

# Economic regulation of Heathrow Airport Limited from January 2020: notice of licence modifications

CAP1852



**Published by the Civil Aviation Authority, 2019**

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**First published November 2019**

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## About this document

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This document gives notice under section 22(6) of the Civil Aviation Act 2012 (“CAA12”) of the CAA’s decision to modify Heathrow Airport Limited’s (“HAL”) Licence granted under section 15 CAA12 (“the Licence”). The modifications that the CAA has decided to make are to:

- extend the current price control by a two year interim period, up to 31 December 2021, taking account of the commercial arrangements between HAL and certain airlines for this period;
- include a new licence condition to promote economy and efficiency by HAL in the operation, maintenance and development of Heathrow airport; and
- make minor changes to update the price control arrangements, remove obsolete terms and make a change to HAL’s regulatory audit requirements to reflect current auditing guidelines.

The decision on these licence modifications follows on from the notice issued by the CAA under section 22(2) of CAA12 in August 2019,<sup>1</sup> which built on the CAA’s consultations on interim price control arrangements in February 2019<sup>2</sup> and April 2018<sup>3</sup> and its consultation on the regulatory framework to support capacity expansion at Heathrow in March 2019.<sup>4</sup>

If you would like to discuss any aspect of this document, please contact Abigail Grenfell ([abigail.grenfell@caa.co.uk](mailto:abigail.grenfell@caa.co.uk)).

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<sup>1</sup> Economic regulation of Heathrow Airport Limited from January 2020: notice of proposed licence modifications [www.caa.co.uk/CAP1825](http://www.caa.co.uk/CAP1825) (“the August 2019 Consultation”).

<sup>2</sup> Economic regulation at Heathrow airport from January 2020: proposals for interim arrangements [www.caa.co.uk/CAP1769](http://www.caa.co.uk/CAP1769) (“the February 2019 Consultation”).

<sup>3</sup> Economic regulation of capacity expansion at Heathrow: policy update and consultation [www.caa.co.uk/CAP1658](http://www.caa.co.uk/CAP1658) (“the April 2018 Consultation”).

<sup>4</sup> Economic regulation of capacity expansion at Heathrow: policy update and consultation [www.caa.co.uk/CAP1782](http://www.caa.co.uk/CAP1782) (“the March 2019 Consultation”).

# Executive summary

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## Purpose of this document

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1. This document is a notice under section 22(6) of the CAA12 of the CAA's decision to modify the Licence with effect from 1 January 2020.
2. The modifications reflect the CAA's decisions to:
  - extend the current price control (the "Q6 price control") by two years to 31 December 2021 on the basis that the commercial arrangements agreed between HAL and certain airlines at Heathrow for 2020 and 2021 should operate alongside the price control and provide an appropriate basis for the CAA to extend the current price control to cover this period;
  - introduce a new licence condition to promote economy and efficiency in the operation, maintenance and development of Heathrow by HAL. This licence modification will remain in place after 31 December 2021; and
  - make further minor and consequential changes to update the price control arrangements for the period to 31 December 2021, remove obsolete terms and make a change to HAL's regulatory audit requirements to reflect current auditing guidelines.
3. This notice follows on from the August 2019 Consultation under section 22(2) CAA12 which set out our proposed modifications to the Licence.<sup>5</sup> It sets out the modifications that the CAA has decided to make to the Licence, the reasons for making those modifications and their effect.

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<sup>5</sup> Responses to the August 2019 Consultation can be found at: <https://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/H7/Consultations-and-policy-documents/>

## Modifications to the Licence

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### Interim price control arrangements for 2020 and 2021

4. The Q6 price control on HAL's charges to airlines is due to expire on 31 December 2019. The CAA has decided to modify the Licence to extend the Q6 price control to 31 December 2021. The advantages of this interim price control ("iH7") include better aligning the next main price control period ("H7") with the wider capacity expansion programme at Heathrow airport.
5. Following the April 2018 Consultation, which set out our proposal for a two year interim price control, there were negotiations between HAL and certain airlines operating at Heathrow on commercial arrangements to cover 2020 and 2021 as an alternative after seeing our original outline proposal for an interim price control. These commercial arrangements are referred to in this document as the "commercial deal" or the "commercial arrangements" and provide for:
  - a "fixed rebate" to all airlines currently operating from Heathrow totalling £260 million, split into two equal payments of £130 million to cover 2020 and 2021;<sup>6</sup>
  - a further volume rebate if the number of passengers rises above certain thresholds in 2020 and 2021;<sup>7</sup>
  - if passenger numbers were to turn out significantly lower than expected, the commercial arrangements also provide some downside protection for HAL (in these circumstances the fixed rebate to airlines would be reduced); and
  - default arrangements for any airlines that did not sign the commercial deal, so that those "non-signatory" airlines would receive an appropriate share of the fixed rebate but would not benefit from the volume rebate.

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<sup>6</sup> Payment of the fixed rebate would be spread over a four year period, commencing after the rebate was accrued.

<sup>7</sup> The volume rebate would be paid in full the year after it is accrued.



6. The commercial arrangements rely on the CAA retaining the current RPI-1.5% price path and retaining some existing price adjustment mechanisms including those for the service quality rebates and bonus (SQRB) scheme<sup>8</sup> and security expenditure. Any capital expenditure adjustments and regulatory depreciation would be based on the baseline capital expenditure assumptions set out in the April 2018 Consultation.<sup>9</sup>
7. In the August 2019 Consultation, we confirmed our view that an extension to the Q6 price control based on the commercial deal is in the interest of consumers as it would better align the timing of the H7 price control with the timetable for the wider capacity expansion programme and allow stakeholders to focus on the important issues associated with capacity expansion. We said that the commercial deal for this interim period could have wider strategic benefits in terms of encouraging a more commercial relationship between HAL and airlines in the future and noted that these advantages could outweigh any possible difficulties associated with concerns about the stringency of the proposed arrangements.
8. We proposed new obligations in the price control condition (Condition C1 “Price Control”) of the Licence both to reflect the existence of the commercial deal (including retaining the RPI-1.5% price path) and appropriately to protect the interests of consumers served by airlines that have not signed the commercial deal.
9. HAL and airline responses were broadly in line with what they had said in relation to previous consultations on interim arrangements for 2020 and 2021. They restated their preference for the commercial deal that they have negotiated with HAL for 2020 and 2021 compared to a price control with a RAB adjustment which we might otherwise have introduced. However, airlines and groups representing airlines, raised some concerns around the process for establishing the commercial deal, whether there will be longer term benefits from the

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<sup>8</sup> The Statement of Standards, Rebates and Bonuses is in the appendix to the Licence.

<sup>9</sup> CAP 1658. Appendix D Table D.4 [www.caa.co.uk/CAP1658](http://www.caa.co.uk/CAP1658) (also set out in Appendix C of this document).

commercial arrangement and how the commercial deal should be reflected in the Licence. These matters are discussed further in chapter 1.

10. We understand from HAL that the commercial deal has been agreed and signed by 46 airlines operating at Heathrow airport, whose operations serve around 89 per cent of the passengers using Heathrow.
11. On balance, stakeholders have not raised any new concerns that would cause us to change our overall position. We remain of the view that an interim price control based on a price path of RPI-1.5%, together with the arrangements set out in the commercial deal negotiated by HAL with airlines for 2020 and 2021 (and appropriate arrangements in relation to passengers served by airlines that are not party to the commercial deal) is in the interest of consumers. As a result, we have decided to modify the Licence to extend the current price control for HAL to the years 2020 and 2021 and to reflect the commercial deal in the Licence. The licence modification is set out in Appendix B.

### **Economy and efficiency condition**

12. The August 2019 Consultation also proposed to modify the Licence to include a new condition to promote economy and efficiency on the part of HAL. This condition had been subject to several rounds of consultation since 2014.
13. Stakeholders broadly adopted similar positions to what they had said in relation to previous consultations, with HAL saying that the CAA had failed to justify the condition or show that it was needed. However, it suggested changes to the drafting of the condition. Other respondents broadly supported the new condition, albeit wanting to see it vigorously enforced and not used as a substitute for the CAA conducting a robust price control review process for setting the H7 price control.
14. Having considered respondents' views, we do not propose to make any changes to the drafting of the licence modifications set out in the August 2019 Consultation. The CAA has, therefore, decided to modify the Licence to include this condition with effect from 1 January 2020. The licence modification is set out in Appendix B.



## Other updates to the Licence

15. The August 2019 Consultation also proposed to modify the Licence to reflect changes in how the Treasury Bill Discount Rate is published and changes to the guidance issued by the Institute of Chartered Accountants in England and Wales (“ICAEW”) on the audit opinion for regulatory accounts, to allow HAL’s licence to be updated for these wider developments. We also proposed simplifying the self-modification clause in the service quality condition (Condition D1 “Service quality standards, rebates, bonuses and publication”) to allow changes to be made to the SQRB at any time (rather than every three months) and we also proposed removing obsolete references to Terminal 1.
16. Stakeholders made no objections to or representations on these modifications and we do not propose to make any changes to the drafting of the modifications set out in the August 2019 Consultation. The CAA has decided to modify the Licence to include these changes with effect from 1 January 2020. The licence modifications are set out in Appendix B.

## Next Steps

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17. As stated above, the modifications to the Licence set out in Appendix B will take effect on 1 January 2020.
18. CAA12 also provides both HAL and materially affected airlines with the right of appeal to the Competition and Markets Authority (CMA) following a notice by the CAA to modify HAL’s licence. It is for HAL and airlines to decide whether to exercise these rights, consistent with the procedures set out in CAA12.

## Our duties

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19. In taking this decision, the CAA had full regard to its statutory duties under CAA12. These are set out more fully in Appendix A.

## Structure of this document

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20. The structure of this document is as follows:

- Chapter 1 sets out our reasons for, and the effects of, the modifications to put in place price control arrangements for 2020 and 2021 and the modifications required to update the Licence to address the other matters outlined above;
- Chapter 2 outlines our reasons for and the effects of the modification to put in place an obligation on HAL to promote economy and efficiency from 2020;
- Appendix A summarises our statutory duties;
- Appendix B sets out the modifications to existing licence conditions and the new licence conditions; and
- Appendix C sets out regulatory depreciation for the interim price control period which we intend to use to determine the opening RAB for HAL at the start of the H7 price control.

21. Chapters 1 and 2 also set out the representations we received to the August 2019 Consultation and explains how we have taken those representations into account in making the decision to modify the Licence.

## Chapter 1

# Interim price control arrangements for HAL

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## Introduction

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- 1.1 Following on from the August 2019 Consultation we have decided to modify the Licence to extend the current price control by two years and to take account of the commercial arrangements negotiated between HAL and airlines for 2020 and 2021. We have also decided to make further minor and consequential changes to update the price control arrangements for the period to 31 December 2021, remove obsolete terms and make a change to HAL's regulatory audit requirements to reflect current auditing guidelines.
- 1.2 The licence modifications will come into effect on 1 January 2020 and are set out in detail in in Appendix B.
- 1.3 This chapter:
- provides a summary of what we said in the August 2019 Consultation;
  - sets out the main points raised by respondents to the August 2019 Consultation and how we have taken them into account; and
  - gives the reasons for, and states the effects of, the licence modifications.

## The August 2019 Consultation

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### **Extending the existing price control by two years**

- 1.4 In the August 2019 Consultation, we proposed extending the price control in the Licence (including the RPI-1.5% price path) to the end of 2021 so that the start of the H7 price control period will be better aligned with the wider capacity expansion programme at Heathrow airport. We said this would further the interests of consumers and allow more robust information on the costs of capacity expansion to be considered during the preparation of the H7 price control.

- 1.5 We proposed several licence modifications to give effect to this extension and noted that these were similar to modifications made when we extended the Q6 price control by one year in 2016.<sup>10</sup>

### **Commercial arrangements between HAL and airlines for 2020 and 2021**

- 1.6 We proposed accepting the two year commercial deal negotiated by HAL and some airlines at Heathrow airport as the basis for the price control arrangements for 2020 and 2021. We said that this would further the interests of consumers by allowing stakeholders to focus on the challenges of capacity expansion and facilitate airport and airline collaboration ahead of the H7 price control, delivering better outcomes for passengers. We also noted that the commercial deal could provide better arrangements for managing passenger traffic risks during 2020 and 2021.
- 1.7 We proposed including new conditions C1.13 – C1.15 “commercial arrangements for the 2020 and 2021 price control extension” in the price control condition (Condition C1 “Price Control”) to ensure that all airlines, whether they were signatories of the commercial deal or not, would be able to access certain high level features of the commercial deal (the fixed rebates). This would provide both regulatory and/or commercial law enforcement options to all airlines for this element of the commercial deal.

### **Other price control issues**

- 1.8 We addressed several other related issues that we had consulted on previously in the February 2018 Consultation:
- we said that we remained of the view that HAL could use the interim price control period to "shadow track" key parts of the future outputs based

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<sup>10</sup> See: Notice in relation to a modification of Heathrow airport Limited’s licence made under section 22(6) of the Civil Aviation Act 2012:Extension of the Q6 price control by 1 year to 31 December 2019 [www.caa.co.uk/Q6ExtensionModification.pdf](http://www.caa.co.uk/Q6ExtensionModification.pdf) (“the 2016 Q6+1 extension”)

regulation (“OBR”) framework that it is currently developing for its H7 business plan;

- we noted that rebates in the commercial deal accrued during 2020 and 2021 will not be paid in full to airlines until subsequent years in the H7 price control period. We confirmed that we do not intend to make any extra allowances when we set the price control for the H7 period because of these rebates<sup>11</sup>; and
- we said that we would retain the option of putting in place further interim arrangements to cover 2022 if the capacity expansion programme is significantly delayed.

## Other updates to the Licence from 2020

1.9 We proposed making several other licence modifications to:

- reflect changes in how the Treasury Bill Discount Rate is published;
- reflect changes to guidance issued by the ICAEW on the audit opinion for regulatory accounts;
- simplify a self-modification clause in the service quality condition (Condition D1 “Service quality standards, rebates, bonuses and publication”) to allow changes to be made to the SQRB at any time rather than every three months; and
- remove references to Terminal 1 in the Licence as this has now been closed and the relevant terms are obsolete.

## Stakeholder views

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### Extending the existing price control by two years to 31 December 2021

1.10 Stakeholders supported our proposal to extend the existing Q6 price control to 31 December 2021 and agreed with most of the licence modifications that we had proposed to give effect to the extension.

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<sup>11</sup> Although we also noted we would consider both affordability and financeability and could rule out adjusting our projections of HAL’s price control revenues to take account of these matters.

- 1.11 However, airline representatives questioned why we were proposing to amend the Licence to continue to allow HAL to recover £10 million per annum of cost pass through for “Category B” expansion planning costs in 2020 and 2021. They considered that this would pre-empt the outcome of the July 2019 Consultation<sup>12</sup> on our Category B policy and that the incentives on HAL for cost efficiency should be strengthened.

### **Commercial arrangements between HAL and airlines for 2020 and 2021**

- 1.12 HAL and the airlines agreed with our proposal to accept the commercial arrangements as the basis for the proposed price control extension but presented different views on the reasons for, and benefits of this approach.
- 1.13 HAL saw this arrangement as a positive step towards aligning HAL and airline incentives for optimising capacity and providing a framework for fostering more commercial engagement for the benefit of consumers and to support the affordable delivery of expansion. Nonetheless, it noted the challenges of further developing such arrangements in the future.
- 1.14 It said that the CAA’s role remains important in providing guidance but offering the right space for deals to develop, and that it should continue to encourage this approach. It suggested that other incentives, such as passenger risk sharing principles, could be investigated and possibly introduced in the next price control.
- 1.15 Airline representatives and an individual airline did not see the commercial deal as a true commercial deal as HAL has significant market power but that they had felt compelled to enter into it as they considered the alternative offered by the CAA was a less favourable option. They did not regard the deal as an optimal solution and that it should not be seen as a precedent for future arrangements. Another airline agreed with the CAA’s view that HAL has a significant amount of work to do to develop a more commercial relationship with airlines in the future. It also noted that this arrangement should not mark a weakening in effective

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<sup>12</sup> Economic regulation of capacity expansion at Heathrow: consultation on early costs and regulatory timetable [www.caa.co.uk/CAP1819](http://www.caa.co.uk/CAP1819) (“the July 2019 Consultation”).



regulation of HAL by the CAA in the future, particularly through this period of expansion.

- 1.16 Airline representatives noted our view that the commercial deal will enable us to have a greater focus on the important matters related to capacity expansion and the H7 price control review. They said they expected this to include greater attendance and active participation by the CAA at key expansion and price control meetings, greater pace in the development of key variables for expansion, such as the Weighted Average Cost of Capital (“WACC”) and regulatory structure, and greater scrutiny of whether HAL’s spend is efficient.
- 1.17 Airline representatives were disappointed that we had not accepted their proposal in their response to the February 2018 Consultation for the rebates to be paid back faster than originally proposed.
- 1.18 We also received a confidential response from one airline suggesting that we impose a number of changes to the terms of the commercial deal.
- 1.19 Heathrow West said that the development of the commercial deal showed classic monopolistic behaviour by HAL and that the regulatory regime was failing.
- 1.20 HAL were supportive of the text of the proposed licence conditions, saying that this approach accurately reflected the commercial deal while minimising change to the Licence.
- 1.21 Airline representatives and one airline were disappointed with our proposal that the commercial deal should be enforced through the courts rather than given full regulatory protection by incorporating all the terms in the Licence. They reiterated their view that the commercial deal is a “one-off”, temporary accommodation with a company that has significant market power. One airline noted that we had not specified where the terms of the fixed rebate should be set out.

## Other price control issues

### Delivering service quality during 2020 and 2021

- 1.22 HAL agreed that it must continue to provide service quality levels throughout the iH7 period and supported the CAA’s objectives in the February 2018 Consultation of reduced prices, improved service quality and the development of new services.

Airline representatives reiterated their view that, as HAL is now regularly exceeding several passenger facing elements of the SQRB, it would be in consumers' interests to increase the required service quality performance standards and were disappointed that this had not been proposed for 2020 and 2021. They did not support our proposals for "shadow tracking" aspects of service quality as they considered that this would incentivise HAL to underperform in this period to limit expectations in H7.

#### Price control arrangements beyond 2021

- 1.23 HAL, airline representatives and an individual airline all supported the proposal for H7 to begin in 2022 but had differing views on any further extensions.
- 1.24 HAL said there should be no further extensions but that the CAA should develop a clear process to allow for regulatory changes or triggers around key milestones in the planning process, to adjust relevant parameters of the regulatory framework.
- 1.25 The airline representatives did not see any merit in either a further extension or a further commercial deal. By contrast, one airline said that we should not dismiss the option of a further extension if needed.
- 1.26 Airlines and airline representatives raised wider points about the regulatory timetable and Constructive Engagement. Heathrow West said we should do more to support competition and the alternative delivery of capacity expansion. We intend to respond to these issues in forthcoming consultations on our approach to developing the regulatory framework for capacity expansion.

#### Other updates to the licence from 2020

- 1.27 Stakeholders made no representations on or objections to the proposed modifications for the other updates set out in the August 2019 Consultation.

### Our views on respondents' comments

#### **Extending the existing price control by a further two years to 31 December 2021**

- 1.28 We note stakeholders' support for extending the price control for a further two years and to accept the commercial deal as the basis for this extension, and we

acknowledge the differing views on the issues relating to this extension. We addressed these issues in detail in the August 2019 Consultation and remain of the view that this approach is appropriate and in the interests of consumers.

- 1.29 We consider that continuing the £10 million per annum cost past through for planning costs is consistent with our decision in extending the price control in 2016 and is in the interests of consumers. We had originally envisaged that HAL would have made more rapid progress with capacity expansion and that Category B costs would have been added to HAL's regulatory asset base sooner and it would have started to recover these costs by price control allowances for regulatory depreciation and returns. In the absence of such arrangements, it is reasonable that the extended control continues to allow for £10 million per year of these costs. This will allow for a smoothed approach to costs recovery, support overall affordability and financeability, and reduce the total amount of charges to be recovered in the longer term. We will address issues relating to efficiency and protecting consumers from any undue increases in these costs in our next update document on early costs, which we plan to publish in November 2019.

### **Commercial arrangements between HAL and airlines for 2020 and 2021**

- 1.30 We acknowledge the reservations that airlines have raised over the commercial deal and its negotiation and have said that acceptance of this commercial deal does not set a precedent for future commercial arrangements at Heathrow. We remain of the view that the commercial deal benefits consumers as it provides the best solution for the price control period to the end of 2021, and that there is no compelling case for further regulatory interventions with respect to the terms of the commercial deal. Nonetheless, we have highlighted to HAL that it would need to strengthen its relationships with airlines significantly if it is to build on the commercial arrangements in the future.
- 1.31 The new licence conditions will further the interests of consumers as they allow for regulatory enforcement for the payment of the fixed rebates, in accordance with the terms of the commercial deal, to all airlines operating at Heathrow.
- 1.32 We acknowledge that airlines considered that we should include all the terms of the commercial deal in the Licence, including the volume rebate. We remain of

the view that enforcement through the courts is a normal and valid route for commercial arrangements and that this approach both provides adequate protection for the interests of the consumers served by those airlines and is consistent with our Regulatory Enforcement Policy.<sup>13</sup> HAL's price control conditions remain in place to provide overall constraints on the revenue HAL can recover from airport charges through a maximum allowed yield per passenger and it would not be appropriate to offer a greater level of regulatory intervention for the commercial deal.

## Reasons for and effects of the licence modifications

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### Extending the Q6 price control by two years to 31 December 2021

- 1.33 The CAA has decided that its proposal to make several modifications to the Licence to extend the current price control by two years meets the tests for a licence modification set out in CAA12. We are, therefore, modifying the Licence, in accordance with the text set out in Appendix B, with no changes to the modifications proposed in the August 2019 Consultation. This will mean that the price control will end on 31 December 2021.
- 1.34 The reasons for the proposed modifications and their effects were set out in the August 2019 Consultation and are summarised below.
- 1.35 Extending the price control is in the interests of consumers as it will align the next main price control period with the wider capacity expansion programme at Heathrow airport, giving HAL more time to produce a high quality interim business plan and enable stakeholders to focus on capacity expansion. The capacity expansion programme at Heathrow airport will be a very large privately financed infrastructure project. Broadly aligning the timetable for the price control with the wider programme should allow for the development of regulatory incentives to promote capital and financial efficiency, so promoting overall efficiency and protecting the interests of consumers.

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<sup>13</sup> For the current CAA Regulatory Enforcement Policy, see: [www.caa.co.uk/CAP1326](http://www.caa.co.uk/CAP1326)

- 1.36 The modifications we are making to give effect to the price control extension are consistent with those we made in the 2016 Q6+1 extension. The modifications include an uplift of the security “s-factor” in Condition C1.4 “allowable security cost per passenger” by inflation to £21 million. Uplifting the s-factor by inflation is consistent with our approach in previous price controls.
- 1.37 We have decided to extend HAL’s ability to recover £10 million per year for planning costs in Condition C1.12 “A: pass-through of Category B costs (planning costs) for runway expansion” as explained above in paragraph 1.29.
- 1.38 The effect of these modifications is that all the terms modified will be in force with effect from 1 January 2020 until 31 December 2021.

### **Reflecting the commercial deal in the Licence**

- 1.39 Having analysed the responses to the August 2019 Consultation, the CAA has decided that its proposal to modify the Licence to include new conditions to set out the arrangements to reflect the commercial deal in the regulatory framework meets the tests to a licence modification set out in CAA12. We are, therefore, modifying the Licence with the new conditions C1.13 to C1.15 “Commercial arrangements for the 2020 and 2021 price control extension”, as set out in Appendix B, with no changes to those proposed in the August 2019 Consultation.
- 1.40 The reasons for the new conditions and the effects of them were set out in the August 2019 Consultation and are summarised below.
- 1.41 Accepting the commercial deal as the basis of the interim price control is in the interests of consumers as it incentivises capacity growth at Heathrow airport with more collaborative working between HAL and the airlines. This is the first time that commercial arrangements have been negotiated to cover operations at Heathrow, so evidence of the wider benefits of such arrangements is limited at this stage. However, we remain of the view that there are advantages in encouraging HAL to adopt a more commercial relationship with airlines.
- 1.42 This approach also facilitates regulation being focused on areas where it is most needed and enables us and other stakeholders to have a greater focus on the important matters related to capacity expansion and the H7 price control review,

which should allow us to protect consumers better in the medium and longer-term. In the longer term, consumers should benefit if HAL achieves greater efficiency savings than those underlying the commercial deal, as these can be shared with consumers at the next main price control review.

- 1.43 Furthermore, airlines have indicated a strong preference for the commercial deal compared to the price control that we would have otherwise set. Airlines whose operations cover 89 per cent of passengers at Heathrow have signed the commercial deal.
- 1.44 Airlines that have not signed the commercial arrangement (and indirectly the consumers that they serve) will benefit from the overall RPI-1.5% path of charges and the fixed rebates that HAL has offered to all airlines operating at Heathrow regardless of whether they have signed the commercial deal. Much of the existing regulatory framework on capital expenditure governance, service quality, HAL's RAB and the work to support capacity expansion, continues in place and will help protect the interests of consumers in the medium and longer term.
- 1.45 The licence modifications include a requirement to set out the terms of the fixed rebate elements of the commercial deal in "alternative arrangements" (and to comply with them) and the hardwiring of the maximum amount of the fixed rebate<sup>14</sup> provides all airlines with the ability to seek redress on issues relating to the fixed rebate through both regulatory and/or commercial law enforcement. This indirectly furthers the interests of the consumers that those airlines serve.
- 1.46 These new licence conditions do not specify the precise form of the "alternative arrangements" but support these arrangements by giving HAL and the airlines flexibility to agree suitable contractual arrangements that are accessible to all airlines using the airport.
- 1.47 These licence conditions also allow for any renegotiation of the commercial deal because this is a feature of the commercial deal itself. This does not imply any requirement or desire on any party to renegotiate the deal but preserves the

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<sup>14</sup> £130 million in each year, in accordance with the terms of the commercial deal including the assumptions on passenger numbers



flexibility that the commercial deal itself contains as a matter of contract law, should parties choose to do so.

- 1.48 The new licence conditions do not include any reference to the terms of the commercial deal relating to the volume rebates that are offered to those airlines who are signatories to the commercial deal. This means that individual airlines will need to seek to enforce those terms through the courts in the ordinary way. We consider that this approach is appropriate as it offers a proportionate approach to managing the relationship between the regulatory regime and the contractual regime.
- 1.49 HAL will still be required to consider airport charges in accordance with the broader requirements of the price control, the Airport Charges Regulations 2011 and competition law.

### **Other updates to licence from 2020**

- 1.50 There were no responses to the August 2019 Consultation on the other licence modifications and the CAA has decided that its proposal to modify the Licence to include them meets the tests for a licence modification set out in CAA12. We are, therefore, modifying the Licence, in accordance with the text set out in Appendix B, with no changes to those proposed in the August 2019 Consultation. The reasons for and effects of these modifications are summarised below.

#### **Condition C1 – Treasury Bill Discount Rate**

- 1.51 The Treasury Bill Discount Rate is used to calculate the specified rate in the passenger correction factor (k) in Condition C1.5 “Kt: per passenger correction factor” and where it is published is specified in the Licence to ensure the correct rate is used. However, the way it is published has changed. We are, therefore, modifying the definition of the specified rate in Condition C1.16 “Definitions”<sup>15</sup> to reflect both the method used up to 2017 and introduce a new definition to reflect the new method of publication.

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<sup>15</sup> Previously C.1.13 (definitions).

### Condition D1 - Self-modifications to the SQRB

- 1.52 In Condition D1 “Service quality standards, rebates, bonuses and publication”, we are modifying the method for making “self modifications” to the SQRB in Condition D1.10 by allowing changes to be made at any time, rather than once every three months. The self modification mechanism still requires the agreement of HAL, the airlines and the CAA, but the modification allows greater flexibility to make changes when they are needed.

### Condition E1 - Auditing arrangements

- 1.53 We are modifying the audit requirements for the regulatory accounts in Condition E1 “Regulatory accounting requirements”. The ICAEW has issued revised guidance on the audit opinion for regulatory accounts. This means that auditors will no longer provide an opinion that the regulatory accounts fairly present the financial position and the financial performance of the Licensee.
- 1.54 We are replacing this requirement with new requirements to obtain a “prepared, in all material respects, in accordance with” opinion and for HAL to make reasonable endeavours to agree “Agreed-upon-Procedures” with us and its auditors, and for its auditors to report on their findings. This approach has been used in other regulated sectors, for example energy, and is designed to mitigate any loss of assurance from the change in ICAEW guidance.

### Schedule to the Licence – removing references to Terminal 1

- 1.55 We are removing references in the SQRB to Terminal 1 and replacing Tables 1a to 1d with ‘Not Used’ because this terminal is now decommissioned, so these references and tables are now obsolete. This modification will, therefore, have no effect on the current application of any obligations in the Licence.

## Chapter 2

## Promoting economy and efficiency

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### Introduction

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- 2.1 We have decided to modify the Licence to include a new condition to promote economy and efficiency on the part of HAL. This condition will come into effect in 1 January 2020. The text of the new licence condition (to be Condition B.3 “Promoting economy and efficiency”) is set out at Appendix B.
- 2.2 This chapter:
- provides a brief summary of what we said in the August 2019 Consultation;
  - sets out the main points raised by respondents to the August 2019 Consultation and how we have taken them into account; and
  - gives the reasons for, and states the effects of, the modification.

### The August 2019 Consultation

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- 2.3 The August 2019 Consultation built on previous consultations since 2014. It proposed a modification to the Licence to insert a new condition promoting economy and efficiency on the part of HAL (the “efficiency condition”). The August 2019 Consultation set out the text for the efficiency condition that took account in the light of respondents’ views on previous consultations, most recently in March 2019.
- 2.4 The August 2019 Consultation explained that an efficiency condition would further the interests of consumers by focussing clearly on how HAL conducts its business rather than mandating particular outcomes. The condition would not require HAL to deliver capacity expansion (which should be the funded and incentivised through HAL’s next price control).
- 2.5 We stressed the importance of an efficiency condition in filling a gap in the regulatory framework for HAL, making clear that it would not be suitable for

determining commercial disputes or insignificant matters, while still enabling the CAA to address more immediate issues in a timely way, rather than waiting until the next price control or developing specific licensing or other regulatory interventions, if serious or systematic failings in HAL's conduct were to arise that could be detrimental to the interests of consumers.

## Stakeholder views

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- 2.6 Stakeholders' views reflected the broad positions that they had adopted in relation to our earlier consultations.
- 2.7 HAL repeated its view that an efficiency condition is neither necessary nor required and that the CAA had failed to substantiate the need for the condition (whether by quantitative analysis or otherwise) or provide assessments of why it is the most effective and appropriate intervention. It considered that the existing regulatory incentives and other tools available to the CAA meant that HAL is already incentivised to behave in an economic and efficient manner. HAL was concerned that an efficiency condition should not become a "catch all" leading to licence investigations that would inhibit efficient behaviour. It said the CAA should publish a specific policy statement on how it would enforce the condition.
- 2.8 HAL also proposed that:
- the word "development" should be removed as it could lead to open-ended interpretation;
  - the requirement to "secure" the reasonable demands of users be replaced by an obligation to "identify and take account of" such demands; and
  - it be obliged to avoid any action or omission that might reasonably be expected to adversely affect its ability to finance its provision of airport operation services.
- 2.9 Airline representatives (with whom some airlines explicitly agreed) did not object to the condition but:
- were concerned that the CAA might rely on airlines to police HAL's compliance reactively rather than enforcing it vigorously;

- wanted “efficiency” to be defined;
- took the view that much of the value of the condition could be achieved by a tight price control and only allowing efficient spending into HAL’s RAB; and
- said the draft condition gave undue weight given to HAL’s financeability as compared to the CAA’s other secondary duties.

2.10 Heathrow West considered that the condition was “desperately needed”, should be imposed as soon as possible and will need to be “triggered” immediately it comes into force, citing HAL’s revised estimates of pre-construction costs as evidence of its inefficiency.

2.11 Heathrow Hub supported the introduction of the condition but doubted whether the efficiency condition could be effective to address what it saw as the inefficiencies of HAL’s expansion plans. It suggested that no further additions to HAL’s RAB should be made until after further assessment of the scheme.

## Our views on respondents’ comments

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2.12 We reject HAL’s suggestion that the CAA has not justified the licence modification necessary to introduce the efficiency condition as the reasons for it have been set out over a series of consultations (and are set out in summary form again below). We consider that the efficiency condition will be in the interests of consumers because it:

- will enable the CAA to address matters that may arise from the way HAL conducts its business; and
- may have a more general impact in driving economy and efficiency.

2.13 While the impact of the condition is difficult reasonably to quantify (because this would require the CAA to have foresight of the specific issues that might be addressed under the condition), we consider that there is no merit in arguments that an efficiency condition would deter efficient spending or efficient behaviour as this is contrary to the clear requirements of the condition.

- 2.14 While we recognise the importance of quantitative analysis, it is not appropriate for the CAA to rely on it in the present case as it is not available.<sup>16</sup> In any event, HAL has not provided any quantitative evidence to contradict the view we expressed in the August 2019 Consultation that:
- HAL’s compliance costs appear likely to be low as compliance should be monitored through existing business assurance processes;
  - there do not appear to be realistic or credible downsides for HAL’s business of a requirement to operate economically and efficiency;
  - investors should take reassurance that the regulatory regime promotes efficient behaviour by HAL; and
  - there is no evidence that the presence of similar obligations in other regulatory regimes has either made it more difficult for entities in those sectors to raise finance or has made finance more expensive for them.
- 2.15 The CAA does not view the introduction of an efficiency condition as a substitute for monitoring HAL’s behaviour. Airlines will, however, inevitably have a closer view of certain aspects of HAL’s conduct because of their day-to-day dealings with HAL and, so, may be able to draw relevant matters to our attention. We do not see an efficiency condition in any way as a substitute for setting an effective price control, nor will its introduction change our approach to scrutinising HAL in setting the H7 control.
- 2.16 We consider that the drafting of the condition is sufficiently clear not to require further amendment since:
- the concept of “efficiency” is well understood as requiring resources to be allocated to their most valuable uses and waste eliminated or minimized. Furthermore, because what constitutes efficient behaviour will change

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<sup>16</sup> The CAA conducted a qualitative assessment of whether an efficiency condition would be necessary or expedient to further the CAA's duties under CAA12, including assessing whether the desired level of protection for consumers can be delivered through less restrictive measures which was set out in Appendix B of the October 2018 Consultation. The outcome of that assessment also underpins this chapter.



depending on the context in question, seeking to define it further risks limiting the effectiveness of the condition;

- the concept of “development” is well enough understood not to require further definition and makes clear that the condition is applicable not only to HAL’s “steady state” activities, but also to the evolution of the airport over time, irrespective of expansion. Reference to “development” in an efficiency obligation is not just relevant to monopoly infrastructure providers as HAL suggests, but also to providers with substantial market power which might otherwise enable them not to act efficiently in taking account of the interests of users over time;
- changing the obligation to “secure” the reasonable demands of users to an obligation to “take account of” those demands would compromise the effectiveness of the condition, giving HAL too great a discretion to disregard those demands. In any event, the condition is drafted (by referring to Condition B3.1) to be read as a whole. So, if actions that were apparently desired by users would be uneconomical and inefficient to deliver, they would fall foul of B3.1, and could not be “reasonable demands” of users; and
- neither of the competing suggestions made by HAL and airline representatives as to the weight to be given to financeability are appropriate. On the one hand, an obligation of the kind suggested by HAL could drive a very risk averse approach from HAL, while on the other, the condition, as drafted, does not give financeability undue weight, as airline representative suggest. Rather, as with the requirement to secure the reasonable interests of users, the drafting helps to inform the question of whether, in all the circumstances. HAL’s behaviour is economical and efficient.

2.17 In any event, the use by the CAA of its Enforcement Guidelines and Prioritisation Principles (see below) will ensure that the efficiency condition does not become an open-ended “catch all” of the kind referred to by HAL.

2.18 Noting Heathrow West’s comments on timing, the licence modification process under CAA12 has the effect that the end of 2019 is the earliest that the efficiency

condition can be brought into force. It will cover HAL's behaviour after that date. However, we do not consider that there would be justification for "triggering" the condition immediately and issues surrounding HAL's costs for expansion are most appropriately dealt with through H7 price control process.<sup>17</sup>

- 2.19 Having taken respondents' views into account, therefore, we do not propose to make any changes to the drafting of the efficiency condition set out in the August 2019 Consultation.

## The reasons for and effect of the modification

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- 2.20 As noted above, we have set out in a series of consultations since 2014 why we consider that modifying the Licence to include an efficiency condition is justified. Having analysed the responses to the August 2019 Consultation as well as those to the earlier consultations,<sup>18</sup> the CAA has decided that its proposal to modify the Licence to include an efficiency condition meets the tests for a licence modification set out in CAA12. Therefore, the CAA has decided to modify the Licence to include an efficiency condition, to be implemented from 1 January 2020 in the form specified in Appendix B.
- 2.21 The reasons for modifying the Licence to include the efficiency condition and the effects of it have been set out in those previous consultations. They are summarised again in the following paragraphs.

An efficiency condition is needed to address the fact that it is not practicable for price control incentives fully to capture all aspects of HAL's behaviour.

- 2.22 This is because:

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<sup>17</sup> Issues relating to costs, such as those raised by both Heathrow West and Heathrow Hub are dealt with in more detail in the CAA's consultation on pre-DCO costs which we intend to publish later in 2019.

<sup>18</sup> For more detail of stakeholders' previous responses on the issues raised in this chapter and the CAA's reasons justifying the proposed modification to insert an efficiency condition, see especially:

- chapter 2 and Appendix B of the October 2018 Consultation [www.caa.co.uk/CAP1722](http://www.caa.co.uk/CAP1722);
- chapter 3 of the March 2019 Consultation [www.caa.co.uk/CAP1782](http://www.caa.co.uk/CAP1782); and
- chapter 2 and Appendix D of the August 2019 Consultation.

- we cannot be certain that incentives can be designed in such a way that they would be "seamless" and could be that relied on, by themselves and without more, to drive economy, efficiency and timeliness in all aspects of HAL's business in every circumstance. This is especially the case for HAL, given both (a) the size and complexity of HAL's business and (b) the requirements for detailed information and foresight that the design of such incentives would require both in relation to its existing activities and in the circumstances of a programme as complex and difficult as capacity expansion;
- there is the risk that incentives may be gamed or may have unforeseen consequences; and
- we cannot be certain that *ex post* reviews (a form of incentive) would be fully effective in protecting consumers from the costs of inefficiency, not least because they are more suited to the disallowance of inefficient expenditure rather than dealing with other inefficiencies.

An efficiency condition is needed to address a "gap" in the regulatory regime applicable to HAL that exists because it does not contain a general obligation to promote economy and efficiency across all HAL's activities.

2.23 Since HAL has neither a general statutory obligation to conduct its activities efficiently, nor a general obligation under its Licence to do so, an efficiency condition is needed to give the CAA a tool to ensure that:

- it has oversight of the way HAL runs its business generally;
- it can consider efficiency issues that both bear on the price control and more widely; and
- there are no "gaps" in the oversight of HAL.

2.24 Although the Licence does contain tightly focussed obligations on efficiency, in relation to the promotion of capital projects (Condition C3 "Publication of a Procurement Code of Practice") and operational resilience (Condition D2 "Operational Resilience"), neither obligation promotes economy and efficiency across the full range of HAL's activities.

2.25 Other regulatory tools do not provide an alternative. For example:

- information gathering powers under competition law and section 50 CAA12 do not provide any substitute for an efficiency condition;
- the CAA's conduct of price control reviews is limited in time and, therefore, cannot deal very well with issues arising between price control reviews;
- the limited<sup>19</sup> commercial pressure that airlines can bring to bear on HAL is not sufficient to ensure HAL always acts efficiently in the interests of consumers or a full substitute for regulatory oversight, not least because HAL has substantial market power, there is an information imbalance between HAL and airlines, and airlines have neither the investigatory nor enforcement tools to address this; and
- competition law is not well suited to being used as an alternative means of addressing efficiency issues.

2.26 The modification of the Licence to include an efficiency condition is, therefore, needed to avoid the CAA being left in a position where it either:

- lacks an appropriate tool to address significant issues raised by HAL's behaviour;
- has to use another licence condition (even if one were available) which was not fit for purpose; or
- needs to develop specific licence conditions to deal with particular problems which are too slow to develop to address ongoing issues.

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<sup>19</sup> Our experience of Enhanced Engagement suggests that, while airlines do have some influence on the commercial behaviour of HAL, there are limits to that influence. The limitations on the commercial pressure that airlines can bring to bear on HAL is also implicit in the substantial market power that HAL holds and which underpins the licensing of HAL. The CAA's views on the Enhanced Engagement process are set out in our advices to the Secretary of State, which can be found at: <https://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/H7/Enhanced-Engagement-Section-16/>

2.27 As such, the efficiency condition will help the CAA to address the risk that consumers may suffer detriment<sup>20</sup> as a result of the limitations of the current regulatory framework.

An efficiency condition is needed to set clear expectations for HAL to conduct its business economically and efficiently, working alongside the price control, not in place of it.

2.28 As noted above, the efficiency condition should complement, not replace the price control.

2.29 To provide clear expectations for HAL, the efficiency condition should make appropriate reference to users' reasonable demands for airport operation services and require HAL to consult appropriately to determine what those reasonable demands are. This will help HAL to frame its conduct, as well as further reflecting the requirements of section 1 CAA12.

An efficiency condition is needed to enable the CAA to address, promptly and in a timely way, more immediate issues arising from HAL's behaviour (including unforeseen circumstances that may have arisen that are, or risk, causing detriment to consumers), without the need either to wait for the outcome of the next price control or the development of issue-specific licence conditions.

2.30 While *ex post* efficiency reviews may have a role to play in regulating HAL, they are more suited to reviewing costs at the next price control than dealing with broader efficiency issues. At the same time:

- new licence conditions are slow to develop, given the need to identify the relevant issues, form an appropriate response and observe the required process under CAA12 to implement them; and
- competition law is not well suited to deal with questions of efficiency and would involve a lengthy process, making timely intervention to protect the interests of users difficult.

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<sup>20</sup> Such detriment could arise equally from under- or over- investment, operational behaviour or other inefficient conduct by HAL.

2.31 Other actions to address efficiency issues, such as terminating the price control, are not appropriate substitutes for the use of an efficiency condition as they are too intrusive, unlikely to be proportionate and would undermine investor confidence.<sup>21</sup>

An efficiency condition is needed to help frame early discussions between the CAA and HAL, potentially reducing the need for formal actions.

2.32 If an issue were to arise under the efficiency condition, our policy on enforcement is proportionate and may lead to a range of responses. Details of our current approach to enforcement activity is set out in the CAA's Regulatory Enforcement Policy and Guidance on Enforcement of Economic Licences.<sup>22</sup>

The efficiency condition will apply to how HAL conducts its activities, rather than specifying what it delivers, promoting economy and efficiency across all HAL's activities.

2.33 The efficiency condition will not mandate or incentivise HAL to deliver capacity expansion as this would be better achieved through the incentive arrangements we put in place for the H7 price control.

2.34 We consider that the requirement for engagement with airlines and other stakeholders in the efficiency condition will ensure that HAL meets the reasonable demands for airport operation services in the interests of users across its activities, since airlines have significant insights into the needs of the passengers they serve. This does not, however, mean that airlines will have a power of "veto" over actions undertaken by HAL.

2.35 While the CAA will remain vigilant on compliance and will be open to evidence from stakeholders, stakeholders will need to bear in mind that the CAA will only commence an investigation in the light of credible evidence that we receive. In

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<sup>21</sup> As noted above, see Appendix B of the October 2018 Consultation for the CAA's assessment of the suitability of an efficiency condition as compared to other possible tools.

<sup>22</sup> For the current CAA policies, see:

- CAA Regulatory Enforcement Policy: [www.caa.co.uk/CAP1326](http://www.caa.co.uk/CAP1326); and
- CAA Guidance on enforcement of Economic Licences: [www.caa.co.uk/CAP1234](http://www.caa.co.uk/CAP1234)

doing so, our general position will be that the CAA's focus in considering taking any steps in relation to an efficiency condition will be to concentrate on matters that seem likely to have a material adverse impact on users. So, while airlines and others will be able to raise issues with the CAA relating to the efficiency condition, our approach to taking any action under an efficiency condition would be guided by our duties under CAA12 as well as our prioritisation principles from time to time in force.<sup>23</sup>

- 2.36 As a result, we do not consider that the efficiency condition will lead to the CAA becoming involved in dealing with either trivial matters or commercial disputes between HAL and airlines. By the same token, noting the experience of the application of similar rules in other regulated sectors, we do not consider that the introduction of this condition will have the adverse effects which HAL has raised concerns about.
- 2.37 In areas where HAL is subject to specific regulatory incentives, we consider that an efficiency condition is unlikely to be relevant to assessment of HAL's behaviour provided that HAL's behaviour is reasonable in the context of the regulatory incentive in question. We would not expect to investigate HAL's behaviour in such an area under the efficiency condition unless it fell significantly short of the minimum parameters contemplated by the relevant incentive.
- 2.38 In the light of all the above, we consider that the efficiency condition will enable the CAA to hold HAL to a high, but achievable, standard that furthers the interests of consumers in a way that is consistent with both the need to manage the risks arising from HAL's significant market power and the CAA's duties under CAA12.

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<sup>23</sup> For the current CAA Prioritisation Principles, see: [www.caa.co.uk/CAP1233](http://www.caa.co.uk/CAP1233)

## Appendix A

## Our duties

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1. The CAA is an independent economic regulator. Our duties in relation to the economic regulation of airport operation services (“AOS”), including capacity expansion, are set out in the CAA12.
2. CAA12 gives the CAA a general (“primary”) duty, to carry out its functions under CAA12 in a manner which it considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of AOS.
3. CAA12 defines users of air transport services as present and future passengers and those with a right in property carried by the service (i.e. cargo owners). We often refer to these users by using the shorthand of “consumers”.
4. The CAA must also carry out its functions, where appropriate, in a manner that will promote competition in the provision of AOS.
5. In discharging this primary duty, the CAA must also have regard to a range of other matters specified in the CAA12. These include:
  - the need to secure that each licensee is able to finance its licensed activities;
  - the need to secure that all reasonable demands for AOS are met;
  - the need to promote economy and efficiency on the part of licensees in the provision of AOS;
  - the need to secure that the licensee is able to take reasonable measures to reduce, control and/or 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
  - the Better Regulation principles.



6. In relation to the capacity expansion at Heathrow, these duties relate to the CAA's functions concerning the activities of HAL as the operator at Heathrow.
7. CAA12 also sets out the circumstances in which we can regulate airport operators through an economic licence. In particular, airport operators must be subject to economic regulation where they fulfil the Market Power Test as set out in CAA12. Airport operators that do not fulfil the Test are not subject to economic regulation. As a result of the market power determinations we completed in 2014 both HAL and GAL are subject to economic regulation.
8. We are only required to update these determinations if we are requested to do so and there has been a material change in circumstances since the most recent determination. We may also undertake a market power determination whenever we consider it appropriate to do so.

## Appendix B

## Licence modifications from 1 January 2020

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The licence modifications are set out below with the changes marked against the provisions of the Licence as at the date of this decision. Where a condition, or part of a condition, is not set out below, no modifications to it have been made.

### Modification to Part A3 Definitions:

Condition A3.1(g) shall be modified as follows:

A3.1 In this Licence:

- (g) the Regulatory Year means for each of the ~~five~~ seven years from 2015 to ~~2019~~2021, 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.

### Modification to Part B: General Conditions

A new condition shall be inserted after condition B2 as follows:

#### B3 Promoting economy and efficiency

B3.1 The Licensee shall conduct its business and its activities that relate to the provision of airport operation services at the Airport so as to secure the economical and efficient:

- (a) operation and maintenance; and
- (a) timely and appropriate enhancement and development of the Airport.

B3.2 In complying with Condition B3.1, the Licensee shall seek to secure that the reasonable demands of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services provided by the Licensee at the Airport are met. In so doing, the Licensee shall carry out appropriate consultation with users, airlines and other relevant stakeholders, including providing timely and accurate information to them, so that they can assist the Licensee to identify reasonable demands for airport operation services.

B.3.3 In complying with its obligations under this condition, the Licensee shall take into account all relevant circumstances, including the need for it to finance its provision of airport operation services at the Airport.

### **Modifications to Part C: The price control conditions**

Condition C1 shall be modified as follows:

#### **C1 Price Control**

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 five~~seven~~ subsequent relevant Regulatory Years starting on 1 January 2015 and ending on 31 December ~~2019~~2021, 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:

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

*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  $t$ ;
- $A_t$  is the cost pass-through for runway expansion in Regulatory Year  $t$  defined in condition C1.12;

- $BR_t$  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:

$$Y_{t-1} = Y_{t-2}(1 + RPI_{t-2} + X) + S_{t-1}$$

Where:

- $Y_{2014} = £22.261 + S_{2014}$
- $RPI_{t-2}$  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  $S_{t-1}$  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 ~~£2021,000,000~~ "deadband" figure; or
- (b) below a cumulative - ~~£2021,000,000~~ "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:  $|EC_{t-1}| > \text{£}2021,000,000$ ; and

$|EC_{t-2}| > \text{£}2021,000,000$

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

*Or if:*  $|EC_{t-1}| > \text{£}2021,000,000$ ; and

$|EC_{t-2}| < \text{£}2021,000,000$

*Then:*  $S_{t-1} = 0.9 \frac{(EC_{t-1} - \text{£}201,000,000)}{(t^*)Q_{t-1}}$

*Or if:*  $|EC_{t-1}| < \text{£}2021,000,000$ ; and

$|EC_{t-2}| > \text{£}2021,000,000$

*Then:*  $S_{t-1} = -0.9 \frac{(EC_{t-2} - \text{£}201,000,000)}{(t^*)Q_{t-1}}$

*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:*  $|EC_{t-1}| > \text{£}2021,000,000$ ; and

$|EC_{t-2}| > \text{£}2021,000,000$

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

*Or if:*  $|EC_{t-1}| > \text{£}2021,000,000$ ; and

$|EC_{t-2}| < \text{£}2021,000,000$

*Then:*  $S_{t-1} = 0.9 \frac{(EC_{t-1} + \text{£}201,000,000)}{(t^*)Q_{t-1}}$

*Or if:*  $|EC_{t-1}| < \text{£}2021,000,000$ ; and

$|EC_{t-2}| > \text{£}2021,000,000$

*Then:*  $S_{t-1} = -0.9 \frac{(EC_{t-2} + \text{£}201,000,000)}{(t^*)Q_{t-1}}$

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

*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	<del>69</del> 93/9
2015	<del>5</del> 7
2016	<del>4</del> 6
2017	<del>3</del> 5
2018	<del>2</del> 4
<u>2019</u>	<u>3</u>
<u>2020</u>	<u>2</u>

- $C_{t-1}$  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 five seven 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	2019	2020
Changes in 2014	0	<del>7.66</del> 10.33 * C <sub>2014</sub> * Q <sub>2014</sub>	<del>7.66</del> 10.33 * C <sub>2014</sub> * Q <sub>2014</sub>	<del>7.66</del> 10.33 * C <sub>2014</sub> * Q <sub>2014</sub>	<del>7.66</del> 10.33 * C <sub>2014</sub> * Q <sub>2014</sub>	<del>7.66</del> 10.33 * C <sub>2014</sub> * Q <sub>2014</sub>	10.33 * C <sub>2014</sub> * Q <sub>2014</sub>	10.33 * C <sub>2014</sub> * Q <sub>2014</sub>
Changes in 2015	0	0	<del>57</del> * C <sub>2015</sub> * Q <sub>2015</sub>	<del>57</del> * C <sub>2015</sub> * Q <sub>2015</sub>	<del>57</del> * C <sub>2015</sub> * Q <sub>2015</sub>	<del>57</del> * C <sub>2015</sub> * Q <sub>2015</sub>	7 * C <sub>2015</sub> * Q <sub>2015</sub>	7 * C <sub>2015</sub> * Q <sub>2015</sub>
Changes in 2016	0	0	0	<del>46</del> * C <sub>2016</sub> * Q <sub>2016</sub>	<del>46</del> * C <sub>2016</sub> * Q <sub>2016</sub>	<del>46</del> * C <sub>2016</sub> * Q <sub>2016</sub>	6 * C <sub>2016</sub> * Q <sub>2016</sub>	6 * C <sub>2016</sub> * Q <sub>2016</sub>
Changes in 2017	0	0	0	0	<del>35</del> * C <sub>2017</sub> * Q <sub>2017</sub>	<del>35</del> * C <sub>2017</sub> * Q <sub>2017</sub>	5 * C <sub>2017</sub> * Q <sub>2017</sub>	5 * C <sub>2017</sub> * Q <sub>2017</sub>
Changes in 2018	0	0	0	0	0	<del>24</del> * C <sub>2018</sub> * Q <sub>2018</sub>	4 * C <sub>2018</sub> * Q <sub>2018</sub>	4 * C <sub>2018</sub> * Q <sub>2018</sub>
<u>Changes in 2019</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	3 * C <sub>2019</sub> * Q <sub>2019</sub>	3 * C <sub>2019</sub> * Q <sub>2019</sub>
<u>Changes in 2020</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	2 * C <sub>2020</sub> * Q <sub>2020</sub>
EC <sub>t</sub> =	Sum rows	Sum rows	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  $t$ .

$K_t$ : 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:  $t \neq 2015$  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:

$$T_t = \sum_i TM_{it} TF_{it}$$

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

- $MTP_i$  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<sub>t</sub>: 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**

Additional revenue requirement for projects in	Year t =							
	9mo. 2014	2015	2016	2017	2018	2019	<u>2020</u>	<u>2021</u>
2014	$0.5 \times d_{2014}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-5}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-6}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-7}} \times d_{2014}$	$\frac{P_{t-1}}{P_{t-8}} \times d_{2014}$
2015	0	$0.5 \times d_{2015}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-5}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-6}} \times d_{2015}$	$\frac{P_{t-1}}{P_{t-7}} \times d_{2015}$
2016	0	0	$0.5 \times d_{2016}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2016}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2016}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2016}$	$\frac{P_{t-1}}{P_{t-5}} \times d_{2016}$	$\frac{P_{t-1}}{P_{t-6}} \times d_{2016}$
2017	0	0	0	$0.5 \times d_{2017}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2017}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2017}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2017}$	$\frac{P_{t-1}}{P_{t-5}} \times d_{2017}$
2018	0	0	0	0	$0.5 \times d_{2018}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2018}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2018}$	$\frac{P_{t-1}}{P_{t-4}} \times d_{2018}$
2019	0	0	0	0	0	$0.5 \times d_{2019}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2019}$	$\frac{P_{t-1}}{P_{t-3}} \times d_{2019}$
<u>2020</u>	0	0	0	0	0	0	$0.5 \times d_{2020}$	$\frac{P_{t-1}}{P_{t-2}} \times d_{2020}$
<u>2021</u>	0	0	0	0	0	0	0	$0.5 \times d_{2021}$
	Sum Rows $\times W$	Sum Rows $\times W$	Sum Rows $\times W$	Sum Rows $\times W$	Sum Rows $\times W$	Sum Rows $\times W$	Sum Rows $\times W$	Sum Rows $\times W$

*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:

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

*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.

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

*If:*  $t = 2020;$

*Then:*  $BR_t = 0.8 * Z_{2020}$

*If:*  $t = 2021;$

*Then:*  $BR_t = 0.8 * Z_{2021}$

*If:*

*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	$(U_t - £136,800,000) * \frac{P_{t-1}}{222.80}$
<u>2020</u>	$(U_t - £136,800,000) * \frac{P_{t-1}}{222.80}$
<u>2021</u>	$(U_t - £136,800,000) * \frac{P_{t-1}}{222.80}$

*Where:*

- $U_t$  is the regulatory allowance for business rates (that is £136,900,000 in 2017, £136,800,000 in 2018 to 2021 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  $t-1$ .

$A_t$ : *pass-through of Category B costs (planning costs) for runway expansion*

C1.12  $A_t$  is the cost pass-through adjustment of up to £10 million in each Regulatory Year to allow for the recovery of the reasonable costs (capital, operating and financing) of applying for planning permission for a third runway and associated infrastructure (Category B costs) since the Government announcement of its decision on 25 October 2016 to support the development of a third runway at the Airport. These Category B costs must, in the CAA's view, have been efficiently incurred. This adjustment shall have regard to any policy guidance that may be issued by the CAA, following consultation, in relation to the recovery of these Category B costs.

*If:*  $t = 2016, 2017, 2018, \text{ or } 2019, \text{ 2020 or 2021}$

*Then:*  $A_t = \text{eligible and efficient Category B costs up to } \pounds 10,000,000$

*Otherwise:*  $A_t = 0$

*Commercial arrangements for the 2020 and 2021 price control extension*

C1.13 Nothing in this Part C shall prevent the Licensee from entering into any commercial agreement.

C1.14 Where the Licensee enters into any commercial agreement, the Licensee shall:

- provide for, and comply with, alternative arrangements to ensure that, in relation to the definition and payment of fixed rebates, the Licensee does not unduly discriminate between airlines that are party to any such commercial agreement and airlines that are not party to a commercial agreement and shall make such arrangements available to all airlines using the Airport;
- save to the extent that any commercial agreements entered into prior to 1 January 2020 have been varied by agreement between the Licensee and airlines, and such variations have been provided for in the alternative arrangements required by condition C1.14(a), pay any fixed rebate in accordance with the terms of the commercial agreements and those alternative arrangements of up to a total of £130 million in respect of each of 2020 and 2021.

[C1.15](#) [The Licensee's ability to enter into agreements or other arrangements in relation to any aspect of airport charges described in Condition C1.13 and the obligations of the Licensee set out in condition C1.14 are without prejudice to Licensee's obligations under conditions C.1.1 and C1.2, and the Airport Charges Regulations 2011 \(2011 No.2491\).](#)

## Definitions<sup>24</sup>

C.1.136 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) [commercial agreement](#) means [any agreements or other arrangements \(as varied from time to time\) entered into between the Licensee and airlines in relation to any aspect of the airport charges that the Licensee levies in respect of relevant air transport services for 2020 and 2021, including \(but not limited to\) the payment of rebates to airlines in respect of those charges;](#)
- (e) **core capex project** is any project that has passed Gateway 3, being taken forward for implementation in accordance with the governance arrangements;
- (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;
- (g) **development capex project** is any project under development that

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<sup>24</sup> The individual definitions have been renumbered from (d) onwards to account for new items being included under C1.16.

has not passed Gateway 3 in accordance with the governance arrangements, but for which an allowance has been included in the development capex allowance;

- (h) [fixed rebate shall bear the same meaning it has in any commercial agreement entered into by the Licensee;](#)
- (i) **Gateway 3** has the meaning set out in the governance arrangements;
- (j) **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, [and updated in April 2015;](#)
- (k) **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;
- (l) **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;
- (m) **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;
- (n) **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;
- (o) **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.
- (p) **specified rate** [\(from 2014 to 2017\)](#) 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.

- (q) [specified rate \(from 2018 to 2021\)](https://www.dmo.gov.uk/data/treasury-bills/tender-results/) means the average of the three month Treasury Bill Discount Rate (expressed as an annual percentage interest rate) published by the UK Debt Management Office (<https://www.dmo.gov.uk/data/treasury-bills/tender-results/>), during the 12 months from the beginning of May in Regulatory Year t-2 to the end of April in Regulatory Year t-1.

Condition C2 shall be modified as follows:

## **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, [2020 and 2021](#) Regulatory Years) 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, [2020 and 2021](#) Regulatory Years actual revenue from any of the Specified Facilities differs from actual revenue in the [2018 preceding](#) 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

C2.7 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.

Condition C4 shall be modified as follows:

### C4 Charges for cargo only operators

- C4.1 In the Regulatory Period and the subsequent [five seven](#) 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.

## **Modifications to Part D: Service quality conditions**

Condition D1 shall be modified as follows:

### **D1 Service quality standards, rebates, bonuses and publication**

- D1.6 The CAA may by notice modify the Statement with immediate effect where there is written agreement between:
- (a) the Licensee; and
  - (b) the AOC.
- D1.7 Where the Licensee and the AOC cannot reach agreement, either party may request that the CAA determines the modification.
- D1.8 Where a request has been made under Condition D1.7, the CAA may by notice determine the modifications, following a reasonable period of consultation.
- D1.9 The modifications that can be made under Conditions D1.6 and D1.8 are any modifications to Schedule 1 except:
- (a) any modifications to the elements listed in the 'Element' columns of Table 1a to Table 6 and Table 10a to Table 10e;
  - (b) any modifications to the table of bonuses (Table 8) and to the calculation of the bonus factor set out in the Statement; and
  - (c) any modifications to Table 9.
- D1.10 Modifications can be made to the Statement under Conditions D1.6 and D1.8 ~~no more frequently than one group of changes in each three month period~~ at any time.

## **Modifications to Part E: Financial conditions**

Condition D1 shall be modified as follows:

### **E1 Regulatory accounting requirements**

- E1.1 This Condition applies for the purpose of making available, in a form and to a standard reasonably satisfactory to the CAA, such audited regulatory

accounting information as will, in furtherance of the requirements of this Licence:

- (a) enable the CAA, airlines and users of air transport services to assess on a consistent basis the financial position of the Licensee and the financial performance of provision of airport operation services and associated services provided in connection with the Airport;
  - (a) assist the CAA, airlines and users of air transport services to assess performance against the assumptions underlying the price control conditions in Conditions C1 and C2 of this Licence; and
  - (b) inform future price control reviews.
- E1.2 The Licensee shall keep and, so far as it is able, procure that any related undertaking keeps the accounting records required by the Companies Act 2006 to keep in such form as is necessary to enable the Licensee to comply with this Condition and the Regulatory Accounting Guidelines.
- E1.3 The Licensee shall prepare on a consistent basis from the accounting records referred to in Condition E1.2, in respect of the Regulatory Period and each subsequent Regulatory Year, regulatory accounts in conformity with the Regulatory Accounting Guidelines for the time being in force in accordance with this Condition.
- E1.4 The Regulatory Accounting Guidelines prepared pursuant to Condition E1.3 shall, without limitation:
- (a) provide that, except so far as the CAA reasonably considers otherwise, the regulatory accounts shall be prepared in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU from time to time; and
  - (b) state the accounting policies to be adopted.
- E1.5 The Licensee shall:
- (a) procure, in respect of the regulatory accounts prepared in accordance with Condition E1.3 in respect of a Regulatory Period or Regulatory Year, a report by the Auditors addressed to the CAA which provides their opinion on those accounts. The opinion should be worded in the form required by those professional bodies accountable for prescribing the form of audit reports on regulatory accounts and should refer to compliance with the Condition and the Regulatory Accounting Guidelines; stating whether in their opinion those accounts including accompanying commentary on performance have been properly prepared in accordance with this Condition and the Regulatory Accounting Guidelines and on that basis fairly present the

~~financial position and the financial performance of the Licensee;~~

- (b) deliver to the CAA the Auditors' report referred to in sub-paragraph a) and the regulatory accounts referred to in Condition E1.3 as soon as reasonably practicable, and in any event not later than six months after the end of the Regulatory Period or Regulatory Year to which they relate; and
- (c) arrange for copies of the regulatory accounts and Auditors' report referred to in Conditions E1.5 a) and b), respectively, to be made publicly available and, so far as reasonably practicable, to do so when the annual statutory accounts of the Licensee are made available.

E1.6 The Licensee shall also:

- (a) make reasonable endeavours to secure agreement between itself, the CAA and the Auditors on Agreed Upon Procedures which are designed to provide the CAA with factual findings, where, from time to time, the CAA reasonably considers such procedures are relevant to the fulfilment of its duties and proportionate to any concerns of the CAA in respect of its fulfilment of those duties
- (b) procure, as required from time to time by the CAA, in respect of the regulatory accounts prepared in accordance with Condition E1.3, a report by the Auditors addressed to the CAA which states that they have carried out Agreed Upon Procedures and which sets out their findings.

**Definitions**

E1.7 In this Condition E1 Regulatory Accounting Guidelines means the guidelines, published from time to time by the CAA so as to fulfil the purpose set out in Condition E1.1, which govern the format and content of such regulatory accounts and the basis on which they are to be prepared.

E1.8 In this Condition E1 Agreed Upon Procedures means procedures which are from time to time agreed between the CAA, the Auditors and the Licensee and which the Auditors carry out and report on factual findings.

## Modifications to Schedule 1

### Statement of Standards, Rebates and Bonuses

Schedule 1 shall be modified as follows:

## 2. Components of the service quality rebates and bonuses (SQRB) scheme

- 2.1 The SQRB scheme consists of elements, standards, bonuses, rebates and publication requirements as set out in Table 1a to Table 10e of this Schedule. In these tables and in this Schedule:
- (a) Group defines the group in which the related elements belong to;
  - (b) Element identifies the relevant element  $i$  of service;
  - (c) Metric defines the basis of measurement for each relevant element  $i$ ;
  - (d)  $\text{Standard}_{i,j,a}$  defines the relevant standard of element  $i$  in month  $j$  in terminal  $a$ ;
  - (e)  $\text{ANNMAX}_i$  is the maximum percentage of Airport Charges (relating to air transport services for the carriage of passengers for the relevant terminal) payable by the Licensee as rebates for any service failure in element  $i$  in the relevant Regulatory Period or Regulatory Year as specified in Table 1a to Table 6 of this Schedule;
  - (f)  $R_{i,j,RP}$  is a proportion of  $\text{ANNMAX}_i$  for any service failure in element  $i$  in month  $j$  for the Regulatory Period as specified in Table 1a to Table 6 of this Schedule;
  - (g)  $R_{i,j,Ry}$  is a proportion of  $\text{ANNMAX}_i$  for any service failure in element  $i$  in month  $j$  for any relevant Regulatory Year as specified in Table 1a to Table 6 of this Schedule;
  - (h) Passenger-sensitive equipment (PSE) includes lifts, escalators and travelators. PSE (priority) is a set of assets for each terminal agreed locally between the Licensee and the AOC and notified in writing from time to time to the CAA;
  - (i) Specified element identifies the relevant element  $k$  of service for which bonuses shall be recovered by the Licensee;
  - (j)  $\text{MB}_k$  is the maximum percentage of Airport Charges (relating to air transport services for the carriage of passengers for the relevant terminal) recoverable by the Licensee as bonuses for performance of specified element  $k$  in the relevant Regulatory Period or Regulatory Year as specified in Table 8 of this Schedule;

- (k)  $LPL_k$  is the lower performance limit for specified element k used in the calculation of bonuses as specified in section 4(b). It has the values assigned in Table 8 of this Schedule; and
- (l)  $UPL_k$  is the upper performance limit for specified element k used in the calculation of bonuses as specified in section 4(b). It has the values assigned in Table 8 of this Schedule.

## 2(a) Quality of Service Monitor (QSM)

2.2 QSM is the Quality of Service Monitor survey. The results of the QSM survey are used to assess the Licensee's performance in the passenger satisfaction elements as specified in Table 4a 2a to Table 5d and Table 8 of this Schedule.

2.3 The performance for passenger satisfaction elements is measured by moving annual averages weighted by passenger numbers in the relevant terminal, using the formulae:

- (a) Except for the period within 12 months after air transport services for the carriage of passengers commence at Terminal 2, performance of element i in month j in terminal a is:

$$\text{Performance}_{i,j,a} = \frac{\sum_{m=1}^{m=12} [\pi_{j-m+1,a} \text{Monthly performance}_{i,j-m+1,a}]}{\sum_{m=1}^{m=12} \pi_{j-m+1,a}}$$

- (b) For the 12 months after air transport services for the carriage of passengers commence at Terminal 2, performance of element i in month j in Terminal 2 is:

$$\text{Performance}_{i,j,2} = \frac{\sum_{m=1}^{m=\mu} [\pi_{j-m+1,2} \text{Monthly performance}_{i,j-m+1,2}]}{\sum_{m=1}^{m=\mu} \pi_{j-m+1,2}}$$

where:

$\pi_{j,a}$  is the number of passengers in month j in terminal a;

Monthly performance $_{i,j,a}$  is the performance of element i in month j in terminal a;

m is a counter of the 12 months ending in month j; and

$\mu$  is a counter of months where

- the month in which air transport services for the carriage of passengers commence at Terminal 2 = 1;

- the month after air transport services for the carriage of passengers commence at Terminal 2 = 2, so on and so forth;
- the eleventh month after air transport services for the carriage of passengers commence at Terminal 2 = 12.

## 4. Bonuses

### 4(a) Payment

4.1 The Licensee may recover bonuses from Relevant Parties. Bonus payments shall be included in the calculation of the Airport Charges in respect of relevant air transport services in Condition C1.

### 4(b) Calculation

4.2  $B_t$ , the bonus factor as specified in Condition C1, is based on performance achieved in respect of specified elements in the relevant Regulatory Period or Regulatory Year  $t$  as set out in Table 8 of this Schedule.

4.3 For the purposes of calculating  $M_t$  as specified in Condition C1, the corresponding periods for which bonuses are recoverable by the Licensee to be included in the calculation of  $M_t$  are set out in Table 9 of this Schedule.

4.4 For the purposes of calculating  $M_t$  for the Regulatory Period,  $B_{t-2} = B_{2012/13}$  is set to zero; for the purposes of calculating  $M_t$  for the Regulatory Year  $t$  starting on 1 January 2015,  $B_{t-2} = B_{2013/14}$  is set to zero. This is because bonuses earned in 2012/13 and 2013/14 should have been recovered through the K factor as specified in Condition C1.

4.5  $B_t$  for the Regulatory Period, i.e.  $B_{2014}$ , shall be calculated as follows:

$$B_t = \sum_{j=\text{April}}^{\text{December}} \sum_k \text{Max} \left[ 0, \text{Min} \left[ \text{BNS}(T1)_{kj}, \text{BNS}(T2)_{kj}, \text{BNS}(T3)_{kj}, \text{BNS}(T4)_{kj}, \text{BNS}(T5)_{kj} \right] \right]$$

For each month  $j$  and specified element  $k$ ;

$$\text{BNS}(T1)_{kj} = \frac{1}{9} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(T1)_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(T2)_{kj} = \frac{1}{9} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(T2)_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$



$$\text{BNS}(\text{T3})_{kj} = \frac{1}{9} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T3})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(\text{T4})_{kj} = \frac{1}{9} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T4})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(\text{T5})_{kj} = \frac{1}{9} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T5})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

where:

$\text{MB}_k$ ,  $\text{LPL}_k$  and  $\text{UPL}_k$  are defined in paragraphs 2.1(j), 2.1(k) and 2.1(l) respectively; and

$\text{MP}(\text{T1})_{kj}$ ,  $\text{MP}(\text{T2})_{kj}$ ,  $\text{MP}(\text{T3})_{kj}$ ,  $\text{MP}(\text{T4})_{kj}$  and  $\text{MP}(\text{T5})_{kj}$  are the moving annual average monthly performance for specified element k in month j weighted by monthly passengers numbers in Terminal 1, Terminal 2, Terminal 3, Terminal 4 and Terminal 5, respectively. It is calculated using the formulae set out in paragraph 2.3.

4.6  $B_t$  for any subsequent relevant Regulatory Year t shall be calculated as follows:

$$B_t = \sum_{j=\text{January}}^{\text{December}} \sum_k \text{Max} \left[ 0, \text{Min} [\text{BNS}(\text{T1})_{kj}, \text{BNS}(\text{T2})_{kj}, \text{BNS}(\text{T3})_{kj}, \text{BNS}(\text{T4})_{kj}, \text{BNS}(\text{T5})_{kj}] \right]$$

For each month j and specified element k;

$$\text{BNS}(\text{T1})_{kj} = \frac{1}{12} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T1})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(\text{T2})_{kj} = \frac{1}{12} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T1})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(\text{T3})_{kj} = \frac{1}{12} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T2})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(\text{T4})_{kj} = \frac{1}{12} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T4})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

$$\text{BNS}(\text{T5})_{kj} = \frac{1}{12} \times \text{MB}_k \frac{\text{Min}[\text{UPL}_k, \text{MP}(\text{T4})_{kj}] - \text{LPL}_k}{\text{UPL}_k - \text{LPL}_k}$$

where:

$MB_k$ ,  $LPL_k$  and  $UPL_k$  are defined in paragraphs 2.1(j), 2.1(k) and 2.1(l) respectively; and

$MP(T1)_{kj}$ ,  $MP(T2)_{kj}$ ,  $MP(T3)_{kj}$ ,  $MP(T4)_{kj}$  and  $MP(T5)_{kj}$  are the moving annual average monthly performance for specified element k in month j weighted by monthly passengers numbers in Terminal 1, Terminal 2, Terminal 3, Terminal 4 and Terminal 5, respectively. It is calculated using the formulae set out in paragraph 2.3.

~~4.7 The calculations set out in paragraphs 4.5 and 4.6 are subject to the following conditions:~~

~~For the months including or after 'Such time when Terminal 1 is decommissioned',  $BNS(T1)_{kj} = 0.36\%$ ; and~~

~~For the months before or including 'Such time when air transport services for the carriage of passengers commence at Terminal 2',  $BNS(T2)_{kj} = 0.36\%$~~

## 7. Tables<sup>25</sup>

**Table 1 a: Terminal 1 – passenger satisfaction elements [Not used]**

<b>i</b>	<b>Element</b>	<b>Metric</b>	<b>Time-of-day-over which performance counts for rebates</b>	<b>Standard<sub>i,j,a</sub></b>	<b>ANNMAX<sub>i</sub></b>	<b>R<sub>i,j</sub>RP</b>	<b>R<sub>i,j</sub>RY</b>	
1	Departure lounge seating availability	Moving annual average QSM scores weighted by monthly passenger numbers	Unrestricted	3.80	0.36%	0.0800%	0.0600%	
2	Cleanliness			4.00	0.36%	0.0800%	0.0600%	
3	Way-finding			4.10	0.36%	0.0800%	0.0600%	
4	Flight information			4.30	0.36%	0.0800%	0.0600%	
5	Security			Publication only				
6	Wi-fi			Publication only				

<sup>25</sup> In Tables 42a 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 42a to Table 6, ANNMAX<sub>i</sub> is defined in paragraph 2.1(e) and is measured to two decimal places. R<sub>i,j</sub>RP and R<sub>i,j</sub>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, MB<sub>k</sub>, LPL<sub>k</sub> and UPL<sub>k</sub> are defined in paragraphs 2.1(j), 2.1(k) and 2.1(l) and are measured to two decimal places.

**Table 1b: Terminal 1 – security<sup>26</sup>**

<b>i</b>	<b>Element</b>	<b>Metric</b>	<b>Time of day over which performance counts for rebates</b>	<b>Standard<sub>t,j,a</sub></b>	<b>ANNMAX<sub>t</sub></b>	<b>R<sub>t,j</sub>RP</b>	<b>R<sub>t,j</sub>RY</b>
7-i1	Central search (interim)	Percentage of queue times measured once every 15 minutes that are less than 5 minutes	05:00 to 22:30	95.00%	1.00%	0.2222%	0.1667%
7-i2		Percentage of queue times measured once every 15 minutes that are less than 10 minutes	05:00 to 22:30	99.00%			
8-i1	Transfer search (interim)	Percentage of queue times measured once every 15 minutes that are less than 10 minutes	05:00 to 22:30	95.00%	0.50%	0.1111%	0.0833%
9	Staff search	Percentage of queue times measured once every 15 minutes that are less than 10 minutes	Period agreed locally between the Licensee and the AOC	95.00%	0.38%	0.0844%	0.0633%

<sup>26</sup> The standards for central and transfer search (interim) (elements 7-i1, 7-i2 and 8-i1) remain in effect until air transport services for the carriage of passengers cease in Terminal 1.

**Table 1c: Terminal 1 – passenger operational elements**

i	Element	Metric	Time of day over which performance counts for rebates	Standard <sub>t,j,a</sub>	ANNMAX <sub>t</sub>	R <sub>t,j</sub> RP	R <sub>t,j</sub> RY
10	PSE (general)	% time serviceable and available for use, independent of any other element	Period agreed locally between the Licensee and the AOC	99.00%	0.35%	0.0778%	0.0583%
11	PSE (priority)			99.00%	0.35%	0.0778%	0.0583%
12	Arrivals baggage carousels			99.00%	0.35%	0.0778%	0.0583%
13a	Track transit system	% one train serviceable and available for use, independent of any other element	Not applicable	Not applicable			
13b		% two trains serviceable and available for use, independent of any other element					

**Table 1d: Terminal 1 – airline operational elements<sup>27</sup>**

i	Element	Metric	Time of day over which performance counts for rebates	Standard <sub>t,j,a</sub>	ANNMAX <sub>t</sub>	R <sub>t,j</sub> RP	R <sub>t,j</sub> RY
14	Stands	% time serviceable and available for use, independent of any other element	Period agreed locally between the Licensee and the AOC	99.00%	0.25%	0.0556%	0.0417%
15	Jetties			99.00%	0.25%	0.0556%	0.0417%
16	Fixed electrical ground power			99.00%	0.20%	0.0444%	0.0333%
17	Stand entry guidance			99.00%	0.25%	0.0556%	0.0417%
18	Pre-conditioned air		Not applicable	Not applicable			
19	Pier served stand usage	Moving annual average of % passengers served (last 12 months)	Unrestricted	95.00%	0.30%	0.0667%	0.0500%

<sup>27</sup>—In this table, pier served stand usage (element 19) would be a combined Terminal 1/Terminal 2 element. Its standard is subject to exceptions to be agreed by the Licensee and the AOC.

**Table 9: Periods of bonuses earned to be taken into account when setting  $M_t$  as specified in Condition C1<sup>28</sup>**

To set the maximum revenue yield per passenger $M_t$	$M_t$ representing the period	Take account bonuses earned in $B_{t-2}$	$B_{t-2}$ 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
<a href="#">M<sub>2020</sub></a>	<a href="#">January 2020 – December 2020</a>	$B_{2018}$	<a href="#">January 2018 – December 2018</a>
<a href="#">M<sub>2021</sub></a>	<a href="#">January 2021 – December 2021</a>	$B_{2019}$	<a href="#">January 2019 – December 2019</a>

<sup>28</sup> 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.

## Appendix C

## Regulatory Depreciation

*Regulatory depreciation*

1. The commercial deal specifies a price path and associated rebates. It states that “regulatory depreciation [is] based on the baseline capital expenditure assumptions in and underpinning CAP 1658 Appendix D Table D.4”. For the avoidance of doubt this table is reproduced in Table B.1.

Table B.1: CAA capital expenditure scenario for 2019 to 2021 (2014 prices). This is table D.4 from the April 2018 Consultation.

	2019	2020	2021
Expansion capex	167	167	485
Non-expansion	182	306	509
Maintenance	391	350	350
<b>Total</b>	<b>740</b>	<b>823</b>	<b>1,344</b>

2. The regulatory depreciation figures used in conjunction with baseline capital expenditure were not set out in the April 2018 Consultation (CAP 1658), but they were calculated in model scenarios for interim price control arrangements in the April 2018 Consultation. For clarity, we present the underlying regulatory depreciation figures below.
3. Regulatory depreciation is not used to calculate the charges for the period to 31 December 2021, but these figures will be needed to determine the opening RAB at the start of the H7 price control.

Table B.2: Regulatory depreciation underpinning CAP 1658 Table D.4

£m, 2016 prices	2020	2021
Depreciation	745	750