

David Milford
Senior Policy Advisor
Civil Aviation Authority
5th Floor, Westferry House,
11 Westferry Circus
London E14 4HD

Heathrow Airport Limited
The Compass Centre, Nelson Road,
Hounslow, Middlesex TW6 2GW

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Dear David

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

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

This response addresses the following aspects from the CAA's initial proposals that require consideration:

- Heathrow's overall view on the CAA's initial proposals;
- Specific issues to consider on the implementation of new targets;
- Granular targets for security;
- Mid-term review of Measures, Targets and Incentives (MTIs); and
- Licence modifications.

Heathrow's overall view on the CAA's initial proposals

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.

We set out specific comments on the carbon measure and the airport departures and arrivals management targets:

a. Carbon measure

We support the CAA adopting Heathrow's existing carbon measure definition included in our annual accounts as a reputational measure to be reported annually. We support the inclusion of Scope 1, 2 and 3. Whilst Scope 3 is not in direct control of Heathrow, it serves as an important measure as part of the wider emissions at the airport and can help influence behaviours and coordinating with stakeholders across the airport.

b. Airport Departures and Arrivals Management targets

We support the CAA in retaining the reputational measure on Airport Departures and Arrivals Management. However, we do 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.

Therefore, we ask the CAA to set the reputational targets for these two measures at the 90th percentile of our current measured performance, corresponding to targets of 15 minutes for Arrivals Management and 38 minutes for Departures Management respectively. Setting the target at this percentile ensures that it remains aspirational, encouraging ongoing performance enhancement and innovation.

Simultaneously, it provides a safeguard against penalizing for anomalies that fall outside our control, thus protecting us from undue reputational risk. This balanced approach underscores our commitment to excellence and continuous improvement while acknowledging the complexities inherent in airport operations.

Issues to consider on the implementation of new targets

The H7 MTI regime came into effect May 2023 and no critical issues regarding the newly introduced measures have become apparent.

However, we reiterate some concerns:

- that the current framework still includes too many input measures, which detracts from the intended shift towards an OBR approach;
- that reputational measures required to be reported by terminal, should either have separate targets for each terminal or performance is reported at an airport wide level against an airport wide target; and
- that the runway operational resilience term requires re-examination to ensure it is fit for purpose.

We will work with stakeholders during H8 Constructive Engagement and the H8 price control review to examine these points and how the MTI regime can be more targeted and proportionate, and consider airline views where they are seeking changes.

The CAA has also proposed to increase the target on availability of pre-conditioned air and Wi-fi, which require further consideration, as follows;

- Pre-conditioned air (PCA) increase from 98% to 99%

Whilst the CAA has noted that performance has consistently met the 98% target, caution is needed before assuming that it is therefore appropriate to increase the target without considering the potential consequences of such a change.

The array of PCA systems spans several generations and some extremely old units that contain obsolete parts and new regulations have significantly restricted the use of Hydrofluorocarbons (HFC's) such as fluorinated gas (FGAS) used in our older PCA units. In addition, the units are also currently underutilised away from summer and because of airline preferences, short turn around times and ease of use. We anticipate increased use of PCA over time to help meet sustainability targets and this increased use combined with an ageing asset base will make meeting this target increasingly difficult and costly.

Moreover, the majority of units are underslung on Airbridges. This means that access to maintain or repair requires closure of the stand. This in turn can lead to degradation of service for passengers in other service measures.

Furthermore, PCA availability is influenced by ground handling procedures. For instance, the PCA's operational guidelines stipulate a two-person operation for hose handling, yet ground handlers often deploy only one person, accelerating the wear and tear on the hoses.

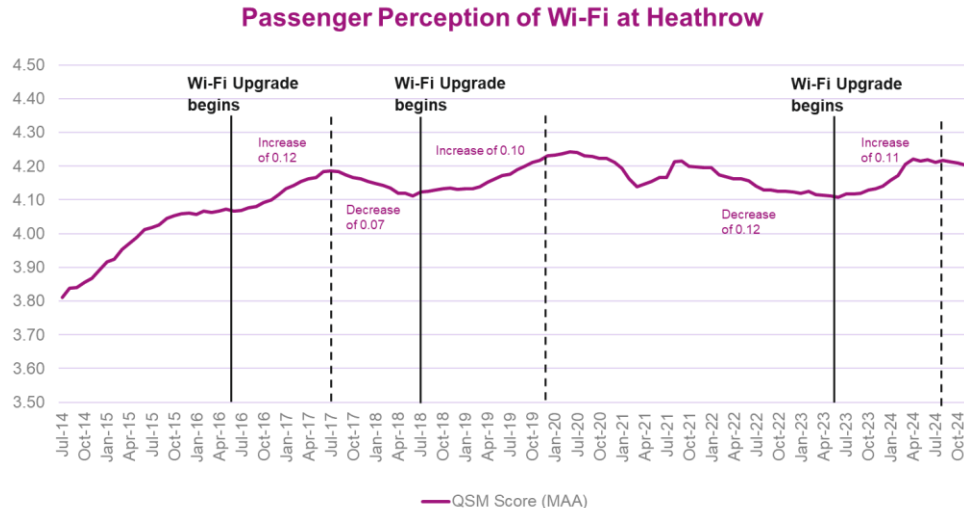
Given these constraints, we consider that it is not in consumers interests to enhance the target for availability of our existing PCA systems to 99% and therefore propose that the PCA availability target should remain capped at 98% until we have completed the full roll-out of new PCA units across the Airport

- Wi-fi target increase from 4.05 to 4.10

Heathrow's Wi-fi performance ranks amongst one of the best compared to other hub airports in Europe. However, passenger satisfaction on Wi-fi performance has a unique cyclical nature.

We currently see a positive response from passengers following Heathrow's decision to bring forward investment in modernising the Wi-fi access ports following seeing a decline in perception starting in 2021 – as shown in Figure 1. However, with technology rapidly changing and consumer experience with public Wi-fi in other transport hubs improves, the QSM scores will decrease over time, reflecting an increase in consumer expectations. Maintaining this target will therefore require continued monitoring and capital investment over time.

Figure 1: Changes in Passenger Perception of Wi-Fi related to upgrading Wi-Fi infrastructure



Source: Heathrow QSM Passenger Satisfaction Survey Jul '14 - Dec '24

It should also be noted that the purpose of the financial measures in the MTI scheme is to provide passengers with a 'Good' level of service. When measuring satisfaction Heathrow uses a 5-point rating scale (1 = Extremely Poor, 2 = Poor, 3 = Average, 4 = Good and 5 = Excellent). This means that any target that is set above 4.0 requires Heathrow to deliver for a greater proportion of passengers providing an 'Excellent' rather than 'Good' rating for the service.

For these reasons, we do not consider it appropriate to increase the Wi-Fi target and ask the CAA to consider this as part of the H8 price control review, at which point we will have an informed view on new technologies and developments required.

We have no further comments on the Security Transformation programme, changes for new investment projects or asset availability targets. We will also focus on the baggage performance measure and how this can be reflected within the MTI regime with stakeholders.

Granular targets for security

Incentives on service performance should be targeted to deliver the right incentives for long-term efficient service delivery. Targets that are too ambitious, or that would require Heathrow to over-compensate for factors outside its control could lead to unnecessary costs without significantly delivering better outcomes for consumers. It is also important that targets focus on consumer priorities and don't drive improvements just for improvements sake.

The current MTI regime places the right incentives to deliver security queuing performance, and we have commercial incentives to provide good security queue experience. There is also a secondary measure set at 99% in less than 10 minutes which equates to less than 5 hours per month where a queue can exceed 10 minutes, which prevents Heathrow from having multiple "bad days" in a month. This provides the right balance of incentives on security queue performance.

We consider that a move away from monthly measurement granularity without the appropriate changes in targets, would have negative consequences for efficiency, whilst not measurably impacting consumer satisfaction. In order to meet the new target, we would have to add margin to our resource planning and infrastructure requirement at all times which could add considerable cost. We consider the current monthly targets sets the right balance between achieving a reliable operation and not exposing Heathrow unduly to factors outside its control.

We remain open to discussing this further with the CAA as part the H8 price control review to assess how the broader MTI regime can be more targeted and enshrine the objectives of the OBR framework.

To help facilitate this and any further review of security, we will share the requested data with the CAA and agree the precise nature of submission and format with the CAA.

Mid-term review of Measures, Targets and Incentives (MTIs)

We support the CAA's proposal for Heathrow to facilitate and pay for an independent audit of the MTI scheme in the next 12 months. We propose the review is carried out in the second half of 2025, which will follow the conclusion of Constructive Engagement round 2 and 3, and Heathrow business plan submission in June 2025. However, it will be key to have a clearly defined scope for the review, which is targeted and proportionate. We look forward to discussing this with the CAA in due course.

Licence modifications

The CAA is proposing 13 modifications of our licence. We have no immediate concerns with the proposed changes 1 to 7 and 13. Regarding proposed changes 8 & 9, our response provides arguments around the target determination for these measures to ensure that these measures are aspirational, encouraging ongoing performance enhancement and innovation. We would like the CAA to clarify its expectations in terms of publication when it comes to change 10 as paragraph 7.2b sets out a monthly publication requirement whilst Table 8 refers to a yearly one. We are addressing in our response our views on proposed changes 11 and 12.

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, flowing script.

Mike King
Director of Regulation & Economics