Notice of proposed modification to Heathrow Airport Limited's economic licence to extend the current price control by one year

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Contents

Chapter 1

Introduction

Purpose of this document

1.1 This document is a formal notice under section 22(2) of the Civil Aviation Act 2012 (the Act) to modify the licence issued to Heathrow Airport Limited (HAL) on 1 April 2014. The proposed modifications are to extend the current price control on HAL, that currently runs from 1 April 2014 to 31 December 2018 (known as Q6), by one year so that it will end on 31 December 2019. The proposal is to roll over the existing control in the last year of Q6 on the same terms, i.e. a price path of the Retail Price Index (RPI) -1.5%.

Background

1.2 In March 2016, we launched a review (known as the H7 review) of the price control and associated arrangements that would apply when the current cap expires at the end of 2018. We published a discussion document and undertook a series of industry workshops and seminars at which we sought views of interested parties on the process, strategic themes and relevant issues for the H7 review.

1.3 In written responses to the document and subsequent discussions, industry stakeholders suggested that we should consider extending the current price control by at least one year.

1.4 Stakeholders thought that the level of uncertainty over the Government response to the work of the Airports Commission on new runway capacity in the South East of England, would affect the quality of the work on the H7 review they could undertake. In particular, HAL thought that the additional time created by an extension, would enable it to enhance the quality and consumer focus of the H7 business plan. Airlines noted the significant staff resource required to engage in expansion plans across the industry and thought that better alignment between H7 and new capacity would reduce the risk of nugatory work and the complexity of H7.

1.5 In light of these views we consulted in July 2016 on whether we should:

- extend Q6 by one year;
- extend Q6 by two years; or
- not extend the price control.

Our preference was to extend Q6 by one year with the current RPI-1.5% price control rolled over for the additional year.

1.6 We received five written responses to our consultation: from HAL, a joint response from the Heathrow Airline Operators Committee (AOC) and the London Airport Consultative Committee (LACC), IAG/British Airways, the Lufthansa Group[1] and Virgin Atlantic Airways. All respondents agreed with our preferred option of extending Q6 by one year. IAG/British Airways, the Lufthansa Group, HAL and AOC/LACC agreed with a roll over of the current price control. Virgin favoured a price control in the additional year that would take account of revised traffic forecasts to account for HAL outperforming the Q6 forecasts. The responses are available on our website and are discussed in further detail in Chapter 2.

1.7 We held a workshop in August 2016 attended by HAL, the AOC, LACC and a number of airlines (including British Airways and Lufthansa). All present supported extending the price control by one additional year and rolling over the current price control into the additional year.

Statutory requirements

1.8 Under sections 22(2) to (4) of the Act before we can modify a licence condition we have to publish a notice that:

- states that we propose to modify the licence;

1 The Lufthansa Group (on behalf of Lufthansa, Swiss International Air Lines and Austrian Airlines) expressed their support for the AOC/LACC response.

- specifies the proposed modification;
- gives our reasons for the proposed modification;
- states the effect of the proposed modification; and
- specifies a reasonable period for making representations.

This document is such a notice.

1.9 Section 1 of the Act gives us a single primary duty to further the interests of users of air transport services in respect of our economic regulation functions. Users are defined in the Act as present and future passengers and those with a right in property carried by the service, i.e. cargo owners.

1.10 The scope of our primary duty concerns the range, availability, continuity, cost and quality of airport operation services. We must carry out our functions, where appropriate, in a manner that will promote competition in the provision of airport operation services.

1.11 In discharging our primary duty, we must have regard to a range of other matters under the Act. These include:

- the need to secure that HAL is able to finance its licensed activities;
- the need to ensure that all reasonable demands are met;
- the need to promote economy and efficiency;
- the need to secure that HAL is able to take measures to reduce, control and mitigate adverse environmental effects;
- any guidance issued by the Secretary of State or international obligation on the UK notified by the Secretary of State; and
- better regulation principles.

Chapter 2

Our reasons for and the effects of the proposed modification

2.1 We propose to modify Condition C1 of HAL's licence to extend the current price control by one year so that it ends at 31 December 2019. The changes to Condition C1 and associated changes to other licence conditions are in Appendix A.

Our reasons for the proposal

2.2 In this section, we set out our reasons for our proposed modification. These are largely unaltered since our July consultation. Most respondents agreed with most of our reasoning in the July consultation. Where respondents disagreed, we comment on whether their views have caused us to change our reasoning.

Extending the price control

2.3 We consider that extending Q6 by one year would be in the interest of users as it would reduce the risk that the H7 process is sub-optimal due to runway uncertainty and lower levels of industry engagement.

2.4 An extension is likely to improve engagement as it would allow stakeholders to plan their engagement on H7 with more certainty and allow resources to be prioritised towards new runway capacity should a Government decision be made. We consider that new runway capacity is likely to deliver considerable consumer benefits, including more choice, lower air fares and higher service quality.

2.5 We recognise that extending Q6 will not eliminate uncertainty around capacity expansion which is likely to persist well into the planning stage of the process. However, without an extension, it will be difficult for stakeholders to focus on a business plan while there is significant uncertainty over whether the airport will operate with 2 or 3 runways in the future.

Rolling over the current price control

2.6 In previous price control extensions the legislation at the time, the Airports Act 1986, only allowed us to maintain the current price control in the additional year (unless the airport consented otherwise). Under the Act we can change the price control in an additional year, but consider that we should maintain the current price control in the additional year.

2.7 In our view the Q6 price control furthers the interests of consumers by reducing airport charges in real terms, by rolling over the price control for an additional year we will maintain this benefit for an additional year. In its response HAL disagreed that falling prices were by definition in consumers' interest. It considered that consumers' interests were best served through appropriate levels of spend to achieve the outcomes that consumers value. We consider that the price control should balance price and quality, ideally offering customers a choice of different price/quality combinations to suit their requirements. Some consumers may prefer higher prices for a higher quality or more resilient service, however, we consider it self-evident that, everything else being equal, consumers prefer lower charges.

2.8 If we were to re-open the price control, we consider that the benefit of the additional time would be negated if it was spent in reassessing the building blocks for the additional year. As mentioned above, HAL, the AOC/LACC, IAG/British Airways and the Lufthansa Group favoured rolling over the price control with no re-opening of any of the building blocks in their written responses.

2.9 However, we acknowledge that there are drawbacks with a simple roll over of the price control based upon assumptions determined in 2014. The risk of actual performance becoming out-of-line from that assumed when the price control was set is higher with the price control rolled over than if we re-opened the price control. HAL's regulatory accounts show that in the first two reporting periods of Q6 (April 2014 to December 2015) its regulatory operating profit of £1.6 billion was 17% higher than the level assumed in the Q6 determination. In their responses to the July 2016 consultation the AOC/LACC, IAG/British Airways and Virgin mentioned this.

2.10 In our July 2016 consultation, we noted that HAL's outperformance against the Q6 determination was driven principally by higher than assumed passenger numbers. In its response Virgin said the price control for the additional year should be based on revised traffic forecasts. Virgin understood that a partial re-opening of the building blocks to set a new price control for the additional year would involve some degree of simplification, but considered that this would be warranted as it would further the interests of users and ensure that HAL's returns are in line with those anticipated in the Q6 determination. If the traffic forecasts were not revised, Virgin thought the difference in outperformance should be considered during the H7 process.

2.11 Re-opening any of the building blocks would use up some of the time freed up to consider regulatory issues around expansion. Re-opening the traffic forecasts would require new forecasts for the additional year and there may be knock-on implications for other building blocks including the capital plan, operating costs and commercial revenues. It seems unlikely that these would be automatically accepted by all stakeholders, and there is no guarantee that they will be accurate. Given this, we continue to believe that we should continue the current price control into the additional year, without revisiting the traffic forecasts or any other of the building blocks.

2.12 HAL said that, consistent with the extension of the Q5 price control, all other variables should be extended from 2018 to 2019. Thus, assumed depreciation should be the same in the additional year as in 2018, and service quality standards should be maintained at the 2018 level.

2.13 On service quality standards we agree with HAL. With respect to depreciation, we will expect HAL to consider this issue further with airlines as part of the discussion around treatment of capital expenditure in the additional year (see para 2.22 below).The AOC and LACC noted that the Q6 settlement contained a smoothing element in the revenue yield per passenger across the years of Q6. It thought it important that any ongoing impact of this provision should be jointly discussed and any resultant action agreed among all stakeholders.

2.14 We have considered whether the value of X, at 1.5% for the additional year of Q6, should be adjusted to account for any smoothing that was assumed at the Q6 determination. We have concluded that the same logic applies to this issue as it does for traffic forecasting and so no adjustments should be made for this reason.

Extending Q6 by two years

2.15 We consulted on the option of extending Q6 by two years. However, this was not our preferred approach as the variance between the Q6 building block forecasts and outturn performance at the end of the extension could be significantly greater than the difference with a one year extension. We did not consider this to be in the interests of consumers as charges could be significantly higher (or lower) than they would otherwise be if a new price control had been set.

2.16 Moreover we considered the likelihood of all stakeholders accepting a two year rollover of the price control as markedly lower. There is no precedent for a two year extension. We also thought that with a two year extension the momentum in the industry following our H7 strategic themes document could be reduced as stakeholders disengaged to work on other priorities.

2.17 No respondent favoured a two year extension, but they all wanted us to leave open the opportunity for a futher extension for a second year if circumstances at the time warranted it. They thought there should be a cut-off date by which we would decide whether there would be an additional one year extension. At the industry workshop stakeholders suggested we should make a decision by 30 June 2017. We agree that we should consider whether the price control should be extended by another additional year, if warranted, by 30 June 2017.

Consumer focus

2.18 We consider that an extension would give us more time to develop our plans to strengthen the consumer elements of H7. These plans include establishing a Consumer Challenge Board (CCB), greater emphasis on consumer outcomes and increasing resilience. The extension will also allow HAL more time to develop a business plan that is designed to deliver the outcomes that consumers value. In its response HAL thought a one year extension would give the CCB an opportunity to fully engage in the process, which it saw as important to the success of H7. Virgin noted that an extension would allow more time to robustly clarify the terms of reference and remit of the CCB. It was open to a short delay to the establishment of the group to ensure this was achieved in a way that is agreeable to all stakeholders. IAG/British Airways also thought that an extension could allow time for a fuller consideration of how the CCB would work before appointing members.

Effects of the proposal

2.19 Extending Q6 by one additional year will free up stakeholders' time to engage more fully in the regulatory implications of any new runway capacity in the South East of England and give opportunity for the H7 review to be more consumer focussed. It will allow:

- the CCB more time to be established and to fulfil its role of providing independent scrutiny and challenge to HAL on behalf of consumers,
- HAL to develop a consumer focussed H7 Business Plan; and
- us and industry stakeholders to develop regulatory measures based on consumer outcomes, including improved resilience.

2.20 The extension may also allow the H7 review to take place when there is greater certainty about the potential location of any new runway capacity.

2.21 The extension is likely to lead to HAL's charges and performance at the end of the period being more out of line with Q6 forecasts than otherwise. We will consider how we can take any additional material out-performance, or under-performance, in the additional year into account in H7.

2.22 HAL and airlines will need to develop a capital programme for the additional year. There is already a governance process in place for HAL's consultation on capital expenditure using the Capital Programme Board. Those present at the workshop agreed that this process should be used for the additional year. We propose that the capital plan should be agreed by 30 June 2017, with HAL and the airline community sending us a joint letter outlining the investment level and projects envisaged together with any consequential adjustments e.g. for the level of depreciation or to capital triggers.

2.23 In their responses HAL, IAG/British Airways and the AOC/LACC highlighted the emphases they considered should apply to the capital programme. HAL thought the emphasis should be to ensure progress on opportunities for passengers going forward, which it described as "H7-1", rather than tidying up Q6 projects. IAG/British Airways thought the additional year should be used to complete Q6 business, and not an opportunity to implement any H7 capital expenditure which had not been fully scrutinised by airlines and us. The AOC/LACC emphasised capital projects which had already been agreed for Q6 but so far HAL had postponed. It mentioned in particular: automating the passenger journey, the next phase of the Heathrow Masterplan featuring Terminal 2 Phase 2; and additional fuel storage. IAG/British Airways and the AOC/LACC named their approach as "Q6+1", rather than "H7-1".

2.24 We consider that the capital expenditure programme for the additional year is, in the first instance, for HAL and its airline customers to detemine through its normal governance arrangements. We look forward to them proposing the most appropriate capital programme for the additional year following which we will review to gain assurance that this approach is likely to further the interests of users.

Revised H7 timetable

2.25 An extension to Q6 will enable us to postpone some of our H7 work. However, as mentioned above, we do not consider it appropriate to delay all of the work by one year, instead we want to ensure that more time is given for priority work. In particular, we want the additional time for H7 to enable the review to be more focussed on consumer requirements.

2.26 We see the establishment of the CCB as a key priority for a consumer focussed review. We aim to appoint the CCB Chair during Autumn 2016 and develop its working arrangements in early 2017. We will also prioritise other consumer focussed work such as incentivising the right consumer outcomes and increasing airport resilience. Other priority areas of work, such as some consultancy studies and guidance on the cost of capital for H7 are in the indicative H7 timetable below.

2.27 In its response HAL mentioned that the establishment of the CCB and benchmarking should continue at pace. It also welcomed our plan to provide guidance on the cost of capital for H7, and that the timetable for confirming regulatory parameters for expansion should be adhered to.

2.28 Virgin said that to enable it to focus resources on the Government's expected decision on new runway capacity, and for the decision to be fully taken in consideration in H7, it anticipated that extending Q6 would result in a replicable delay in H7 work.

2.29 The publication of HAL's H7 business plan will be a key stage in the H7 project. In the illustrative timetable set our in our July consultation we indicated that November 2017 should be the date for HAL's initial plan to be issued to stakeholders. HAL regarded this date as too early and recommended issuing its H7 plan in March 2018. This would align it with its internal business planning processes which concludes at the end of January each year. HAL also mentioned that general business practice argued for shorter, more focused, intensive planning cycles as close to the period planned for as possible.

2.30 IAG/British Airways and the AOC/LACC thought that if HAL produced its initial Business Plan in March 2018 the opportunity for airlines and CCB to scrutinise and challenge the Plan would be substantially limited. The AOC/LACC noted that previously HAL had planned to publish its initial Business Plan in May/June 2017, so it should be able to publish a plan in November 2017 which is more than twelve months away.

2.31 We agree with IAG/British Airways the AOC/LACC that if HAL did not publish its initial Business Plan until March 2018, the time for stakeholder consultation on it would be foreshortened. While we respect regulated companies' normal business planning cycles as far as possible, we cannot allow them to interfere unduly with stakeholder involvement during the regulatory process. We, therefore, continue to expect HAL to produce its initial Business Plan in November 2017. Although this date is more than two years before the new starting date for H7, its revised Business Plan following stakeholder engagement is due to be produced in August 2018 much closer to the start of H7. We will continue to keep this timetable under review and we may need to revise the timetable and timing for the business plan if there is a government decision on the location of new runway capacity.

Table 1: Updated timetable for H7

Timing	Activity
Preparation phase	
November 2016	Decision on extending Q6 Chair of CCB appointed Consultation on outcome based regulation
March/April 2017	Policy update and latest thinking on framework for review
Industry led delivery phase	
Jun - Oct 2017	Airport-Airline engagement on H7 business plan
November 2017	HAL's H7 initial business plan issued to stakeholders
Dec 2017 – May 2018	Constructive engagement
August 2018	HAL's revised plan reflecting stakeholder feedback
CAA led delivery phase	
December 2018	CAA initial proposals
May 2019	CAA final proposals
Licence modification and implementation	
September 2019	CAA final decision/statutory notice for licence modifications
October 2019	Licence modification notice published
1 January 2020	New licence conditions take effect

Chapter 3

Views invited and next steps

Views invited

3.1 We welcome views on the proposed licence modifications. Any representations on them should be sent, if possible by e-mail, to economicregulation@caa.co.uk, by 5pm on Friday 28 October 2016. Alternatively, comments can be sent by post to:

Rod Gander
Consumers and Markets Group
Civil Aviation Authority
CAA House
London, WC2B 6TE

3.2 We expect to publish the representations on our website for other interested parties to read after the period for written representations expires. Any material that is regarded as confidential should be clearly marked as such. Please note that we have powers and duties with respect to information under Section 59 of the Civil Aviation Act 2012 and the Freedom of Information Act 2000.

3.3 If you have any questions on this document please contact Rob Toal on 020 7453 6211 (or by e-mail to robert.toal@caa.co.uk).

Next steps

3.4 Once we have considered the representations, we will decide what modifications, if any, to make to HAL's licence. If we decide to modify HAL's licence we shall publish a notice of the modification in accordance with Condition 22(6) of the Act. If we decide not to modify the licence we will publish a notice giving our reasons for not doing so in accordance with Condition 22(5) of the Act.

Appendix A

Proposed licence modifications

Our proposed licence modifications are shown below:

A3 Definitions

A3.1 In this Licence:

a) airport charges has the meaning assigned to it by regulation 3(1) of the Airport Charges Regulations 2011 (2011 No.2491);

b) the CAA means the Civil Aviation Authority;

c) the Act means the Civil Aviation Act 2012;

d) airlines means providers of air transport services;

e) the AOC means Heathrow Airline Operators Committee, a company limited by guarantee representing all airlines at the Airport. Agreement of the AOC shall be decided according to the AOC's governance arrangements;

f) the Regulatory Period means the period of nine months between 1 April 2014 and 31 December 2014 and this period shall also be considered to be the Licensee's financial year for the purposes of this Licence; and

g) the Regulatory Year means for each of the ~~four~~ five years from 2015 to ~~2018~~2019, the twelve month period beginning on 1 January and ending on 31 December. These years shall also be considered to be the Licensee's financial year for the purposes of this Licence.

Part C: The price control conditions

C1 Price Control

C1.1 When the Licensee fixes the amounts to be levied by it by way of airport charges in respect of relevant air transport services in the Regulatory Period it shall fix those charges at the levels best calculated to secure that; in the Regulatory Period, the total revenue at the Airport from such charges divided by the total number of passengers using the Airport does not exceed the maximum revenue yield per passenger, which shall be calculated as follows:

$$M_{2014} = £22.261\left(1 + B_{2012/13}\right) + \frac{D_{2014}}{Q_{2014}} - \frac{T_{2014}}{Q_{2014}} - K_{2014}$$

Where:

- M_{2014} is the maximum revenue yield per passenger using the Airport in the Regulatory Period expressed in pounds;
- $B_{2012/13}$ is the bonus factor in the Regulatory Period based on the Licensee's performance in 2012/13, as defined in condition C1.8;
- D_{2014} is the cumulative development capex adjustment in the Regulatory Period defined in condition C1.9;
- T_{2014} is the capital 'trigger' factor in the Regulatory Period defined in condition C1.7;
- Q_{2014} is passengers using the Airport in the Regulatory Period; and
- K_{2014} is the per passenger correction factor in the Regulatory Period defined in condition C1.5.

C1.2 On each occasion on which the Licensee fixes the amounts to be levied by it by way of airport charges in respect of relevant air transport services in each of the ~~four~~ five subsequent relevant Regulatory Years beginning with 1 January 2015, the Licensee shall fix those charges at the levels best calculated to secure that, in each relevant Regulatory Year, total revenue at the Airport from such charges divided by the total number of passengers using the Airport does not exceed the amount set in accordance with the formula below:

$$M_t = (1 + RPI_{t-1} + X + B_{t-2})Y_{t-1} + \frac{D_t}{Q_t} - \frac{T_t}{Q_t} + \frac{BR_t}{Q_t} - K_t$$

Where:

- M_t is the maximum revenue yield per passenger using the Airport in Regulatory Year t expressed in pounds;

Where:

- RPI_{t-1} is the percentage change (positive or negative) in the Office for National Statistics (ONS) CHAW Retail Price Index between April in year t-1 and the immediately preceding April;
- X = -1.5%;
- B_{t-2} is the bonus factor in Regulatory Year t, based on the Licensee's performance in t-2, as defined in condition C1.8;
- Y_{t-1} is the revenue yield per passenger in Regulatory Period or Regulatory Year t-1 defined in condition C1.3;
- D_t is the cumulative development capex adjustment in Regulatory Year t defined in condition C1.9;
- T_t is the capital 'trigger' factor in Regulatory Year t defined in condition C1.7;
- Q_t is passengers using the Airport in Regulatory Year t;
- BR_t is the business rate revaluation factor in Regulatory Year t defined in condition C1.11; and
- K_t is the per passenger correction factor in Regulatory Year t defined in condition C1.5.

Y_{t-1}: average revenue yield per passenger

C1.3 Y_{t-1} is the average revenue yield per passenger in Regulatory Period or Regulatory Year t-1 calculated in accordance with the following formula:

$$\mathrm{Y}_{t-1} = \mathrm{Y}_{t-2}(1 + \mathrm{RPI}_{t-2} + \mathrm{X}) + \mathrm{S}_{t-1}$$

Where:

- $\mathrm{Y}_{2014} = £22.261 + \mathrm{S}_{2014}$
- RPI_{t-2} is the percentage change (positive or negative) in the Retail Price Index between that published with respect to April in Regulatory Period or Regulatory Year t-2 and that published with respect to the immediately preceding April;
- X = -1.5%
- S_{t-1} is the allowable security cost per passenger defined in condition C1.4.

S_{t-1}: allowable security cost per passenger

C1.4 St-1 is the allowable security cost per passenger in Regulatory Period or Regulatory Year t-1 arising as a result of changes to security standards. Additional costs from changes in security standards are considered as positive values. Reductions in cost from changes in security standards are considered as negative values. This mechanism only applies when the expected cumulative cost associated with changes to security standards are:

a) above a cumulative £~~19~~20,000,000 "deadband" figure; or

b) below a cumulative - £~~19~~20,000,000 "deadband" figure.

S_{t-1} is calculated in accordance with the following formulae expressed in pounds:

For each relevant Regulatory Period or Regulatory Year t-1, in the case that EC is a positive value, with reference to the absolute value of EC:

If: $|EC_{t-1}| > £\cancel{19}20{,}000{,}000$; *and*
$|EC_{t-2}| > £\cancel{19}20{,}000{,}000$

Then: $S_{t-1} = 0.9C_{t-1}$

Or if: $|EC_{t-1}| > £\cancel{19}20{,}000{,}000$; *and*
$|EC_{t-2}| < £\cancel{19}20{,}000{,}000$

Then: $\mathrm{S_{t-1}} = 0.9\frac{(\mathrm{EC_{t-1}} - £\cancel{19}20{,}000{,}000)}{(\mathrm{t}^*)\mathrm{Q_{t-1}}}$

Or if: $|EC_{t-1}| < £\cancel{19}20{,}000{,}000$; *and*
$|EC_{t-2}| > £\cancel{19}20{,}000{,}000$

Then: $S_{t-1} = -0.9\frac{(EC_{t-2} - £\cancel{19}20{,}000{,}000)}{(t^*)Q_{t-1}}$

Otherwise: $S_{t-1} = 0$

For each relevant Regulatory Period or Regulatory Year t-1, if EC is a negative number, with reference to the absolute value of EC:

If: |EC_{t-1}|> £~~19~~20,000,000; and

|EC_{t-2}|> £~~19~~20,000,000

Then: $S_{t-1} = 0.9C_{t-1}$

Or if: |EC_{t-1}|> £~~19~~20,000,000; and

|EC_{t-2}|< £~~19~~20,000,000

Then: $S_{t-1} = 0.9\frac{(EC_{t-1}+£\cancel{19}20{,}000{,}000)}{(t^*)Q_{t-1}}$

Or if: |EC_{t-1}|< £~~19~~20,000,000; and

|EC_{t-2}|> £~~19~~20,000,000

Then: $S_{t-1} = -0.9\frac{(EC_{t-2}+£\cancel{19}20{,}000{,}000)}{(t^*)Q_{t-1}}$

Where:

- Q_{t-1} is passengers using the Airport in Regulatory Period or Regulatory Year t-1.
- t* is a time variable, which is defined for each Regulatory Period or Regulatory Year in table C.1 below:

Table C.1: Time variable

Period t =	t* =
9mo. 2014	~~57~~69/9
2015	~~4~~5
2016	~~3~~4
2017	~~2~~3
2018	2

- C_{t-1} is the total allowable security claim per passenger using the Airport in Regulatory Period or Regulatory Year t-1 (whether of a positive or negative value) expressed in pounds relative to security costs per passenger in the previous period;
- EC_t is the expected cumulative security claim over the relevant Regulatory Period and ~~four~~ five Regulatory Years starting on 1 April 2014, in period t, which shall be calculated in accordance with table C.2 below:

Table C.2: Calculation of annualised allowable security costs

Period t =	**2013**	**9mo. 2014**	**2015**	**2016**	**2017**	**2018**
Changes in 2014	0	~~6.33~~7.66 * C_{2014} * Q_{2014}	~~6.33~~7.66 * C_{2014} * Q_{2014}	~~6.33~~7.66 * C_{2014} * Q_{2014}	~~6.33~~7.66 * C_{2014} * Q_{2014}	7.66 * C_{2014} * Q_{2014}
Changes in 2015	0	0	~~4~~ 5 * C_{2015} * Q_{2015}	~~4~~ 5 * C_{2015} * Q_{2015}	~~4~~ 5 * C_{2015} * Q_{2015}	5 * C_{2015} * Q_{2015}
Changes in 2016	0	0	0	~~3~~ 4 * C_{2016} * Q_{2016}	~~3~~ 4 * C_{2016} * Q_{2016}	4 * C_{2016} * Q_{2016}
Changes in 2017	0	0	0	0	~~2~~ 3 * C_{2017} * Q_{2017}	3 * C_{2017} * Q_{2017}
Changes in 2018	0	0	0	0	0	2 * C_{2018} * Q_{2018}
EC_t =	Sum rows	Sum rows	Sum rows	Sum rows	Sum rows	Sum rows

Where:

- C_t is the total allowable security claim per passenger using the Airport in Regulatory Period or Regulatory Year t (whether of a positive or negative value) expressed in pounds, relative to security costs per passenger in the previous period; and
- Q_t is the actual number of passengers using the Airport in Regulatory Period or Regulatory Year t.

Kt: per passenger correction factor

C1.5 K_t is the per passenger correction factor (whether positive or negative value) to be made in Regulatory Period or Regulatory Year t, which is calculated as follows:

Where: t = 2015 or 2016

$$K_t = \frac{R_{t-2} - (Q_{t-2}M_{t-2})}{Q_t}\left(1 + \frac{I_{t-2}}{100}\right)^{21/12}$$

Where: t ≠ 2015 or 2016

$$K_t = \frac{R_{t-2} - (Q_{t-2}M_{t-2})}{Q_t}\left(1 + \frac{I_{t-2}}{100}\right)^{2}$$

Where:

- R_{t-2} is total revenue from airport charges in respect of relevant air transport services levied at the Airport in Regulatory Period or Regulatory Year t-2 expressed in pounds;
- Q_t is passengers using the Airport in Regulatory Period or Regulatory Year t;
- M_{t-2} is the maximum revenue yield per passenger using the Airport in Regulatory Period or Regulatory Year t-2;
- I_{t-2} is the appropriate interest rate for Regulatory Period or Regulatory Year t-2, which is equal to:
  - the specified rate plus 3% where K_t is positive; or
  - the specified rate where K_t is negative. In both cases K_t takes no account of I_t for this purpose.

C1.6 In relation to the Regulatory Period and the Regulatory Year 2015, the values of R_{t-2}, Q_{t-2}, M_{t-2} and I_{t-2} shall be calculated by reference to the conditions as to airport charges imposed in relation to the Airport under the Airports Act 1986 in force at 31 March 2014. In the case of the Regulatory Period, t-2 refers to the 12-month period from 1 April 2012 to 31 March 2013.

T_t: trigger factor

C1.7 T_t is the trigger factor, which is a reduction in the maximum revenue yield per passenger occurring when the Licensee has not achieved specific capital investment milestones associated with relevant projects. The factor shall be calculated as follows:

$$\mathrm{T_t} = \sum_{\mathrm{i}} \mathrm{TM_{it}TF_{it}}$$

Where:

For any specific trigger i, in Regulatory Period or Regulatory Year t:

- TF_{it} is the number of months between the milestone month and the earlier of; the project completion date or the end of Regulatory

Period or Regulatory Year t, up to a maximum of 12. In 2014 TF_{it} is restricted to a maximum of 9.

- TM_{it} is the trigger payment associated with each trigger in Regulatory Period or Regulatory Year t;

Where: $TM_{ti} = MTP_i \frac{P_{t-1}}{222.80}$

- MTP_i is the monthly trigger payment which is defined for each relevant project; and
- P_{t-1} is the value of the ONS CHAW Retail Price Index in April in Regulatory Period or Regulatory Year t-1;
- The triggers, milestone month and monthly trigger payments are defined in the Q6 Capital Investment Triggers Handbook and may be modified in accordance with the modification processes set out in that handbook.

*B_{t-2}: bonus factor****

C1.8 B_{t-2} is the bonus factor based on performance achieved in respect of specified elements k of the Licensee's service quality rebates and bonuses scheme (SQRB) as defined in Condition D1. The bonus factor shall be calculated in accordance with Schedule 1 of this Licence.

D_t: cumulative development capex adjustment

C1.9 D_t is the cumulative development capex adjustment, which adjusts the maximum revenue yield per passenger in Regulatory Period or Regulatory Year t to account for cumulative changes in the revenue requirement associated with development capex projects. D_t shall be calculated in accordance with table C.3 below.

Table C.3: Development capex adjustment

		Year t =					
		9mo. 2014	**2015**	**2016**	**2017**	**2018**	**2019**
Additional revenue requirement for projects	2014	$0.5 \times d_{2014}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-5}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-6}} \times d_{2014}$
	2015	0	$0.5 \times d_{2015}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-5}} \times d_{2015}$

in	2016	0	0	$0.5 \times d_{2016}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2016}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2016}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2016}$
	2017	0	0	0	$0.5 \times d_{2017}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2017}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2017}$
	2018	0	0	0	0	$0.5 \times d_{2018}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2018}$
	2019	0	0	0	0	0	$0.5 \times d_{2019}$
		Sum rows x W	Sum rows x W	Sum rows x W	Sum rows x W	Sum rows x W	Sum rows x W

Where:

- W is the Weighted Average Cost of Capital which shall have a value of 5.35%;
- d_t is the annual development capex adjustment in Regulatory Period or Regulatory Year t defined in condition C1.10; and
- P_{t-1} is the value of the ONS CHAW Retail Price Index in April in Regulatory Period or Regulatory Year t-1.

d_t: annual development capex adjustment

C1.10 The annual development capex adjustment in Regulatory Period or Regulatory Year t is an amount equal to the net difference between the development capex allowance included in the Q6 settlement and the total capex associated with new core capex projects in Regulatory Period or Regulatory Year t, to be calculated as follows:

$$d_t = O_t - (V_t * \frac{P_{t-1}}{222.80})$$

Where:

- O_t is the total capex in Regulatory Period or Regulatory Year t associated with all development capex projects that have transitioned to core capex project status after the Q6 settlement either during or before Regulatory Period or Regulatory Year t, which includes the capital spend incurred during the development stages of projects, irrespective of whether projects have transitioned from development to core as determined through the governance arrangements;

- V_t is the development capex allowance in Regulatory Period or Regulatory Year t; and
- P_{t-1} is the value of the ONS CHAW Retail Price Index in April in Regulatory Period or Regulatory Year t-1.

BRt: business rate revaluation factor

C1.11 BR_t is the business rate revaluation factor in Regulatory Period or Regulatory Year t, calculated in accordance with the following formulae.

If: *t = 2018;*

Then: $BR_t = 0.8[(Z_{2017}) * (1 + RPI_{t-1}) + Z_{2018})]$

If: *t = 2019;*

Then: $BR_t = 0.8 * Z_{2019}$

Otherwise: $BR_t = 0$

Where:

- RPI_{t-1} is the percentage change (positive or negative) in the ONS CHAW Retail Price Index between April in Regulatory Period or Regulatory Year t-1 and the immediately preceding April.
- Z_t is the business rate forecast variance in Regulatory Period or Regulatory Year t, calculated in accordance with table C.4 below:

Table C.4: Business rate forecast variance

Period t =	Z_t =
9mo. 2014	0
2015	0
2016	0
2017	$(U_t - £136{,}900{,}000) * \frac{P_{t-1}}{222.80}$
2018	$(U_t - £136{,}800{,}000) * \frac{P_{t-1}}{222.80}$
2019	$(U_t - £136{,}800{,}000) * \frac{P_{t-1}}{222.80}$

Where:

- U_t is the regulatory allowance for business rates (that is £136,900,000 in 2017 ~~and~~, £136,800,000 in 2018 and £136,800,000 in 2019) multiplied by the revaluation impact.
- P_{t-1} is the value of the ONS CHAW Retail Price Index in April in Regulatory Period or Regulatory Year t-1.

Definitions

C.1.12 In this Condition C.1:

a) **allowable security claim per passenger** means the annual equivalent of the increase or decrease in security costs at the Airport in the relevant Regulatory Period or Regulatory Year which arise as a result of a change in required security standards at the Airport, as certified by the CAA, divided by the number of passengers using the Airport in that Regulatory Period or Regulatory Year;

b) **average revenue yield per passenger** means the revenue from airport charges levied in respect of relevant air transport services in the relevant Regulatory Period or Regulatory Year, before any deduction of rebates under the Service Quality Rebates and Bonuses Scheme, divided by the total number of passengers using the Airport in the relevant Regulatory Period or Regulatory Year;

c) **business rate cost** is the tax paid by the Licensee associated with the Airport's land and property assets, as determined by the Valuation Office Agency;

d) **core capex project** is any project that has passed Gateway 3, being taken forward for implementation in accordance with the governance arrangements;

e) **development capex allowance** is a capex allowance included in the Q6 RAB based on the sum of development capex project P80 cost estimates as set out in the governance arrangements;

f) **development capex project** is any project under development that has not passed Gateway 3 in accordance with the governance arrangements, but for which an allowance has been included in the development capex allowance;

g) **Gateway 3** has the meaning set out in the governance arrangements;

h) **the governance arrangements** means the arrangements set out in the Q6 Capital Efficiency Handbook published by the Licensee by 1 October 2014 as agreed by the CAA;

i) **passenger using the Airport** means a terminal passenger joining or leaving an aircraft at the Airport. A passenger who changes from one aircraft to another, carrying the same flight number is treated as a terminal passenger, as is an interlining passenger;

j) **project completion date** is the date when in the judgement of the CAA the Licensee has achieved the trigger criteria as defined for each project through the governance arrangements;

k) **the Q6 Capital Investment Triggers Handbook** means the handbook in existence when this Licence comes into force, having been agreed by the Licensee and the airlines. This handbook contains details of the triggers, milestone months and monthly trigger payments for core capex projects and details of how future changes to those elements can be made with the agreement of the Licensee and the airlines;

l) **relevant air transport services** means air transport services carrying passengers that join or leave an aircraft at the Airport, including air transport services operated for the purpose of business or general aviation;

m) **revaluation impact is equal to one plus the difference between the actual increase in rateable value** measured as a percentage change and +9%, (being the percentage increase assumed in the regulatory allowance) occurring as a result of the rate revaluation undertaken by the Valuation Office Agency in 2017. The actual change will be calculated by multiplying the actual percentage increase in the Cumulo Rateable Value due to the revaluation and the actual percentage increase in the national Uniform Business Rate;

n) **specified rate** means the average of the Treasury Bill Discount Rate (expressed as an annual percentage **interest** rate) published weekly by the Bank of England, during the 12 months from the beginning of May in Regulatory Period or Regulatory Year t-2 to the end of April in Regulatory Period or Regulatory Year t-1.

C2 Charges for other services

C2.1 By 30 September 2014 and by 30 September in each subsequent year the Licensee shall inform the CAA of the system used by it to allocate costs to the Specified Facilities. The Licensee shall make any amendments to its cost allocation system if so requested by CAA by 31 December prior to each charging year commencing on 1 January.

C2.2 By 30 September 2014 and by 30 September in each subsequent year the Licensee shall provide to the CAA statements of actual costs and revenues in respect of each of the Specified Facilities for the year ending the previous 31 December.

C2.3 By 31 December each year, the Licensee shall provide to the CAA and to users of the Specified Facilities or their representatives prior to implementing any price changes a statement of the pricing principles for each item charged including the assumptions and relevant cost information adequate to verify that the charges derive from the application of the pricing principles.

C2.4 Where charges for the Specified Facilities are not established in relation to cost the Licensee shall provide to the CAA and to users of the Specified Facilities or their representatives a statement of the principles on the basis of which the charges have been set with full background information as to the calculation of such charges including statements of any comparables used.

C2.5 Where in respect of any relevant Regulatory Period or Regulatory Year (apart from the 2019 Regulatory Year) actual revenue for any of the Specified Facilities differs from that forecast for the purposes of the price control review for the period 1 April 2014 to 31 December 2018 (as specified by the CAA), the Licensee shall provide to the CAA and to users of the Specified Facilities or their representatives detailed reasons for the differences.

C2.6 Where in respect of the 2019 Regulatory Year actual revenue from any of the Specified Facilities differs from actual revenue in the 2018 Regulatory Year, the Licensee shall provide to the CAA and to users of the Specified Facilities or their representatives detailed reasons for the differences.

Definitions

C2.~~6~~ 7 In this Condition C2 the Specified Facilities are:

a) check-in desks;
b) baggage systems;
c) services for PRMs;
d) staff car parking;
e) staff ID cards;
f) fixed electrical ground power;
g) pre-conditioned air;
h) airside licences;
i) waste, recycling and refuse collection;
j) taxi feeder park;
k) heating and utility services (including electricity, gas, water and sewerage);
l) facilities for bus and coach operators;
m) common IT infrastructure; and
n) HAL contribution to the funding of the AOC.

C4 Charges for cargo only operators

C4.1 In the Regulatory Period and the subsequent ~~four~~ five Regulatory Years, the Licensee shall not levy airport charges in respect of air services that do not fall within the definition of passenger air services that are higher than are levied in respect of equivalent air services falling within that definition.

Definitions

C4.2 In this Condition C4 passenger air services means air services carrying passengers that join or leave an aircraft at the Airport, including air services operated for the purpose of business or general aviation.

Schedule 1

Statement of Standards, Rebates and Bonuses

7. Tables[2]

Table 9: Periods of bonuses earned to be taken into account when setting $\mathbf{M_t}$ as specified in Condition C1[3]

To set the maximum revenue yield per passenger$\mathbf{M_t}$	$\mathbf{M_t}$ representing the period	Take account bonuses earned in $\mathbf{B_{t-2}}$	$\mathbf{B_{t-2}}$ representing the period
M_{2014}	April 2014 – December 2014	$B_{2012/13}$	April 2012 – March 2013
M_{2015}	January 2015 – December 2015	$B_{2013/14}$	April 2013 – March 2014
M_{2016}	January 2016 – December 2016	B_{2014}	April 2014 – December 2014
M_{2017}	January 2017 – December 2017	B_{2015}	January 2015 – December 2015
M_{2018}	January 2018 – December 2018	B_{2016}	January 2016 – December 2016
M_{2019}	January 2019 – December 2019	B_{2017}	January 2017 – December 2017

2 In Tables 1a to Table 5d, for the time of day over which performance counts for rebates, where relevant, if the Licensee and the AOC fail to agree a period for a particular element, the default time period will be the period specified for central search. In Tables 1a to Table 6, $\mathrm{ANNMAX_i}$ is defined in paragraph 2.1(e) and is measured to two decimal places. $\mathrm{R_{i,j}RP}$ and $\mathrm{R_{i,j}RY}$ are defined in paragraphs 2.1(f) and 2.1(g) respectively and are measured to four decimal places. In Table 7, the calculation of ACT rebates in thousands is specified in section 2(e) and is measured to two decimal places. In Table 8, $\mathrm{MB_k}$, $\mathrm{LPL_k}$and $\mathrm{UPL_k}$ are defined in paragraphs 2.1(j), 2.1(k) and 2.1(l) and are measured to two decimal places.

3 In Table 9, for the purposes of calculating M_{2014}, $B_{2012/13}$ is set to zero; for the purposes of calculating M_{2015}, $B_{2013/14}$ is set to zero.