

H7 Heathrow Airport Licence Modification Appeals

Summary of final determinations

Issued: 17 October 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. As an independent body with legal, financial and economic expertise, the CMA plays an important role in ensuring that economic regulators in the UK act consistently within their powers and duties, protecting the interests of consumers and supporting long term investment.
3. 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.
4. 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.
5. 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?

6. 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 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.
7. 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 happened since the Provisional Determination was announced?

8. On 8 September 2023 we issued our provisional determinations (Provisional Determination) to the Parties and published a summary on our webpage. All Parties responded with comments, which we have considered before making our final determinations.
9. As part of our final determinations, we have issued an Order requiring the CAA to reconsider promptly particular areas of the H7 price control in which we have decided it made errors. We have also published this high level summary, which is not part of the final determinations but provides a separate overview for a wider audience.

What has the CMA decided?

10. We have decided to maintain the decisions indicated in our Provisional Determination. Overall, we still consider that the CAA was not wrong in most of the decisions that were appealed to us. We set out below, at a high level, the reasons why we reached these conclusions.
11. 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 in appeals. 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.
12. 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.
13. 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.

14. 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.
15. 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 determined that the CAA had not been wrong in making the RAB adjustment that it did.
16. 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 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.
17. 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 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).
18. 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 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.
19. Lastly, HAL appealed new arrangements introduced by the CAA to provide incentives for efficiency and delivery of capital expenditure projects, but we determined that the CAA was not wrong to introduce these.

What happens next?

20. We have ordered the CAA to look again promptly at the small number of issues where we have found in favour of HAL or the Airlines. We expect the CAA to prioritise this work to provide clarity about charges for the remainder of the price control period. While it is not possible now to quantify any changes in the price cap that could result from the CAA reconsidering these issues, we would expect

any such changes to have only a small impact overall relative to the CAA's overall price control decision, particularly as they may work in opposite directions.

21. A non-sensitive version of the full final determinations report will be published on our case page shortly.