

Response to the CAA's initial proposals with respect to Other Regulated Charges for the H8 price control period

This response is submitted by the Arora Group for the group as a whole (**Arora**) in respect of the CAA's Initial Proposals for the H8 price control relating to Other Regulated Charges (**ORCs**), as set out in Chapter 7 of CAP 3232B. While we address the specific proposals relating to water, wastewater and electricity charges, this response is primarily concerned with a more fundamental issue: the CAA's initial proposals do not adequately address the consequences of Grant Thornton's finding that HAL's ORC cost allocation methodology could not be validated as fair and reasonable.

In summary:

- The Grant Thornton independent review was unable to validate that HAL's ORC fixed costs have been allocated on a fair and reasonable basis. In its H7 Final Decision, the CAA committed to ensuring that the independent review did not result in windfall gains or losses for HAL. The initial proposals acknowledge the review's findings but do not address their consequences: they do not require HAL to remediate the identified failings within a defined timetable, they do not assess the extent of any overcharge resulting from those failings (during H7 but also historically), and they propose to downgrade the independent review requirement from mandatory to discretionary. Arora urges the CAA to address each of these matters in its final proposals, to explain how its H7 commitment will be honoured, and to set out the remedy it proposes for ORC users who may have been overcharged as a result of these failings.
- Arora welcomes the CAA's recognition that HAL's water and wastewater charges are "*clearly out of line with benchmarks*" and supports the proposal to cap recovery of fixed costs from water and wastewater charges at 100% of direct costs – but only as an interim measure pending the CAA's full assessment of HAL's ORC methodology. Even with the new cap in place, Arora calculates that HAL's water charges remain more than 3.5 times what is available on the open market.
- We consider that the case for applying a similar cap to electricity fixed costs is at least as strong as for water. The CAA's conclusion that "*HAL's electricity charges appear to be broadly in line with other UK airports*" is not consistent with the findings of its own consultants, Europe Economics and York Aviation (**EE/YA**), regarding the prices paid by HAL during the H7 period.
- We support the proposal to introduce a new licence Condition C2.8 requiring HAL to explain year-on-year increases in real unit charges but have doubts as to whether this will ultimately "*provide a stronger basis for scrutinising and, where necessary, investigating the drivers of increases in ORC direct costs*". We note the limitations of the existing governance framework in this context. We ask that the CAA supports this measure by providing a clear commitment to commission an independent review where cost increases exceed a prescribed threshold or exceed a set threshold over cumulative years.

- The pass-through nature of ORCs means there is no financial incentive on HAL to control these costs efficiently. The CAA should introduce a cost-efficiency mechanism — such as a sharing arrangement or a cap on real-terms increases in unit charges — to ensure that ORC users are not fully exposed to the consequences of HAL’s procurement decisions.

1. HAL’S COST ALLOCATION METHODOLOGY AND THE CONSEQUENCES OF THE GRANT THORNTON FINDINGS

- 1.1 The starting point for this response is the finding of the Grant Thornton independent review, carried out pursuant to a licence obligation imposed by the CAA, that HAL’s ORC cost allocation methodology could not be validated as fair and reasonable. Grant Thornton raised seven red-rated findings, identifying systemic failings including the absence of any consolidated methodology document, the use of annuity rates of return with no clear rationale, and the lack of data-driven evidence for the allocation shares applied to each Specified Facility. These are not peripheral or technical shortcomings. They go to the heart of how HAL calculates the charges that ORC users — including Arora — are required to pay.
- 1.2 Two consequences follow from this finding, neither of which is addressed in the initial proposals as currently framed, and Arora urges the CAA to address both as it develops its final proposals.
- 1.3 First, if HAL has been charging ORC users on a basis that was not fair and reasonable, then ORC users may have been overcharged. The initial proposals identify a narrow “over-recovery” of approximately £3 million based on HAL’s own revised estimates, but this does not address the broader question. ORC costs must be allocated on a fair and reasonable basis. To the extent that they have not been — as the Grant Thornton review demonstrates — the CAA must, in its final proposals, assess the full extent of any overcharge and set out an appropriate remedy. In the H7 Final Decision, the CAA committed to “*make adjustments to prevent HAL from experiencing windfall gains and losses*”¹ where the independent review identified significant issues. The initial proposals do not explain how this commitment will be honoured. Arora requests that the final proposals do so.
- 1.4 Second, the methodology itself must be fixed. HAL continues to charge ORC users on a basis that has been independently found to fall materially short of the CAA’s own ORC charging principles. Nearly two years after the Grant Thornton review, there is no defined process, timetable or set of milestones for HAL to remediate the identified failings. The CAA’s proposal to downgrade the independent review requirement from mandatory to discretionary sends the wrong signal. Arora requests that the final proposals introduce a binding mechanism to compel HAL to remediate these failings, with independent verification.
- 1.5 The specific proposals we address in the remainder of this response — the caps on water and electricity fixed costs, the efficiency incentives, and the governance reforms — must be understood in this context. They are welcome but partial measures that do not address the root cause: a cost allocation methodology that has been found wanting.

¹ H7 Final Decision, Section 2, Chapter 8, paragraphs 8.47 and 8.59.

2. CAP ON WATER AND WASTEWATER FIXED COSTS

- 2.1 Arora supports the CAA's proposal to introduce a cap on the recovery of fixed costs for water and wastewater charges at 100% of direct costs – as an interim measure. The CAA's finding that absent this cap, *"the level of the charges would be very significantly out of line with those at other major airports in the UK"* is consistent with the concerns we have raised for over a decade regarding the unreasonableness of HAL's charges.
- 2.2 The introduction of this cap represents an important acknowledgement by the CAA of the systemic issues with HAL's approach to cost recovery for essential services. It also vindicates our long-standing representations, at least in so far as they concern water and wastewater charges.
- 2.3 However, we make three further observations.
- 2.4 First, even with the cap in place, Arora calculates that HAL's water and wastewater charges to non-airline users remain more than 3.5 times what is available on the open market. This is consistent with Grant Thornton's observation (at Finding 4.3) that the inclusion of annuity costs in ORCs can result in *"charges that are above levels seen in some external markets."* Moreover, the cap is set at 100% of HAL's own estimated direct costs for water and wastewater. This means the level of the cap is itself derived from HAL's unverified cost data. If those direct costs are above efficient levels — and Arora's evidence, supported by the EE/YA analysis, indicates that they are — then the cap will be set too high. EE/YA noted that they were *"not able to draw any conclusion about the charges paid by HAL for water"* because *"it is not known whether this rate is the rate that is applicable to Heathrow."*² Critically, nothing in the initial proposals provides for independent verification of these direct costs on an ongoing basis. The new Condition C2.8 requires HAL to explain real increases in unit charges, but does not require verification of the underlying cost data. The proposed amendments to Condition C2.4 make the independent review discretionary rather than mandatory, and in any event that review is directed at cost allocation methodology rather than the efficiency of the direct costs themselves. There is therefore no mechanism in the proposals to ensure that the direct costs against which the cap is calibrated are themselves efficient or market-tested. The CAA should address this gap in its final proposals by requiring HAL to disclose its water supply contractual arrangements and applicable tariffs so that a proper benchmarking assessment can be undertaken.
- 2.5 Second, the cap should only be imposed as an interim measure pending the CAA's full assessment of HAL's ORC cost allocation methodology. The Grant Thornton independent review identified fundamental failings in that methodology. Until HAL has remediated those failings and its methodology has been independently verified, the cap provides a necessary but provisional safeguard against disproportionate cost recovery. The CAA should make clear in its final proposals that the cap will be reviewed once HAL has demonstrably addressed the deficiencies identified by Grant Thornton.
- 2.6 Third, the CAA should go further and apply a similar cap to other ORCs, in particular electricity, for the reasons set out below.

² Joint report for the CAA by Europe Economics and York Aviation titled, *Opex and Commercial Revenues for H8 – Recommendations*, March 2026 (**EE/YA Joint Report**), page 141.

3. ELECTRICITY CHARGES — THE CASE FOR A CAP

- 3.1 We do not agree with the CAA's conclusion that it does “*not consider a cap necessary for the recovery of other non-airline ORCs*”. The CAA cites HAL’s electricity charges as justification for this view, noting how they “*appear to be broadly in line with other UK airports.*”
- 3.2 This conclusion is inconsistent with evidence put before the CAA. In particular, the findings of its own consultants, EE/YA which present a compelling case for applying greater scrutiny to electricity fixed costs.³
- 3.3 HAL’s electricity unit prices were 17% above the Department for Energy Security & Net Zero (**DESNZ**) benchmark in 2024,⁴ having been as high as 26% above benchmark (around 5.8 pence) in 2023. EE/YA observe that “*whilst electricity consumption does not appear inefficient, the prices being paid by HAL would suggest some level of inefficiency in 2024*”.⁵ They further recommend a 15% efficiency adjustment to electricity costs in establishing the efficient baseline for H8.⁶
- 3.4 This evidence suggests that HAL's electricity charges are not “*broadly in line*” with appropriate benchmarks. The fact that other UK airports may have similarly elevated costs does not, in itself, demonstrate that those costs are efficient or that ORC users are being treated fairly. If the CAA's assessment rests solely on comparisons with other UK airports rather than with underlying cost benchmarks such as the DESNZ index, then we submit that the wrong comparator is being applied.
- 3.5 Moreover, EE/YA's analysis of the real price effects shows a historically positive and statistically significant wedge between electricity prices and CPI of 6.4%, with the wedge remaining significant at 4.6% even when the recent energy price shock is excluded.⁷ This persistent premium above economy-wide inflation, combined with the finding that HAL pays substantially more than the industry average, raises questions about whether the current fixed cost allocation for electricity (£4.12 million per annum in 2024 CPI, down from £11.05 million in the H7 Final Decision) is subject to the same risk of disproportionate recovery that the CAA has identified in respect of water.⁸
- 3.6 Arora therefore requests that the CAA reconsiders its position on electricity and explains in its final proposals why a cap on fixed cost recovery is not warranted for electricity, notwithstanding the evidence that HAL's electricity pricing is above efficient levels. If the CAA declines to impose a cap, we request that it sets out clearly its basis for distinguishing the two utilities.

³ Notably, despite the CAA’s assessment, in the EE/YA Joint Report, EE/YA express “*some reservations about the ability to benchmark against other airports*” (page 131).

⁴ This benchmark measures consumption for extra-large non-domestic consumers, i.e. over 150,000 MWh.

⁵ EE/YA Joint Report, pages 134-5.

⁶ Table A1.3.23, EE/YA Joint Report, page 142.

⁷ EE/YA Joint Report, page 262.

⁸ Table 7.1, H8 Initial Proposals Section 2, page 87.

4. LICENCE CONDITION C2 AND GOVERNANCE

Comments on new condition C2.8

- 4.1 Arora supports the CAA's proposal to introduce a new Condition C2.8, requiring HAL to provide an annual written explanation where the outturn real unit charge of any ORC, or any of its components, increases year-on-year. This step goes some way toward addressing our concern about the absence of any specific efficiency incentive linked to ORCs in HAL's licence.
- 4.2 However, the effectiveness of this condition will depend upon the quality of HAL's engagement with ORC users and the CAA's willingness to act upon the information provided. Our experience to date is that existing governance mechanisms have been inadequate to secure meaningful transparency and accountability. In particular:
- a) The ORC Protocol, which is intended to provide the framework for governance and engagement between HAL and ORC users, has not been formally approved by ORC users.⁹ The Protocol therefore lacks the legitimacy and buy-in necessary to function as an effective instrument of accountability.
 - b) As Grant Thornton found, there is no consolidated document setting out HAL's end-to-end ORC cost allocation methodology. This means that ORC users lack clarity over how costs are calculated and have low confidence in HAL's processes as well.
- 4.3 We therefore urge the CAA to consider whether the introduction of Condition C2.8 is sufficient on its own to drive the accountability that ORC users need. The CAA should consider supplementary measures including:
- a) a clear commitment by the CAA to commission an independent review where cost increases exceed a prescribed threshold or exceed a set threshold over cumulative years; and
 - b) requiring the ORC Protocol to be formally approved by ORC users before it is relied upon as part of the governance framework.

Proposed adjustments to condition C2, to improve transparency and accountability

- 4.4 The Grant Thornton independent review identified material deficiencies in HAL's cost allocation methodology which go to the fundamental question of whether ORC fixed costs have been allocated on a fair and reasonable basis. Grant Thornton raised seven red-rated findings across three of the four core scope items and the additional findings section. These included that:¹⁰
- a) annuity costs could not be reconciled with the figures underpinning the H7 Final Decision (Finding 1.1);

⁹ In December 2023, the Arora Group, Pandox and The Perfectionist Cafe wrote jointly to the CAA to confirm that they would not sign the Protocol on its current terms, on the basis that it contained a "fundamental flaw" in failing to cover fixed costs and therefore did not meet the CAA's own transparency principle. See also the Arora Group's response to CAP2524F, in which Arora criticised the Protocol framework as "weak" and noted that "*without effective regulation – which has not existed to date – the principles can become irrelevant*", and that the principles failed to include the requirement that charges are cost-related and market-tested.

¹⁰ References in (a)–(g) are to the findings in the GT Draft Report.

- b) the annuity rates of return applied by HAL (8% for assets and 6% for land) lacked a clear rationale and could not be validated against the regulatory WACC (Finding 4.1);
 - c) no data-driven evidence existed for the share figures used to determine allocated costs for each Specified Facility (Finding 2.2);
 - d) the 2012 FAR could not be clearly mapped to the shared Specified Facilities (Finding 2.1);
 - e) there was no consolidated document setting out the end-to-end ORC cost allocation process (Finding 5.1);
 - f) the 2012 FAR used to estimate Annuity Costs includes assets that have been fully depreciated, meaning ORC users may be paying annuity costs on expired assets (Finding 4.2); and
 - g) Allocated Costs could not be confirmed as clearly and robustly identified, given that their estimation depends on both Annuity Costs and Direct Costs, both of which have identified deficiencies (Finding 1.2).
- 4.5 These are not minor or technical shortcomings. They represent systemic failings in the methodology by which HAL has been calculating and recovering costs from ORC users over a prolonged period.
- 4.6 Despite the seriousness of these findings, the pathway to resolving the identified deficiencies is not currently clear. The CAA’s Initial Proposals indicate that there is ongoing engagement between HAL and the CAA regarding aspects of its fixed cost re-estimation but no further detail is given. Nor is there any defined process, timeline or milestones for HAL to remediate the failings identified by Grant Thornton.
- 4.7 Moreover, the CAA’s initial proposals rely on HAL’s own revised estimate of non-airline fixed costs (£8.05 million per annum in 2020 CPI) without independent verification. Even Grant Thornton, as the appointed independent reviewer, was unable to access the data sources or calculations behind key inputs in Figure G.4 and was therefore “*unable to assess the underlying Fixed Costs allocated between airline and non-airline shared SFs in their entirety.*” Grant Thornton also found that the 2012 FAR includes fully depreciated assets that continue to generate annuity costs, meaning ORC users may be paying for assets that have reached the end of their economic life. The CAA should satisfy itself that the 2023 FAR has been compiled in a manner which is consistent with the ORC charging principles, and that it does not reproduce the errors identified in the 2012 FAR — including the inclusion of fully depreciated assets — before relying upon it as the basis for regulatory action.¹¹
- 4.8 The CAA must urgently address these failings by introducing in condition C2 (or a new licence condition, as appropriate) a binding mechanism to compel targeted corrective action by HAL. Specifically, the CAA should require HAL to produce and implement a remediation plan addressing each of the red-rated Grant Thornton

¹¹ For instance, for fixed costs Grant Thornton recommended that HAL updates the FAR used “*with a particular focus on the assets included and the rate of return used*” (GT Draft Report, pages 6, 29-30). It is not clear that the CAA has undertaken any further work to satisfy itself that HAL has addressed these failings.

findings, with defined milestones and a clear timetable for completion. At a minimum, such a plan should require HAL to:

- a) produce a consolidated document setting out its end-to-end ORC cost allocation methodology, as recommended by Grant Thornton at Finding 5.1;
- b) provide an evidenced rationale for the annuity rates of return applied, benchmarked against the regulatory WACC, as recommended at Finding 4.1;
- c) produce data-driven evidence for the allocation shares used to determine costs for each Specified Facility, as recommended at Finding 2.2; and
- d) produce periodic status update reports for the CAA and ORC users.

4.9 The CAA should not refrain from taking enforcement action in so far as these milestones are not met or respected.

4.10 Condition C2.4 should then be amended to require HAL to commission an annual independent review of its ORC cost allocation methodology, with the scope of such review extended to encompass:

- a) Independent review of the remediation plan referred to 4.8 above and subsequent verification of HAL’s implementation of the plan;
- b) Confirmation that the FAR has been updated to reflect any changes in asset allocation or valuation;¹² and
- c) Assessment of HAL’s compliance with the ORC charging principles.

4.11 The results of each annual review should be reported to the CAA and shared with ORC users within a defined timeframe. Here again the CAA should not refrain from taking enforcement action if HAL does not comply with the above requirements and/or the findings of the independent review are negative. These measures would go some way to giving effect to Grant Thornton’s recommendation that the end-to-end methodology document be “*reviewed, updated (where required) and the review evidenced once a year.*”

4.12 In addition, the CAA should confirm in its final proposals the mechanism by which amounts over-recovered from ORC users will be returned. If it is not feasible to complete this work before the start of the H8 price control period, the CAA should establish a clear timetable for its completion as soon as practicable in 2027 and include an appropriate rectification mechanism within its H8 proposals.

5. ORC EFFICIENCY INCENTIVES

5.1 The CAA acknowledges that there is no specific efficiency incentive linked to ORCs and that the pass-through nature of these charges means that all cost growth is borne entirely by ORC users. The proposed transparency requirement in Condition C2.8, while welcome, does not change this fundamental incentive structure. We urge the CAA to consider introducing a cost-efficiency mechanism for ORCs — for example, a sharing arrangement under which HAL bears a proportion of any above-forecast ORC cost growth, or a cap on real-terms increases in unit charges for each Specified

¹² To the extent that the CAA opts not to undertake its own independent verification of HAL’s 2023 FAR, licence condition C2.4 could be adapted to cater for the independent review as well.

Facility. Without such a mechanism, HAL has no financial incentive to control ORC costs efficiently, and ORC users — who have no ability to switch provider — remain fully exposed to the consequences of any inefficiency.

6. CONCLUSION

6.1 Arora welcomes a number of the proposals in Chapter 7, in particular the cap on water and wastewater fixed costs and the new transparency reporting requirement. These represent meaningful progress in addressing the long-standing deficiencies in HAL's approach to ORCs which we have consistently highlighted to the CAA.

6.2 However, we have serious concerns that the initial proposals do not adequately address the consequences of the Grant Thornton findings. The CAA has not explained how its commitment to prevent windfall gains or losses is being honoured; it has not assessed the full extent of any overcharge resulting from HAL's flawed methodology; it has not defined a pathway for HAL to remediate the identified failings; the water cap, while welcome, remains insufficient given that charges are still more than 3.5 times market rates; no cap has been applied to electricity; the efficiency challenge applied to ORC direct costs is too weak; and there is no specific financial incentive on HAL to control ORC costs efficiently. We urge the CAA to address these matters in its final proposals.

Arora Holdings Limited

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