Tim Griffiths
Policy Regulation Group
Economic Regulation
Civil Aviation Authority
CAA House, 45- 49 Kingsway
London WC2B 6TE

22 October 2013

Dear Tim

CAA's FINAL PROPOSALS – INTERIM SUBMISSION

1. Introduction

1.1 This note is an interim submission by the Gatwick ACC to the CAA's final Q6 proposals for Gatwick Airport.

1.2 This note is primarily concerned with the drafting of:

(a) The new draft Conditions of Use prepared by Gatwick Airport Limited ("GAL")with the intention of incorporating its Commitments, as recently published by the CAA (the "Proposed Conditions of Use");[1] and

(b) the draft Licence appended to the Final Proposals.[2]

1.3 Whilst we have raised a number of important substantive issues - as well as drafting points - we have not sought to deal in this note in any detail with our overriding concern that GAL's proposed pricing under the Commitments is at a level that is just too high. We will deal separately with this issue in another note to be provided in response to the CAA consultation but, in brief:

(a) The comparison the CAA makes between its "*fair price*" and the pricing in GAL's Commitments does not compare "*apples with apples*". A comparison based on the same assumptions as to capital expenditure, service quality rebates, duration and other terms would show that the price in GAL's Commitments is well above the "*fair price*"; and

(b) The "*fair price*" is, itself, higher than it should be for all the various reasons previously submitted and which we will revisit, where appropriate, in our forthcoming note.

1.4 The ACC would like to make it clear that we are unable to support the Commitments as currently drafted in the Proposed Conditions of Use as updated by the revised (September) Heads of Terms document.

2. The Proposed Conditions of Use

2.1 We set out below our various comments on the Proposed Conditions of Use broken down as between the different sections of the document.

(i) Variation of the Commitments

[1] See http://www.caa.co.uk/docs/78/Conditions%20of%20Use%20%20270813%20unmarked.pdf. A pdf copy of the document as it existed on 21 October 2013 is provided with this advice in case the document at the linked page subsequently changes.

[2] *Economic Regulation at Gatwick from April 2014: final proposals* published on 3 October 2013.

2.2 There are two typographical errors in Condition 2.1.3:

(a) The Condition that refers to Term is Condition 1.1.23 not 1.1.2.3; and

(b) It should say "other than" in the penultimate line of the Condition rather than "other then".

(ii) Waiver and Indemnity

2.3 Conditions 2.1.9 to 2.1.11 are, as currently drafted, solely for the benefit of GAL. This was arguably appropriate when the Conditions of Use were purely a private document and only imposed obligations on Operators but there is no justification for this approach continuing where the Conditions of Use impose obligations of a regulatory nature on GAL. The provisions should be mutual such that:

(a) no failure or delay by an Operator to exercise a right or remedy under the Conditions of Use (or a partial exercise of rights) is to be taken as precluding any further exercise or acting as a waiver of any breach (Condition 2.1.9);

(b) any express waiver by an Operator is to be strictly and narrowly construed (Condition 2.1.10); and

(c) GAL shall keep all Operators indemnified against any losses caused by GAL's breach of the Conditions.

(iii) Dispute Resolution Procedure

2.4 Although the proposed text is consistent with that in the Heads of Terms from September 2013[3] (the "Heads of Terms"), we believe that there are certain undesirable features in the currently proposed Dispute Resolution Procedure (Conditions 2.1.12 to 2.1.21). In particular:

(a) Although not as clear as it could be, it appears from Conditions 2.1.12, 2.1.19, 2.1.21 and 2.1.23 that GAL's intention is that neither party should be able to take a dispute to court without first exhausting the temporarily binding expert determination process (other than to seek urgent injunctive relief). Given that the expert determination is only supposed to be binding until superceded by a court judgment, we cannot see that there is necessarily a benefit to requiring a delay to commencement of the court process. The Heads of Terms indicated that the expert determination process was supposed to follow the adjudication approach provided for by Section 108 of the Housing Grants, Construction and Regeneration Act 1996. The adjudication process provided for by that Act does not prevent simultaneous or alternative recourse to the courts. There may be occasions where there is no benefit in obtaining a temporarily binding resolution and where it is better to be able to go straight to court. The Parties should not be prevented from immediately pursuing their avenues of redress before the courts.

(b) Condition 2.1.19 imposes a very short limitation period for any legal proceedings in relation to a dispute or an expert determination of a dispute, namely 90 days from the expert's determination. We do not believe that this shortening of the limitation period is appropriate or helpful. Ordinarily, there would be a limitation period of six years from the alleged breach of contract. As currently drafted, it may be that one party can refer a dispute to the expert before all the facts are known and thereby force the other party

[3] *Heads of terms of Airport Commitments in relation to Airport Services & Charges beyond Q5* (Finalised Draft September 2013) available at http://www.caa.co.uk/docs/78/20SeptemberFinalCommitmentsProposals.pdf. A pdf copy is also provided with this advice.

either to issue a claim when not fully prepared or able to make out its case or otherwise lose its right to bring any claim. This is a particular issue for the airlines where, if all are affected, there will be a need to coordinate a response that will make it particularly difficult to comply with short deadlines. We consider that Condition 2.1.19 should be deleted in its entirety.

(iv) Operational

2.5 We have spotted an apparent typographical error in Condition 2.2.2. We believe that the last part of the last sentence should say "*...prohibiting the Operator or particular services of the Operator from operating from the airport for a fixed period of time*".

(v) Price Commitment

2.6 The ACC remains of the view, as indicated in previous consultation responses, that it is inappropriate for GAL to maintain a concept of Premium Service Charges that are payable even in the absence of Bilateral Contracts but outside the effective price cap. It should be sufficient that it is open to GAL and any airline to enter into a Bilateral Contract for delivery of different services. We do not understand why there might be any need for something additional. We would propose the deletion of the concept of Premium Service Charges.

2.7 We have the following comments on Schedule 2:

(a) We note that there may be scope for ambiguity and/or subjective interpretation by GAL in the reference to "*charges equivalent to the Core Service Charge and Selected Ancillary Service Charges*" in the definitions of 'Aggregate Blended Revenue' and 'Aggregate Core Revenue' in Paragraphs 1.1 and 1.2 respectively. This could be important given that the phrase is used to define what charges under Bilateral Contracts are taken into account in calculating compliance with the Indicative Yield Profile Commitments. We consider that it should be made clear that Aggregate Blended Revenue and Aggregate Core Revenue include the revenue from all charges under Bilateral Contracts save to the extent that the charges are made for services that are genuinely different from and additional to those that GAL is required to provide and/or does provide in the absence of Bilateral Contracts. There should be a presumption that all Bilateral Contract charges are included unless GAL can make out a clear case for their exclusion.

(b) The definition of 'Core Service Charge' is not adequate because defining it as "*...those charges referred to in Appendix 1 of the Schedule of Charges as may be varied from time to time...*" leaves GAL scope to unilaterally change the types of charges that fall within this crucially important definition as Appendix 1 of the Schedule of Charges is subject to unilateral change by GAL subject only to the requirements of the Airport Charges Regulations. The definition should, instead, indicate that it includes all charges other than a specific list of items to be provided in the first instance by GAL. If GAL considers that the list should change in the future then it can seek a modification but the presumption should be that charges fall within the effective price cap unless it is established that it is not appropriate to do so.

(c) The defined term 'B_t' in Paragraphs 1.7, 1.10 and 1.11 of Schedule 2 is now redundant given that bonuses have been deleted. Paragraph 1.7 should be deleted and the other two paragraphs should be amended to remove reference to B_t.

ACC Office, South Terminal, Gatwick Airport, West Sussex. RH6 0DW
Tel: +44 (0) 1293 501872 Mb: +44 (0) 7855 521825 or email: Jorettie@mac.com

(d) For consistency with Heathrow's licence, and for greater clarity, we would propose that GAL should redefine 'RPI_{t-1}' (Paragraph 1.16) as "*the percentage change (positive or negative) in the Office for National Statistics (ONS) CHAW Retail Price Index between August in year t-1 and the immediately preceding August*"[4].

(e) The defined term 'S_t' (Paragraph 1.17) used to effect the security cost pass-through is problematic for a number of reasons, as follows:

(i) Paragraph 1.17.1 is not consistent with the Heads of Terms and Final Proposals. It currently allows GAL to pass-through 90% of the increase above £1m rather than 90% above £1.75m as set out in the Heads of Terms (September version). We suspect that this issue is simply the result of the Proposed Conditions of Use having been drafted before the changes made in September;

(ii) Paragraph 1.17.1 still allows GAL to pass-through increases in costs without passing-through any reduction in costs. The ACC has previously complained about this and the CAA agrees that it "*does not consider that this would operate in passengers' interests and it could affect the overall price in the Commitments*" (paragraph 10.99 in the Final Proposals). Despite recognising the issue, the CAA has not offered any solution through its licence provisions or otherwise. The Proposed Conditions of Use should be amended so that reductions in security costs are also passed through.

(iii) Paragraph 1.17.1 compounds the unfairness of only passing-through increases by looking only at increases in one year, implicitly against the amount paid in the previous year. This has the result that Operators could theoretically be charged extra even if the total cost of security is less over the duration of the Commitments than in Q5. Thus, to provide a worked example, assume the following hypothetical security costs:

2013/14 (i.e. current price control)	£100m
2014/15	£50m
2015/16	£60m
2016/17	£70m
2017/18	£80m
2018/19	£90m
2019/20	£100m
2020/21	£100m

In this situation, there would be an "increase" in every year of the control apart from the first and last year with £9m passed through in each of the years from 2015/16 until 2019/20 such that Operators pay an extra £45m in charges even though the total cost of security is £150m less than if costs had remained flat across the whole duration of the Commitments.

[4] Text from Condition C1.2 in the Heathrow Draft Licence appended to the CAA's Final Proposals for Heathrow.

At a minimum, the only increase allowed should be that which is (i) an increase on the amount paid in 2013/14; and (ii) an increase on the previous highest amount of security costs paid in any year of the Commitments.

(f) Paragraph 5 of Schedule 2 should be amended to clarify that "*GAL shall set the Core Service Charges and Selected Ancillary Service Charges in any Relevant Year with the intent that the Core Yield shall not exceed the Core Yield in the prior year by more than RPI + 10%...*". We see no justification for limiting this provision to Core Service Charges when the Core Yield relates to both Core Service Charges and Selected Ancillary Service Charges (as emerges from the definitions of 'Core Yield' and 'Aggregate Core Revenue' in Paragraphs 1.5 and 1.2 respectively).

(g) We note that Paragraph 6.2 of Schedule 2 continues to place little restriction on GAL's pass-through recovery of Runway 2 costs despite the CAA identifying this as an issue (paragraph 10.94 of the Final Proposals). The CAA's indication that it could look to modify the licence if GAL did not strictly obey its views on Runway 2 cost recovery (paragraph 10.109 of the Final Proposals) does not offer much comfort given the limits on the CAA's ability to modify the licence and GAL's ability to appeal any modification. We propose, instead, that paragraph 6.2 is deleted and there is an additional licence condition as follows:

"New Licence Condition C1.5A

If following the completion of the Airports Commission the Government supports the development of a second runway at Gatwick Airport (or if Gatwick is permitted by any other mechanism analogous thereto) then the Licensee may propose amendments to the indicative price path set out in the Commitments to allow for the recovery of the reasonable costs in respect of the development of a second runway. Notwithstanding the provisions of Condition C1.4, any such proposed amendments shall be treated as proposed modifications to this Licence, the acceptance of which would be subject to the provisions of the Act governing the modification of licences."

(vi) Service Commitments

2.8 Page 12 of the Heads of Terms anticipated that airlines might continue to qualify for service rebates under the Conditions of Use even if they entered into Bilateral Contracts albeit that the Bilateral Contracts would specifically provide for that eventuality. As currently drafted, Condition 6.3 anticipates that rebates will only be available to Operators operating exclusively under the Conditions of Use. Whilst the terms of any Bilateral Contract could override this restriction, we consider that it would be better to expressly recognise in Condition 6.3 that rebates will continue to be payable under the Conditions of Use unless expressly excluded by the terms of the relevant Bilateral Contract.

2.9 Paragraph 5.1 of Schedule 3 should use the defined term "Bilateral Contracts" rather than "bilateral contracts".

2.10 The Proposed Conditions of Use need to be amended to reflect the agreement reached between GAL and the airlines on the Service Rebate Percentage and Annual Reconciliation of Rebates as set out at page 13 of the Heads of Terms (September version). We would note, though, that the formula in the Service Rebate Proceedings section of the Heads of Terms is currently incomplete since it does not clarify that '$P_{i,t}$' needs to be multiplied by the annual forecast revenue before

ACC Office, South Terminal, Gatwick Airport, West Sussex. RH6 0DW
Tel: +44 (0) 1293 501872 Mb: +44 (0) 7855 521825 or email: Jorettie@mac.com

being divided by 12. The ACC believes this should be uncontroversial as it simply reflects the approach already adopted in Q5.

2.11 We note that no standards have yet been defined for "airfield congestion / availability" in the Proposed Conditions of Use. These should be defined before the Proposed Conditions of Use are adopted by reference to the agreement reached between GAL and the airlines as set out in the joint letter to Tim Griffiths of the CAA on 9 October 2013.

2.12 We note that the service quality rebates are effectively lower than they were in Q5 because GAL has claimed the right to off-set airline service quality penalties that were not imposed in the last price control and that the CAA considers could not be imposed in a price control it would be able to adopt (paragraph 10.97 of the Final Proposals). The ACC continues to oppose imposition of standards by GAL, but in the absence of any change, GAL should at least be required to provide more generous rebates in order to maintain the same level of incentives to meet its service quality standards. Otherwise GAL would have a perverse incentive to increase airline standards as a means of avoiding rebate payments for inadequate airport services.

2.13 It will be necessary to ensure that the carve-outs from the service quality standards in Paragraph 4 of Schedule 3 Appendix II are the same as currently apply.

(vii) Operational and Financial Resilience

2.14 Condition 7.4 imposes an obligation on GAL to consult on its draft operational resilience plan but does not say how it should do that. There should be a more detailed statement of how GAL must consult or, at a minimum, a requirement that GAL should respect the principles of adequate consultation mandated of public authorities (through such cases as *R v North and East Devon Health Authority, ex p Coughlan* [2001] QB 213). Such a requirement would ensure that GAL consults whilst proposals are still at a formative stage, provides sufficient information and time for intelligent comment and takes account of comments received.

2.15 Condition 7.5 sets a minimum of only one meeting per year to discuss the requirements of the operational resilience commitment. Whilst this is consistent with the Heads of Terms, we consider that there should be more frequent meetings. At a minimum, we would propose there be two meetings per year.

2.16 Condition 7.6 imposes an obligation on all providers of air transport services and ground handlers to "*take the actions allocated to them in [GAL's] plan(s) during periods of disruption*". The CAA has expressed concern about the idea of GAL being able to dictate what the airlines must do (paragraph 10.102 of the Final Proposals) and that issue remains despite the use of the phrase "*reasonable endeavours to cooperate with [GAL]*" in the first part of the Condition. We would propose that GAL should delete the words "*shall take the actions allocated to them in [GAL's] plan(s) during periods of disruption*".

2.17 Condition 7.8 (requiring GAL's directors to confirm the adequacy of financial resources) is not now consistent with the terms of the licence provision that the CAA proposes to impose. We would propose that Condition 7.8 be deleted as it is now redundant. At the same time, however, we believe that the relevant licence conditions should adopt the approach in Condition 7.8 of requiring GAL's directors to certify that GAL has adequate resources to deliver its core services rather than merely to provide undefined airport operating services.

(viii) Investment and Consultation Commitment

2.18 The consultation obligations in Schedule 4 should be clarified to indicate that GAL will be required to follow the principles required of a public authority in consulting (as discussed in paragraph 2.14

above). There could also usefully be more detail on the nature of the consultation that will be conducted in relation to the Master Plan (Paragraph 3 of Schedule 4).

2.19 There should be definitions of the Master Plan and the various Tollgates.

2.20 Paragraph 4.2.5 of Schedule 4 requires GAL to report annually on differences between the latest forecast cost of the capital investment programme and "*the forecast incorporated in the CAA's 2013 price control review*". We think this phrase is ambiguous and could cause confusion and disagreement. It would be better to refer to specific paragraphs of the Final Proposals.

2.21 We note that Paragraph 6.1 of Schedule 4 only requires GAL to meet annually with the capital sub-committee of the ACC to review GAL's delivery of the Capital Investment Programme. Whilst this is consistent with the Heads of Terms, and a full review may only be needed once per year, we consider that the Proposed Conditions of Use should reflect the existing arrangements of monthly sub-committee meetings so that it is clear that no change of approach is intended.

3. The draft Licence

3.1 On Part C, we have the following suggestions:

(a) The first heading and the first sub-heading should delete the word "price" as the relevant Commitments go beyond the price Commitments and include Commitments as to service standards, operational resilience and so on.

(b) Condition C1.1 needs to be modified to reflect the different way in which GAL now proposes the Commitments are given effect. They are not merely a Schedule to the Proposed Conditions of Use but are given effect throughout the Conditions. Condition C1.1 should set out precisely which elements of the Conditions of Use are to be considered conditions of the Licence (and they can then be described by the defined term "Commitments").

(c) Conditions C1.2 and C1.7(a) refer to the Licensee's pricing principles and, in the former case, say that they are set out in the Commitments, but they are not now set out in the Commitments at all. It would seem that there is no need for any reference to the principles at all in the Licence.

(d) Condition C1.3 should be amended to refer explicitly to the Commitments so that the public interest objectives unquestionably apply to GAL's performance of the Commitments. It should say, "*In complying with the Commitments and this Condition C1...*" as though the Commitments are said to be incorporated in the Licence, we are not sure that it can be said that they are specifically part of Condition 3.

(e) Conditions C1.4 and C1.5 each refer to "*the modification provisions of the Commitments*". The specific provisions should be listed to referenced in order to avoid any ambiguity.

(f) As noted in paragraph 2.7 above, we propose that there be an additional licence condition as follows:

> **"New Licence Condition C1.5A**
>
> If following the completion of the Airports Commission the Government supports the development of a second runway at Gatwick Airport (or if Gatwick is permitted by any other mechanism analogous thereto) then the Licensee may

ACC Office, South Terminal, Gatwick Airport, West Sussex. RH6 0DW
Tel: +44 (0) 1293 501872 Mb: +44 (0) 7855 521825 or email: Jorettie@mac.com

propose amendments to the indicative price path set out in the Commitments to allow for the recovery of the reasonable costs in respect of the development of a second runway. Notwithstanding the provisions of Condition C1.4, any such proposed amendments shall be treated as proposed modifications to this Licence, the acceptance of which would be subject to the provisions of the Act governing the modification of licences."

3.2 On Part D, and as discussed in paragraph 2.17 above, we note that all the obligations are linked to a very low threshold of the ability "*to provide airport operation services at the Airport*". We suggest that the threshold should be higher and linked to the services currently being provided. Thus, for example, it could say "*to provide airport operation services at the Airport not materially less substantial than were provided at 1 April 2014*". This would need to be incorporated in Condition D1.1 and in each form of the certificate wording in Condition D1.2.

Naturally, we must stress that this submission is made without prejudice to our final position or to any individual submissions made by particular airlines. Nonetheless, in the interim I hope that this clarifies our position

Yours Sincerely

Jason Holt
Chairman
Gatwick Airline Consultative Committee

ACC Office, South Terminal, Gatwick Airport, West Sussex. RH6 0DW
Tel: +44 (0) 1293 501872 Mb: +44 (0) 7855 521825 or email: Jorettie@mac.com