAA's consultation. The Airline Appellants' process-based criticisms are addressed in detail below from paragraph 59 onwards.

B(4) The adjustments to the passenger forecasts made by the CAA in the Decision do not contain any errors of law, fact, or in the exercise of the CAA's discretion

44. In their notices of appeal, the Airline Appellants target the four steps that the CAA said it took in the Decision to modify its base forecast to produce the final passenger forecasts.⁷⁵ The criticisms made by the Airline Appellants of the CAA's step adjustments are unwarranted. The Airline Appellants have not identified any errors of law, fact, or in the exercise of the CAA's discretion capable of justifying a decision that the CAA's decision was wrong.
45. This section addresses each of the CAA's four step adjustments to its Final Proposals forecasts in turn. Heathrow's submissions are as follows:

⁷⁴ Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.65, pages 32 and 33.

⁷⁵ See: BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.11.5, page 45; Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.56, page 30; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.92, page 40.

- 45.1. It was entirely appropriate for the CAA not to make the adjustments requested by the Airline Appellants concerning the impact of Local Rule A, and it would have imposed an unjustified and unfair penalty on Heathrow had the CAA done so (section (I)).
- 45.2. The CAA was not wrong to make a reduction in passenger forecasts to take account of recent economic outlook forecasts in Step 2 (section (II)).
- 45.3. The CAA was not wrong (as the Airline Appellants allege) in not making an upwards adjustment in light of recent external forecasts in Step 3 (section (III)).
- 45.4. The CAA's update for traffic shocks in Step 4 was not inappropriate and has not resulted in a double-count of downside risk adjustments (section (IV)).

(I) It was entirely appropriate for the CAA not to make the adjustments requested by Airline Appellants concerning the impact of Local Rule A, and it would have imposed an unjustified and unfair penalty on Heathrow had the CAA done so

46. At Step 1, the Airline Appellants say the CAA made two errors.
47. First, the Airline Appellants say it was wrong for the CAA to ignore the impact of Local Rule A and threatened capacity restrictions in coming to a conclusion for passenger numbers in 2022 and in constructing the appropriate baseline of demand for 2023 onward.⁷⁶ The Airline Appellants' submission is unjustified:
 - 47.1. In respect of 2022, the CAA's "forecast" is really just Heathrow's actual passenger numbers. To use a different number from actuals, when available, would need a convincing justification. The Airline Appellants say a higher number should be used because it was Heathrow's "fault" that the Local Rule A capacity cap was imposed.⁷⁷ Heathrow rejects this allegation. As is explained in 1st Powell, the Local Rule A capacity cap was introduced in response to legitimate concerns about the ability of airlines, as well as Heathrow, to cope with a sharp increase of

⁷⁶ BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.11.5(a), page 45; Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.56(b), page 31; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.92(a), page 40.

⁷⁷ See, for example, Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.72, page 34: "the reason that the introduction of Local Rule A was required sat squarely with HAL's lack of operational readiness".

passenger numbers following the relaxation of Government restrictions and recovery from Covid-19 over summer 2022. As recognised by the CAA, it was not merely Heathrow dealing with these issues.⁷⁸ It was plain at the time that airlines did not have sufficient resources or contractual commitments with suppliers to service the projected passenger numbers in the absence of the Local Rule A capacity cap.⁷⁹ Similar caps were also introduced at other airports including Gatwick, Schiphol and Frankfurt.⁸⁰ Taking account of actual passenger numbers in those circumstances cannot conceivably have been “wrong”. In addition, Heathrow shares the CAA’s view that to make the adjustment proposed by the Airline Appellants would penalise Heathrow and create perverse incentives for the future, which would not be in the interests of consumers.⁸¹

- 47.2. In respect of 2023–2026, the airlines say the CAA should have taken account of “*the depressive effect of Local Rule A on the passenger numbers when setting its baseline for 2023*”.⁸² However, as 1st Powell explains, the cap imposed by Local Rule A was lifted gradually in the two months leading up to its expiry in October 2022, and the actual passenger numbers and forward bookings utilised by the CAA in calibrating its forecasts for 2023–2026 were only taken from the months of November and December 2022.⁸³ The Airline Appellants maintain that “*the effect of Local Rule A between July and October... will have had a negative impact on the total number of passengers who flew to/from Heathrow in November and*

⁷⁸ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.45 [Supp/2/42] states that Local Rule A “*was introduced in the exceptional circumstances of the recovery from the covid-19 pandemic and in response to legitimate concerns about the ability of the airport and a range of service providers (including airlines) to cope with a relatively sharp increase in passenger numbers and the difficulties for passengers that might be created if such concerns were to crystallise*”.

⁷⁹ HAL CAP2365: [Economic regulation of Heathrow Airport Limited: H7 Final Proposals – Heathrow response](#), 9 August 2022, Chapter 2, paragraph 2.4.8 [CEB1/13/133].

⁸⁰ See 1st Powell, paragraph 3.25. [Intv/8/243] 1st Berridge also explains why the 2.7 million passenger forecast proposed increase to 2022 provided by the Airline Appellants is flawed – see paragraph 6.10 *et seq.* [Intv/7/207]

⁸¹ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.45 [Supp/2/42].

⁸² See, for example, Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.77, page 34.

⁸³ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.45 [Supp/2/44].

December 2022”,⁸⁴ and that “the actual numbers for November and December 2022 were also depressed by threatened capacity restrictions”.⁸⁵ However, no evidence is provided to support these assertions. As explained in 1st Powell, Heathrow’s experience was that, since Local Rule A expired and the summer 2022 capacity cap was lifted, passenger numbers were not artificially deflated by those controls (or any other potential capacity restrictions).⁸⁶

48. Second, the Airline Appellants say the CAA was “unduly pessimistic”⁸⁷ and therefore wrong to have found 2023 traffic levels would be 92% of 2019 levels (being the midpoint of the lower and upper bounds identified by the CAA).⁸⁸ They say that forecasts should be 77.6 million for 2023,⁸⁹ which is approximately 96% of 2019 levels. This criticism is also without foundation:

48.1. The Airline Appellants point to the data from the first few months of 2023 as evidence that the CAA’s annual forecast for 2023 is wrong.⁹⁰

48.1.1. First, 1st Berridge explains that the data for 2023 so far all falls within the 90–94% CAA range, with the exception of March (which was only slightly higher).⁹¹ March will also have performed slightly better in 2023 rather than 2019 as the schools broke up for the Easter holidays at the end of March in 2023, whereas Easter fell in the second half of April in 2019. The figures for April 2023 – which are not accounted for by Airline Appellants since they were published after the Notices of Appeal were submitted – also provide early indications of passenger growth levelling off given they show lower recovery rates than March and February.

⁸⁴ Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.78(a), page 35.

⁸⁵ Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.78(b), page 35.

⁸⁶ See 1st Powell, paragraph 4.5. **[Intv/8/250]**

⁸⁷ See, for example, VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.99.

⁸⁸ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.56 **[Supp/2/44]**.

⁸⁹ See, for example: VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.127, page 48; and VAA: *1st Webster*, 18 April 2023, paragraph 166, page 60.

⁹⁰ See, for example, Delta: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.86, page 36.

⁹¹ 1st Berridge, paragraph 6.13. **[Intv/7/211]**

48.1.2. Second, the CAA’s figure is an annual figure of 73 million, not broken down by months, so it is not possible to compare actuals to CAA’s forecasts on a month-by-month basis. The Airline Appellants’ forecast is 77.6 million for 2023. Adjusting for the shock factor, 1st Berridge explains how Heathrow would therefore need to achieve 98% of its 2019 volumes for the rest of the year in order to meet the Airline Appellants’ forecast.⁹² (More generally, 1st Berridge outlines a number of flaws with the Airline Appellants’ approach to forecasting.⁹³)

48.1.3. Third, and in any event, it is also not appropriate to make judgments about an entire price control based on three months’ worth of data. The entire point of forecasting for a price control period is to provide a “fair bet”,⁹⁴ whereby there are likely to be periods where forecasts are exceeded and other periods where they are not.

48.2. Additionally, the Airline Appellants say that it was inappropriate of the CAA to use booking data as at December 2022 as an upper bound for its 2023 forecast.⁹⁵ The CAA decided that, since forward bookings for 2023 (as reported in December 2022) were at 94% of the equivalent period in 2019, this was the appropriate upper bound for its Decision (particularly taking into account downside risks).⁹⁶ However, the Airline Appellants assert that forward bookings as reported in December 2022 are likely to have been depressed, for instance, as a result of Heathrow's threatened capacity caps for winter 2022 and because January is historically the largest month for bookings.⁹⁷ Instead, the Airline Appellants now “urge” the CMA to have “*particular regard*” to up-to-date forward booking data when considering the Airline Appellants’ appeals, and argue that the updated booking data shows that the CAA has underestimated the likely number of

⁹² 1st Berridge, paragraph 7.13.1. [Intv/7/223]

⁹³ See 1st Berridge, paragraph 7.1 et seq. [Intv/7/217]

⁹⁴ See: 1st Jevons, paragraph 2.10 et seq. [Intv/9/269]; and 1st Berridge, paragraph 4.11. [Intv/7/190]

⁹⁵ See, for example, BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.11.19, page 50.

⁹⁶ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.55 [Supp/2/44].

⁹⁷ See BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.11.19, page 50-51; VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 4.106.

passengers in 2023 and beyond.⁹⁸ First, Heathrow explains in paragraph 47.2 above why it disagrees with the unevidenced claims from Airline Appellants about the impact of threatened capacity caps on consumer confidence. In addition, 1st Jevons highlights the recent trend of travel bookings being made earlier by passengers than in 2019.⁹⁹ Contrary to the Airline Appellants' claims, this suggests that it was appropriate for the CAA to use 94% (of 2019 levels) as an upper bound for 2023 given that the data reported in December 2022 is likely to have been inflated due to the trend of people booking earlier than in 2019.

(II) The CAA was not wrong to make a reduction in passenger forecasts to take account of recent economic outlook forecasts in Step 2

49. At Step 2, the Airline Appellants say the CAA was wrong to have downgraded its forecast for 2023–2026 in response to macroeconomic forecasts. Heathrow disagrees. As outlined in 1st Jevons, the CAA's downward adjustment in response to macroeconomic conditions was both reasonable and appropriate for the following reasons.
50. First, Heathrow's success is inextricably linked to economic downturns, as air passenger demand is highly dependent on passengers' income (which, during periods of economic recession, is significantly reduced). Given that the CAA rightly noted in its Decision that the economic outlook has worsened since the Final Proposals in July 2022,¹⁰⁰ it was entirely appropriate to impose a downwards adjustment to forecasts to account for this change – especially in light of the fragile global economic outlook and with continually rising inflation rates exceeding those forecasted by the Bank of England.
51. Second, the Airline Appellants emphasise Heathrow's performance during the 2008 financial crisis as their justification for not making a downwards adjustment. This criticism is misplaced since the CAA has already "*taken the experience of the 2008 recession to indicate how changes to UK GDP affect passenger demand at Heathrow, and have applied this to all forecast years of H7*".¹⁰¹ Moreover, Heathrow would

⁹⁸ See BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraph 3.11.23, page 52.

⁹⁹ See 1st Jevons, paragraph 4.26. [Intv/9/294]

¹⁰⁰ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.38 [Supp/2/40].

¹⁰¹ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.60 [Supp/2/45].

highlight that the current economic circumstances cannot be compared entirely on a like-for-like basis, particularly given the unique challenges arising following a global pandemic which had a particularly catastrophic impact on airports globally. As described in 1st Jevons, there are well-known difficulties with forecasting the timing and magnitude of economic recessions based on historical trends and, furthermore, 1st Berridge explains Heathrow’s exposure in the current cost of living crisis, whereby passengers have less income to spend on luxuries such as holidays.¹⁰² Heathrow therefore cannot see how the CAA’s decision to make a downwards adjustment to account for updated macroeconomic forecast data could be characterised as “wrong”.

(III) CAA was not wrong (as the Airline Appellants allege) in not making an upwards adjustment in light of recent external forecasts in Step 3

52. At Step 3, the Airline Appellants say the CAA was wrong not to have uplifted its forecasts in light of its cross-checks against external forecasts. Heathrow’s position is that whether and how to take account of cross-checks is a matter for the CAA’s judgment as the expert regulator. The Airline Appellants have not pointed to any evidence capable of demonstrating that the CAA’s approach was wrong in this respect.
53. Moreover, whilst the CAA should have regard to independent third-party forecasts by way of a sense check, it is reasonable for the CAA to consider the forecasts in light of its specific knowledge and evidence relating to Heathrow – especially since certain external forecasts do not consider Heathrow-specific characteristics such as the legal limit on ATMs and terminal capacity cap of 85 million passengers (see 1st Jevons, section 4E, and 1st Berridge¹⁰³).

¹⁰² 1st Berridge, paragraph 6.20. [Intv/7/214]

¹⁰³ See 1st Jevons, paragraph 4.49 *et seq.* [Intv/9/301], and 1st Berridge, paragraph 6.22 *et seq.* [Intv/7/214]

(IV) The CAA’s update for traffic shocks in Step 4 has not resulted in a double-count of downside risk adjustments

54. At Step 4, the Airline Appellants say the CAA was wrong to apply a shock factor of 0.87% – and wrong to apply a shock factor in full to 2023 when some months in 2023 had already elapsed. Heathrow disagrees.
55. The shock factor is a small downward adjustment applied to passenger numbers over the regulatory period to reflect that there will be events during the forecast that are completely unpredictable, but that cause a non-recoverable reduction in passenger volumes. Contrary to Airline Appellant assertions, the shock factor is also clearly accounting for a different type of risk than the adjustments made to reflect the macroeconomic forecasts. As explained in 1st Berridge and 1st Jevons, the wider economic climate might improve or deteriorate over H7 (meaning there is potential upside¹⁰⁴ and downside risk for Heathrow); by contrast, the sorts of risks targeted by the shock factor are unpredictable, one-off risks, that only carry downside risk.
56. In addition, the Airline Appellants also argue this adjustment was duplicative of risk already captured elsewhere in the cost of capital. 1st Jevons explains that the shock factor does not constitute double counting: the cost of capital captures the risk of passenger volumes deviating from expected forecasts, whereas the purpose of the downward adjustment to passenger forecasts is to take into account low-probability, high impact downside shocks in the expected forecasts (recognising that these are not offset by low-probability, high impact upside shocks). This difference is also (rightly) recognised by the CAA.¹⁰⁵
57. 1st Berridge also explains how it is appropriate to apply the shock factor to 2023 (given that actual passenger numbers are only being used in 2022), and explains how the shock factor has been calculated looking at historic ‘shock’ events and the size of their impact.¹⁰⁶

¹⁰⁴ Noting that at all times Heathrow’s ATMs are capped at 480,000 per annum.

¹⁰⁵ See 1st Berridge, paragraph 6.28. [Intv/7/215]

¹⁰⁶ See 1st Berridge, paragraph 6.31 *et seq.* [Intv/7/217]

58. Heathrow therefore considers that the Airline Appellants have not demonstrated that the CAA was wrong in this respect.

B(5) The CAA’s use of Heathrow’s model does not amount to a procedural failure

59. Heathrow rejects the Airline Appellants’ argument that the CAA erred in law (or in the exercise of its discretion) by having regard to Heathrow’s passenger forecasting models without sharing the detail of those models with the airlines.

60. In this section, Heathrow first addresses the relevant legal threshold for intervention, as reflected in the CMA’s previous decisional practice (section (I)). In short, the Airline Appellants are required to show that any alleged process defect was so serious as to call the entire basis of the CAA’s decision into doubt. The airlines have not done so. The Airline Appellants cannot meet this legal test on the facts of this appeal because:

60.1. Heathrow’s passenger forecast model was just one element considered by the CAA in arriving at its own passenger forecasts, so the fact that the detail of the model was not disclosed to the Airline Appellants cannot be said to give rise to any error of law or in the exercise of the CAA’s discretion; or otherwise to establish that the CAA’s passenger forecasts are “wrong” (section (II)); and

60.2. in any event, airlines were consulted extensively regarding the CAA’s approach to passenger forecasting throughout the H7 decision-making exercise; they provided extensive submissions and evidence to the CAA as part of the process; and this was taken into account by the CAA (section (III)).

61. Finally, for completeness, this section of Heathrow’s notice of intervention then briefly outlines Heathrow’s reasons for rejecting the Airline Appellants’ criticisms of its own approach to disclosure (section (IV)).

(I) Relevant authorities specify a high legal threshold for overturning the CAA’s passenger forecast decision on process grounds

62. In previous price control decisions, the CMA has held:

62.1. *“[i]f the CMA is satisfied that the regulator’s decision was correct, then the fact that the regulator’s consultation process was deficient ought not to matter, unless*

the process was so deficient that the CMA cannot be assured that the regulator did indeed get it right”,¹⁰⁷ and

62.2. *“our analysis should only take into account procedural deficiencies (including a flawed consultation process) if they are so serious that we cannot be assured that the Decision was not wrong”*.¹⁰⁸

63. Also relevant is the 2012 decision of the Competition Appeal Tribunal (“CAT”) in *TalkTalk Telecom Group plc v Office of Communications*.¹⁰⁹ There, the appellant telecommunications company had challenged the regulator’s first instance charge control decision on the basis of alleged procedural deficiencies (among other things). Considering the appellant’s arguments, the CAT held “[i]t is clear law that where a decision of an administrative body... is subject to a full, on the merits appeal, such an appeal is capable of making good any deficiency in the procedure of the administrative body taking the original decision”.¹¹⁰ The CAT indicated it would only overturn decisions for procedural errors in the limited class of case where a regulator’s process “was *so* defective”, and involved procedural deficiencies that were “*so serious*”, that it would be “*unsafe*” for the CAT to uphold the ultimate decision on appeal.¹¹¹
64. In the present appeal, the CMA is empowered to consider the merits of the CAA’s decision. The Airline Appellants have raised a number of substantive objections to the CAA’s forecasts, which the CMA will consider and determine for the purposes of assessing whether those forecasts are materially wrong. In that context, there is no basis for the CMA to consider that any alleged process failures were “*so serious*” as to justify, in themselves, setting the CAA’s decision on passenger forecasts aside.
65. In particular:

¹⁰⁷ CMA: [Firmus Energy \(Distribution\) Limited v Northern Ireland Authority for Utility Regulations Final Determination](#), 26 June 2017, paragraph 3.20(e) [BANO/62/4781].

¹⁰⁸ CMA: [Cadent Gas Limited and others v the Gas and Electricity Markets Authority Final Determination](#), 28 October 2021, paragraph 3.54. [Auth/15/957].

¹⁰⁹ *TalkTalk Telecom Group plc v Office of Communications* [2012] CAT 1. [Case/4/80]

¹¹⁰ *TalkTalk Telecom Group plc v Office of Communications* [2012] CAT 1, paragraph 126. [Case/4/135]

¹¹¹ *TalkTalk Telecom Group plc v Office of Communications* [2012] CAT 1, paragraph 131. [Case/4/136]

- 65.1. Heathrow’s passenger forecast methodology was just one input into the CAA’s own passenger forecasts, rather than the sole consideration to which the CAA had regard; and
- 65.2. the airlines were consulted extensively on the CAA’s approach to passenger forecasts throughout the H7 decision-making process, and were able to respond effectively to the consultations without needing to have any further detail regarding Heathrow’s model.

(II) Heathrow’s passenger forecast model is just one input into the CAA’s assessment

66. The first reason Heathrow submits the CAA’s non-disclosure of Heathrow’s passenger forecast model is not a sufficiently serious procedural error to overturn the CAA’s forecasts on appeal is that, as outlined from paragraphs 17 to 21 above, Heathrow’s model was just one input in the CAA’s forecast.
67. The Airline Appellants’ complaints concern the non-disclosure of Heathrow’s passenger forecast model, which they repeatedly say “*formed the basis*” of the CAA’s forecasts. However, the CAA was clear that Heathrow’s model was only “*one of a number of forecasts that we have considered*”.¹¹² As the CAA has explained, its forecasts were arrived at based on an in-the-round assessment of all of the available evidence. As well as Heathrow’s forecasts, it also considered “*a range of traffic forecasts, alongside other relevant information and evidence, including inputs from stakeholders during engagement, macroeconomic forecasts, the evolution of actual passenger data [and] the current challenges facing the industry*”.¹¹³
68. The changes made by the CAA to Heathrow’s forecast model were significant – as was the range of other sources the CAA consulted. By way of overview:
- 68.1. at the Initial Proposals stage, the CAA made a series of adjustments to Heathrow’s forecasts to reflect its own views of various matters, including to correct for the

¹¹² CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.18 [Supp/13/500].

¹¹³ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.17 [Supp/13/499].

asymmetric distributions in Heathrow's Monte Carlo simulations¹¹⁴ and to reduce the assumed impact of changes in business travel,¹¹⁵ capacity issues coming out of Covid-19,¹¹⁶ future fleet requirements,¹¹⁷ and changes in Heathrow's market share,¹¹⁸ among other things;

68.2. at the Final Proposals stage, the CAA:

68.2.1. made further adjustments to its passenger forecasts to reflect its updated views of various matters, including to further reduce the assumed impact of changes in business travel,¹¹⁹ and to reduce the assumed impact of carbon pricing on passenger numbers;¹²⁰

68.2.2. identified seven specific external forecasts that it deemed of sufficient detail, relevance and robustness to be of use for forecasting passenger numbers for H7, adjusted those forecasts with the benefit of Heathrow-specific information where the CAA considered possible and appropriate, and utilised those forecasts to validate its own passenger forecasts;¹²¹ and

68.2.3. applied a series of qualitative adjustments to its passenger forecasts in light of updated economic factors, the Russian invasion of Ukraine,

¹¹⁴ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraph 2.25 to 2.26 [Supp/25/1141].

¹¹⁵ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraphs 2.27 to 2.29 [Supp/25/1142].

¹¹⁶ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraphs 2.30 to 2.32 [Supp/25/1142].

¹¹⁷ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraphs 2.33 to 2.35 [Supp/25/1143].

¹¹⁸ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraphs 2.36 to 2.39 [Supp/25/1143-1144].

¹¹⁹ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraphs 1.43 to 1.46 [Supp/13/507-508].

¹²⁰ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraphs 1.43 to 1.46 [Supp/13/508-509].

¹²¹ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraphs 1.35 to 1.41 [Supp/13/505-507].

recruiting challenges and the risk of further disruption related to Covid-19;¹²²
and

68.3. at the Decision stage, the CAA made a final set of adjustments to its passenger forecasts in light of actual passenger numbers for 2022 and forward bookings for 2023, as well as to reflect the up-to-date macroeconomic outlook.¹²³

69. The passenger forecasts ultimately utilised by the CAA in the price control were therefore derived using a very different approach to that reflected in Heathrow's methodology. Accordingly, disclosure of Heathrow's model to the Airline Appellants would not have materially affected their ability to engage in the CAA's consultation, to make submissions to the CAA on their own views on passenger forecasts, or to provide any relevant evidence to support their views. Heathrow submits that the CAA's decision not to disclose this model therefore cannot amount to a procedural error of sufficient seriousness to meet the high legal threshold described above.

70. In their notices of appeal, the Airline Appellants seek to rely on the Court of Appeal's decision in *R (Eisai Limited) v National Institute for Health and Clinical Excellence* to support their submission that it was procedurally unfair for the CAA to not disclose Heathrow's methodology.¹²⁴ The *Eisai* decision concerned the consultation process adopted by the National Institute for Health and Clinical Excellence prior to issuing new guidance and recommendations to the NHS relating to the use of certain drugs for the treatment of Alzheimer's Disease.¹²⁵ There, the Court of Appeal held that the defendant should have disclosed to consultees a fully executable version of the economic model used to assess the cost-effectiveness of the drugs in question.¹²⁶

¹²² CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.68 [Supp/13/514].

¹²³ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraphs 1.53 to 1.60 [Supp/13/509-512].

¹²⁴ See: BA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraphs 3.8.2 and 3.10.1(c), pages 37 and 43; and VAA: [Notice of Appeal \(Airport Licence Condition\)](#), 18 April 2023, paragraphs 4.60 and 4.87(2), pages 33 and 38.

¹²⁵ *R (Eisai Limited) v National Institute for Health and Clinical Excellence* [2008] EWCA Civ 438, paragraph 1 [BANOA/70/5801].

¹²⁶ *R (Eisai Limited) v National Institute for Health and Clinical Excellence* [2008] EWCA Civ 438, paragraph 66 [BANOA/70/5825].

71. Heathrow submits that the decision in *Eisai* should be distinguished on the facts of this price control appeal:

71.1. **Different context:** First, as the Court of Appeal recognised in the later case of *R (easyJet Airline Company Limited v Civil Aviation Authority*, the regulatory decision under scrutiny in *Eisai* (deciding whether to encourage the use in the NHS of a particular drug for treatment) “*is not analogous to the function of fixing price caps at airports*”.¹²⁷ As Lord Mustill explained in *R v Secretary of State for the Home Department, ex parte Doody*, “[t]he principles of fairness are not to be applied by rote identically in every situation”.¹²⁸ Rather, “[w]hat fairness demands is dependent on the context of the decision”.¹²⁹

71.2. **Model not as important here:** Second, and more importantly, the economic model concerned in *Eisai* was central to the decision-maker’s assessment of the cost-effectiveness of the treatment options at issue. By contrast, as outlined above, Heathrow’s passenger forecast model is just one of a number of inputs that were taken into consideration by the CAA in its decision-making process; and the forecasts eventually produced by the CAA were substantially different from those generated by Heathrow’s methodology. Therefore, while disclosure of the economic model was required in *Eisai*, it does not follow that disclosure of just one input into the CAA’s passenger forecasts should be required in this case.

71.3. **Airlines informed of the gist:** In *Eisai*, the Court of Appeal observed that “[t]he mere fact that information is “significant” does not mean that fairness necessarily requires its disclosure to consultees”.¹³⁰ Recent case law has affirmed that a decision-maker is not required to disclose all of the information available to them before making their decision, nor even all of the *significant* information before

¹²⁷ *R (easyJet Airline Company Limited) v Civil Aviation Authority* [2009] EWCA Civ 1361, paragraph 58 [BANOA/71/5851].

¹²⁸ *R v SoS for the Home Department, ex parte Doody* [1994] 1 AC 531, page 560. [Case/2/66]

¹²⁹ *R v SoS for the Home Department, ex parte Doody* [1994] 1 AC 531, page 560. [Case/2/66]

¹³⁰ *R (Eisai Limited) v National Institute for Health and Clinical Excellence* [2008] EWCA Civ 438, paragraph 26 [BANOA/70/5812].

them.¹³¹ What is necessary is that there has been sufficient disclosure to enable those being consulted to engage and respond in a meaningful way. This will typically require that consultees are “*informed of the gist*” of the matter under consultation.¹³² As is set out below, in this instance, Heathrow submits that the Airline Appellants were provided with such an opportunity by the CAA.

(III) Airlines were consulted extensively regarding the CAA’s approach to passenger forecasting

72. The second reason Heathrow submits that the Airline Appellants have not identified a procedural error that is grave enough to overturn the CAA’s passenger forecasts is that the Airline Appellants had ample opportunity to comment on the CAA’s forecasting approach during the H7 consultation.
73. Well-established principles of public law dictate that fair and effective consultation requires fulfilling certain basic requirements, including that the consultation must be at a time when proposals are still at a formative stage, sufficient reasons are given to permit intelligent consideration and response, adequate time is given for consideration and response, and conscientious consideration is given to any response before a decision is made.¹³³ The CAA’s Decision and Final Proposals show that airlines were given adequate opportunity to participate in the CAA’s decision-making, and that their submissions on passenger forecasts were taken into consideration conscientiously by the CAA. Indeed, throughout the H7 period, airlines made multiple submissions commenting on the proposed passenger forecasts, including in response to the Initial Proposals and Final Proposals.
74. By way of overview:

¹³¹ For example, *Bouchti v London Borough of Enfield* [2022] EWHC 2809, para. 70: “*Whether fairness requires particular documents to be disclosed to the consultees in advance of the decision will depend on the circumstances. A failure to disclose can limit the opportunity for an intelligent response and thereby undermine a central element of the consultation process ... Nonetheless what is necessary is that there has been sufficient disclosure to enable those being consulted to make an intelligent response. That may mean that it is not necessary to disclose before the decision all the information available to the decision-maker even if the information which is not disclosed is significant.*” [Case/6/176]

¹³² *R v SoS for the Home Department, ex parte Doody* [1994] 1 AC 531, page 560. [Case/2/66]

¹³³ Hodgson J in *R v Brent London Borough Council, ex p Gunning* (1985) 84 LGR 168 at 189 [Case/1/24], endorsed by the Supreme Court in *R (on the application of Moseley) v London Borough of Haringey* [2014] UKSC 56, [2014] 1 WLR 3947 at paragraphs 25 and 26 (per Lord Wilson). [Case/5/152-153]

- 74.1. In October 2021, the CAA issued its Initial Proposals. There, the CAA said it had decided to use Heathrow’s methodology as the basis for its passenger forecast, with adjustments / corrections to Heathrow’s models where its views differed from Heathrow’s.¹³⁴
- 74.2. On 17 December 2021, each of BA, Delta and VAA responded to the CAA’s consultation on the Initial Proposals. BA’s submissions on passenger forecasts ran to 17 pages, and Delta and VAA’s submissions on the matter ran to 16 pages.
- 74.3. In June 2022, the CAA published its Final Proposals. There, the CAA:
- 74.3.1. acknowledged concerns expressed by the airlines regarding a perceived overreliance on Heathrow’s methodology;¹³⁵
- 74.3.2. noted arguments made by airlines that its forecasts were “*unduly pessimistic*” in light of recent forecasts for total flights for 2022 indicating that “*the recovery will be faster than we had suggested*”;¹³⁶ and
- 74.3.3. also acknowledged specific criticisms of its forecasting approach made by the airlines, such as its use of a shock factor in its modelling.¹³⁷
- 74.4. In light of the airlines’ views, the CAA “*decided to modify the approach [it] used for the Initial Proposals in developing [its] forecast for [the] Final Proposals*”.¹³⁸ The CAA said it had now sourced and considered “*a range of traffic forecasts, alongside other relevant information and evidence, including inputs from stakeholders during engagement, macroeconomic forecasts, the evolution of actual passenger data and assessment of the current challenges facing the industry*”.¹³⁹

¹³⁴ CAA CAP2265B: [H7 Initial Proposals Section 1: Overall approach and building blocks](#), 19 October 2021, paragraph 2.24 [Supp/25/1141].

¹³⁵ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.9 [Supp/13/497].

¹³⁶ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.9 [Supp/13/497].

¹³⁷ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.10 [Supp/13/498].

¹³⁸ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.17 [Supp/13/499].

¹³⁹ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.17 [Supp/13/499].

This, the CAA said, was “*a broader approach that uses a much wider range of information than we used for Initial Proposals*”.¹⁴⁰

74.5. Subsequently, on 9 August 2022, each of BA, Delta and VAA responded to the CAA’s consultation on the Final Proposals. Relevantly:

74.5.1. BA argued that the CAA’s passenger forecasts “*remain too low for the H7 period*” and the CAA “*remains too reliant on Heathrow’s model*”.¹⁴¹

74.5.2. Delta and VAA argued that the passenger forecasts in the Final Proposals remained “*unrealistically pessimistic*” and continued to rely too heavily on Heathrow’s forecast.¹⁴²

74.5.3. All three Airline Appellants submitted a jointly commissioned expert report from AlixPartners which argued that the CAA had made limited use of alternative forecasts and arbitrary amendments to Heathrow’s models. The report also criticised the shock factor applied.¹⁴³

74.6. The Decision was issued by the CAA in March 2023. There, the CAA responded to the airlines’ criticisms of its approach outlined in the Final Proposals:

74.6.1. The CAA acknowledged the airlines’ continued criticism of the CAA’s use of Heathrow’s forecasting model.¹⁴⁴

74.6.2. The CAA also noted the airlines’ new argument that the CAA’s forecasts should not reflect the effect of the Local Rule A capacity cap in 2022, but should instead use the underlying demand that would have been served by the airport had the cap not been imposed.¹⁴⁵

¹⁴⁰ CAA CAP2365B: [H7 Final Proposals Section 1: Regulatory Framework](#), 27 June 2022, paragraph 1.18 [Supp/13/500].

¹⁴¹ BA: [Response to CAP2365 Final Proposals](#), 9 August 2022, page 2 [BANO/34/2004].

¹⁴² VAA and Delta: [Delta and Virgin Atlantic joint response Final Proposals](#), 9 August 2022, paragraph 1.19.1 [VAANO/29/1358].

¹⁴³ AlixPartners: [Analysis of the CAA’s Final Proposals](#), 9 August 2022 [BANO/35/2162].

¹⁴⁴ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.23 [Supp/2/38].

¹⁴⁵ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.33 [Supp/2/39].

74.6.3. The CAA then accepted that, in light of the faster-than-anticipated recovery from Covid-19, the forecasts it had used in the Final Proposals were no longer appropriate, so needed to be updated.¹⁴⁶

75. As a result, the CAA ultimately decided to base its decision on the forecast used for the Final Proposals, after modifying that forecast to reflect the actual demand and forward bookings observed in late 2022 and the change in economic outlook since the Final Proposals were published.¹⁴⁷
76. The procedural history therefore shows that the Airline Appellants were able to, and did, participate fully in the consultation process; and their detailed submissions and evidence were considered conscientiously by the CAA, resulting in multiple adjustments to the CAA's final passenger forecasts, which were ultimately much closer to the airlines' forecasts than to those produced by Heathrow's model.

(IV) Heathrow rejects airline criticisms regarding its approach to disclosing its forecast model

77. Finally, for completeness, Heathrow briefly addresses the Airline Appellants' criticisms of its approach to disclosure of its model having regard to the commercial sensitivity of its contents. For the reasons, those criticisms are misplaced.
78. Heathrow had legitimate legal concerns about disclosing the detailed contents of its model directly to airlines (including competition law concerns around sharing competitively sensitive data between different airlines in direct competition with each other). However, Heathrow actively sought to cooperate with the CAA to provide the airlines with further information relating to its model (without contravening competition law) to provide input on Heathrow's model at numerous stages throughout the H7 decision-making process. For example:
- 78.1. Heathrow engaged extensively with the airline community to develop the approach and gather evidence for the assumptions in the model. Heathrow worked closely with airlines to give them opportunities to understand the model, engaged in weeks

¹⁴⁶ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.41 [Supp/2/42].

¹⁴⁷ CAA CAP2524B: [H7 Final Decision Section 1: Regulatory Framework](#), 8 March 2023, paragraph 1.52 [Supp/2/44].

of Constructive Engagement at the beginning of the H7 planning process, and hosted additional follow-up engagement sessions with agendas tailored to the airlines' requests. 1st Berridge sets out the chronology of events on this engagement with airlines.¹⁴⁸

78.2. As set out in detail in 1st Berridge,¹⁴⁹ Heathrow made multiple attempts in correspondence with the CAA to try to facilitate disclosure of its passenger forecast model to the airlines with appropriate confidentiality protections in place. Heathrow made clear to the CAA right up until the point of the Decision that it was open to disclosure of its model with airline representatives. Indeed, in view of the significant adjustments made by the CAA, Heathrow itself consistently sought disclosure of the CAA's underlying workings and modelling informing the forecasts given that Heathrow's own model could not reveal the underpinning of the CAA's decision-making in relation to its forecasts.

(V) Process issues – concluding remarks

79. For the reasons outlined above, Heathrow submits that the CAA's decision-making process provided the Airline Appellants with sufficient opportunity to be heard on passenger forecasting matters. The CMA may wish to provide some additional guidance to the CAA in its final determination to the extent that the CMA considers that the CAA's process did not fully accord with regulatory best practice. Heathrow agrees that the CAA could and should have adopted a more transparent approach, including towards Heathrow. However, given the high legal threshold that must be met for the Airline Appellants to succeed on this argument, the fact that Heathrow's forecast model was just one input into the passenger forecasts ultimately produced by the CAA, and the extensive involvement of the Airline Appellants throughout the decision-making process, Heathrow submits there is no basis to consider that the process followed by the CAA was so unfair that its decision should be quashed for that reason alone.

¹⁴⁸ 1st Berridge, paragraph 4.23 *et seq.* [Intv/7/193]

¹⁴⁹ 1st Berridge, paragraph 4.24. [Intv/7/193]

C. JOINED GROUND A: RAB ADJUSTMENT

C(1) Introduction

80. Each of the Airline Appeals contends that the CAA should not have granted Heathrow a RAB Adjustment of £300 million in the April 2021 Covid Statement, and that its decision to do so should have been reconsidered and reversed in the final Decision (i.e. the Decision of 8 March 2023).
81. As the CMA is aware, Heathrow's own NoA submits that the CAA should have made a much larger RAB adjustment than it in fact did, in order (a) properly to fulfil Heathrow's and investors' expectations as to the allocation of risk under the Q6 price control framework; and/or (b) to ensure that Heathrow was able to obtain the return of its previously efficiently invested capital. That remains Heathrow's primary position and, to the extent that it is well founded, the Airline Appeals fall away. **[Core/1/23-64]**.
82. In any event, however, Heathrow submits that the grounds of appeal in respect of the RAB adjustment set out in the Airline NoAs are misconceived and fail to identify any proper basis on which the £300 million RAB adjustment should be removed.

C(2) The CAA's Decisions and Heathrow's appeal

83. As explained at §§39 and 59-70 of Heathrow's NoA **[Core/1/25, 30-34]**, the RAB Adjustment consisted of two distinct but related decisions, the April 2021 Covid Statement¹⁵⁰ and the final Decision (i.e. the Decision of 8 March 2023). The Airline Appeals appear to proceed on the basis of misunderstandings as to the content of those two decisions and the relationship between them. In fact, those Decisions arose as follows.

Heathrow's Requests for a RAB Adjustment

84. The background to those decisions is set out at Heathrow NoA §§ 43-58 **[Core/1/27-31]** and 1st Squire §§3.1-5.40 **[Core/4/231-253]**. In short, Heathrow made a formal request for a RAB Adjustment in July 2020, consisting of an immediate depreciation holiday and a subsequent adjustment based on a revenue-risk sharing arrangement which it estimated

¹⁵⁰ CAP2140, *Economic regulation of Heathrow Airport Limited: response to its request for a covid 19 related RAB adjustment*, 4 May 2021. (Note that the 4 May date reflects that this document was updated on that day; it was originally issued in April 2021.) **[LS1/48/1379]**

would likely be c.£1.7 billion. In March 2021, in the light of further information as to the severity and duration of the pandemic and as to the CAA's proposals, Heathrow submitted an amended request based on a traffic risk-sharing arrangement which it estimated at around £2.6 billion. Heathrow's requests were therefore for immediate action.

85. Those requests were made explicitly on the basis that a suspension of depreciation would enable better outcomes for consumers in the medium and long term by facilitating debt and equity financeability and (i) providing a clear signal to investors and rating agencies that the regulatory regime was consistent, easing access to finance and investment at a challenging time; and (ii) provide a clear signal to Heathrow that the regulatory regime supported investment over the long term, providing confidence to take investment decisions based on the long term passenger interest rather than the short term crisis.¹⁵¹
86. As part of those requests, Heathrow gave illustrative examples of the types of immediate investment projects which (at the time) it believed would not be made absent such a RAB adjustment, but which it believed may be possible in the event of a RAB Adjustment of the kind of scale which Heathrow was requesting, which restored investor confidence in the longer term. Those example investment projects included early installation of security scanner technology; a reversal of Heathrow's £60 million cut to planned asset replacement spend in 2021 which would have enabled runway resurfacing, repair of perimeter road and work on the baggage logistics and conformance project; investment of a further £24 million in automation;¹⁵² critical maintenance on Terminal 4 to allow for a quick re-opening in 2022 rather than the planned 2023 date; investment in sustainability projects;¹⁵³ earlier completion of works on tunnels to the Central Terminal Area; earlier recruitment of security staff following the cuts required by the Covid-19 restrictions; and reinstatement of the free travel area around the airport funded by Heathrow which had been suspended during Covid-19.¹⁵⁴ Those investments were cumulatively valued at around £221m in 2018 prices. As part of its overall investment plan, Heathrow ultimately

¹⁵¹ See 2nd Squire §3.3. [Intv/2/83]

¹⁵² i.e. self-service bag drops, boarding gates, check-in machines and automated announcements.

¹⁵³ Such as airspace and ground aircraft efficiency projected to reduce carbon emissions.

¹⁵⁴ See 2nd Squire §3.7. [Intv/2/84]

progressed some but not all of its investment, in particular where it was necessary to ensure airport safety and resilience.¹⁵⁵

87. For the avoidance of doubt, however, Heathrow did not advance its request on the basis that the RAB Adjustment should be given in exchange for these specific investment projects. (Indeed that would have made little sense, given that Heathrow was seeking a RAB Adjustment of a scale obviously much larger than the cost of these projects.) Rather Heathrow’s point was that the making of a RAB Adjustment would help ensure long-term confidence in the regulatory scheme, in particular the willingness of the regulator to take action in the event of truly exceptional circumstances to fulfil the basis on which investors had invested. That long-term confidence would have long term advantages in terms of Heathrow’s ability to access finance at low rates and the willingness of Heathrow to invest at an appropriate pace in the longer term.¹⁵⁶ That longer term willingness to invest would have been demonstrated in the short term by investment in these kinds of projects.

The April 2021 Covid Statement

88. In the April 2021 Covid Statement, the CAA decided to implement a RAB adjustment of £300 million. It did so on the basis that this was “*a transparent and proportionate intervention that is needed now to further the interests of consumers*” (April 2021 Covid Statement, Summary at §4, emphasis added). The CAA stated that the best way for it to further the interests of consumers was “*by making a targeted and focused regulatory intervention ahead of the H7 price review*” (§3, emphasis added). By contrast, the CAA considered that the two other options under consideration “*either not intervening now or making an adjustment of the scale proposed by HAL...would not meet our duties*” (§3, emphasis added) [LS1/48/1384].
89. As these formulations imply, this was a clear decision to “intervene now”, that is to make an immediate and firm commitment to adjust the RAB at least by £300 million, with consideration being given to a further adjustment in line with Heathrow’s arguments. It was not a decision to consider making a RAB adjustment of £300 million in the H7 price

¹⁵⁵ See 2nd Squire §4.17. The investment progressed included the work on tunnels connecting to the Central Terminal Area; investment in asset renewal and replacement including on the airfield; and continuing to invest in reopening capacity. [Intv/2/90]

¹⁵⁶ See 2nd Squire §3.5. [Intv/2/84]

control review; nor was it a provisional decision which was subject to reconsideration in the H7 review; nor a conditional decision with the RAB adjustment only being triggered if certain conditions were met.¹⁵⁷

90. This was made crystal clear in section 3 of the April 2021 Covid Statement **[LS1/48/1404ff]**. The CAA postulated 4 packages of intervention, having ruled out the option of no action at all: see §§3.2-3.3 and 3.11-3.13: Package 1 was no intervention before H7, but consider interventions at H7; Package 2 was “*targeted intervention now and consider further intervention at H7*”; Packages 3 and 4 were variants of the relief requested by Heathrow. The CAA specifically rejected Package 1 on the basis that there were “*some potential short term risks to consumers from lower service quality and a higher cost of debt*” (§3.31).
91. Although the CAA’s decision did not require immediate modifications to be made to HAL’s licence, it was clear that the decision itself was a firm commitment to adjust the RAB at least to the extent of £300 million, and hence the CAA stated that “*This decision will, however, be reflected in the modifications we make to Hal’s licence to implement the H7 price control*” (Summary §6) **[LS1/48/1386]**.
92. The CAA concluded that¹⁵⁸

“an early regulatory intervention, in the form of a RAB adjustment, ahead of the H7 price review (in line with Package 2) is the best way to further ...the interests of consumers in respect to the impact of the covid-19 pandemic having regard to our secondary duties. We consider that such an intervention will further the interests of consumers, particularly by:

- *signalling to HAL the importance of maintaining appropriate investment and service quality levels ahead of the start of H7;*

¹⁵⁷ See also 2nd Squire §§4.10-4.28 **[Intv/2/89-94]**. For the avoidance of doubt, the CAA also undertook to “assess the case for additional interventions” in the H7 Final Decision (see April 2021 Covid Statement §4.27, emphasis added). The CAA also reserved the right to take a separate further decision to reduce the £300 million RAB adjustment or make an offsetting adjustment to revenues in the event that Heathrow was not delivering an appropriate quality of service in 2021. (See April 2021 Covid Statement at §§ 4.22-4.25). However, the possibility of such further separate decisions does not mean that the CAA had not taken a firm and final decision that a RAB adjustment of at least £300 million should be implemented. **[Intv/2/89]**

¹⁵⁸ CAP2140, *Economic regulation of Heathrow Airport Limited: response to its request for a covid 19 related RAB adjustment*, 4 May 2021, para. 24. **[LS1/48/1389]**

- *providing stronger incentives and financial capacity for HAL to be proactive in planning for potentially higher than expected traffic levels from the summer of 2021; and*
- *facilitating HAL in being able to continue to access investment grade debt to finance its activities, particularly if traffic forecasts are instead lower than currently forecast.”*

The final Decision

93. In the Decision of 8 March 2023, the CAA concluded that the H7 opening RAB should be based on a roll-forward of the Q6 RAB, subject only to an end-of-period adjustment of £300 million which reflected its April 2021 Covid Statement: see Decision paragraphs 10.6, 10.22 and 10.74-10.75.
94. The CAA considered but rejected a further, more substantial RAB adjustment as requested by Heathrow. It did so in particular on the basis that, contrary to Heathrow’s submissions, it considered that it had not created any expectations that it would intervene in the event of an exceptional demand shock.
95. Heathrow considers that the CAA’s decision in that respect was fundamentally flawed for the reasons set out in its Notice of Appeal at section D **[Core/1/23ff]**, in particular because: (i) in refusing to make a RAB adjustment calibrated to redress the catastrophic shortfall in passengers and hence revenue, the CAA failed to respect reasonable investor expectations as to the allocation of risk in the current regulatory settlement; and (ii) in any event, the CAA erred in failing to make a RAB Adjustment calibrated to compensate for depreciation of the RAB during the period of pandemic restrictions, as Heathrow was effectively prevented from recovering this depreciation and without a RAB adjustment Heathrow would be prevented from recovering its efficiently invested capital.
96. However, in treating the point as settled that the RAB adjustment should be at least £300 million, whilst considering making a larger adjustment the CAA was acting consistently with its decision in the April 2021 Covid Statement.
97. In the H7 Review, the CAA also considered submissions made by the airlines to the effect that the RAB Adjustment made by the CAA in April 2021 should be reversed: see Final Proposals §§10.18-10.19 **[Supp/15/780]**; Decision §§10-20-10.21 **[Supp/4/191-192]**. Specifically, BA contended that the £300 million adjustment should be reversed on the basis that: (i) the investment referred to in the April 2021 Covid Statement had not in fact

been delivered, there had been delays in re-opening capacity and desired service quality outcomes had not been delivered; and (ii) incentives would be undermined if HAL were allowed to retain this adjustment if the necessary service quality and terminal capacity were not delivered in 2022.¹⁵⁹ It appears that VAA had also submitted that the adjustment should be reviewed.¹⁶⁰

98. The CAA rejected the airlines' submissions in this regard, in particular for three reasons:

98.1. First, the CAA stated that:

“the focus of the RAB adjustment made under the April 2021 Decision was on outcomes, namely, service quality and investment in 2021: that is, before we were able to take account of such outcomes in our H7 price control proposals. As such, we do not consider that it would be appropriate to revisit our April 2021 RAB Adjustment Decision on the basis of outcomes in 2022”¹⁶¹

98.2. Secondly:

“We do not consider that the reversal of the £300 million RAB adjustment, as proposed by some airline stakeholders, would further the interests of consumers. We remain of the view that this adjustment was justified and appropriately calibrated given the information available at the time. To reverse this now would tend to increase investor perceptions of risk, increase the cost of capital and put upward pressure on airport charges, which would not be in the interests of consumers.”¹⁶²

98.3. Thirdly, the CAA stated that it disagreed with the airlines' suggestion *“that the application of the RAB adjustment will materially undermine incentives to deliver on service quality. Our decision on the H7 price control includes a suite of incentives that encourage service quality improvement, and our capex incentive mechanism will penalise non-delivery of capital projects.”* [Supp/4/199]

99. That reasoning speaks for itself.

¹⁵⁹ Decision §10.21. [Supp/4/191]

¹⁶⁰ Final Proposals §10.19. [Supp/15/781]

¹⁶¹ Decision §10.68. [Supp/4/199]

¹⁶² Final Proposals §10.99, [Supp/15/797] repeated in the Decision §10.69. [Supp/4/199]

Conclusion on the CAA's decision

100. Thus, the CAA took three, separate decisions:

100.1. In the April 2021 Covid Statement [LS1/48], the CAA decided that it should take immediate action to address short term risks in relation to service quality and increases in Heathrow's cost of debt, and that longer term issues should be considered in the H7 review. The CAA calibrated that immediate action by reference to its perception of those risks, in the exercise of its judgment.

100.2. In the Decision [Supp/4/187ff], the CAA considered but rejected Heathrow's submission that a RAB adjustment should be made on an entirely different basis, namely that the regulatory settlement required that demand risk in the event of a catastrophic event was to be shared between Heathrow and airport users, and in any event, that Heathrow should obtain at least the return of its invested capital,

100.3. Also in the Decision (§10.73), the CAA dismissed the Airlines' requests that it reverse the decision taken in the April 2021 Covid Statement [Supp/4/200].

101. As further set out below, the Airline Appeals appear to attack both the first and the third decisions. The second decision is the subject of Heathrow's appeal, which contends that the CAA erred in principle in failing to make an adjustment on the basis requested. If such an adjustment were made it would supersede the adjustment actually made by the CAA, and the Airline Appeals would fall away.

C(3) The Airline Appeals in relation to the RAB Adjustment and Heathrow's Response

102. Broadly, the Airlines' arguments fall into two groups:

102.1. Criticisms of the CAA's alleged failure to review the RAB adjustment in the Decision: The Airlines contend (i) that the Decision in the April 2021 Covid Statement was in some sense provisional, and that the CAA should simply have reconsidered it; (ii) that by failing to do so the CAA wrongly disregarded evidence before it; and (iii) that the CAA erred in treating the Airlines' requests as being for the reversal of an amount added to the RAB (§§ 106ff below).

102.2. Criticisms of the decision to grant a RAB adjustment of £300 million contained in the April 2021 Covid Statement itself: The Airlines contend that: (i) the CAA erred in principle in making a RAB adjustment that did not relate to specific efficient investments; (ii) it is wrong in principle for the CAA to compensate Heathrow, through the RAB for historic losses; (iii) other aspects of the price control framework adequately and/or more appropriately mitigate the uncertainty for investors arising out of the Covid-19 pandemic; (iv) a RAB Adjustment was not necessary to ensure the financeability of the notional company; (v) the CAA was wrong to conclude that an adjustment to the RAB was necessary to secure that all reasonable demands for airport operation services at Heathrow were met; (vi) the CAA was wrong to conclude in the Decision that a RAB adjustment had been necessary to allow Heathrow the flexibility to respond to changing circumstances; and (vii) the RAB adjustment was contrary to the interests of consumers (see §§ 111ff below).

103. Those arguments are incorrect for the reasons set out in section C(4) below.

C(4) Heathrow's response to the Airline Appeals

104. As an overriding point, Heathrow submits that the Airline Appeals should be rejected simply because the CMA should instead allow Heathrow's appeal. By its appeal, Heathrow contends that the CAA failed, in both the April 2021 Covid Statement and in the Decision, properly to address the issues raised by Heathrow's request for a RAB Adjustment. The CAA should have recognised that the impact of the Covid-19 restrictions fell far outside the risks which had been allocated to Heathrow under the existing price control settlement, and asked itself what intervention was required in order to fulfil the regulatory contract in those circumstances. It follows that the CAA was in fact obliged to make a much more extensive RAB Adjustment than that it actually made. Acceptance of Heathrow's appeal would also entail the rejection of the Airlines Appeals since (as further explained below), they are each premised on the assumption that all traffic risk (even in the event of a pandemic scale demand shock) had been allocated to Heathrow under the Q6 settlement and that additions to the RAB should only be made to reflect specific efficient investments.

105. Even if the CMA does not allow Heathrow’s appeal, however, Heathrow submits that the Airline Appeals are misconceived and should be rejected. As set out in more detail below, the Airline Appeals are (a) based on an erroneous understanding of the RAB; (b) misread the decision contained in the April 2021 Covid Statement and/or (c) simply contend that the CAA should have weighed differently the risks to financeability and the consumer interest without identifying any real error of law or approach. On a proper understanding of these matters, it is clear that the CAA was entitled - when faced with the unprecedented and exceptional circumstances caused by the Covid-19 restrictions, in particular the uncertainty of the situation in early 2021 which required planning for both a return of demand and the possibility of a continued suppression of demand - to take action through an immediate adjustment to the RAB with a view to providing reassurance to Heathrow and its investors that investment would be supported in the longer term.

Alleged Failure to Review

106. Collectively, the Airline Appellants advance three arguments in respect of an alleged error on the part of the CAA in the Decision in failing to review the RAB adjustment.

107. First, the Airline Appellants argue that the CAA decided in April 2021 to make the RAB Adjustment contingent or provisional upon Heathrow making specified capital investments, and that the CAA therefore fundamentally misdirected itself by upholding that RAB adjustment despite alleged failings on the part of Heathrow “*to do as it had promised*”.¹⁶³

108. However, this is based on a fundamental misreading of the April 2021 Covid Statement. As set out above, although the CAA left over to the H7 process consideration of making a fuller RAB adjustment on the basis requested by Heathrow, the decision in the April 2021 Covid Statement was neither conditional nor provisional as regards the making of a RAB adjustment of £300 million. Although the amendment to HAL’s licence would come later, the April 2021 Covid Statement was a firm and binding decision – to take action “*now*” in order to provide a clear signal to Heathrow and investors and thus address financeability and incentivise future investment. Nor was the £300 million RAB adjustment simply a payment for specific investment projects or the making of an equivalent amount of investment. Indeed, such an arrangement would have done nothing

¹⁶³ BA NoA §§4.6.1-4.6.17; Delta NoA §§6.49-6.56, VAA NoA §§6.49-6.56.

additional to tackle the problems caused by Covid-19 and the pandemic restrictions, as specific investments would be added to the RAB in any event. The RAB adjustment made by the CAA was intended to be an additional and immediate signal to Heathrow that it could continue to invest in the airport despite the highly uncertain outlook. This misunderstanding runs throughout the Airline Appeals and vitiates their arguments.

109. Secondly, the Airline Appellants argue that the CAA failed to consider various items of evidence before it at the Decision.¹⁶⁴ However, this does not add anything to the previous argument. If it were the case that the CAA’s April 2021 Covid Statement had merely signalled a present intention to make a RAB Adjustment in the future, then it would have been under an obligation to consider the evidence in the round. But that is not the case: although in the April 2021 Covid Statement, the CAA had deferred taking a final decision on the issues raised by Heathrow regarding a RAB adjustment, the CAA had taken a binding decision on the £300 million RAB adjustment. As set out further below, to the extent that the CAA might consider reversing that RAB adjustment, that would not simply be a matter of considering the evidence in the round; rather a higher threshold for intervention would apply.
110. Thirdly, the Airline Appellants argue that the CAA misdirected itself in noting that the reversal of amounts previously included in the RAB had been explicitly proscribed in a previous CMA Appeal by Phoenix Gas Networks.¹⁶⁵ However, the CAA was clearly correct to make reference to this precedent. As is clear from the account of the CMA’s decisions set out above, it is clear that the April 2021 Covid Statement was a decision to implement a RAB Adjustment. Any reversal of that RAB adjustment would require a fresh decision, and as the Competition Commission stated in the *Phoenix Gas* case “*to reduce ex post and without clear signalling the opening value of a RAB is a step that should not normally be taken without very good justification*” [BANO1/83/6181]. For the avoidance of doubt, it is accepted that the CAA indicated to both Heathrow and airlines that any appeal that could be brought against the April 2021 Covid Statement could be brought against the H7 Decision. That means it is open to the Airline Appellants to seek to challenge the substance of the April 2021 decision. However, it does not follow

¹⁶⁴ Delta NoA 6.57-6.66.; VAA NoA §§6.57-6.66.

¹⁶⁵ BA NoA §§4.7.10-4.7.4, Delta NoA §§6.67-6.74; VAA NoA §§6.67-6.74.

that the CAA fell into error in the H7 Decision in concluding that it should not itself interfere with a final decision to add amounts to the RAB.

Alleged Errors in the April 2021 Covid Statement

111. The Airline Appellants argue, first, that the CAA erred in making a RAB adjustment in the April 2021 Covid Statement because it is wrong in principle to increase the RAB other than by adding the value of efficient investments, or conditional amounts which incentivise specific investments.¹⁶⁶ However, this is fundamentally wrong in two respects:

111.1. It misunderstands and misrepresents the nature of the RAB. As explained in 1st Bolt, the RAB is “*a financial concept, not directly related to the value of physical assets*”.¹⁶⁷ The overriding purpose, within a Financial Capital Maintenance framework, is to ensure that investors receive the return of, and an appropriate opportunity to earn a return on, invested capital. As 2nd Cuchra explains at §38, **[Intv/3/119]** efficient investments can only be encouraged and incentivised at reasonable cost in the future when commitments of the past are honoured. The RAB is therefore to be understood as an “instrument of regulatory commitment”.¹⁶⁸ Although it is correct that this does entail that efficiently made investments will be added to the RAB, the RAB is not restricted to that purpose.

111.2. It also ignores the fact that, by reason of the pandemic restrictions, Heathrow had in effect been deprived of a large part of the RAB which did reflect previous efficient investments, in the sum of approximately £1.6 billion: see Heathrow NoA at §§91-100 **[Core/1/47]**. Heathrow submits that the CAA should, at the least, have adjusted the RAB to ensure that it could recover that sum. In any event, however, it cannot be said to be impermissible for the CAA to make any adjustment at all.

112. Secondly, Delta and VAA specifically argue that it is wrong in principle for the CAA to compensate Heathrow, through the RAB, for historic losses and that to do so gives rise

¹⁶⁶ See BA NoA §§4.9.1-4.9.12; Delta NoA §6.22(h); VAA NoA §6.22(h).

¹⁶⁷ 1st Bolt §3.10. **[Core/7/340]**

¹⁶⁸ See 1st Bolt §4.9 **[Core/7/344]**; See Stern J (2014) The Role of the Regulatory Asset Base as an Instrument of Regulatory Commitment, European Networks Law and Regulation Quarterly, 2:1 **[LS1/14/874]**. See 2nd Cuchra. **[Intv/3/119]**

to double recovery.¹⁶⁹ This argument misunderstands the RAB; Heathrow's request for an adjustment; and the CAA's decision:

112.1. As §111 above, the RAB is a tool which can appropriately be used to ensure financial capital maintenance and it was legitimate to use it in this way in the present case, where Heathrow had been deprived of the opportunity to recover previous efficient investments (and where the operation of the price control would otherwise deprive Heathrow of the opportunity to do so in the future). The problem with the CAA's decision was that the adjustment was too small, not that it was too large.

112.2. Heathrow's request was not that it be compensated for historic accounting losses, but that the CAA should fulfil the expectations set in the existing price control framework. That request was made on the basis that Heathrow was not expected under the framework to bear all demand risk in the event of exceptional events, and that the RAB should therefore be adjusted "*to allow for recovery of an appropriate amount of the revenues lost due to Covid-19 and ensure that Heathrow continued to be an investable proposition*": see 1st Squire §§4.31-4.40 and 5.1 [Core/4/241-244]. Heathrow's requested adjustment was and is far lower than its actual losses during 2020 and 2021 of some £3.8 billion: 1st Squire 3.11. [Core/4/233]

112.3. As set out at §§111 above, the CAA's decision in the April 2021 Covid Statement was expressly made on a forward looking basis, and was intended to provide a signal to Heathrow and its investors as to future investment.

113. Thirdly, the Airline Appellants argue that other aspects of the price control framework adequately and/or more appropriately mitigate the uncertainty for investors arising out of the Covid-19 pandemic, such as the TRS mechanism, a shock factor for future passenger forecasts, asymmetric risk allowance, a higher asset beta and guidance on price control reopening.¹⁷⁰ However, each of the matters referred to by the Airline Appellants deal only with what would happen if a further Covid-type event arose in the future: they do not grapple with the impacts of the actual Covid-19 pandemic and associated restrictions, which arose under a price control framework which did not contain these features.

¹⁶⁹ Delta NoA §6.23; VAA NoA §6.23. This argument is not specifically raised by BA.

¹⁷⁰ BA NoA §4.11.9; Delta NoA §§6.24-6.26; VAA NoA §6.24-6.26.

Heathrow contends in its main appeal that, since the pandemic restrictions were not accommodated by that price control framework and the risk was not allocated to Heathrow, the CAA should have taken effective action properly to reflect that risk allocation. Even if that is wrong, however, it was legitimate for the CAA to take action to reflect the fact that an unforeseen and exceptional event had occurred, and in circumstances where the CAA concluded that to fail to act would not accord with its statutory duties.¹⁷¹

114. Fourthly, the Airline Appellants argue that a RAB Adjustment was not necessary to ensure the financeability of the notional company.¹⁷² As to this:

114.1. Many of the Airline Appellants' submissions under this point appear simply to be arguments that the CAA should have exercised its judgment differently, for example Delta and VAA argue that they "disagree" with the CAA's starting point that the notional company's gearing would have stood at 60% prior to the pandemic.¹⁷³ Such statements do not raise any arguable error of law, fact or discretion.

114.2. The Airline Appellants wrongly compare the cost of the RAB adjustment to the potential savings on interest payments in relation to debt finance during the H7 period: see BA NoA §4.11.6(b) Delta NoA §6.36(a)(i); VAA NoA §6.36(a)(i); the expert report jointly commissioned by all three Airline Appellants produced by AlixPartners¹⁷⁴. In fact, although the only metric examined by the CAA was the gearing of the notional company, the CAA's decision was not solely concerned with the cost of debt finance across the H7 period. The CAA could legitimately have regard to the need to incentivise additional investment (in particular to provide

¹⁷¹ Delta NoA §6.27 and VAA NoA §§6.27 suggest that another more appropriate means to mitigate this uncertainty would have been for Heathrow's shareholders to inject capital. This misses the point entirely: Heathrow's shareholders injecting capital would not address the fundamental concern of whether Heathrow's regulated business will generate a sufficient return to make investment attractive for both shareholders and bondholders. Further, Heathrow's shareholders did inject capital: see 1st Squire §3.10.

¹⁷² BA NoA §§4.11.1-4.11.11; Delta NoA §§6.33-6.37; VAA NoA §§6.33-6.37.

¹⁷³ Delta NoA §6.36(a)(ii).

¹⁷⁴ AlixPartners: *Assessment of the CAA's H7 RAB Adjustment*, 17 April 2023 (the "Airlines' RAB Report"), §2.5.23, page 17.

for the possibility of a stronger than expected recovery) and the need to ensure both debt and equity financeability in the longer term.

114.3. As explained at 1st Squire §§3.7-3.11 [**Core/4/232**], 2nd Squire §§6.1-6.9 [**Intv/2/98-101**] and 1st Cuchra §§147ffs [**Core/8/396**], in the uncertain circumstances of 2021, after more than a year of pandemic restrictions and with no end in sight, there was a real threat to Heathrow's debt financeability, both of the actual company (as shown both by the statement of credit rating agencies, and by the operational and financial measures taken by Heathrow to ensure that it could continue to service its debt) and the notional company. Despite drastic cost-cutting and a substantial injection of capital, Heathrow's debt had been downgraded by both S&P and Moody's through 2020 and remained on a negative outlook or creditwatch negative for the rest of the Covid period.¹⁷⁵ Further in July 2021, S&P noted that a multi notch downgrade to Heathrow's credit rating was possible if it assessed that the regulatory environment had increased Heathrow's business risk.¹⁷⁶ Contrary to Delta NoA §6.36(c); VAA NoA 6.36(c) and BA NoA §4.11.6(b), the fact that the actual Heathrow company managed to remain financeable, does not mean that those risks were not real, nor that the CAA was not entitled to take action to address them.

115. Fifthly, the Airline Appellants contend that the CAA was wrong to conclude that an adjustment to the RAB was necessary to secure that all reasonable demands for airport operation services at Heathrow were met.¹⁷⁷ The Airline Appellants attack the RAB adjustment on the basis that it could not be regarded as paying for or incentivising specific efficient investments and that there was no evidence that Heathrow made any incremental expenditure due to the RAB adjustment: see Delta NoA §6.38(d), VAA NoA §6.38(d); BA NoA §4.10.1. However:

115.1. As already explained above, the RAB adjustment was not intended to pay for specific investment projects, nor even to incentivise specific investment projects in the short term. Rather, the RAB adjustment was intended in part to incentivise

¹⁷⁵ See 2nd Squire §6.2.3. [**Intv/2/99**]

¹⁷⁶ 2nd Squire §6.8. [**Intv/2/100**]

¹⁷⁷ BA NoA §§4.10-1-4.10.2; Delta NoA §§6.38-6.39; VAA NoA §§6.38-6.39.

Heathrow to invest – or perhaps more accurately reduce its strong disincentive to invest – in circumstances where there was extreme uncertainty for the future. As the CAA explained in the April 2021 Covid Statement at §§3.39-3.40 [LS1/48/1412]:

3.39 In normal times, HAL faces incentives to undertake necessary investment through including efficient investment in the RAB and earning an allowed cost of capital. In these unprecedented circumstances, we can see that HAL has significantly reduced its investment, focusing on minimum safety requirements. This could also mean that HAL takes a slower and more reactive approach if traffic recovers, which might not provide capacity in a timely way in the event of a faster than expected recovery in traffic.

3.40 This suggests that, in the exceptional circumstances of the covid-19 pandemic, a targeted regulatory intervention may be appropriate. This would be designed to ensure that HAL has both the capacity and incentives to invest in a way that fully meets the needs of consumers. This would be applied alongside incentives from the SQRB regime, which incentivise HAL to maintain service quality levels.

115.2. By its nature, it is impossible to match the RAB adjustment to specific investment projects, but that does not undermine its validity, as it was not granted in return for specific projects. Further, the Airline Appellants unfairly compare Heathrow's investment in 2021 to its investment in 2020¹⁷⁸ and argue that, since investment dropped, the RAB adjustment failed in its incentive effect.¹⁷⁹ That simply misses the point, which was that the CAA was seeking to grapple with the fact that Heathrow faced circumstances of extreme uncertainty for the future.

115.3. To the extent that the Airline Appellants complain that Heathrow did not make all of the investments to which it referred in its request for a RAB adjustment,¹⁸⁰ that ignores the fact that Heathrow did not receive a RAB adjustment of anything like the scale which it was requesting, and that Heathrow was not proffering them as specific projects which could be paid for through the RAB adjustment. Heathrow gave those as illustrative examples of the types of immediate investment which

¹⁷⁸ 2020 included months unaffected by the pandemic. Accordingly, it cannot fairly be inferred from a lower overall investment in 2021 compared to 2021 that Heathrow's investment was falling in 2021.

¹⁷⁹ See BA NoA §4.10.1; Delta NoA §6.41(b); VAA NoA §6.41(b).

¹⁸⁰ As to which see §115 above.

might be made if the CAA were to give long term confidence by means of a RAB adjustment which appropriately reflected Heathrow's expectations under the Q6 price control framework (See 2nd Squire at §§4.1ff [Intv/2/85]).

116. Sixthly, Delta and VAA argue that the CAA was wrong to conclude in the Decision that a RAB adjustment had been necessary to allow Heathrow the flexibility to respond to changing circumstances, and that the RAB adjustment should have been reversed in the event that it turned out that investment of an equivalent scale was not required.¹⁸¹ The problem with this line of argument is, first, that it misreads the RAB adjustment as simply being a pre-payment for expected investment, which it wrong for the reasons set out at §115 above. Secondly, it simply ignores the fact that in April 2021, Heathrow faced unprecedented uncertainty as to whether there would be high or low demand in the future, and had to decide whether or not to invest for a higher demand case in circumstances where demand might continue to be catastrophically low. In those circumstances, it was entirely appropriate for the CAA to seek to provide confidence to Heathrow and its investors.

117. Seventhly, the Airline Appellants argue that the RAB adjustment was contrary to the interests of consumers.¹⁸² The logic of the Airline Appellants' argument is essentially that the RAB Adjustment was contrary to the consumer interest because (a) additions to the RAB should only be made to reflect or incentivise specific efficient investments; and (b) the CAA could not point to specific efficient investments totalling £300 million with which the RAB Adjustment could be associated. This argument fails for the same reasons as set out at above:

117.1. The RAB is not limited to reflecting efficient investments in specific physical assets. It is an instrument of regulatory commitment which operates on the principle of financial capital maintenance and forms part of the overall price control mechanism. It is legitimate and appropriate for the CAA to make additions to the

¹⁸¹ Delta NoA §6.40-6.42; VAA NoA §§6.40-6.42. BA does not specifically make this point and appears to concede that it was understandable that the CAA would wish to allow both for the eventualities of high and low demand: BA NoA §4.9.11. However, BA fails to follow through that logic and argues that the high and low demand scenarios can be considered separately, without accounting for the uncertainty faced by Heathrow.

¹⁸² BA NoA §§4.12.1-4.12.7; Delta NoA §§6.43-6.46; VAA NoA §§6.43-6.46.

RAB where to do so serves the purpose of ensuring the return of and a fair return on invested capital, and where to do so serves the CAA's statutory purposes.

117.2. Heathrow's primary position is that, in the specific and exceptional circumstances of the Covid-19 pandemic and associated restrictions, the CAA should have made a much larger adjustment in order properly to reflect that allocation of risk in the Q6 price control settlement and/or in order to ensure that Heathrow could receive the return of capital which it would otherwise have been deprived of by depreciation on the RAB during the pandemic period.

117.3. Even if that primary position is not accepted, however, it was in any event entirely appropriate for the CAA to make an addition to the RAB which did not simply reflect specific additional investments. Indeed, an addition which only reflected specific additional investments would have done nothing additional to tackle the problems caused by Covid-19 and the pandemic restrictions, as such investments would be added to the RAB in any event. The RAB adjustment was intended to be an additional and immediate signal to Heathrow that it could continue to invest in the airport despite the highly uncertain outlook.

117.4. The provision of such a signal is in accordance with the longer-term consumer interest, even if the Airline Appellants (who are not consumers and who may have shorter-term financial targets) do not like it.

C(5) Conclusion

118. For the reasons set out above, it is submitted that each of the Airline Appeals on the RAB adjustment should be dismissed.

D. JOINED GROUND B: COST OF CAPITAL

D(1) Joined Sub-ground B(i): Asset Beta

The Airline Appellants' Grounds

119. The Airline Appellants have all advanced Grounds which implicitly accept the three-stage approach followed by the CAA in the Decision in estimating Heathrow's asset beta (i.e. estimating a pre-pandemic asset beta, adjusting for the likely impact of future pandemic like event, and then adjusting for the impact of the TRS mechanism). However,

the Airline Appellants allege that the CAA has made errors at each stage of its analysis, relying on a joint economic expert report produced by Derek Holt of AlixPartners in support.¹⁸³

120. The Airline Appellants' arguments as to asset beta substantively mirror one another and can be summarised as follows.

120.1. First, they argue that the CAA has erred in not using the most recent data to estimate the pre-pandemic asset beta, and that if it had done so its estimate would be 0.44.¹⁸⁴

120.2. Secondly, they argue that the CAA was wrong to adjust Heathrow's pre-pandemic asset beta upwards because (on their view) Heathrow is not riskier than comparators.¹⁸⁵

120.3. Thirdly, they argue that the CAA and Flint, the CAA's advisers in this respect, made a methodological error in addressing the structural break in the share price time series caused by Covid-19 through a weighted least squares ("WLS") estimator.¹⁸⁶

120.4. Fourthly, they argue that the CAA and Flint made a methodological error when calculating the pandemic adjustment by not accounting for the different levels of gearing during the period assumed to be affected by the pandemic.¹⁸⁷

120.5. Fifthly, they argue that traffic risk is the only driver of difference in systematic risk between Heathrow and network (water and energy) utilities, and therefore that the CAA's TRS adjustment should have been greater.¹⁸⁸

Heathrow's response to the Airline Appellants' arguments

121. As Heathrow explains in Ground 2 of the Heathrow NoA (but does not repeat in detail here), the CAA's overall approach to estimating asset beta is flawed and should be

¹⁸³ AlixPartners: *Cost of capital issues raised by the Heathrow Airport H7 Price Control*, 17 April 2023 (the "Airlines' WACC Report").

¹⁸⁴ BA NoA §5.7.6; Delta NoA §§5.38-40; VAA NoA §§5.37-5.38.

¹⁸⁵ BA NoA §§5.7.7-5.7.9; Delta NoA §§5.41-5.46; VAA NoA §§5.40-5.44.

¹⁸⁶ BA NoA §5.7.11; Delta NoA §5.48; VAA NoA §5.46.

¹⁸⁷ BA NoA §5.7.12; Delta NoA §§4.49-5.53; VAA NoA §§5.47-5.51.

¹⁸⁸ BA NoA §§5.7.15-5.7.21; Delta NoA §§5.55-5.61; VAA NoA §§5.53-5.60.

rejected, because it effectively shuns market evidence and instead relies on the subjective three-stage approach to estimating Heathrow's asset beta referred to above. Had the CAA followed best practice, the three stages addressed by the Airline Appellants would not have occurred. Any alleged errors in relating to these stages would therefore never have arisen and the Airline Appellants' Asset Beta Sub-grounds (and the arguments contained therein) fall away, if the CMA is with Heathrow in its contention that the CAA's overall approach should be rejected.

122. Notwithstanding the above, the arguments advanced within the Airline Appellants' Asset Beta sub-ground are also each individually in error for the reasons set out below.

Asset beta: pre-pandemic beta

123. The Airline Appellants argue, relying on the Airlines' WACC Report authored by AlixPartners, that the CAA has erred in not using the most recent data to estimate the pre-pandemic asset beta, and that if it had done so its estimate would be 0.44.

124. However, as explained in 2nd King, the estimate of 0.44 is neither consistent with the CMA's own estimate of airport asset betas pre-pandemic, nor with AlixPartners' own assessment of asset betas, and is itself not based on up-to-date market information as it relies on historical differences between market data and CAA assumptions of Heathrow's asset beta.¹⁸⁹ Rather, based on the CMA estimates of airport asset beta in early 2020, an appropriate range for Heathrow's pre-pandemic asset beta is 0.50–0.65.¹⁹⁰

Asset beta: the risk adjustment

125. The Airline Appellants argue that the CAA and Flint were wrong to adjust Heathrow's pre-pandemic asset beta upwards because (on their view) Heathrow is not riskier than comparators.

126. However, Heathrow's NoA sets out numerous reasons why Heathrow would be expected to face more risk than the comparator listed airports (i.e. relatively long-duration price control, intense competition from neighbouring airports, a much lower share of more

¹⁸⁹ 2nd King §§4.2-4.7. [Intv/4/133] See also 2nd Hope §§2.4-2.6. [Intv/6/166]

¹⁹⁰ 2nd King §4.4-4.7. [Intv/4/133]

resilient domestic travel and a greater traffic risk overall based on the outturn financial results from the Covid-19 pandemic).¹⁹¹

127. Further, analyses of Heathrow's revenue volatility relative to comparator airports during the last two 'major shocks' to hit airports (i.e. the financial crisis and Covid-19) demonstrate that Heathrow in fact carries more systematic risk.
128. First, as explained in 2nd King, an analysis by NERA Economic Consulting shows that the negative impact of the financial crisis on Heathrow's revenue was in fact greater than that experienced by comparator airports, in part due to the more supportive regulatory regimes of the latter.¹⁹²
129. Secondly, as explained in 2nd Hope, an earlier Oxera analysis demonstrates that Heathrow was more affected by Covid-19 than comparator airports due to its higher exposure to international traffic.¹⁹³ It was due to this increased risk faced by Heathrow that Oxera recommended an asset beta higher than the mid-point of the asset beta range for comparator airports.¹⁹⁴
130. Finally, a key impact of Heathrow's capacity constraints is that they lead to negatively-skewed risk for investors (by limiting the potential for upside). The CAA was therefore correct, within the context of its methodology, to apply an upwards adjustment to Heathrow's pre-pandemic asset beta to account for the relatively higher level of risk faced by Heathrow.

Asset beta: the WLS estimator

131. The Airline Appellants argue that the CAA and Flint, the CAA's advisers in this respect, made a methodological error in addressing the structural break in the share price time series caused by Covid-19 through the statistical tool of a WLS (weighted least squares) estimator. In their view, the CAA and Flint should have used an alternative weighting that the Airline Appellants prefer.

¹⁹¹ Heathrow NoA §186.3. [Core/1/76]

¹⁹² 2nd King §4.11. [Intv/4/134]

¹⁹³ 2nd Hope §2.9. [Intv/6/167] See also HAL (2021), Response to initial proposals, §7.4.16 [Supp/32/1514] and Oxera, Cost of Capital issues for the H7 period, December 2021, Figure 2.1. [MK1/9/433]

¹⁹⁴ 2nd Hope §2.9. [Intv/6/167]

132. However, as explained in 2nd King, the key point is that the data should not have been weighted at all, since doing so introduces an additional arbitrary element into the CAA’s estimate.¹⁹⁵ In fact, the Airline Appellants’ proposed alternative weighting is equivalent to the cross-checking method used by the CAA and Flint. Their proposal is therefore essentially to substitute one arbitrary weighting scheme with another, which is obviously misguided. The correct approach, as explained in 1st Hope §3.31 [Core/9/500], is an evidence-based one which simply uses unweighted market data.

Asset beta: the pandemic adjustment

133. The Airline Appellants argue that the CAA and Flint made a methodological error by not accounting for the different levels of gearing during the period assumed to be affected by the pandemic in calculating the pandemic adjustment.

134. However, as explained in both 2nd King and 2nd Hope, due to the specific manner in which Flint calculated the pandemic adjustment, any increase in equity beta due to the increase in gearing would have been offset during that calculation.¹⁹⁶ The CAA’s pandemic adjustment therefore isolated the underlying change in asset beta specifically attributable to the pandemic, and no further accounting for gearing was required. The Airline Appellants’ argument on this point is therefore simply wrong.¹⁹⁷

The TRS adjustment

135. The Airline Appellants argue that traffic risk is the only driver of difference in systematic risk between Heathrow and network utilities, and therefore that the CAA’s TRS adjustment should have been greater. In particular, they argue that 90-100% of the differential between Heathrow and network utilities’ asset betas is attributable to traffic risk (compared to the 50-90% assumed by the CAA).

136. However, as set out in detail in the Heathrow NoA, the CAA has wrongly assumed that the TRS mechanism is able meaningfully to reduce Heathrow’s asset beta (see Heathrow NoA, Ground 2B).¹⁹⁸ The Airlines’ WACC Report by AlixPartners, relied on by the

¹⁹⁵ 2nd King §4.16. [Intv/4/135]

¹⁹⁶ 2nd King §4.17 [Intv/4/135]; 2nd Hope §§2.10-2.13. [Intv/6/168]

¹⁹⁷ 2nd King §4.17. [Intv/4/135]

¹⁹⁸ See also the summary in 2nd Hope, §§2.14-2.16. [Intv/6/169]

Airline Appellants, does not engage with this fundamental issue.¹⁹⁹ If the CMA accepts Heathrow's submissions in relation to its own Ground 2B, then this argument raised by the Airline Appellants falls away.

137. Notwithstanding the above, the Airline Appellants' arguments are misconceived for the following further reasons²⁰⁰:

137.1. First, they present no evidence in support of their assertion that the entirety of the difference in the asset beta between Heathrow and network utilities is related to demand risk. This is unsurprising, as no such evidence exists. To the contrary, as explained in 2nd King, there are clear differences between Heathrow and network utilities that would be expected to increase systematic risk (e.g. the fact that 35% of Heathrow's revenue relates to commercial activities and is therefore exposed to other risk concerning consumers' willingness to spend, price effects, the impact of service on demand, etc).²⁰¹ Further, as explained in 2nd King, empirical studies support the fact that there are lots of reasons why systematic risk varies between industries, and caution needs to be applied before assuming that an asset beta differential is (wholly) attributable to any specific difference.²⁰²

137.2. Secondly, they assume that the asset beta response to demand risk is linearly related to the level of demand risk. As explained in 2nd King, this is unlikely to be the case due to the effects of investor risk aversion.²⁰³ The impact of increasing from zero demand risk to 50% demand risk is likely to be greater on asset beta than the impact of increasing from 50% to 100%.

137.3. Thirdly, they implicitly assume that the demand risk for utilities makes no contribution to systematic risk. However, as explained in 2nd King, this contribution is likely to be negative (i.e. a significant addition to the beta of network utilities

¹⁹⁹ 2nd Hope, §2.19. [Intv/6/171]

²⁰⁰ 2nd King §§5.2-5.6. [Intv/4/136]

²⁰¹ 2nd King §5.2. [Intv/4/136]

²⁰² 2nd King §§5.2-5.3. [Intv/4/136]

²⁰³ 2nd King §5.6. [Intv/4/137]

might be required in order to get an equivalent asset beta for a company with zero systematic risk related to demand).²⁰⁴

138. The impact of the TRS is effectively to reduce the expected operational gearing of Heathrow (i.e. to reduce the variation in expected returns attributable to variation in revenue). However, as explained in 2nd King, neither the Airline Appellants nor the CAA refer to the available empirical evidence concerning the relationship between changes in operational gearing and changes in revenue.²⁰⁵ Having regard to that evidence, it is clear that neither the reduction proposed by the CAA of 0.08-0.09 nor that proposed by the Airline Appellants of 0.05-0.07 is credible.

Conclusion

139. For the reasons set out above, the Airline Appellants' arguments in relation to the Asset Beta Sub-ground are misconceived.

140. More fundamentally, as set out in detail in the Heathrow NoA:

140.1. There was no justification for the CAA to depart from well-established regulatory best practice of relying directly on market data to estimate Heathrow's asset beta. The CAA's approach of "manually" adjusting a pre-pandemic asset beta is subjective and littered with arbitrary assumptions that lack any solid evidential support. It is impossible to apply consistently over future price control periods and does not self-correct. It is without regulatory precedent and clearly inferior to a market-based approach (see Ground 2A – Post-pandemic asset beta).

140.2. The CAA's further downward adjustment of the asset beta on account of the TRS mechanism is also misconceived. The TRS does not reduce Heathrow's risk in a sufficiently certain or immediate way that it would credibly reduce asset beta during the H7 price control period. The CAA's adjustment is in any event again dependent on arbitrary assumptions that lack evidential support and should be rejected (see Ground 2B – TRS adjustment).

²⁰⁴ 2nd King §5.6. [Intv/4/137]

²⁰⁵ 2nd King §5.7. [Intv/4/137]

141. As explained in Heathrow's NoA, correcting for these errors by adopting an evidence-based approach in line with best regulatory practice leads to an asset beta of 0.82 (compared to the CAA's 0.53) and a cost of equity of 10.8%.²⁰⁶

D(2) Joined Sub-ground B(ii): Cost of Debt

The Airline Appellants' Grounds

142. The Airline Appellants have all argued that the CAA was wrong to include a 15bps premium when calculating the cost of index-linked debt (for both new and embedded debt), relying on the joint expert Airlines' WACC Report by AlixPartners.

143. The Airline Appellants' arguments substantively mirror one another and can be summarised as follows:

143.1. First, they argue that the CAA has failed to provide a proper justification for a positive adjustment:²⁰⁷

143.1.1. the approach is novel, and no such premium was used in recent decisions by other regulators;

143.1.2. the CAA's statistical approach is flawed, and it should have used a simple average (rather than a weighted average) when comparing Heathrow's index-linked bonds to contemporaneous iBoxx spreads; and

143.1.3. because investors generally require a lower return on index-linked debt due to the fact that it does not carry inflation risk, it is apparent that a proper evaluation of all relevant factors would have yielded an adjustment that should be subtracted from rather than added to nominal gilt yields to calculate the cost of index-linked debt.

143.2. Secondly, they argue that the CAA has in any event misstated the magnitude of any adjustment required to calculate the cost of Heathrow's index-linked debt because:²⁰⁸

²⁰⁶ HAL NoA Section E. [Core/1/64]

²⁰⁷ BA NoA §§5.8.2-5.8.4; Delta NoA §§66-67; VAA NoA §§5.65-5.65.

²⁰⁸ BA NoA §§5.8.5-5.8.8; Delta NoA §§68-71; VAA NoA §§5.66-5.69.

143.2.1. rather than considering a sample of Heathrow's index-linked bonds to assess the magnitude of an adjustment, the CAA should have considered the position as regards all index-linked bonds issued in the market;

143.2.2. had the CAA done this, the analysis would have indicated that nominal yields (less inflation) have been higher than observed index-linked yields (in each case proxied by gilt yields), so that the cost of index-linked debt should be reduced, rather than increased, compared to the cost of nominal bonds.

143.3. Finally, it is said to be inappropriate to add a premium of 15bps in circumstances where (as the experience of energy network companies is said to show) Heathrow will in fact receive a benefit of being able to issue its own index-linked bonds at a lower cost than nominal debt.

Heathrow's response to the Airline Appellants' arguments

144. The Airline Appellants' arguments are misconceived and can easily be shown to be wrong as Heathrow's treasurer, Ms Ding, explains in her witness statement:

144.1. First, the Airlines' WACC Report by AlixPartners looks at the wrong target. It seeks to calculate a premium/discount for index-linked gilts rather than corporate debt. However, the gilt market in this respect behaves fundamentally differently. It is a risk free and liquid market. In contrast, corporate index-linked debt consistently exhibits a premium over nominal debt which reflects both lower liquidity (the corporate index-linked market is comparatively small) and higher risk (as cash flows on index-linked debt are more back-end weighted due to smaller coupons during a bond's lifetime). These factors are reflected in the observable spread which should be compared to the iBoxx index, instead of relying on the theoretical construct of the Bank of England yield curve for government debt.²⁰⁹

144.2. Secondly, as Ms Ding explains, the AlixPartners calculations suffer from several errors, both in terms of input data and methodology. Importantly, the argument that

²⁰⁹ 2nd Ding §§3.6-3.8. [Intv/5/153]

a simple rather than weighted average should have been used is misplaced, as it would grossly overweight small, and often unrepresentative, private trades.²¹⁰

144.3. Finally, the most reliable method of assessing the appropriate allowance for Heathrow's index linked debt is to compare the actual pricing of its index linked debt to the cost of its fixed rate debt. As Ms Ding explains, this consistently shows a premium of around 15–20bps, which in her extensive experience matches how Heathrow's index linked debt is priced in practice, which is precisely by reference to its fixed term debt but adding a liquidity premium of 15–20bps.

Conclusion

145. For these reasons, the Airline Appellants' abstract and theoretical criticism is plainly misconceived and should be dismissed.

D(3) Joined Sub-ground B(iii): Selecting a Point Estimate for the WACC

The Airline Appellants' Grounds

146. The Airline Appellants have all advanced Grounds that the CAA wrongly chose the mid-point of the WACC range when selecting a point estimate when instead it should have aimed down, relying on the joint expert report produced by AlixPartners.

147. The Airline Appellants' arguments as to selecting a point estimate for the WACC substantively mirror one another and can be summarised as follows:

147.1. First, they argue that the CAA's decision not to aim down is unjustified because it has ignored or misjudged the following relevant factors:

147.1.1. Asymmetry of costs and benefits: they allege that the CAA was wrong to conclude that the trade-off between welfare effects and investment considerations warrants aiming up in the WACC range when, for H7, the opposite is allegedly true;²¹¹

²¹⁰ 2nd Ding §§3.10-3.13. [Intv/5/155]

²¹¹ BA NoA §5.9.4(a); Delta NoA §§5.77-5.81; VAA NoA §§5.74-5.78.

147.1.2. Asymmetry of pandemic events: they allege that the CAA failed to have proper regard to or account for the asymmetry in probabilities of a pandemic event when estimating Heathrow's asset beta;²¹²

147.1.3. Information asymmetries between Heathrow and the CAA: they allege that the CAA failed to have regard to or give appropriate weight to information asymmetries between Heathrow and the CAA when selecting the WACC point estimate;²¹³

147.1.4. The effect of distortions created by the outer band of the TRS: they allege that the CAA should have accounted for the distortions created by the outer band of the TRS mechanism when selecting the WACC point estimate;²¹⁴ and

147.1.5. Delta and VAA additionally argue that the CAA failed to have proper regard to other relevant factors when it failed to consider its proposals for H7 in the aggregate and to pay due regard to Heathrow's financial position when selecting the WACC point estimate.²¹⁵

147.2. Secondly, they argue that the CAA's decision not to aim-down when selecting the point estimate for the WACC will give rise to material harm to consumers.²¹⁶

Heathrow's response to the Airline Appellants' arguments

148. The arguments advanced by the Airline Appellants are misconceived for the reasons set out in detail in 2nd King and 2nd Hope, which are summarised below.

149. Further, and in any event, as Heathrow has explained in its NoA (and the accompanying evidence) in the context of selecting the appropriate asset beta estimate, there are strong reasons to aim up in this case.²¹⁷ In particular, as Heathrow showed, a lower asset beta would lead to a cost of equity that is inconsistent with Heathrow's observed cost of debt,

²¹² BA NoA §5.9.4(b); Delta NoA §§5.82-5.86; VAA NoA §§5.79-5.83.

²¹³ BA NoA §5.9.4(c); Delta NoA §§5.87-5.91; VAA NoA §§5.84-5.88.

²¹⁴ BA NoA §5.9.4(d); Delta NoA §§5.92-5.97; VAA NoA §§5.89-5.94.

²¹⁵ Delta NoA §§5.98-5.102; VAA NoA §§5.95-5.97.

²¹⁶ BA NoA §5.9.5; Delta NoA §§5.103-5.106; VAA NoA §§5.98-5.100.

²¹⁷ Heathrow NoA §186. **[Core/1/75]**

which is wrong as a matter of first economic principles. As Mr Hope explains, the same issue arises in relation to AlixPartners arguments now.²¹⁸ Indeed, these seem to imply a return on Heathrow's assets some 100–120bps lower than Heathrow's costs of debt. For that reason alone, it is clear that no estimate in AlixPartner's proposed range is credible.

150. As to the specific arguments:

150.1. The asymmetry of costs and benefits arguments contain a number of errors²¹⁹ and fundamentally misunderstand the logic for why consumer welfare is maximised above the mid-point of an estimate range, which is concerned with balancing the interests of present and future consumers.²²⁰ The Airline Appellants' arguments that post-Covid there is little pressing need for investment and that recovery would be aided by keeping prices low are in any event in tension with the airlines' own approach to pricing which does not support the implicit assumption that any reduction in charges would be passed on to consumers. As Mr King explains, on a like-for-like basis, prices per passenger have increased by about £55–85, well above inflation and any change in Heathrow's charges.²²¹

150.2. The asymmetry of pandemic events arguments only arise when accepting the CAA's approach to determining the asset beta, which for all the reasons set out in Heathrow's NOA and summarised in brief above is flawed and should be rejected. However, even on its own terms, it is far from clear that there would be a pronounced asymmetry. Instead, once one assumes that the actual values for recurrence and duration of pandemic events lie towards the middle, rather than at the extremes of the CAA's estimated ranges, then the alleged effect largely disappears as explained by Mr King.²²²

150.3. Any alleged information asymmetries also do not provide a good basis for aiming down. As the CMA has explained in rejecting the 'outperformance wedge' mechanism in the RIIO-2 energy appeals, such asymmetries are best addressed in

²¹⁸ 2nd Hope §§2.23–2.26. [Intv/6/172]

²¹⁹ 2nd King §§6.6–6.7. [Intv/4/139]

²²⁰ 2nd Hope §§2.25 - 2.27. [Intv/6/173]

²²¹ 2nd King §§6.9. [Intv/4/140]

²²² 2nd King §6.12. [Intv/4/141]

the context of the specific variables where they are said to arise.²²³ It is clear that the CAA has made significant efforts to reduce any information asymmetries across the price control, largely by relying on outside information sources instead or in addition to Heathrow. There are also a number of factual errors in the Airline Appellants' assertions, as explained by Mr King.²²⁴

150.4. While it is right that the lower band of the TRS is more likely to be engaged than the upper band, this does not imply a positively skewed distribution of returns. In fact, a risk profile with a downwards skew would indicate higher risk and therefore the need for higher returns and aiming up.²²⁵

150.5. As to the other allegedly relevant factors identified by VAA and Delta, there is no basis for the allegation that consideration of the price control as a whole, in combination with an alleged “*long history of shareholders reaping the benefits of HAL’s monopoly profits*”²²⁶ should have led the CAA to aim down. Indeed, as 2nd Hope explains, when the CMA considered evidence on historical returns across regulated sectors in the RIIO-2 energy appeals, data before it showed that underperformance was identified for three of the four CAA price controls included, including the last two Heathrow price controls.²²⁷

Conclusion

151. For all these reasons, the Airline Appellants' arguments are misconceived. As explained in Heathrow's own appeal, the CAA should have chosen an asset beta estimate towards the top of the (appropriately) estimated range. That is an error the CMA should correct. No further adjustment in light of the Airline Appellants' arguments is warranted.

²²³ 2nd Hope §§2E.4. [Intv/6/175]

²²⁴ 2nd King §§6.13–6.20. [Intv/4/141]

²²⁵ 2nd Hope §§2.40 – 2.41 [Intv/6/177] and 2nd King §§3.13-3.17. [Intv/4/131]

²²⁶ Delta NoA §5.102.

²²⁷ 2nd Hope §2.39. [Intv/6/177]

E. ASYMMETRIC RISK ALLOWANCE

The Airline Appellants' Grounds

152. The Airline Appellants all argue that the CAA has erred in specifying the Asymmetric Risk Allowance by failing to update its value to account for the higher-than-expected outturn passenger volumes in 2022. This is said to mean that the H7 revenue requirement was over-estimated by around £7 million.²²⁸

Heathrow's response to the Airline Appellants' arguments

153. In Heathrow's respectful submission this alleged error does not pass the *de minimis* threshold below which the CMA should not intervene. In *Carphone Warehouse*, the Competition Commission found that a perceived error with an impact of a 0.1 percent change in the price control level fell within the acceptable margin of error for a regulator.²²⁹ Regardless of whether Heathrow's revenue is looked at on a gross or net basis, the alleged £7 million impact the Airline Appellants contend falls below this materiality threshold.²³⁰

154. It would in any event be wrong to update only the Asymmetric Risk Allowance to reflect actual 2022 performance rather than an estimate. As 2nd King §§7.15 et seq. [Intv/4/147]. explains, there a large number of areas in which the Decision continues to rely on estimates for 2022. Adjusting even the most obvious of these, the estimate of the risk free rate and commercial revenues, to reflect 2022 outturns would increase Heathrow's revenue allowance by £146 million for 2022.

155. Furthermore, there are also other errors in the implementation of the Asymmetric Risk Allowance, which mean that it fails to provide the protection the CAA says it is intended to achieve, and which the CMA would need to consider if it were to reassess the allowance. As 2nd King §§7.3–7.14 [Intv/4/143-147] explains, the present

²²⁸ BA NoA section 5.10; Delta NoA §§4.106–4.108; VAA §§4.128–4.130.

²²⁹ *Carphone Warehouse Group plc v Ofcom*, Determination, Case 1111/3/3/09, 31 August 2010, §1.62. [Case/3/79]

²³⁰ See H7 Final Decision–Summary CAP2425A §64, Table 7 setting out Heathrow's gross and net revenue requirements over the H7 price control period, and indicating a materiality cut off of either £14 million or £9 million. [Supp/1/22]

implementation has the consequence of leaving gaps in the allowance, which properly calculated should provide £54 million more over the course of H7.

Conclusion

156. For these reasons, the CMA should not make any adjustments to the Asymmetric Risk Allowance. If it were minded to do so, the Decision would need to be remitted back so that the allowance can be reconsidered properly, and the CAA can ensure that its use of 2022 actual figures versus estimates is consistent across the Decision.

F. CONCLUSION

157. For all the reasons given above, in the accompanying evidence and in Heathrow's NoA, the CMA is respectfully invited to dismiss the Airline Appeals in their entirety.

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