

Draft for discussion

Heathrow – draft expansion licence condition

Condition []: Early Expansion Costs

Expansion targets

1. Where the Licensee is proposing to undertake Expansion, the Licensee shall make reasonable commercial endeavours to undertake a programme of early works aimed at:
 - i. commencing the provision of airport operation services using a third runway and associated works at the Airport to commence not later than a date set by the CAA in line with national policy and schedule considerations (the **Delivery Target**); and
 - ii. incurring an amount of Early Category C Costs no higher than the amount set by the CAA in line with schedule considerations (the **Early Category C Cost Target**).
2. The Delivery Target shall not be earlier than 31 December 2029. The Early Category C Cost Target shall not be lower than [£1.7] billion.
3. Nothing in this condition shall require the Licensee either to undertake Expansion or carry out specific works in relation to Expansion.
4. The Licensee will not be in breach of Condition X.1 by incurring amounts higher or aiming at a timeframe later than the Targets, where the Licensee considers the Targets to be no longer achievable using reasonable commercial endeavours (for example, in light of any expenditure or commitments reasonably required to achieve Development Consent Success). However, the Licensee must make reasonable commercial endeavours to keep as close to the Targets as it considers prudent.

Governance and updates to the expansion targets

5. The Licensee must provide updated forecasts of its performance against the Targets at least once every six months together with any other information about the Licensee's planning for Expansion which the CAA reasonably requests.
6. The Targets will be revised, and promptly republished by the CAA, in any of the following circumstances:
 - i. the revision has the agreement of the Licensee and the Airline Community;
 - ii. the following requirements are met:
 - I. the Licensee requests the revision in a written request to the CAA;
 - II. the request contains a detailed explanation of how the proposed revision better fulfils the Consumer Interest, and is accompanied by a recommendation by the

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Independent Fund Surveyor that the revision is reasonable in light of the circumstances of Expansion; and

- III. the CAA has not, within 1 month of receipt the written request, determined by notice to the Licensee that the revision is contrary to the Consumer Interest. The CAA may only make such determination if it considers that the revision does not reasonably reflect the circumstances of Expansion; or
- iii. the CAA determines, after Consultation, to make a revision to the Targets. However, such a revision may not bring forward the Delivery Target or reduce the Early Category C Cost Target except with the consent of the Licensee.

Residual Category B Costs

7. Residual Category B Costs shall:

- i. be recorded by the Licensee as they are incurred and reported to the CAA in a manner reasonably required by the CAA through the Licensee's regulatory accounts; and
- ii. form part of the regulatory asset base (including indexation from the time the costs were incurred to the Recovery Point, at the same rate as the rest of the regulatory asset base) together with the Category B Recovery Amount, from the Recovery Point (or, if the costs were incurred after the Recovery Point, from the time the expenditure was incurred),

but the regulatory asset base shall be subject to future deductions to reflect any CAA determination made in writing, no later than [x] months after the DCO Determination Point, that any of the Residual Category B Costs have been inefficiently incurred.

Early Category C Costs: Option 1 – leverage the development and core framework

8. Early Category C Costs shall be recorded by the Licensee as they are incurred and reported to the CAA in a manner reasonably required by the CAA through the Licensee's regulatory accounts.

9. Conditions C1.9, C1.10 and C1.16 of the licence shall also be amended as follows:

C1.9 *Dt 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 **and Early Category C Costs**. Dt shall be calculated in accordance with table C.3 below.*

Where:

- *W is the Weighted Average Cost of Capital which shall have a value of 5.35%;*
- *dt is the annual development capex adjustment in Regulatory Period or Regulatory Year t defined in Condition C1.10; and*

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- *P_{t-1} is the value of the ONS CHAW Retail Price Index in April in Regulatory Period or Regulatory Year t-1.*

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 **and Early Category C Costs** in Regulatory Period or Regulatory Year t, to be calculated as follows:*

$$dt = Ot - (Vt * Pt-1 222.80)$$

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, **and total capex in Regulatory Period or Regulatory Year t associated with Early Category C Costs incurred.***
- *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.*

C1.16 *In this Condition C.1:*

...

*(f) 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. **The development capex allowance in respect of Early Category C Costs shall be taken from the table D4 of the CAA's CAP1658 consultation document...***

Early Category C Costs: Option 2 – adjustment to depreciation where DCO unsuccessful

10. Early Category C Costs shall:
- i. be recorded by the Licensee as they are incurred and reported to the CAA in a manner reasonably required by the CAA through the Licensee's regulatory accounts; and
 - ii. form part of the regulatory asset base (including indexation from the time the costs were incurred to the Recovery Point, at the same rate as the rest of the regulatory asset base for that period) together with the Expansion Recovery Amount, but only from the Recovery Point (or, if the costs were incurred after the Recovery Point, from the time the expenditure was incurred).

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11. The regulatory asset base shall be subject to future deductions to reflect any CAA determination made in writing, no later than [x] months after the DCO Determination Point, that any of the Early Category C Costs have been inefficiently incurred.
12. Following a Development Consent Failure, the amount the Licensee would otherwise be allowed to charge by this licence shall be amended in accordance with a Depreciation Policy published by the CAA after Consultation. The Depreciation Policy shall: (i) only address the depreciation of Early Category C Costs in the regulatory asset base; and (ii) not impose a depreciation period for such costs of longer than 50 years.

Early Category C Costs: Option 3 - Incentive structure for achieving milestones

13. Early Category C Costs shall:
 - i. be recorded by the Licensee as they are incurred and reported to the CAA in a manner reasonably required by the CAA through the Licensee's regulatory accounts; and
 - ii. form part of the regulatory asset base (including indexation from the time the costs were incurred to the Recovery Point, at the same rate as the rest of the regulatory asset base for that period) together with the Expansion Recovery Amount, but only from the Recovery Point (or, if the costs were incurred after the Recovery Point, from the time the expenditure was incurred).
14. The regulatory asset base shall be subject to future deductions to reflect any CAA determination made in writing, no later than [x] months after the DCO Determination Point, that any of the Early Category C Costs have been inefficiently incurred.
15. On each of the five occasions following the DCO Determination Point on which the Licensee fixes the amounts to be levied by way of airport charges in respect of relevant air transport services under Condition C1.2, the maximum revenue yield per passenger using the Airport allowed by Condition C1.2 (the **Maximum Yield**) shall be amended as follows (in each case with amendments spread evenly over the five occasions):
 - i. If Development Consent Success occurs and the amount of Early Category C Costs is at or above the applicable Target in force at that time, the Maximum Yield will not be amended;
 - ii. If Development Consent Success occurs and the amount of Early Category C Costs is below the applicable Target in force at that time, then the Maximum Yield will be amended to allow the Licensee to recover an additional amount equal to 5% of the Licensee's Early Category C Costs (in 2018 prices);
 - iii. If a Development Consent Failure occurs, and it is a Licensee Development Consent Failure, then the Maximum Yield will be amended to require the Licensee to reduce the amount it would otherwise recover by 5% of the Licensee's Early Category C Costs (in 2018 prices); and

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- iv. If a Development Consent Failure occurs, and there is no Licensee Development Consent Failure, then the Maximum Yield will be amended to require the Licensee to reduce the amount it would otherwise recover by an amount equal to:
 - I. 5% of the Licensee’s Early Category C Costs (in 2018 prices) (the **Starting Amount**); minus
 - II. any reductions to the Starting Amount applicable under the Milestones Incentive Policy.

16. The **Milestones Incentives Policy** referred to in condition X.15:

- i. shall be set out in writing by the CAA following Consultation, and only amended following Consultation;
- ii. shall define the conditions in which reductions to the Starting Amount apply, which shall be intended to incentivise the Licensee to achieve five following milestones as determined by the CAA to be appropriate based on the schedule:

Milestone	Maximum reduction
Grundons TCPS approved by Slough BC	In each case, 1% of the Licensee’s Early Category C Costs
Launch of Residential Property bond	
DCO acceptance by PINS	
Grundons start on site	
Start of clearance for ecological works	
PINS recommendation of DCO to Secretary of State	

- iii. may provide specifications as to when a Milestone shall be considered to be achieved.

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Definitions

17. In this condition:

- i. "Airports National Policy Statement" means the Airports National Policy Statement designated by the Secretary of State under section 5(1) of the Planning Act 2008 on 26 June 2018.
- ii. "Category B Costs" means the reasonable costs (capital, operating and financing) of applying for Development Consent since the Government announcement of its decision on 25 October 2016 to support the development of a third runway at the Airport.
- iii. "Category B Recovery Amount" is any additional amount that the Licensee would have been entitled to recover in respect of Residual Category B Costs if they were added to the regulatory asset base as they were incurred rather than from the Recovery Point.
- iv. "Consultation" means the CAA is (in addition to complying with the general standards of public authorities in respect of consultation) to provide its proposal to the Licensee and any other stakeholders the CAA considers may be affected; allow a minimum of 28 days for the Licensee and relevant stakeholders to provide written submissions on the proposal; duly take those submissions into account; and not reach any final decision which is materially different to the proposal without undertaking further Consultation.
- v. "Consumer Interest" means the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services in accordance with section 1 of the Act.
- vi. "DCO Determination Point" means the Development Consent Failure or the Development Consent Success (whichever occurs first).
- vii. "Development Consent" means planning permission for a third runway and associated infrastructure.
- viii. "Development Consent Failure" means the Licensee has definitively failed to obtain Development Consent to permit it to undertake Expansion under the Planning Act 2008. A Development Consent Failure occurs when the following three criteria are met:
 - I. There is a decision by the Secretary of State not to grant Development Consent;
 - II. (i) any period for appealing, reviewing or challenging that decision has expired and no such appeal, review or challenge has commenced; or (ii) if such an appeal, review or challenge has commenced, the relevant proceedings (including any consequent appeals) have definitively concluded in a manner which confirms Development Consent will not be granted and there can be no further appeal; and
 - III. The Licensee has announced its intention not to reapply for Development Consent.

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- ix. “Development Consent Success” means the Licensee has obtained Development Consent to permit it to undertake Expansion under the Planning Act 2008. Development Consent Success means that the Secretary of State for Transport (SoS) has made the Heathrow Expansion DCO, and any subsequent challenge or appeal to that decision to make the DCO which upholds the decision is determined
- x. “Early Category C Costs” means costs incurred by the Licensee prior to the DCO Determination Point in relation to the construction of all of the infrastructure required for Expansion. Early Category C Costs do not include Residual Category B costs.
- xi. “Expansion” means the expansion of the capacity of the Airport in the manner provided for in the Airports National Policy Statement.
- xii. “Expansion Recovery Amount” is any additional amount that the Licensee would have been entitled to recover in respect of Early Category C Costs if they were added to the regulatory asset base as they were incurred rather than from the Recovery Point.
- xiii. “Licensee Development Consent Failure” means that the Licensee has had its application for Development Consent rejected by the Planning Inspectorate (and any appeal, review or challenge process has finally concluded in a manner adverse to the Licensee, and any period for further appeal, review or challenge expired) and the Licensee has announced its intention not to reapply for Development Consent.
- xiv. “Recovery Point” means the DCO Determination Point or 1 January 2022, whichever occurs first.
- xv. “Residual Category B Costs” means Category B Costs, excluding those costs covered under condition C1.12.
- xvi. “Targets” means the Delivery Target and the Early Category C Cost Target defined in condition X.1.