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Dear David

Economic regulation of Heathrow airport: Outcome Based Regulation Mid-Term Review – Final Proposals

Thank you for the opportunity to provide a representation to the CAA's final proposals (proposals) on the Outcome Based Regulation (OBR) mid-term review.

As we have mentioned before, Heathrow has been supportive of the CAA finalising, where possible, relevant outstanding issues from the H7 Final Decision (FD) that are in the interest of the consumer. Given that the OBR framework is still maturing, we are supportive of the cautious approach that the CAA has taken in its review. It is important to strike the right balance in the proposals so that they are consistent with the risk allocation already set for the five-year period to 2026. Therefore, we support the CAA ambition to adopt a proportionate approach to setting the new proposals and to be consistent with the broader price control decision.

Heathrow has submitted its H8 Business Plan which has been developed with insights and stakeholders through Constructive Engagement. We will continue to develop and evolve our MTI proposal to strike the right balance for passengers and our customers that delivers a "fair bet".

This response does not repeat our views or concerns that have been previously shared with the CAA on Initial Proposals. However, we make a further representation on the proposed increase in the Pre-conditioned air (PCA) target from 98% to 99% and Airport Departures Management and Airport Arrivals Management measures.

1) PCA

PCA overview

The CAA is correct to highlight recent performance has been above the 98% and often exceeding the CAA's proposed target. However, we do not consider this performance is a reasonable basis for predicting future availability, particularly in the upcoming few years.

The CAA's proposals do not take sufficient account of the factors affecting PCA availability during the remainder of H7 and into H8. There are several issues impacting likely performance in the near future, including:

- The delivery of the capital programme to refresh PCA units across the airport has taken longer than originally anticipated.
- The impact of varied asset age on Heathrow's PCA availability performance, with older assets suffering more outages.
- The two-fold year on year increase in usage of PCA and Heathrow's ability to maintain performance standards.

Taken together, these mean that recent performance cannot reasonably be expected to predict future performance for PCA, particularly in the next couple of years. This is an issue we are beginning to see emerge with asset availability in June falling to 98.74% in Terminal 5. Increasing the target now would materially increase the risk that the new target will be unattainable for Heathrow as it moves through H7. This would not be in line with the CAA's own principles for the mid-term review, which state that changes should not expose stakeholders to additional risk and that adjustments would not generally be expected until the next price control review.

Given these challenges, Heathrow proposes that the current 98% target be maintained for H7, but with a glide path to reaching the 99% target which we can review at the H8 OBR mid-term review. This target date reflects:

- Planned installation of new PCA units across the campus.
- 12 months of testing and commissioning for these assets to find and fix initial faults.

This process would allow the CAA to take a broader view of Heathrow's plans when deciding on the merits of increasing the target as part of the H8 process.

PCA investment plan

Our investment project timescales have changed since the CAA's H7 determination. Heathrow's PCA assets are aged. 46% of the original estate of assets have either reached or exceeded their expected asset life.

The H7 Final Decision noted that, to remedy this, Heathrow was planning to upgrade the provision of PCA during H7. Given this, the CAA would consider in the mid-term review whether the target for the measure could be increased.

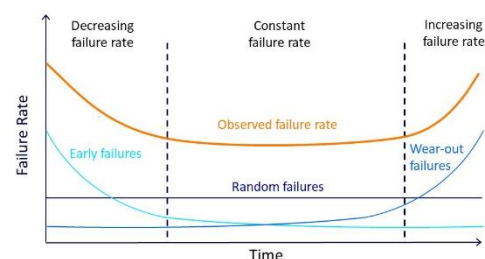
The programme to update PCA is currently nine months behind the schedule proposed at H7, partly due to extended airline governance processes. While this has required more time than initially anticipated, it has enabled stronger alignment among stakeholders. It's also important to recognise that the programme involves significant change management across the ground handler community, adding complexity to its implementation.

At the time the H7 decision was made, Heathrow had expected to have installed, tested and commissioned into service 40 new PCA units by the end of H7, but only 12 of these new units have been installed and it is likely that 30 will be installed by the end of the H7 period. This revised timeline introduces a level of risk and uncertainty for availability performance that was not assumed to be present when the H7 decision was made. The ongoing delays and reliance on an aging asset fleet are the direct cause of this increased risk, which would be compounded by the implementation of a higher target

Challenges with new PCA units

The newer PCA assets pose their own challenges. Asset reliability over time is often described using the concept of the bathtub curve. This visual representation plots the failure rate of an asset against the asset's age.

The principle is that new assets exhibit high levels of early failure while issues are ironed out. It then moves to a period of relative stability with a consistent, low failure rate until failures begin to increase again as the asset reaches the end of its useful life.



In line with the expected bathtub curve, the newly installed PCA units in Terminal 5 are experiencing these initial faults.

Since installation the new T5 assets have experienced more faults than assets that have been in operation between 5-10 years.

Increases usage of the units

In addition to the assets' lifecycle stages, we are also seeing regular issues with their incorrect usage. This is to be expected as airlines and ground handlers adapt to the new equipment, and we are collaborating with airlines and ground handlers to mitigate this. This demonstrates the material impact that new, less reliable assets have on overall availability, reinforcing the case against increasing the availability target at this time.

As expected, we are seeing increased usage of the units which is putting further strain on assets, leading to an increase in faults. Alongside this, we have seen vastly different usage rates amongst our airlines and their ground handlers in the past 12 months demonstrating the criticality of change management.

In order to extract maximum value from the new assets, Heathrow is working with the airlines to define protocols around the expected use of PCA. Together, we have increased usage of PCA by 100% year on year to date in 2025. Heathrow will continue working with airlines to further increase usage, in line with other airports. This will require joint working to ensure that all stakeholders have an agreed expectation of both usage and the service provided by the asset. Given the increase in usage and the subsequent rise in faults, increasing the target now would compound the operational challenges and introduce further risk of underperformance.

Regulatory risk and "fair bet"

We consider that increasing the target now is not in line with the overall purpose of the CAA's mid-term review. The proposals for the mid-term review set out the principles the CAA used to define the scope of the mid-term review in its H7 Final Decision:

- It should not undermine the structure of the five-yearly price control reviews;
- It should not expose stakeholders to additional risk;
- Where a target appears potentially too low, we would not generally expect to make any adjustment until the next price control review; and
- where changes are proposed as part of the Review for the H7 period (for security queues and asset availability targets granularity, control post groupings, and security queue targets harmonisation), our aim would be to ensure these have neutral impact on the net revenues HAL might expect to earn from bonuses and/or pay out as rebates during the remainder of H7.

Increasing the PCA target now would expose Heathrow to additional risk through the H7 period.

Conclusion

As set out above, investments in PCA have been delayed and the newly delivered assets are taking time to perform to full capacity. Given this, it cannot be assumed that Heathrow's past performance can accurately predict the performance of PCA assets going forward.

Heathrow is continuing to work closely with the airlines to deliver new PCA assets and is committed to improving the PCA reporting processes through a mixture of short- and longer-term changes. For this reason, we propose holding the target at 98% for H7 and working towards the implementation of a 99% target to be reviewed at the H8 OBR Mid-term review.

This approach would allow for the capital programme to catch up, for new assets to stabilise, and for the impact of increased usage to be fully understood, all of which will inform a more robust and achievable target for the next price control period. It would also allow the CAA to take a broader view of the impact of Heathrow's investment and operational plans, as well as the benefits to consumers of any change to the target.

2) Airport Departures Management and Airport Arrivals Management measure

We support the CAA in retaining the reputational measure on Airport Departures and Arrivals Management. However, we maintain that we have concerns on the proposed target. Given that Arrivals Management and Departures Management measures are impacted by a range of factors that are outside Heathrow's control, we consider the targets should be set to address this complexity.

We have set out our proposal in the H8 Business Plan that the appropriate targets should be set at 15 minutes for Arrivals Management and 38 minutes for Departures Management. We ask the CAA to assess our H8 Business Plan and conclude this matter through the H8 price control process. This would also be in line with the CAA's own principles for the mid-term review, which state that changes should not expose stakeholders to additional risk and that adjustments would not generally be expected until the next price control review.

I trust this response enables the CAA to reach a pragmatic and proportionate final decision. If you have any queries or would like to discuss any aspect of this response, please do not hesitate to contact me or my team directly.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Mike King', with a stylized flourish at the end.

Mike King
Director of Regulation & Economics