

H7 Heathrow Airport Licence Modification Appeals

Summary of provisional determinations

Issued: 8 September 2023

What is the CAA decision under appeal to the CMA?

1. The CMA determines appeals about price controls in some regulated sectors, including airports, when a regulated company or a company affected by a price control decides to appeal the decisions made by a regulator.
2. Heathrow Airport Limited (**HAL**) is regulated by the Civil Aviation Authority (**CAA**), which sets the maximum charge per passenger that HAL is allowed to charge airlines for using Heathrow airport.
3. The CAA sets this price control every few years after considering the cost of operating the airport efficiently, plans for investment in infrastructure, and the appropriate return for investors in HAL. In doing so, the CAA must act in accordance with its statutory duties, including its duty to carry out its functions in a manner which it considers will further the interests of users of air transport services. In this context, the CAA seeks to balance the interests of current and future consumers, by ensuring that charges are no higher than necessary while ensuring HAL can finance its current and future activities.
4. On 9 March 2023, the CAA published its Final Decision and changes to HAL's licence to implement the new price control for 2022-2026 (known as **H7**) (**CAA Decision**).

Who appealed the CAA Decision?

5. In April 2023, HAL, British Airways plc (**BA**), Delta Air Lines Inc. (**Delta**) and Virgin Atlantic Airways Limited (**VAA**) (together the **Airlines**) appealed to the

CMA against the CAA's decision. An overarching theme of HAL's appeal was that the CAA was not allowing it to earn sufficient revenue to support investment, particularly after the difficulties of the COVID-19 period. Conversely, an overarching theme of the Airlines' appeals was that the CAA was allowing HAL to charge too high a price per passenger. Both HAL and the Airlines argued in various parts of their appeals that the CAA Decision was not in the interests of consumers.

6. The main submissions of HAL, BA, Delta and VAA, and the response of the CAA (together the **Parties**) can be found on the CMA case page [here](#).

What has the CMA provisionally decided?

7. Overall we provisionally consider that the CAA was not wrong in most of the decisions that were appealed to us. We have issued the parties with our formal provisional determination document setting our provisional findings and reasons. This summary is not part of that, but is published as a high-level update.
8. The CMA's role in airport appeals is not to revisit the CAA's entire decision and decide the whole matter afresh ourselves. The law requires us instead to decide whether the decision is wrong because it is based on errors of fact, is wrong in law or because the CAA made errors in the exercise of a discretion. We carry out this assessment in the context of the specific arguments put forward to us by appellants. In this case, we assessed a wide range of evidence provided to us by the Parties in their written submissions, responses to requests for information and in hearings and considered whether the CAA had made any errors in reaching its decision on the specific issues appealed.
9. We recognise the unusual context of the H7 price control. There was an unprecedented drop in passenger numbers due to the COVID-19 pandemic and the uncertainty of the pace and extent of recovery led to a difficult environment for setting a price control. We also recognise that the pandemic led to challenging financial times for HAL and the Airlines, as well as for passengers.
10. Many of the issues in these appeals had, as a common theme, the extent to which HAL and its investors should be relieved of bearing the costs of the COVID-19 pandemic and related restrictions on air travel - with airlines and their customers consequently bearing a greater share of those costs by way of higher airport charges - as well as who should bear the risks of any future major downward shocks in passenger numbers.
11. Some of HAL and the Airlines' arguments covered the returns HAL's investors could expect to earn, which the CAA calculated in the price control based on the

size of the Regulated Asset Base (the RAB) and the level of the weighted average cost of capital (the WACC) for HAL.

12. HAL and the Airlines both challenged the decision concerning an adjustment that the CAA had made to part of the price control (relating to the RAB) owing to the impact of the COVID-19 pandemic. HAL had argued that a much larger increase to the RAB should have been made while the Airlines argued that no adjustment had been justified. We provisionally determined that the CAA had not been wrong in making the RAB adjustment that it did.
13. Both HAL and the Airlines raised a number of challenges to the CAA's treatment of the WACC. In nearly all aspects of the CAA's approach that were challenged, we have provisionally found that the CAA had not been wrong in its approach. However, we agreed with the Airlines that the CAA made an error in one, relatively minor, aspect of its cost of debt calculation.
14. The Airlines also challenged the CAA's passenger forecast, which is used to set a per passenger charge over the H7 price control period, arguing that the CAA had underestimated the number of passengers which were going to use Heathrow airport during the period 2023-2026. We did not provisionally determine that the CAA was wrong in its overall approach to forecasting passenger numbers, although we agree with the Airlines that the CAA was wrong in relation to one small element within its calculation (the 'Shock Factor', making an allowance for exceptional events which might reduce passenger numbers).
15. HAL also appealed a specific adjustment (the AK-factor) which the CAA had introduced to claw back what the CAA described as 'over-recovered revenues' in 2020 and 2021. We have provisionally found that the application of this adjustment in a purely mechanistic way was inappropriate given the extreme impact of the COVID-19 pandemic on passenger numbers at Heathrow airport.
16. Lastly, HAL appealed new arrangements introduced by the CAA to provide incentives for efficiency and delivery of capital expenditure projects, but we provisionally determined that the CAA was not wrong to introduce these.
17. Where we have provisionally found that the CAA has made errors, we have provisionally decided to require the CAA to reconsider them.
18. While it is not possible now to quantify any changes in the price cap that could result from CAA reconsideration of these aspects, we would expect any such changes to have only a small net impact relative to the CAA's overall price control decision, particularly as they may work in opposite directions.

What happens next?

19. We have issued the full provisional determinations to the Parties and invited them to comment.
20. The CMA has until 17 October 2023 to decide whether to allow or dismiss the appeals. We will consider the comments from the Parties on our provisional determinations and will issue our final determinations in line with the statutory deadline. A non-sensitive version of the full final determinations will be published on our case page.