

# YOUR LONDON AIRPORT *Gatwick*



Economic regulation at Gatwick from April 2014:  
CAA's final proposals

**RESPONSE FROM GATWICK AIRPORT LTD**



November 2013

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### Executive summary

We welcome the opportunity to comment on the CAA's final proposals for Gatwick. This response is separated into three themes:

- 1) Our response to the CAA's acceptance of Gatwick's Commitments framework;
- 2) Our thoughts on the calculation of the "fair price"; and
- 3) Comments on the proposals for continued regulation.

The appendices provide our commentary on the component parts of the "fair price" calculation, together with suggested revisions to the Commitments terms sheet, Conditions of Use and proposed CAA licence.

### The Commitments framework

We welcome the fact that the CAA's final proposals reflect the Commitments framework offered by Gatwick. We believe firmly that the Commitments represent a transformational change in the way that Gatwick operates, how we co-operate commercially with our airline customers, and how together, we can transform further the passenger experience at Gatwick. This approach will also facilitate increased competition between the London airports that will also benefit passengers.

We have made further changes to the Commitments framework that meet most of the concerns expressed by the CAA and airlines. These changes include: i) stating a policy that the recovery of reasonable second runway related costs will follow the CAA's forthcoming policy guidance; ii) clarifying that Core Services will remain available for the Core Service Charges, to allay unfounded concerns as to Gatwick's intended treatment of Premium Services; as well as iii) the recovery of savings and increases associated with security related costs; and iv) how consultation with our passenger advisory group would operate. We look forward to the CAA confirming its support for the Commitments framework in the final decision document that is due in early 2014. We will honour the Commitments whether they are mandated by a regulatory licence or, should the CAA determine that Gatwick does not meet the market power test, there is no licence.

### The "fair price"

We retain significant concerns about the "fair price", against which the CAA has judged the Commitments framework. Our concerns relate to the relevance, on its own, of a simple RAB-based metric but even more so about how it has been applied in practice. While we recognise that it is Gatwick's Commitments price, rather than the "fair price", which is being taken forward, the CAA's calculation has systematically underestimated the "fair price" and therefore the value that our customers should place on Gatwick's Commitment price:

- The CAA continues to set aside, without adequate justification, evidence that has been provided to correct the assumptions underlying the building blocks of the "fair price", in particular relating to flawed analysis by consultants; and
- The CAA has made a series of errors in its analysis of Gatwick's business plan.

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We consider that the CAA should properly take account of these points, and correct any errors, in its final assessment of the Commitments framework following the current consultation. These points would also clearly take on even greater importance should an independent review body either choose to resurrect the RAB-based approach for the period beyond Q5 or need to re-evaluate the calculation against which the Commitments framework had been assessed.

Detailed comments on the “fair price” calculation are contained in the main response document.

### **Comments on the CAA’s final proposals for continued regulation**

As we have previously made clear, Gatwick is committed to its proposed framework whatever the outcome of the CAA’s market power assessment. We believe that the existence of the Commitments framework should have a major impact on the CAA’s assessment of the market power test for Gatwick. We look forward to seeing the CAA’s updated analysis early in 2014. This should reflect also the CAA’s views on the impact on the market power test at Stansted of the announcement of long term contracts with Ryanair and easyJet. The CAA’s initial views, that the existence of these agreements means tests B and C are no longer met at Stansted, must be equally applicable to the impact of the Commitments on tests B and C at Gatwick, if not more so, as the Commitments apply to all airlines and are publicly available.

### **Further clarification requested**

The CAA’s final proposals contain two areas where further clarity would be welcome:

First, it is important that the focus of the 2016 review should be clarified to ensure that it does not undermine the long term nature of the Commitments framework. Consistent with that aim, Gatwick believes that the review should simply consider whether Gatwick has lived up to the commitments it has given. In particular, the CAA should be sensitive to the commercial realities of long term contracting between the airport and airlines. This should include taking into account the risk to passenger, airline and airport interests of distorting any agreements that are already in place.

Second, the way in which the CAA intends to allow the recovery (or otherwise) of second runway-related costs will be an important part of any decision by Gatwick to proceed with any expansion plans. Early clarity in this area will be necessary in early 2014. A regulatory policy statement will be a fundamental input to the business case necessary to support investment in additional runway capacity.

### **Conclusion**

Early indications are that progress in airline discussions about long term contracts is already being assisted by the signal given by the CAA that it is proposing a Commitments framework for Gatwick. This is most welcome, although Gatwick believes that, without the prolonged regulatory uncertainty over the future of regulation at Gatwick, in contrast to the early indications at Stansted, earlier progress could have been made on putting contracts in place. This will be to the benefit of the passengers enjoying the facilities of the London airports in terms of service quality, price and competition.

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### **Plan of Gatwick's response document**

This response document draws out the key issues that arise from the CAA's final proposals, in the first 3 chapters:

Chapter 1: Commitments framework;

Chapter 2: "Fair price"; and

Chapter 3: Comments on the CAA's final proposals for continued regulation.

The appendices provide our detailed commentary on the components of the CAA's "fair price" calculation:

Appendix 1: Revised Commitments head of terms;

Appendix 2: Revised Conditions of Use;

Appendix 3: Cost of capital;

Appendix 4: Traffic;

Appendix 5: Capital expenditure and consultation;

Appendix 6: Operating costs; and

Appendix 7: Commercial revenue.

With additional evidence provided, concerning:

Appendix 8: Licence marked up;

Appendix 9: Leigh Fisher analysis; and

Appendix 10: SLG Economics analysis.

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### Chapter 1: Commitments framework

#### 1.1 Introduction

We welcome the fact that CAA's final proposals reflect the Commitments framework offered by Gatwick.

We have made further changes to the Commitments framework aimed at meeting the central concerns expressed by the CAA (in its final proposals) and the key concerns of the airlines and ACC (as set out in their letters of 22 October 2013 to the CAA). This is in addition to the changes that Gatwick has already made to the Commitments in response to issues raised previously by the ACC and the CAA, most recently in September following the submission in August by Gatwick of its response to the CAA's initial proposals.

In particular, we have provided further clarity on:

- Recovery of second runway development costs;
- Purpose and definition of premium services; and
- Other elements of the Commitments framework, which include the:
  - Recovery of costs and savings from the security operation; and
  - Approach to consultation with Gatwick's Passenger Advisory Group.

These changes are set out in further detail below, together with commentary on a number of other issues.

In addition, we request additional clarification on two areas in the CAA's proposals: i) the CAA's policy towards the second runway; and ii) the proposed monitoring regime and review in 2016.

We have appended to this document a revised Heads of Terms (Appendix 1), marked up relative to the version provided to the CAA in September (and subsequently published by them). We have also appended a revised Conditions of Use (Appendix 2) consistent with this Heads of Terms. Both documents have been released today to the ACC.

On Monday 28 October, we received an email from the CAA containing possible licence condition amendments that it wished Gatwick to consider in preparing our submission, due on Monday 4 November. These licence amendments appear to have been drafted by the CAA in reaction to letters received by the CAA from the ACC (dated 22 October 2013), easyJet, BA and Virgin, all in relation to the Commitments. It is concerning that the CAA, at such a late stage and a week after receiving correspondence from the airline community, is proposing new licence conditions on which it asks Gatwick to comment within 7 days.

Nevertheless, in this document we have sought, as best we can in the timescale permitted, to address the key issues raised. Much of the comment from the ACC addresses detailed drafting in the Conditions of Use rather than points of principle. We propose that these are dealt with through proper process during the consultation on the Conditions of Use which we will undertake with airlines in November.



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### 1.2 Recovery of second runway development costs

#### *Response to the final proposals*

In its final proposals, the CAA expressed concerns that the Commitments would only *have regard to*, rather than *follow* CAA policy guidance in relation to the financing of a second runway at Gatwick. Gatwick considered (and still considers) that this position was not unreasonable in relation to a policy that we have not yet seen, and which will be issued by a regulator that may, or may not, be licensing Gatwick in the future.

However, we note the CAA's concerns and those of the airlines on this point and, given our understanding that this policy statement will be issued for consultation early in 2014, we are prepared to commit to follow CAA policy in this matter and have revised the wording of the Commitments accordingly. In making this change, we recognise the reality that:

- It is unlikely that the CAA will end up with a policy which deters promoters from taking forward any efficiently developed scheme recommended by the Airports Commission, given that provision of any additional capacity which the Commission recommends is likely to be in the interests of passengers; and
- If the CAA policy made it impossible for Gatwick to develop a viable business case for a second runway at Gatwick, we would not proceed with the development of such a scheme.

In making this change, Gatwick has fully addressed the concern of the CAA as expressed in its final proposals. In particular, Gatwick notes the very strong guidance the CAA has given in this regard (in paragraph 11.68):

*“To this end the CAA will consider further its treatment of the costs of second runway early in Q6 and will consult further at an appropriate time. If Gatwick does not follow CAA policy lines laid down in this area then the CAA will actively consider a licence amendment, given the scale of passenger detriment that could occur.”*

#### *Response to CAA's latest revision to final proposals (CAA Letter of Monday 28 October)*

In its latest revision, the CAA provided further material from the airlines and the ACC, which included commentary on the costs of a second runway. The CAA also included proposed drafting for a licence condition that, Gatwick can only presume that the CAA believes would meet the requirements of its duties and the demands made of the CAA by the airlines.

As noted above, in its final proposals, the CAA provided a clear regulatory mechanism to ensure that the interests of passengers were safeguarded in relation to second runway costs. Gatwick has amended the Commitments to remove any ambiguity regarding its approach to the CAA policy. This would apply whether Gatwick is licenced or not.

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We have extracted below the drafting proposed by the CAA and ACC (as also reflected in the easyJet letter):

Party	Drafting proposed
CAA	<p><b>"Condition C1.5A:</b> The licensee can only amend the indicative price path in the commitments to allow for the recovery of the reasonable costs of a second runway at the airport if:</p> <ul style="list-style-type: none"> <li>(a) they are efficiently incurred, taking into account value for money including scope, aggregated direct and indirect costs for the airlines affected by the project, programme timing risk and benefit to users of air transport services; and</li> <li>(b) the CAA agrees to the amendments.</li> </ul> <p>Second runway costs are defined as the capital, operating and financing of:</p> <ul style="list-style-type: none"> <li>(a) applying for planning permission for a second runway; and</li> <li>(b) the subsequent development of the second runway and associated airport infrastructure." <p>The CAA would expect to consult as appropriate on any amendment to the indicative price path on second runway costs.</p> </li></ul>
ACC & easyJet	<p><b>"New Licence Condition C1.5A</b></p> <p>If following the completion of the Airports Commission the Government supports the development of a second runway at Gatwick Airport (or if Gatwick is permitted by any other mechanism analogous thereto) then the Licensee may propose amendments to the indicative price path set out in the Commitments to allow for the recovery of the reasonable costs in respect of the development of a second runway. Notwithstanding the provisions of Condition C1.4, any such proposed amendments shall be treated as proposed modifications to this Licence, the acceptance of which would be subject to the provisions of the Act governing the modification of licences."</p>

We have adopted in the Commitments framework CAA and ACC drafting that helps to describe more tightly aspects of the price path amendments. Gatwick does not believe that a licence condition is required in addition to this amendment to the Commitments framework. Regardless, we believe that the drafting put forward by the CAA goes beyond that proposed by the airlines and pre-empts the content of the CAA's policy on the financing of additional runways, which has not yet been published for consultation (as foreshadowed in the final proposals (paragraph 11.68)). In particular, it would be premature to specify that:

*"The licensee can only amend the indicative price path in the commitments to allow for the recovery of the reasonable costs of a second runway at the airport if: (a) they are efficiently incurred, taking into account value for money including scope, aggregated direct and indirect costs for the airlines affected by the project, programme timing risk and benefit to users of air transport services; and (b) the CAA agrees to the amendments."*

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We would expect the CAA policy when published, to address the circumstances in which costs would be regarded as reasonable (and anticipate that being efficiently incurred and subject to consultation in accordance with the Investment and Consultation Commitment would be an element of this). But at this stage, we would propose that it would be more appropriate to provide in any required licence condition that:

*“The licensee can only amend the indicative price path in the commitments to allow for the recovery of the reasonable costs of a second runway at the airport if the licensee does so in a manner consistent with the CAA’s published policy in relation to the funding of costs for additional runways.”*

Such wording avoids pre-empting the content of a policy that has yet to be consulted upon, but is consistent with the airlines’ intent.

### 1.3 Purpose and definition of premium services

#### *Response to the final proposals*

The CAA has expressed a concern (paragraph 11.16) as to the *“ability of Gatwick to introduce new premium service charges which could operate against the passenger interest.”*

One of the cornerstones of the Commitments is the recognition that, over time, airlines may wish to differentiate their product offering at Gatwick. The Core Service Standard is a baseline, which meets the broad requirements of airlines and their passengers and the CAA (acting in the interest of passengers).

If an airline wishes to develop a premium offering, this may require an increase in Gatwick’s manpower or capital investment. The concept of a ‘dedicated airline project’ is an illustration of this point. Such increased costs would warrant an increase in associated charges to the airline(s) using such a service. It would not be correct to incorporate such increased charges into the calculation of the Core Yield or Blended Yield given that these relate to the Core Service Standard. Indeed, to do so would not further the interests of passengers regarding the range, cost and quality of services. Gatwick would expect that such premium services would be delivered under bilateral contracts and would not form part of the tariff - as such they would not be considered part of the Core Yield or Blended Yield.

In drafting the Commitments, we provided that such Premium Services might in the future also be offered under a published tariff. While this proposal was well intentioned, it appears to have drawn disproportionate attention and generated unwarranted concern. In particular, there appears to be concern that we might convert what was offered under the Core Service Charges into a premium service. This was never Gatwick’s intention and we have made it clear in our revised drafting that the services and facilities provided as at April 2013 will remain available and charged under the Core Service Charges. Potential enhancements and/or additions to these services and facilities may be charged as a premium service either under Bilateral Contracts or under the Conditions of Use in the future. We believe this revised drafting should meet the CAA and ACC concern.

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### *Response to CAA's latest revision to the final proposals (CAA letter of Monday 28 October)*

As noted above, Gatwick has amended the Commitments to address the issue of premium services referenced in the Commitments framework. In doing so, we have provided a definition of Core Services that will be provided under the Core Service Charge. This follows closely the wording proposed by the CAA in its latest revision letter.

Conversely, the ACC proposed that charges under a bilateral contract should be presumed to be the equivalent of Core Service Charges, unless otherwise agreed (presumably by the ACC). This seeks to return to the old regulatory model and would undermine the flexibility and innovation that the Commitments approach seeks to encourage. Under the ACC proposal, if an airline, business, or passenger requires a new or enhanced service that requires Gatwick incurring additional operational and/or capital costs then, unless the ACC agrees, the revenue from the provision of that service must be used to reduce automatically the charges paid by other airlines.

Party	Drafting proposed
CAA	<p><b>"Conditions C1.5B:</b> Premium Service Charges are defined as charges for services that, as at 1 April 2013 were not covered by:</p> <ul style="list-style-type: none"> <li>a) airport charges, defined as: <ul style="list-style-type: none"> <li>i) charges levied on operators of aircraft in connection with the landing, parking or taking off of aircraft at the airport (including charges that are determined by reference to the number of passengers on board the aircraft), including any separate charge for aerodrome navigation services; and,</li> <li>ii) charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air; or</li> </ul> </li> <li>b) ancillary charges, defined under the commitments as selected ancillary service charges and other ancillary service charges"</li> </ul>
ACC	<p>2.6 The ACC remains of the view, as indicated in previous consultation responses, that it is inappropriate for GAL to maintain a concept of Premium Service Charges that are payable even in the absence of Bilateral Contracts but outside the effective price cap. It should be sufficient that it is open to GAL and any airline to enter into a Bilateral Contract for delivery of different services. We do not understand why there might be any need for something additional. We would propose the deletion of the concept of Premium Service Charges.</p>
	<p>compliance with the Indicative Yield Profile Commitments. We consider that it should be made clear that Aggregate Blended Revenue and Aggregate Core Revenue include the revenue from all charges under Bilateral Contracts save to the extent that the charges are made for services that are genuinely different from and additional to those that GAL is required to provide and/or does provide in the absence of Bilateral Contracts. There should be a presumption that all Bilateral Contract charges are included unless GAL can make out a clear case for their exclusion.</p>

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Party	Drafting proposed
Gatwick	<p>To be included in the Conditions of Use:</p> <ol style="list-style-type: none"> <li>Gatwick Airport Limited shall make available Core Services to Operators of aircraft at the Core Service Charges rate as amended from time to time; and</li> <li>Paragraph 1 above shall not prevent Gatwick Airport Limited from offering enhancements or additions to the Core Services either under Bilateral Contracts or at charges separate from the Core Service Charges.</li> </ol> <p>Definitions:</p> <p>Core Services means such services and facilities in connection with the landing, parking or taking off of aircraft at the airport as were provided as at 1st April 2013 in consideration of charges levied under Appendix I (Schedule of airport charges) of the Gatwick Airport Conditions of Use effective from the 1st of April 2013. Such charges will include charges for such services and facilities that are determined by reference to the number of passengers on board the aircraft, any separate charge for aerodrome navigation services and charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air.</p> <p>Core Service Charges means those charges set out in Schedule 1 Appendix 1 Charges to the Gatwick Airport Conditions of Use effective from 1st April 2014 as amended from time to time.</p>

### 1.4 Other elements of the Commitments framework

Summarised in the table below are Gatwick's detailed comments on the issues discussed above, together with our response to a number of other matters in relation to Commitments.

Issue	Comment
Second runway costs	<p>Gatwick's principal response in relation to the second runway costs is set out above. For completeness, we set out below two additional observations.</p> <p>First, the CAA commented (paragraph 10.94) that "<i>Gatwick has caveated the pass through in that it would follow government support and have regard to any policy guidance issued by the CAA in relation to the financing of new runway developments.</i>" In forming the view that this term in the Commitments poses "<i>significant risks to passengers' interests</i>", we note that the CAA has not, in summarising Gatwick's proposal:</p> <ul style="list-style-type: none"> <li>Commented upon the caveat that it relates to "<i>the recovery of reasonable costs for the planning and development</i>" of the second runway. Gatwick believes that efficient project management and consultation in line with the Commitments would be a key element in demonstrating this test has been met;</li> <li>Acknowledged that the amendment to the price path may only be made "<i>following consultation by Gatwick ... with the CAA</i>".</li> </ul> <p>We believe the CAA has not given due weight to these factors which afford significant protection to users.</p> <p>Second, the CAA has erred in commenting (paragraph 10.94) that "<i>in previous versions of the commitments Gatwick was seeking to recover the planning and development costs of a second runway spread equally over ten years</i>". This statement is incorrect. Gatwick had indicated that, rather than pass through the planning costs (which might be charged to Gatwick's P&amp;L rather than capitalised) in the year in which they occur, Gatwick would propose that these be spread over a ten year period and thus reduce the impact on users. This ten year duration did not apply to development costs which would be presumed to be capitalised and recovered over a period reflecting the long-lived nature of such assets and the private financing requirements of the business.</p>

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Issue	Comment										
<b>SQR regime</b>	<p>The CAA has indicated (paragraph 11.63) that it has remaining concerns regarding the “SQR where there are weaker controls if there are repeated service quality failures.” In particular, it commented (paragraph 11.66) that “rebates fall to zero if Gatwick continuously fails an individual metric for more than six months”.</p> <p>Gatwick is somewhat perplexed that the CAA has chosen to criticise the proposed SQR scheme. It is a scheme based on the CAA’s own design for Q5 and reflected in the CAA’s Initial Proposals; and was adopted by Gatwick at the behest of the CAA. For the CAA to then suggest that the very structure of this SQR requires the “backstop of a CAA investigation if failures persist for more than six months” (paragraph 10.86) is confusing.</p> <p>In the draft Commitments Gatwick prepared prior to September 2013, we proposed a solution to the SQR that addressed the shortcomings of the Q5 scheme and placed further risk on Gatwick. We have written to the CAA in this regard:</p> <p><i>“The Commitments proposal sets out challenging service standards for Gatwick to meet, recognising that these will be binding for the full 7-year duration of the Commitments and that over this time period the existing airport facilities will need to handle increasing numbers of passengers.</i></p> <p><i>Our Commitments proposal has gone further than the regulatory counter-factual. We have removed bonuses and introduced a 25% “ratchet” for selected passenger facing measures in the event of sustained failures, both of which represent a meaningful increase in net risk exposure for Gatwick.</i></p> <p><i>You are correct that the proposed service quality regime runs over a 12 month period, not 6 months. We think this is entirely reasonable and logical. First, the measure is continuous and as such a failure to meet a target in any month would give rise to a payment irrespective of performance in prior months. Second, the rebates are profiled pro rata to monthly airport charges, and as such a failure to meet a target in a busy summer month (when facilities and services are most under pressure) would give rise to a payment of well over twice the amount that would be payable during a quieter winter month.”</i></p> <p>Gatwick remains of the view that our original SQR formulation is, from a passenger’s perspective, far superior to that now proposed. Gatwick would be prepared to revert to this construct should the ACC or CAA support this. We suggest that the CAA allows Gatwick to agree with the airlines which option to pursue as part of the Conditions of Use consultation.</p>										
<b>SQR metrics</b>	<p>The CAA has made a number of detailed comments in relation to the SQR regime (paragraph 10.96), as addressed below:</p> <ul style="list-style-type: none"> <li> <b>Airfield availability:</b> Agreement has been reached with the ACC to retain the ACT measurement as per Q5 (see the joint letter, dated 9 October 2013), but with one alteration as to the level of rebates. These are stated below: <table border="1" data-bbox="454 1285 951 1458"> <thead> <tr> <th>Gatwick Rebate</th> <th>Proposed (£000s)</th> </tr> </thead> <tbody> <tr> <td>0 to 3</td> <td>0</td> </tr> <tr> <td>4 to 8</td> <td>7</td> </tr> <tr> <td>9 to 16</td> <td>20</td> </tr> <tr> <td>17 or more per day</td> <td>30</td> </tr> </tbody> </table> </li> <li> <b>Pier service levels:</b> These are still to be agreed with airlines. Gatwick’s current proposal is 93% for ST and 92% for NT, the former until 6 months after Pier 1 opens and the latter until 6 months after Pier 6 extension opens. We continue to progress discussions with the airlines and would hope to conclude by the end of November with a joint proposal to the CAA. In the absence of such a conclusion, we will provide the CAA with the figures Gatwick believes should be included in the Commitments, together with the rationale; </li> <li> <b>Definition of measurements:</b> The CAA suggests that some details of measurement are undefined. As set out in Appendix 1 of the Commitments, we have indicated that it is our intention that the measurement and exclusions process remains the same as in Q5 and the subsequent joint letter from Gatwick/ACC on 7 August 2013, unless Gatwick and the ACC subsequently agree to change. Accordingly, in drafting the Conditions of Use, we are incorporating the details either directly or by reference based on the agreements already agreed with the AOC for Q5 and this will form part of the Conditions of Use consultation; </li> <li> <b>Security queue measurement:</b> The CAA is incorrect when referring to security queue measurements not applying when airlines do not comply with stand planning rules. It is pier service levels that need to be decided with consideration for stand planning adherence; and </li> <li> <b>Changes to service levels:</b> The CAA has interpreted the statement in the Commitments regarding changes to core and airline standards to imply that only Gatwick can make changes. This is not correct as it is a joint process, requiring both Gatwick and the airlines to agree to changes. </li> </ul>	Gatwick Rebate	Proposed (£000s)	0 to 3	0	4 to 8	7	9 to 16	20	17 or more per day	30
Gatwick Rebate	Proposed (£000s)										
0 to 3	0										
4 to 8	7										
9 to 16	20										
17 or more per day	30										

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Issue	Comment
<b>Publication of SQR performance</b>	Gatwick has updated the Commitments to set out the approach to publication of SQR performance.
<b>Shadow RAB</b>	<p>The CAA commented (paragraph 11.64) that to “<i>address the concerns over a RAB value the CAA intends to require Gatwick to continue to undertake a shadow RAB calculation. This calculation will be useful in case tighter price control regulation needs to be reintroduced.</i>” The requirement to prepare a shadow RAB calculation forms part of the CAA’s monitoring framework and is not a licence condition. The CAA does not explain why the continued calculation is important should any subsequent re-regulation be required.</p> <p>Gatwick has agreed to publish the value of its asset value and the underlying assumptions and calculations. The future shadow RAB and such alternative asset values may differ, but the reasons for this can be readily understood. The disclosure of assumptions and calculations by Gatwick (asset additions and disposals, indexation factors, depreciation, etc.) together with the CAA’s assumptions as to the end-Q5 RAB and regulatory depreciation over the subsequent 5 to 7 years (as set out in the final proposals) enable any interested party to perform a roll forward of a shadow RAB.</p> <p>Although Gatwick does not believe it is necessary for it to prepare a shadow RAB, Gatwick will maintain such a calculation for the benefit of the CAA as part of its ongoing monitoring regime, up to the review scheduled for late 2016.</p>
<b>Passenger Advisory Group (“PAG”)</b>	The CAA commented (FP 11.67) that it would “ <i>expect Gatwick to honour its commitment to formally consult the PAG on airport development projects.</i> ” Gatwick has every intention of doing so and, accordingly, we have amended the Investment & consultation commitments.
<b>Pass through of security costs</b>	The Commitments include provision for an adjustment (in limited, prescribed circumstances) to the price path if there are substantial increases in operating costs as a result of new security requirements imposed upon Gatwick. This provision is consistent with the concept introduced in Q5, recognising that in recent years tougher security standards, introduced for the benefit of users, have increased the cost to end users of aviation services. Gatwick believes that this risk is asymmetric and not captured in the underlying price path. Nevertheless, Gatwick is comfortable with adjusting the security cost formula to provide for symmetrical treatment of such substantial changes in cost, positive or negative. We have amended the Commitments accordingly.
<b>Underlying net yield in the Commitments</b>	<p>Gatwick has included in the update to the Commitments its estimate of the Underlying net yield (Ut).</p> <p>The commitments price path conditions relate to the aggregation of Core Service Charges and Selected Ancillary Services Charges (which includes, amongst other items, Staff ID charges and FEGP charges). As such, the Underlying net yield (Ut) is the combination of the yield from Core Service Charges (£8.800 as per the CAA final proposals price calculation) and the yield from Selected Ancillary Service Charges (estimated as £0.094, based on relevant costs revenue of £3.2m per GAL’s Other Charges projections submitted in August 2013 and adjusted for the revisions made by the CAA in its final proposals). These estimates will need to be confirmed.</p>



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Issue	Comment
Capital	<p>We note that the CAA has expressed a concern (paragraph 11.63) that <i>“the capital plan includes no commitments to deliver specific outputs beyond those encompassed in the SQR, subject to a minimum spend of £100m per year, which would provide Gatwick with considerable flexibility not to deliver outputs that may be in passengers’ interests.”</i></p> <p>Gatwick does not think the CAA has given sufficient weight to the comments in this regard set out in Gatwick’s June response to the CAA’s initial proposals:</p> <p><i>Gatwick is highly incentivised to deliver the capital investment programme that it has set out in its business plan, since this has been developed in the context of an over-arching need for Gatwick to compete for passengers and airlines. Examining the programme at a more granular level, it is further evident that it comprises a range of projects and programmes that are:</i></p> <ul style="list-style-type: none"> <li>• <i>closely aligned to the delivering the service levels as agreed under the service quality regime e.g. security queuing, pier service, airfield availability and asset availability; and/or</i></li> <li>• <i>undertaken only in partnership with airlines to deliver benefits to passengers and airlines alike, even though not directly part of the airport’s service quality regime service e.g. check-in transformation, which can only be progressed with airline buy-in; and/or</i></li> <li>• <i>Commercial revenue generating projects that deliver sound returns without the need for incremental airport charges; and/or</i></li> <li>• <i>Necessary to ensure that Gatwick continues to operate facilities that are compliant with all relevant environmental, health and safety standards.</i></li> </ul> <p><i>As such, there are clear incentives for Gatwick to execute its capital investment programme. Nevertheless, Gatwick believes it can offer further assurances through the Commitments framework as to the execution of the capital programme and the provision of information to enable the CAA, airlines and passenger groups to track the progress of the capital programme, as set out in the business plan. These assurances are reflected in the revised Commitments, but summarised below:</i></p> <ul style="list-style-type: none"> <li>• <i>Gatwick commits to maintaining the airport to comply with all applicable safety and environmental requirements. This undertaking was included in Gatwick’s January Business Plan. However, the CAA appears to have given this little weight. We believe that this is important, in an industry in which safety and security is paramount and where growth can only be realised by focusing on safety and environmental concerns;</i></li> <li>• <i>Gatwick commits to maintain and develop the infrastructure of the airport to enable the airport-wide service standards to be achieved; and</i></li> <li>• <i>Gatwick will publish annually a 5 year rolling forecast for the capital investment programme and provide an explanation as to any material differences between the latest forecast and (i) the prior year forecast; and (ii) the forecast arising from the current CAA review. We believe that the publication of data relative to the current capital investment programme will assist the CAA and airlines in determining whether there has been a material or unjustified departure from the programme as currently envisaged.</i></li> </ul> <p>Nevertheless, if the CAA confirms the need for a licence at Gatwick, we are comfortable that the CAA has proposed to address this concern through the monitoring framework.</p>

### 1.5 Further clarification required

We have a number of concerns about two policy proposals from the CAA in connection with the Commitments framework: i) the CAA’s policy towards the second runway, as mentioned above; and ii) the proposed monitoring framework, as discussed below.

#### *Monitoring framework*

If a licence at Gatwick is implemented, which as stated above we consider unnecessary, we are comfortable that the CAA is proposing to monitor the performance of the Commitments and that this will include in the second half of 2016 *“a short and focused assessment of the performance of the commitments”*. However, it is important to avoid undermining the credibility of the Commitments framework. The scope of this review should therefore be, as the CAA sets out in in the final proposals (paragraph 11.65), focused on the short list of issues raised by the CAA as warranting the monitoring



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framework in the first instance. As reiterated below, these issues were (paragraph 11.63):

- *“The pass through of the planning and development costs of the second runway which would only have regard to rather than follow CAA policy. Given the scale of costs in this area this could have significant implications for airport charges and passenger interests;*
- *“The SQR where there are weaker controls if there are repeated service quality failures;*
- *“The capital plan includes no commitments to deliver specific outputs beyond those encompassed in the SQR, subject to a minimum spend of £100m per year, which would provide Gatwick with considerable flexibility not to deliver outputs that may be in passengers’ interests;*
- *“The ability of Gatwick to introduce new premium service charges which could operate against the passenger interest;*
- *“The pass through of increased security costs to meet new security requirements but not cost savings from relaxations in security requirements;*
- *“The commitments do not include a requirement to publish the value of the regulatory asset base; and*
- *“The operational resilience commitment only ‘has regard to’ guidance issued by the CAA and the requirement for airlines to comply with Gatwick’s rules of conduct could be used by Gatwick to exert its substantial market power.”*

A number of these issues have already been addressed through amendments to the Commitments – e.g. in relation to second runway costs, premium services, pass through of security costs, such that Gatwick believes the scope of the review should in practical terms be narrowed to assessing whether Gatwick has complied with the Commitments which the CAA, by their acceptance, presumably considers will further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services.

It may also be appropriate at this stage for the CAA to go on to consider removing the licence.

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### Chapter 2: “Fair price”

#### 2.1 Introduction

The CAA’s final proposals compare Gatwick’s Commitments framework with its calculation of a RAB-based price, which it calls a “fair price”. We welcome the CAA’s adoption of the Commitments framework. However, there are elements of the CAA’s calculation of the “fair price” to which Gatwick strongly objects.

This chapter provides a summary of Gatwick’s objections. Fundamentally, we believe that the CAA’s “fair price” comparison undervalues Gatwick’s Commitments framework, as explained below. The following appendices provide our detailed position concerning the building block parts of the calculation.

We consider that the CAA should properly take account of these points, and correct any errors, in its final assessment of the Commitments framework following the current consultation. These points would also clearly take on even greater importance should an independent review body either choose to resurrect the RAB-based approach for the period beyond Q5, or need to re-evaluate the calculation against which the Commitments framework had been assessed.

#### 2.2 Commitments framework creates more value than RAB-based approach

As described in Chapter 2 of our response to the initial proposals, Gatwick has promoted its concept of a Commitments framework as a superior output driven future for the airport, its passengers and airlines, compared with a traditional input driven RAB-based regulatory approach. While we note the CAA’s reasoning for comparing the RAB-based price with the Commitments price, the approach taken by the CAA fundamentally underestimates the benefits of the Commitments framework.

The Commitments provide the opportunity for win-win contractual opportunities to benefit both passengers and airlines at the airport, whereas the RAB-based price requires all parties to accept a one-size-fits-all product. The RAB-based approach disincentivised the tailoring of service and contractual arrangements because any value generated for the airline or airport was lost at the end of the relatively short control period. Under the Commitments framework, both the airport and individual airlines will be able to negotiate various tailored contracts, based on value generating opportunities, rather than based solely on costs. Such contracts could feature such requirements as discounted prices, volume incentives, specific service offerings, against a background in which non-contracting airlines’ interests are protected by the Commitments. Such benefits are secured without the need to incur the high cost of regulation, by the airport, airlines and the CAA.

Such value generating benefits of Commitments should be included in the CAA’s comparison of the RAB-based price and the Commitments framework. While the blended price commitment of only RPI+0.5% represents the overall cost to airlines, the value generation potential within the framework effectively releases benefits to airlines beyond the blended price. We believe this point is important in the context of both confirming the pricing approach for beyond Q5, as well as tests B and C of the CAA’s market power decision, which is due in January 2014.

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### 2.3 “Fair price” based on inadequate evidence

We believe that the basis for the CAA’s calculation of the “fair price” is based on inadequate evidence. Our objections can be categorised as follows:

- The poor quality of consultant reports used to support the CAA’s conclusions; and
- The CAA has applied insufficiently rigorous review and judgement in using its consultant reports.

#### *The poor quality of consultant reports used to support the CAA’s conclusions*

Many of the CAA’s decisions for the building blocks within the “fair price” have been based upon conclusions derived from consultant reports. We have submitted multiple comments to the CAA concerning its consultant reports and have been genuinely shocked by the poor quality of these reports. Specifically, we have been concerned that:

- Consultant reports have been based on inadequate evidence;
- Consultant reports appear to lack balance; and
- Consultant reports have not sufficiently addressed the feedback provided by Gatwick.

#### Consultant reports have been based on inadequate evidence

We have pointed out to the CAA and to its consultants in numerous responses the poor level of evidence that has been compiled and at times, in some of the reports on which the CAA has relied in calculating the “fair price”, the reliance on assertion rather than fact and analysis. Some of the worst examples of this include:

- **Poor level of evidence:** For example, Helios’ back office benchmarking did not feature any benchmarks that were tailored to a company of Gatwick’s size, location and industry, despite such benchmarking products being available. For example, LECG conducted an identical study for the CAA’s previous price control review of NERL and featured benchmarks that were tailored to NERL’s size, location and industry. Instead, Helios based its conclusions on such benchmarks as the off-the-shelf Gartner benchmark, with weaknesses of:
  - Composition: Only 3% of comparator companies work in “transportation” and could be directly comparable. We simply do not see how Gatwick is comparable with “banking and financial services (11% of the benchmark)”, “education (7%)” or in fact “software publishing and internet service (4%)”, with their obvious heavy use of IT;
  - Location: Less than one third of comparator companies come from “Europe, Middle East and Africa”, which means that an even smaller proportion of these comparators is British, let alone from the South East; and
  - Company size: The average company size in the comparator group has 13,074 FTEs, whereas Gatwick in 2011/12 had 2,049 FTEs, with the loss of comparable scale benefits that this smaller size brings. Even the transportation comparator companies are significantly larger than Gatwick, with 18,759 FTEs on average.

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Clearly, the non-tailored benchmark used by Helios is in no way comparable with Gatwick Airport. This was not an isolated example.

- **Assertion:** For example, SDG's review of Gatwick's commercial revenue projection was particularly prone to assertion, instead of evidenced conclusions. SDG took the view that the airport can achieve higher margins from our retail concessionaires than those included in the Revised Business Plan, but this assertion by SDG is completely unfounded. Margin enhancement of +1.8% has already been included in the Revised Business Plan for BQ5 in the 22 new stores that will open during 2013 as part of the South Terminal Development. SDG has not provided any evidence that such further enhancements are achievable.

Further detail has been provided to the CAA in response to its consultant reports.

We do not believe that the mere existence of a third party consultant report is sufficient to justify the conclusions that the CAA has made, based on such reports. We have pointed out consistently that consultant statements that are not based on reasoned evidence cannot be relied upon to make regulatory decisions, by the CAA or other relevant bodies.

### Consultant reports appear to lack balance

We have pointed out to the CAA that, in the most recent iteration of its consultant reports, no area of the airport has been found to be efficient – with efficiencies (or 'stretch') required in each area. We find this to be an untenable and incredible result, which suggests to us that the reports have lacked balance.

In response, the CAA has pointed out that the consultants have found some areas that "*were currently comparable to external benchmarks*". However, "*many of the efficiency proposals are therefore based on applying less cautious assumptions*". We find this statement concerning. This implies that where Gatwick's performance was worse than the benchmark, efficiencies should be found; but that where performance was better than the benchmark, efficiencies should still be found. We find this to be a concerning, no-win scenario, which clearly lacks balance.

Such a lack of balance in a number of the consultants' reports suggests that either the written and verbal remits given to the consultants were unbalanced, or else, the consultants have collectively failed to understand the need for balanced independent assessments.

### Consultant reports have not sufficiently addressed the feedback provided by Gatwick

While we are pleased that the CAA has requested comments from Gatwick on each of the consultant reports, we have been surprised by the apparent lack of notice consultants have taken of Gatwick's feedback. Since we expect the CAA and its consultants to base their conclusions on analysis and evidence, we did not expect the consultants to accept Gatwick's feedback without scrutiny. However, the almost universal lack of uptake of Gatwick's feedback and the apparent concentration of consultants on dismissing, rather than considering the feedback, suggests that this has not been a balanced and considered process, in which the CAA and its consultants have aimed to identify the evidenced right answer.

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For example, we have pointed out that neither the CAA nor the CAA's consultants, IDS, have transparently reviewed our feedback on its report, which we provided in response to the initial proposals. The CAA has stated to us that it has "*discussed [Gatwick's] new comments with IDS and do not consider that they affect the conclusions of the study<sup>1</sup>*". We do not consider this comment to be satisfactory given the importance of the points we made to the conclusions drawn from the report.

One example of the points that we do not believe to have been considered and discussed with stakeholders is an inconsistency between IDS' approach to the CAA's NERL review and its report on Gatwick. In the latter case, the consultants do not make any allowance for statistical noise within the IDS benchmarking. This is entirely inconsistent with IDS' report for the CAA as part of the NERL price control review.

We have shared this concern with the CAA previously, to which the CAA responded with an assertion that "*the consultants have not agreed with [Gatwick's] points and their rationale for doing so is provided in each final report<sup>1</sup>*". This is an inadequate response to an issue of regulatory and professional consistency, which also has a major impact on the CAA's efficiency figures.

*The CAA has applied insufficiently rigorous review and judgement in using its consultant reports*  
We believe that the CAA has relied excessively upon its consultants, rather than displaying appropriate judgement about their individual conclusions. While the CAA has not chosen to apply all of the efficiencies derived by the consultants, its overall judgement was within a range informed by those consultant reports. To the extent that the reports were flawed, in particular in their assessment of efficiency potential, that will have fed through to the parameters with which the CAA reached its view.

Further, the CAA has overlaid consultant top down and bottom up benchmarking reports. As we describe in Appendix 6, we told the CAA about our serious reservations concerning the way that these techniques had been overlaid, potentially leading to double counting, when we responded to the initial proposals. We do not see evidence that the CAA has investigated this possibility, which challenges the overall conclusions derived for opex.

In addition, we have been concerned that the CAA has not sought to engage directly with stakeholders' feedback on the reports. Rather, the CAA has allowed the consultants to 'mark their own homework', and then to respond somewhat inevitably in defence of their work. We would have expected the CAA to take a view on individual consultant reports and the stakeholder feedback on them.

We look to the CAA to reflect our comments on its "fair price" calculation in its assessment of the value to users of the Commitments framework proposed by Gatwick. We also expect the CAA to recognise that significant concerns remain about the pricing level calculated by the CAA and how it had reached those conclusions, regardless of the fact that the RAB-based price is not proposed to be used to set a price control.

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<sup>1</sup> CAA letter to Gatwick dated 12 September 2013.

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### Chapter 3: Comments on the CAA's final proposals for continued regulation

#### 3.1 Introduction

This chapter provides Gatwick's response to some of the implications of the CAA's final proposals for its market power decision, imposition of a licence and alternative forms of regulation.

#### 3.2 Alternative forms of regulation and implications of the final proposals for the CAA's market power decision

Gatwick maintains its position that it does not meet the market power test under section 6 of the Civil Aviation Act 2012 and that accordingly it does not require a licence under the Act. It is without prejudice to this position that Gatwick comments on the CAA's analysis of different potential forms of regulation.

Without prejudice to the above, on the basis of the CAA's proposals that Gatwick should be issued with a licence, we are broadly supportive of the CAA's proposals to include our Commitments in a licence. On further review of the Commitments framework, we consider that there are a number of further enhancements that we can make. We have detailed these in Chapter 1 above.

Below we set out our comments on the CAA's assessment of possible forms of regulation. Some of these are also pertinent to the CAA's market power analysis. We expect the CAA to take these points fully into account in its market power determination, due in January 2014.

##### *The CAA's evaluation criteria*

We continue to have concerns about the CAA's evaluation criteria and consider that the CAA has not addressed the points set out in our response to the initial proposals. Without repeating those in this response, there are a number of points worth noting from the material presented in the final proposals consultation:

- The focus on price protection should focus on benefits to passengers. We consider that the CAA's concept of a "fair price" is not focused on benefit to passengers and that other levels of price could serve the passenger interest to an equal or greater extent. Thus we consider the CAA's "fair price" is an inappropriate benchmark against which to assess different forms of regulation; and
- In particular, we are concerned by the implication that any price above the CAA's "fair price" can be considered excessive and that a reduction in airline profitability at Gatwick would lead to a reduction in travel opportunities for passengers, higher ticket prices or reduced quality of service. No real evidence is presented to support such a conclusion and, to the extent that this conclusion rests upon the SLG report on distribution of rents, we have a number of serious reservations about the economic analysis it contains – some of which displays insufficient acquaintance with the aviation sector. We attach a separate report on this in Appendix 10.

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### *The CAA's assessment of forms of regulation*

#### Commitments proposal

Gatwick welcomes the CAA's view that our Commitments are a positive step forward and that our Commitments could, in principle, be relied upon as evidence to support a conclusion that it is not appropriate to license Gatwick. We also welcome the CAA acknowledging that our Commitments have a number of significant benefits and that they can be enforced by airlines.

However, the CAA's assessment appears to require our Commitments to better protect passengers' interests than licence regulation. This is too high a hurdle: in order to be consistent with test C of the market power test, the CAA needs to consider whether our Commitments provide sufficient protection for passengers' interests. We also consider that the CAA does not have grounds to be concerned over enforceability by end users, which we consider to be a theoretical rather than a practical concern, as discussed in section 3.3 below.

We welcome the CAA's acceptance of our Commitments price. However, the CAA has identified a number of terms in our Commitments about which it still has concerns. We consider that our further enhancements, as set out in Chapter 1, address the remaining central concerns. Overall, we consider that neither test B nor test C of the market power test are met, given the existence of our Commitments framework.

We note the CAA's preliminary views in CAP 1104 on tests B and C at Stansted following the announcement of the long term contracts with Ryanair and easyJet. The CAA's view that bilateral agreements reduce substantially the risk of price based abuse must be equally applicable to the Commitments, if not more so, as they apply to all airlines operating at Gatwick. This 100% airline coverage reduces the residual risk that the CAA identifies as existing at Stansted. In addition, with the inclusion of an SQR regime, the Commitments also reduces substantially the risk of decreased service. In addition, unlike the bilateral contracts at Stansted, the terms of the Commitments are publicly available.

In relation to test C at Stansted, the CAA states that the existence of long-term bilateral agreements that cover over 90% of the existing passenger traffic, and prices that are within the range of what the CAA considers to be a competitive level, are likely to lead to test C being failed. With the Commitments covering 100% of the traffic at Gatwick and having prices within the range of the CAA's "fair price", following precedent, Gatwick's test C must also be failed. We will be providing more a detailed submission in response to the CAA's CAP1104 consultation.

#### Commitments backed by a licence

We have provided in Chapter 1 above our response to the CAA's proposal.



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### RAB-based approach

We are concerned that the CAA continues to draw comparisons with RAB-based controls used by other regulators. The CAA fails to acknowledge that these are in the context of the regulation of natural monopoly network businesses and where there is an absence of competition and significant volume fluctuation. Nevertheless, we welcome the CAA's acknowledgment that a RAB-based approach can have a number of drawbacks, and we continue to consider that this form of regulation is inappropriate for Gatwick and its passengers.

### Long-run incremental costs approach

Gatwick is concerned that the CAA and its advisers have not addressed sufficiently our previously raised concerns with the analysis of LRIC.

### Price caps based on pegging tariffs to competitor airports

Gatwick welcomes the CAA's view that it does not consider it appropriate to set price caps based on comparator benchmarks. However in coming to this view, the CAA has presented additional evidence and analysis, in part, to address our previous submissions on Leigh Fisher's report to the CAA. This includes the use by the CAA of the Leigh Fisher analysis to support its view that current regulated prices are not significantly below the level of prices that could be expected in a competitive market. We continue to have a number of substantial concerns with the Leigh Fisher analysis and how this has been used by the CAA. We provide a further submission on this issue in Appendix 9.

### Price monitoring

In the absence of our Commitments, Gatwick considers that price monitoring could be a suitable way to regulate if the CAA concludes that Gatwick needs to be issued with a licence. However, given our Commitments, price monitoring is unnecessary.

## **3.3 Licensing**

This section responds to the issues raised by the CAA in Chapters 11 and 12 of the final proposals and the draft Gatwick licence at Appendix B of the proposals.

Gatwick maintains its position that it does not meet the market power test under section 6 of the Civil Aviation Act 2012 and that accordingly it does not require a licence under the Act. Nevertheless, without prejudice to this position, Gatwick is responding to the licensing issues and draft licence conditions that have been provided by the CAA.

Gatwick welcomes the CAA's endorsement of the Commitments and its recognition that there are likely to be a number of potential benefits from Commitments plus bilateral contracts. However, Gatwick does not accept that the CAA cannot fulfil its statutory duties by relying on Commitments without a licence. Without prejudice to that contention, Gatwick provides below a number of comments on the licence condition proposals.



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### *Requirement for a licence*

In paragraph 21 of chapter 1 of the final proposals, the CAA gives three reasons why it believes it cannot be confident about fulfilling its statutory duties by relying on Commitments without a licence. First, it refers to the relatively weaker regime of enforcement by airlines (rather than CAA), which is likely to operate in interests of airlines rather than end users. Second, it refers to the lack of a licence limiting the CAA's ability to respond to future events, for example non-compliance with CAA policy on future second runway costs. Lastly, it suggests that Gatwick's commitments do not provide transparency around a shadow RAB or effective protection against financial resilience.

Dealing with each of these points in turn, Gatwick has already provided its reasoning as to why the lack of enforcement by end users is a theoretical rather than a practical concern. In Gatwick's response of 7<sup>th</sup> August 2013 to the CAA's "*Proposed licence conditions under section 18 of the Civil Aviation Act 2012 in relation to price commitments*" Gatwick also pointed out that passengers' and airlines' interests will often align and that Gatwick will be competing for passengers and thus incentivised to ensure that the service provided by Gatwick to passengers best suits the interests of those passengers. Gatwick also made suggestions to enhance the role of the Passenger Advisory Group. These suggestions have now been incorporated into the latest revision of the Commitments.

Second, introduction of a licence to protect against the possibility of non-compliance with a policy, not yet finalised, is neither reasonable nor proportionate. Should the CAA consider that future behaviours are inconsistent with its market power assessment, the CAA can make a fresh market power determination whenever it considers it appropriate to do so. In relation to the example the CAA has given of second runway costs, Gatwick has strengthened its commitment in the latest revision of the Commitments.

Finally, Gatwick has made some revisions to the Commitments in response to the CAA's concerns in relation to the absence of a shadow RAB. However, it is unclear to us how these CAA concerns relate to the risks of abuse of SMP identified by the CAA, namely excessive pricing or failure in service standards and therefore, how far they are relevant to the market power tests that the CAA has to undertake.

Gatwick responds below to the key matters set out in Chapter 11 of the final proposals under the headings used by the CAA.

### *Conditions making the commitments part of the licence and requiring Gatwick to comply with the commitments in passengers interests*

Gatwick has set out above and elsewhere why it does not believe the Commitments need to be supported by a licence. Without prejudice to that contention, and if the Commitments are to be backed by a licence, Gatwick remains strongly of the view that clear contractual obligations should not be clouded by a requirement to carry out those obligations in a manner designed to further the interests of end users. The Commitments have been designed to further the interests of end users and the appropriate time for the CAA to consider whether or not they do so is at the point of adoption. In addition, this transportation of the obligation places Gatwick in double jeopardy by enabling the CAA simply to claim that its interpretation should override any actions Gatwick takes in pursuit of the Commitments.

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The Commitments framework is also designed to replicate what might be agreed in a bilateral contract in a commercial non-regulated context. Such commercially negotiated contracts seek to achieve certainty and would not condition clear contractual obligations in the manner suggested by the CAA. The insertion of “*so far as reasonably practicable*” does not meet the concern that Gatwick has previously raised as to the statutory objectives potentially being at odds with each other and also with the main terms of the Commitments (better service may come at a cost etc.).

The CAA states that it would not consider obligations on third parties or Gatwick's pricing principles to form part of the Commitments. Gatwick never intended the pricing principles, which were intended to provide transparency as to future conduct, to form part of the Commitments and they will not be included in the Conditions of Use. While Gatwick understands that the CAA considers that it has no locus to set standards on airlines, this does not prevent the licence mandating Commitments which include service standard rebates which net off airline service standard rebates.

### *A condition preventing Gatwick from withdrawing or amending the commitments*

We note the CAA's proposal to include a condition requiring Gatwick to include the Commitments in the Conditions of Use and also the incorporation of a condition as to modification. Gatwick proposes that, in addition to the modification provisions covering price and service, there is also a modification provision relating to the measurement of Core Service Standards as in practice these continue to evolve. It is proposed that any such amendments are required to be signed off by the AOC and the ACC.

### *A condition allowing the CAA to be an appeal body where Gatwick and the airlines cannot reach agreement*

Gatwick welcomes the CAA's decision not to include a right for the CAA to direct changes to the Commitments in the event of a dispute and its recognition of the intended purpose of the adjudication provisions. To do otherwise would have detracted from the contractual certainty of bilateral agreements which the Commitments seek to replicate.

### *A condition imposing a temporary price freeze*

Gatwick welcomes the CAA's proposal not to proceed with a price freeze condition since it could reduce certainty under the Commitments and we also agree that it is unnecessary in view of other powers available to the CAA under the Act.

### *A condition relating to other regulated charges*

Gatwick welcomes the CAA's acceptance of its proposed commitment on former specified activities. As subsequently requested by the CAA, Gatwick will amend the Conditions of Use to make it clear that these commitments may be enforced by all users who pay such charges.

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### *Financial resilience conditions*

Gatwick welcomes the CAA's reliance on Gatwick's contractual ringfence in its debt covenants. However, we do not understand why the CAA seeks to replicate the business restriction covenant in the licence. It should be equally prepared to rely on the debt covenant restriction on business as it is to rely on the other debt covenants. We also believe that the financial resilience conditions can all be included in the Conditions of Use, rather than in a licence. We note the CAA's comments on the certificate of adequacy of resources, but would suggest that a period of 18 months would be adequate and closer to Listing Rule requirements of at least 12 months. We remain of the view that an ultimate holding company undertaking is not a meaningful or proportionate method of addressing the risk of excessive pricing or failure in service standards, which are more than adequately mitigated by the price and service Commitments.

### *Continuity of service plan*

Gatwick welcomes the CAA's acceptance of the CSP commitment and decision not to include CSP as a licence condition.

### *Monitoring framework*

Gatwick responds in Chapter 1 to the CAA's residual concerns on the Commitments and at paragraph 1.5 addresses the CAA's proposal for a monitoring framework.

### *Scope and interpretation*

We note that the CAA will review Gatwick's contentions on areas where it is not the operator following its final MPD.

### *Licence revocation*

Gatwick welcomes the CAA's acceptance of its representations on licence revocation.

### *Other licencing conditions*

Gatwick welcomes the CAA's decision not to impose specific conditions on service quality, operational resilience, non-discrimination, price control reopener, safety and security, complaints handling or consultation.

### *Draft Licence*

Gatwick has provided a mark-up of the draft licence at Appendix 8, with comments.

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## **Appendix 1: Revised Commitments heads of terms**

*Attached overleaf*

**Subject to Contract**  
**Finalised Draft ~~September~~ 4 November 2013**

**Heads of terms of Airport Commitments in relation to Airport Services & Charges beyond Q5**

Section A	General Conditions
Parties	Gatwick Airport Limited (GAL) and all airlines operating at Gatwick Airport.
Regulatory background	<p>The CAA published (April 2013) its initial assessment of the three elements of the “Market Power Test” in accordance with the Civil Aviation Act 2012 (the Act). The CAA has concluded that the Market Power Test is met in relation to GAL as operator of Gatwick Airport, and that it is minded to issue Gatwick with a Licence.</p> <p>GAL disputes the CAA’s assessment and believes it does not meet the Market Power Test and, accordingly, should not be issued with a Licence. GAL remains subject to the provisions of Airport Charges Regulations 2011 (the ACR) and, where applicable, general competition law. The CAA will have concurrent powers under competition law through the framework of the Act. Nevertheless, GAL has decided that it would be commercially expedient for it to put in place the Airport Commitments for the benefit of all airlines operating at Gatwick Airport. The Commitments address the key interests of airport users including the range, availability, continuity, cost and quality of airport operation services.</p> <p>These Airport Commitments will create binding contractual arrangements between GAL and airlines operating at Gatwick. They have been drafted on the basis that GAL is not issued with a Licence. However, without prejudice to our contention that GAL does not require a licence under the Act, the Commitments would be effective if backed by a licence framework as discussed in paragraphs 12.37-12.41 of the Initial Proposals.</p>
Conditions of Use	<p>GAL undertakes to incorporate the Airport Commitments into GAL’s Conditions of Use, for the benefit of all airlines who may operate at Gatwick Airport during the period covered by the Airport Commitments.</p> <p>Set out below is indicative drafting to be incorporated into the Conditions of Use:</p> <ul style="list-style-type: none"> <li>• <u>“Applicability and Enforceability</u>  <i>The publication of these Conditions of Use constitutes an offer by Gatwick Airport Limited to permit the use of its facilities on the terms set out herein. The use of any facilities at the airport whether airside or landside other than as a passenger constitutes acceptance of these Conditions of Use. It is intended that these Conditions of Use constitute a contract as between Gatwick Airport Limited and each and every Operator using the facilities at the airport.</i></li> <li>• <u>Variation</u>  <i>Gatwick Airport Limited may at its sole discretion vary amend or add to these Conditions of Use and any such variation, amendment, or addition may be promulgated by means of a Gatwick Airport Directive (GAD) save</i></li> </ul>

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	<p><i>that no variation may be made to clauses ● and ● [i.e. those dealing with the substantive provisions of the commitments including: initial term; contractual remedies and independent adjudication; price commitment; service commitment; investment &amp; consultation commitment; information commitment; and operational &amp; financial resilience commitments], other than in accordance with the variation provisions contained in clauses ● and ● respectively.”</i></p>
<b>Initial term of Airport Commitments</b>	7 years to 31 March 2021
<b>Extension of Airport Commitments</b>	<p>It is envisaged that, over time, the number of airlines operating under bilateral contracts rather than under the Conditions of Use will increase, such that the majority of passenger traffic is under contract.</p> <p>The scope of any future airport commitments will be a matter for commercial consideration by GAL and its airline customers prior to the end of the initial term of the Airport Commitments.</p> <p>GAL will notify the CAA and the airlines operating at Gatwick at least 2 years prior to the end of the initial term of the Airport Commitments of its intention with regards to the modification, extension, termination, or otherwise of the Airport Commitments.</p>
<b>Bilateral airline-airport contracts</b>	<p>Airlines operating at Gatwick Airport will operate under the terms of either:</p> <ul style="list-style-type: none"> <li>• the airport’s Conditions of Use which will incorporate a published airport tariff and set out airport wide service standards consistent with the Airport Commitments; or</li> <li>• bilateral contracts setting out the commercial arrangements between the airport and airline, including price and service standards. Such bilateral contracts may contain additional service penalty/bonus mechanisms and may include prices that are at a discount or premium to the published airport tariff. Alternatively, such contracts may place reliance on the Conditions of Use save for limited, specific alterations.</li> </ul> <p>The charges for services rendered under the Conditions of Use and bilateral contracts will need to be consistent with the requirements of the ACR and any relevant provisions of competition law, but no prior regulatory approval of the detail of these contracts will be required.</p>
<b>Pricing principles</b>	GAL will provide users, from time to time, with a summary of the pricing principles it has adopted in setting the airport tariff and entering into bilateral contracts. These pricing principles do not form part of the Commitments, but for information an extract has been set out at Attachment 1.
<b>Contractual remedies and independent adjudication</b>	<p>Normal contractual remedies will be available to airlines operating under the Conditions of Use, within which the Airport Commitments have been incorporated.</p> <p>The right of redress would be to the courts but with an adjudication provision (of the type imposed by section 108 of the Housing Grants Construction and Regeneration Act 1996) built in to encourage speedy resolution of disputes by providing for non-binding adjudication by independent experts drawn from an agreed panel.</p>

Airlines will continue to have separate rights of redress under the Airport Charges Regulations 2011 where the airport operator has failed to set airport charges in accordance with the Regulations. In addition the CAA will continue to have rights to investigate and make compliance orders in relation to the airport operator's failure to comply with the Regulations.

Set out below is indicative drafting to be incorporated into the Conditions of Use:

"Dispute Resolution Procedure

- *Either party shall refer any Dispute to an Expert for determination by serving notice in writing to that effect on the other party. The notice shall contain sufficient particulars of the Dispute to be referred to an Expert.*
- *The parties shall agree the identity of the Expert to be appointed. In default of agreement, within ten working days of the date of service of a notice referring a Dispute to an Expert for determination, the Expert shall be appointed on the application of any party to the President of the Law Society or the Chairman of the Bar Council.*
- *The Expert shall not act as an arbitrator and the provisions of the Arbitration Act 1996 shall not apply.*
- *The Expert shall determine the Dispute referred to him impartially and acting reasonably. The Expert will establish the procedural rules to be applied to the determination which must include the following steps:*
  - *each party will be entitled to make submissions to the Expert;*
  - *the Expert may request any party to provide him with any further information as he may require in order to determine the Dispute provided any such information is made available to the other party to comment;*
  - *all communications between a party and an Expert shall be copied to the other party;*
  - *any failure by a party to respond to any request or direction by the Expert shall not invalidate the Expert's determination.*
- *Unless a shorter period is agreed between the parties at the time of the Expert's appointment, a fully reasoned written determination must be delivered to the parties within 21 working days of the Expert's appointment.*
- *The fees and expenses of the Expert shall be borne by the parties in equal shares unless the Expert determines otherwise. Each party shall be solely responsible for bearing its legal and other costs arising out of any reference of a Dispute to an Expert.*
- *Any decision of the Expert shall be binding until the Dispute is finally determined by legal proceedings or by agreement.*
- *Neither party shall make any application to a competent court in relation to the conduct of the determination or the Expert's determination or the Dispute after ninety days from the date of the Expert's determination or, in the event the Expert has failed to reach a decision, the date on which the Expert should have reached a determination.*
- *The dispute resolution procedure set out in clauses [●] above is without prejudice to, and does not impact upon, Gatwick Airport Limited's right to*

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	<p><i>exercise its power to detain aircraft for the non-payment of Airport charges, pursuant to the Civil Aviation Act 1982. Gatwick Airport Limited may at all times exercise that power without recourse to this dispute resolution procedure.</i></p> <ul style="list-style-type: none"><li>• <i>The dispute resolution procedure set out in clauses • above shall not prevent either party from seeking urgent relief by applying to a competent court for injunctive relief.”</i></li></ul>
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Section B	Price commitment
<p><b>Published airport tariff</b></p>	<p>The published airport tariff will include the following elements:</p> <p>(1) <u>Core Service Charges</u> for commercial passenger flights receiving the Core Service Standard. This will include:</p> <ul style="list-style-type: none"> <li>• ATM fees (landing &amp; take-off)</li> <li>• passenger fees</li> <li>• aircraft parking fees</li> </ul> <p>The Core Airport Charges may include general discount and incentive structures available to all airlines operating under the Conditions of Use.</p> <p><del>(2) <u>Premium Service Charges</u> for commercial passenger flights receiving Premium Service Products.</del></p> <p><del>(3) <u>Selected Ancillary Service Charges</u> for other services provided by the airport including for:</del></p> <ul style="list-style-type: none"> <li>• certain currently Specified Activities, namely: <ul style="list-style-type: none"> <li>- Staff ID</li> <li>- airside licences</li> <li>- FEGP (net of cost of electricity)</li> <li>- Airside Parking</li> <li>- Hydrant Refuelling</li> </ul> </li> </ul> <p><del>(34) <u>Other Ancillary Services Charges</u> for other services provided by the airport including for:</del></p> <ul style="list-style-type: none"> <li>• PRM services</li> <li>• Property related charges (rental, utilities, etc)</li> <li>• Certain currently Specified Activities, namely: <ul style="list-style-type: none"> <li>- Check-in &amp; Baggage Charges</li> <li>- Staff car parks</li> <li>- Facilities for bus &amp; coach operators</li> <li>- Utilities (gas, water, electricity, heating)</li> <li>- Cable routing</li> </ul> </li> </ul> <p><del>(45) Other Airport Charges for cargo, general aviation and other non-passenger flights including related landing, take-off and parking fees and ancillary <u>service</u> charges.</del></p> <p><del>(5) <u>Charges which may be charged for enhancements or additions to the Core Services provided that Core Services will remain available at the Core Service Charges rate.</u></del></p> <p><del><u>Core Services means such services and facilities in connection with the landing, parking or taking off of aircraft at the airport as were provided as at 1st April 2013 in consideration of charges levied under Appendix I (Schedule of airport charges) of the Gatwick Airport Conditions of Use -effective from the 1st of April 2013-. Such charges will include charges for such services and facilities that are determined by reference to the number of passengers on board the aircraft, any separate charge for aerodrome navigation services and charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air.</u></del></p> <p>Public interest conditions in relation to currently Specified Activities to be</p>

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	removed. Check-in & Baggage Charges and other charges for groundhandling activities remain subject to the provisions of the Groundhandling Regulations.
<b>Scope of price commitment</b>	<u>Core Service Charges and Selected Ancillary Service Charges</u> in the published airport tariff will be set at a level such that the indicative price path condition is met (see below).
<b>Indicative price path condition</b>	<p>GAL intends for the Aggregate Core Revenue per Passenger (the “Core Yield”) and the Aggregate Blended Revenue per Passenger (the “Blended Yield”) to be set in line with, respectively, the Indicative Gross Yield profile and the Indicative Net Yield profile (set out below). The actual Core Yield and actual Blended Yield may deviate from its associated indicative yield in any given year. GAL undertakes that, taking the period of the airport commitments as a whole, there will be no aggregate “over-recovery” in airport charges relative to the indicative yield profiles.</p> <p>The Indicative Net Yield profile in a relevant year t (NY<sub>t</sub>) is defined as:</p> $NY_t = U_t - B_t + S_t$ <p>The Indicative Gross Yield profile in a relevant year t (GY<sub>t</sub>) is defined as:</p> $GY_t = W_t - B_t + S_t$ <p>These are indicative profiles since, in any given year, the actual Core Yield and Blended Yield may be less than, or greater than, its associated Indicative Yield. Such phasing differences may be due to unanticipated circumstances (e.g. changes in actual vs. expected mix of traffic) or deliberate business decisions (e.g. to alter charges below/above that implied in the Indicative Yield profiles taking into account factors such as: prior year under- or over-recoveries, economic conditions, competitive threats, growth opportunities, etc).</p> <p>The amount by which the actual Core Yield differs from the Indicative Gross Yield in a relevant year t will generate a revenue difference which, over time, will give rise at the end of a relevant year t to a Cumulative Gross Revenue Difference (CGRD<sub>t</sub>) defined as:</p> $CGRD_t = (T_t - Q_t \cdot GY_t) + CGRD_{t-1}(1 + I_{t-1})$ <p>and where,</p> $CGRD_{2013/14} = 0$ <p>Similarly, the amount by which the actual Blended Yield differs from the Indicative Net Yield in a relevant year t will generate a revenue difference which, over time, will give rise at the end of a relevant year t to a Cumulative Net Revenue Difference (CNRD<sub>t</sub>) defined as:</p> $CNRD_t = (R_t - Q_t \cdot NY_t) + CNRD_{t-1}(1 + I_{t-1})$ <p>and where,</p> $CNRD_{2013/14} = 0$

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	<p>GAL undertakes that:</p> <ul style="list-style-type: none"> <li>• the Cumulative Gross Revenue Difference shall not exceed: <ul style="list-style-type: none"> <li>- £nil at the end of the initial term of the Airport Commitment i.e. <math>CGRD_{2020/21} \leq 0</math> ; and</li> <li>- £10m in any year during the initial term of the Airport Commitments i.e. <math>CGRD_t \leq £10m</math>.</li> </ul> </li> <li>• in setting airport charges each year, GAL will do so with the objective that the change in estimated Core Yield between any year “t-1” and subsequent year “t” should not exceed RPI+10%, provided that this objective shall not limit GAL from attaining a <math>CGRD_{2020/21}</math> of £nil;</li> <li>• the Cumulative Net Revenue Difference shall not exceed: <ul style="list-style-type: none"> <li>- £nil at the end of the initial term of the Airport Commitment i.e. <math>CNRD_{2020/21} \leq 0</math></li> </ul> </li> </ul>
<p><b>Publication of Cumulative Revenue Differences</b></p>	<p>The Cumulative Revenue Differences (CRD, meaning both CGRD and CNRD) will be published by GAL as part of the annual airport charges consultation, together with the CRD’s for prior years which will have been updated with actual data when available.</p> <p>As the consultation in relation to year “t” is undertaken part way through year “t-1”, GAL will publish at this time:</p> <ul style="list-style-type: none"> <li>• the actual <math>CRD_{t-2}</math>;</li> <li>• a revised estimate of <math>CRD_{t-1}</math>; and</li> <li>• an estimate of <math>CRD_t</math>.</li> </ul> <p>Assumptions underlying the estimated figures (including actual charges, traffic and revenue data for historic years, as and when available) will be provided to enable airlines to verify the calculations.</p>
<p><b>Adjustments to indicative price path upon airline approval</b></p>	<p>Amendments to the indicative price path may be made by GAL, following consultation by GAL with the Gatwick Airline Consultative Committee (ACC):</p> <ul style="list-style-type: none"> <li>• if approved in writing by airlines paying charges under the published tariff that together account for at least 67% of the passengers (in the 12 months immediately preceding the month in which GAL requested written approval from the airlines of the proposed amendment) travelling through the airport on airlines paying charges under the published tariff <u>or under bilateral contracts (where such contracts adopt the airport tariff as a reference price index)</u>, and representing at least 51% of the airlines responding in writing.</li> </ul>
<p><b>Second runway costs and potential adjustments to the indicative price path</b></p>	<p>Amendments to the indicative price path may be made by GAL, following consultation by GAL with the Gatwick ACC and the CAA:</p> <ul style="list-style-type: none"> <li>• if following the completion of the Airports Commission the Government supports the development of a second runway at Gatwick Airport, to allow for the recovery of the reasonable costs (<u>including</u> capital, operating and financing <u>costs</u>) of: (i) applying for planning permission for a second runway; and (ii) the subsequent development of the second runway and associated airport infrastructure.</li> <li>• Any such amendment to the indicative price path will <del>have regard</del><u>follow to</u> any policy guidance issued by the CAA in relation to the financing of new runway developments in the London airport market. <u>Confirmation of this will be one element of the consultation with the CAA.</u></li> </ul>
<p><b>Annual consultation on charges</b></p>	<p>Consultation on charges in the published airport tariff of the Conditions of Use, together with associated service standards and investment, will be undertaken annually in accordance with the Airport Charges Regulations 2011. GAL will</p>

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	provide additional financial information to support this consultation as set out in “Information Commitment” below.
<b>Definitions for the Price Commitment</b>	Set out below.
Aggregate Core Revenue	<p>Aggregate Core Revenue is the sum of:</p> <p>(i) revenue arising from Core Service Charges and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of the published airport tariff set out in the Conditions of Use; and</p> <p>(ii) revenue arising from charges equivalent to the Core Service Charge and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of bilateral contracts, but substituting for the actual revenue received the revenue that would have been received if such services had been offered and charged under the published airport tariff.</p> <p>For the avoidance of doubt:</p> <ul style="list-style-type: none"> <li>• Aggregate Core Revenue does not include: revenue from <del>Premium Service Charges</del>, Other Ancillary Service Charges, Other Airport Charges and Ancillary Charges arising under the terms of the published airport tariff; nor revenue arising from equivalent charges under the terms of bilateral contracts; <u>nor revenue arising from charges for services that are enhancements or additions to the Core Services offered under bilateral contracts or which may become but not available under the published airport tariff</u>; and</li> <li>• Revenue from FEGP charges, included in Selected Ancillary Service Charges, is net of the cost of electricity.</li> </ul>
Aggregate Blended Revenue	<p>Aggregate Blended Revenue is the sum of:</p> <p>(i) revenue arising from Core Service Charges and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of the published airport tariff set out in the Conditions of Use; and</p> <p>(ii) revenue arising from charges equivalent to the Core Service Charge and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of bilateral contracts.</p> <p>For the avoidance of doubt:</p> <ul style="list-style-type: none"> <li>• Aggregate Blended Revenue does not include: revenue from <del>Premium Service Charges</del>, Other Ancillary Service Charges, Other Airport Charges and Ancillary Charges arising under the terms of the published airport tariff; nor revenue arising from equivalent charges under the terms of bilateral contracts; <u>nor revenue arising from charges for services that are enhancements or additions to the Core Services offered under bilateral contracts or which may but not become available under the published airport tariff</u>; and</li> <li>• Revenue from FEGP charges, included in Selected Ancillary Service Charges, is net of the cost of electricity.</li> </ul>
Passengers	For the purpose of the calculation of the Core Yield, “Passengers” includes all passengers, whether carried by an airline under the terms of the published airport tariff or a bilateral contract.

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$t$	The annotation “t” denotes the relevant year t, being a period of twelve months starting on 1 April and ending on 31 March in the following year, the annotation “t-1” denotes relevant year “t-1” immediately preceding relevant year “t”, and so forth. By way of example, the annotation “2014/15” denotes the year commencing 1 April 2014 and ending on 31 March 2015.
$U_t$	<p><math>U_t</math> is the underlying net yield in relevant year t, defined as:</p> $U_t = U_{t-1}(1 + RPI_{t-1} + X)$ <p>and,</p> $U_{2013/14} = [\text{£}8.894]$
$W_t$	<p><math>W_t</math> is the underlying gross yield in relevant year t, defined as:</p> $W_t = W_{t-1}(1 + RPI_{t-1} + X + 1\%)$ <p>and,</p> $W_{2013/14} = U_{2013/14}$
$RPI_{t-1}$	$RPI_{t-1}$ means the percentage change in the Retail Price Index between that published with respect to August in relevant year t-1 and that published with respect to August in relevant year t-2.
$X$	$X$ is 0.5%
<del><math>B_t</math></del>	<p><del><math>B_t</math> is the bonus per passenger earned in relevant of year t, if any, being:</del></p> <ul style="list-style-type: none"> <li><del>• the amount of the Core Service Bonus calculated as set out under “Service Commitment” below; divided by</del></li> <li><del>• the number of passengers using the airport in year t (<math>Q_t</math>)</del></li> </ul> <p><del>Any estimate of <math>B_t</math> prepared prior to the start of year t will be assumed to be £nil.</del></p>
$S_t$	<p><math>S_t</math> is the permitted security cost per passenger in relevant year t, if any, being:</p> <ul style="list-style-type: none"> <li>• the aggregate of: <ul style="list-style-type: none"> <li>- 90% of the amount by which the increase, <u>or decrease</u>, in security costs at the airport in year t, which arise as a result of a change in required security standards at the airport, exceeds £1.75m; and</li> <li>- the cost of installing new hold baggage screening equipment in accordance with the requirements of Gatwick’s security regulator and as agreed through the capital investment programme consultation process. The recovery of the capital costs and associated funding costs will be presumed to be made over the assessed life of the equipment, in equal annual amounts.</li> </ul> </li> <li>• divided by: <ul style="list-style-type: none"> <li>- the number of passengers using the airport in year t (<math>Q_t</math>).</li> </ul> </li> </ul>
$T_t$	$T_t$ is the Aggregate Core Revenue in relevant year t.
$R_t$	$R_t$ is the Aggregate Blended Revenue in relevant year t.
$Q_t$	$Q_t$ is the total number of passengers using Gatwick airport in relevant year t. This includes all passengers, whether carried by an airline under the terms of the

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	published airport tariff or a bilateral contract.
$I_{t-1}$	$I_{t-1}$ is the annual percentage interest rate equal to the sum of (i) the average of the UK 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 September in relevant year t-1 to the end of August in relevant year t; and (ii) if the relevant CGRD <sub>t-1</sub> or CNRD <sub>t-1</sub> to which the interest rate is being applied has a positive value, 3%, otherwise, 0%.
<b>Specified Activities Charges</b>	<p>Gatwick Airport Limited shall ensure that those charges relating to Specified Activities are set at a level which is fair, reasonable and non-discriminatory.</p> <p>Specified Activities for these purposes will comprise:</p> <ul style="list-style-type: none"> <li>• Staff ID</li> <li>• airside licences</li> <li>• FEGP</li> <li>• Airside parking</li> <li>• Hydrant refuelling</li> <li>• Staff car parks</li> <li>• Facilities for bus &amp; coach operators</li> <li>• Utilities (gas, water, electricity, heating)</li> <li>• Cable routing</li> </ul> <p>At least 3 months prior to making any amendments to those charges relating to Specified Activities, GAL will provide to users of the Specified Activities and the CAA:</p> <ul style="list-style-type: none"> <li>• relevant information (including cost information, where relevant, or other information if charges for the specified facilities are not established in relation to cost) and assumptions adequate to verify the basis upon which the charges have been calculated.</li> </ul> <p>GAL will provide additional financial information to support this consultation as set out in “Information Commitment” below.</p>
<b>PRM and Check-in &amp; Baggage Charges</b>	<p>GAL will comply with the relevant legislation in relation to the setting of check-in &amp; baggage charges and PRM charges.</p> <p>GAL will provide additional financial information to support this consultation as set out in “Information Commitment” below.</p>

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Section C	Service commitment
<b>Airport-wide standards to be monitored <u>and</u> subject to rebates</b>	<p>The Core Service Standards are as set out in Table A (appended).</p> <p>These are broadly based on the existing Q5 SQR scheme with some modifications as to:</p> <ul style="list-style-type: none"> <li>• the exclusion of all service bonuses</li> <li>• the inclusion of an outbound baggage target;</li> <li>• the inclusion of an airfield availability metric or retention of the existing aerodrome congestion term (but to include a measure of snow event readiness);</li> <li>• the maximum annual rebate amount remains 7% of Core Service Charges revenue;</li> <li>• the monthly maximum potential rebate percentage will be one-sixth of the annual maximum potential rebate percentage for each service standard, as in Q5;</li> <li>• an incremental penalty factor of 25% applied to the rebate percentage for certain selected passenger facing measures if the relevant service standard has not been met for six consecutive months; and</li> <li>• failure of an airline to meet certain Airline Service Standards will reduce the amount payable by GAL in any month to such airline under the Core Service Rebates.</li> </ul>
<b>Adjustments to service standards upon airline approval</b>	<p>Amendments to the Core Service Standards may be made by GAL:</p> <ul style="list-style-type: none"> <li>• following consultation by GAL with the Gatwick Airline Operators Committee (AOC) &amp; Gatwick ACC; and</li> <li>• if approved in writing by airlines paying charges under the published tariff or under bilateral contract (save for those airlines that have expressly waived the application of these service standards under the terms of their contract) that together account for at least 67% of the passengers (in the 12 months immediately preceding the month in which GAL requested written approval from the airlines of the proposed amendment) travelling through the airport on airlines paying charges under the published tariff or under bilateral contract (save for those airlines that have expressly waived the application of these service standards under the terms of their contract), and representing at least 51% of that airlines responding in writing.</li> </ul>
<b>Airline Service Standards to be monitored and published, and subject to rebates</b>	<p>GAL will monitor and publish the performance of individual airlines in relation to certain airport-wide activities. These include:</p> <ul style="list-style-type: none"> <li>• Check-in queue performance;</li> <li>• Arrival bag performance; and</li> <li>• PRM service and pre-notification.</li> </ul> <p>GAL may amend the airline service standards that it is monitoring and publishing from time-to-time, following consultation with the Gatwick AOC &amp; ACC.</p> <p>The first two of these standards are designated as Airline Service Standards for the purposes of determining the Core Service Rebate for individual airlines. These standards are set out in Table B (attached). The third standard (in relation to PRM) is already a factor that determines the PRM charges payable by individual airlines.</p>
<b>Airport-wide standards to</b>	<ul style="list-style-type: none"> <li>• Airlines &amp; airport: On-time performance (departures and arrivals);</li> </ul>

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<b>be monitored <u>but not</u> subject to rebates</b>	<ul style="list-style-type: none"> <li>• UKBF: Immigration performance</li> <li>• Airport: ASQ</li> </ul>
<b>Publication of standards</b>	GAL to publish monthly <a href="#">a</a> report on achievement of Airport-wide standards and the Airline Standards. <a href="#">This will be made available on the Gatwick airport website and, as in Q5, displayed in the terminals.</a>
<b>Payment of Core Service Rebate</b>	<p>The Core Service Rebate is the amount payable by GAL for a failure by it to meet the Core Service Standards.</p> <p>The Core Service Rebate will be paid quarterly, within 1 month of the end of each quarter (end June, September, December, March) only to those airlines operating exclusively under the terms of the published airport tariff set out in the Conditions of Use during the relevant period (“Qualifying Airlines”). An airline operating under the terms of a bilateral contract will not be entitled to the Core Service Rebate, unless otherwise provided for in such an agreement.</p> <p>The rebates will be calculated by terminal by month, and then allocated to the Qualifying Airlines that used the terminal pro-rata with the Core Service Charges payable by each Qualifying Airline in relation to that terminal in that month.</p> <p>A Qualifying Airline that has not met the applicable Airline Standards (as set out in Table B) will have its entitlement to Core Service Rebates reduced. Further, GAL shall be under no obligation to pay the rebate to an airline if there are unpaid amounts outstanding from such an airline to GAL. If the entitlement of an individual airline to Service Rebates is so reduced, there will be no change in the entitlement of other airlines to the Core Service Rebate.</p>
<b>Core Service Rebate</b>	<p>The aggregate amount (“Core Service Rebate”) payable by GAL to Qualifying Airlines in month “j” for a failure to meet the Core Service Standard Levels in terminal “t” will be calculated as:</p> $\text{Core Service Rebate}_{t,j} = \text{Service Rebate Percentage}_{t,j} \cdot \text{Annual Core Service Charges}_t$ <p>Where:</p> $\text{Annual Core Service Charges}_t =$ <p style="margin-left: 40px;">in respect of terminal “t”, in relevant financial year ending 31 March, the annual revenue arising from Core Service Charges for relevant commercial passenger services operated by Qualifying Airlines under the terms of the published airport tariff set out in the Conditions of Use.</p> <p>The rebate by each terminal will be allocated to the Qualifying Airlines that used the terminal pro-rata with the Core Service Charges payable by each Qualifying Airline in relation to that terminal in that month. The deduction to be made from this rebate amount if an airline fails to meet airline standards will be calculated as:</p> $\text{Deduction from Core Service Rebate}_{a,t,j} = \text{Airline Standard Reduction Percentage}_{a,t,j} \cdot \text{Core Service Charges}_{a,t,j}$ <p>For the avoidance of doubt, the deduction only operates to reduce the Core Service Rebate (if any) payable by GAL to an airline; it cannot result in a payment being due from an airline to GAL.</p>



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<p><b>Annual reconciliation of rebates</b></p>	<p>Rebates payable within a relevant year t will be based on a forecast of Core Service Charges revenue for year t, for each terminal. To the extent that actual revenues differ from forecast revenues, rebates will be recalculated and under- or over- payments of rebate will be reconciled and paid or invoiced (as appropriate) within 1 month of the publication by GAL of its annual report &amp; accounts.</p>
<p><b>Service Rebate Percentage</b></p>	<p>Rebates shall be calculated separately for each terminal based on the performance against the standards for that terminal; with the exception of airfield availability, which will be calculated at an airfield level and the same percentage applied to both terminals. As noted in Table A, the inter-terminal transit availability standards and potential rebate percentages relate only to the North Terminal.</p> <p>For each terminal t, the Service Rebate Percentage for the month j shall be calculated as:</p> $\text{Service Rebate Percentage}_{t,j} = \sum_{\text{standard } i} 2 \cdot \frac{p_{i,t}}{12} \cdot x_{i,t,j}$ <p>Where:</p> <p><math>p_{i,t}</math> = the potential service rebate percentage for standard “i”, for terminal “t”, as set out in Table A.</p> <p>if the standard “i”, for terminal “t”, in month “j” is greater than or equal to the service rebate level, as set out in Table A, then</p> $x_{i,t,j} = 0$ <p>if the standard “i”, for terminal “t”, in month “j” is less than the service rebate level, as set out in Table A, then</p> $x_{i,t,j} = 1; \text{ or}$ <p><b>1.25</b>, in relation only to Selected Passenger Facing Measures, if the relevant standard “i”, for terminal “t”, in each one of the six immediately preceding months (i.e. “j-1”, “j-2”, “j-3”, “j-4”, “j-5”, “j-6”) was less than the service rebate level, as set out in Table A . Provided that the maximum aggregate Service Rebate Percentage payable in relation to all Selected Passenger Facing Measures shall not exceed 2.85% in any financial year ending 31 March; or</p> <p><b>0</b>, if prior to month “j” there have been any six months in a relevant financial year ending 31 March in which the standard “i”, for terminal “t” was less than the service rebate level, as set out in Table A. This condition applies in precedence to, and overrides, the two conditions set out immediately above.</p> <p>For the purposes of this calculation, the Selected Passenger Facing Measures comprise: Departure Lounge Seat Availability; Cleanliness; Way-Finding; Flight Information; Central Passenger Search (times&lt;5minutes, times &lt; 15 minutes); Passenger Sensitive Equipment (General); Passenger Sensitive Equipment (Priority); and Arrivals Reclaim (Baggage Carousels).</p>

## Final Airport Commitments

<p><b>Airline Standard Reduction Percentage</b></p>	<p>For each airline “a”, Airline Standard Reduction Percentage for the month j shall be calculated as:</p> $\text{Airline Standard Reduction Percentage}_{a,t,j} = \sum_{\text{standard } k} r_{k,t} \cdot z_{a,t,j,k}$ <p>Where:</p> <p><math>r_{k,t}</math> = the potential airline standard reduction percentage for standard “k”, for terminal “t”, as set out in Table B.</p> <p><math>z_{a,t,j,k}</math> = 0 if the standard “k”, for terminal “t”, in month “j” is greater than or equal to the standard reduction level, as set out in Table B; or</p> <p style="padding-left: 40px;">1 if the standard “k”, for terminal “t”, in month “j” is less than the standard reduction level, as set out in Table B.</p>
<p><b>Repeated failures by GAL to meet service quality targets</b></p>	<p>In the event that any service quality target is not met for a period of 6 months, in addition to the increase in service rebate percentage that this would attract and the requirement for monthly publication of its performance standards, GAL will draw up an improvement plan in consultation with the ACC. In preparing such a plan, GAL and the ACC will consider any representations from the CAA made in the passengers’ interest.</p>
<p><b>Premium Service Products</b></p>	<p>GAL may provide airlines and their customers with products and services over-and-above the Core Service Standard. These <del>would</del><u>may</u> be offered under the terms of <del>the Conditions of Use or</del> a bilateral agreement <u>or under the airport published tariff</u>.</p>

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Section D	Investment & consultation commitment
<b>Service enhancement through investment</b>	<p>GAL shall retain sole responsibility for managing the capital investment programme to enable it to meet its obligations regarding airport-wide service standards.</p> <p>GAL commits to maintaining the airport to comply with all applicable safety and environmental requirements and to maintain and develop the infrastructure of the airport to enable the airport-wide service standards to be achieved. In doing so, GAL commits to investing a minimum of £100m p.a. on average over each year of the initial term, although there is no binding programme of specific capital expenditure nor are there projects that are subject to capital expenditure triggers.</p> <p>GAL will undertake appropriate consultation in relation to capital investment, as described in the following sections. This approach to consultation goes beyond the capital expenditure consultation requirements of the Airport Charges Regulations 2011.</p>
<b>Categorisation of capital expenditure</b>	<ul style="list-style-type: none"> <li>• For the purposes of consultation, GAL proposes categorising capital expenditure into one of three areas: <ul style="list-style-type: none"> <li>- Major Development Projects, comprising those individual projects or individual programmes of projects in excess of £10m (excluding the Asset Stewardship Programme) and the Second Runway Project;</li> <li>- Minor Development Projects, being those individual projects or individual programmes of projects less than £10m (excluding both the Asset Stewardship Programme and Second Runway Project); and</li> <li>- Asset Stewardship Programme, comprising all asset stewardship projects split into five broad elements - Airfield, Commercial, IT, Facilities and Compliance/Risk.</li> </ul> </li> </ul>
<b>Airline consultative groups</b>	<ul style="list-style-type: none"> <li>• Consultation with the airlines will need to be undertaken at a number of different levels, with groups formed appropriately: <ul style="list-style-type: none"> <li>- ACC: to consider strategic matters involving the medium- to long-term development of the airport;</li> <li>- Capital sub-committee of ACC: to consider tactical matters involving the delivery by GAL of the capital development programme; and</li> <li>- Working groups (informal and formal): to consider operational impacts of projects on the day-to-day activities of the airlines operating at the airport. These working groups (where required) will be project specific, involve affected airlines, and may require a formally constituted working group (e.g. the AOC) for significant projects requiring a high degree of airline input into the design and execution planning (e.g. check-in transformation).</li> </ul> </li> </ul>
<b>Master Plan</b>	<ul style="list-style-type: none"> <li>• GAL published a Master Plan in July 2012. GAL will publish a revised Master Plan every five years, in consultation with airlines (including the ACC), other business partners and the local community. The exact timing of Master Plan updates will be dependent on Government airport policy consultations/decisions (e.g. in relation to the Airports Commission) and on the need to keep the overall long-term vision for the airport up-to-date.</li> </ul>
<b>Capital Investment Programme</b>	<ul style="list-style-type: none"> <li>• GAL will publish annually a rolling five year Capital Investment Programme</li> <li>• The CIP will be the key document around which strategic-level consultation</li> </ul>

## Final Airport Commitments

	<p>on future airport development will take place. This consultation with the ACC will address:</p> <ul style="list-style-type: none"> <li>- the principal business drivers behind the airport’s development strategy, including service levels;</li> <li>- forecast traffic demand and associated demand for airport capacities and services;</li> <li>- the capacities that the airport intends to provide, taken in the context of forecasted demand; and</li> <li>- the cost of the capital investment programme, and the resulting effect on the Asset Base of the airport.</li> </ul> <ul style="list-style-type: none"> <li>• The forecast cost of the capital investment programme will: <ul style="list-style-type: none"> <li>- summarise expenditure on each of the Major Development Projects;</li> <li>- summarise aggregate expenditure on the Asset Stewardship Programme (across all five elements);</li> <li>- summarise aggregate expenditure on Minor Development Projects;</li> <li>- be at a level of detail that naturally reflects the planning horizon and Tollgate status for projects, with those in the short-term being more granular and certain than those in the final years of the forecast.</li> <li>- provide an explanation as to any material differences between the latest forecast and: <ul style="list-style-type: none"> <li>○ the prior year forecast; and</li> <li>○ the forecast per the CAA’s price control review.</li> </ul> </li> </ul> </li> </ul> <ul style="list-style-type: none"> <li>• <u>GAL will also consult with the Gatwick Passenger Advisory Group (PAG) in relation to the CIP.</u></li> </ul>
<p><b>Individual Major Development Project consultation</b></p>	<ul style="list-style-type: none"> <li>• As part of the annual Capital Investment Programme consultation with the ACC, GAL will consult with airlines in relation to Major Development Projects (with the exception of “commercial return projects” and “dedicated airline projects”) covering: <ul style="list-style-type: none"> <li>- high-level options for the development of Major Development Projects and the trade-offs involved between alternatives;</li> <li>- the outputs that are expected to be delivered in terms of service, capacity, operating cost, and revenue;</li> <li>- scope, programme and cost of the project required to deliver the business objectives; and</li> <li>- the business case for the project. (This would be in a form consistent with those prepared by GAL for the ACC in Q5 and in preparation for BQ5).</li> </ul> </li> <li>• GAL will consult with the Capital sub-committee of the ACC in relation to the Major Development Projects at Tollgate 2, Tollgate 3, and Tollgate 4. This will require meetings on a more frequent basis than annually.</li> <li>• <u>Following Tollgate 4, progress with the delivery of Major Development Projects will be reviewed by the Capital sub-committee of the ACC as part of its annual Capital Investment Performance Review (see below).</u></li> <li>• <u>GAL will also consult with PAG in relation to the Major Development Projects, at appropriate times in the lifecycle of such projects. Working groups for major projects will meet on a regular basis as needed and PAG will be invited to nominate a member to such working groups.</u></li> <li>• A “commercial return project” is any project with associated commercial revenues that has a positive NPV not taking into account incremental airport</li> </ul>

## Final Airport Commitments

	<p>charges.</p> <ul style="list-style-type: none"> <li>• A “dedicated airline project” would be a project undertaken for the benefit of one or more specified airlines and which is remunerated by a separate commercial arrangement or specific airport charge payable by users of the project.</li> </ul>
<p><b>Annual Capital Investment Performance Review</b></p>	<ul style="list-style-type: none"> <li>• GAL will meet annually with the Capital sub-committee of the ACC <a href="#">and members of PAG</a> to review GAL’s delivery of the Capital Investment Programme, specifically:             <ul style="list-style-type: none"> <li>- in relation to the following 12 months:                 <ul style="list-style-type: none"> <li>○ the schedule and expenditure for each Major Development Project;</li> <li>○ the priorities and aggregate expenditure of the Asset Stewardship Programme across each of the five broad elements (separately identifying individual projects in excess of £1m).</li> <li>○ the expenditure on Minor Development Projects (separately identifying individual projects in excess of £1m).</li> </ul> </li> <li>- in relation to the preceding 12 months, works undertaken and progress with:                 <ul style="list-style-type: none"> <li>○ each Major Development Project;</li> <li>○ Minor Development Projects (separately identifying individual projects in excess of £1m); and</li> <li>○ Asset Stewardship Programme across each of the five broad elements (separately identifying individual projects in excess of £1m).</li> </ul> </li> </ul> </li> </ul>

## Final Airport Commitments

Section E	Information commitment
<b>Financial performance</b>	<ul style="list-style-type: none"> <li>• GAL publishes detailed statutory accounts consistent with its status as a UK registered company, with debt securities listed on the London Stock Exchange, and falling within the Walker Guidelines relevant to a private equity owned company.</li> <li>• These statutory accounts (refer, for example, to GAL's Report &amp; Financial Statements for the year ended 31 March 2012):               <ul style="list-style-type: none"> <li>- provide greater disclosure than the current regulatory accounts; and</li> <li>- contain sufficient, meaningful data in relation to the operating cost and revenue components of EBITDA, and in relation to the capital expenditure and depreciation components of GAL's asset base, to enable airlines, the CAA, and other users of GAL's accounts to undertake an analytical review of GAL's on-going business performance, capital investment, and financial returns, (including relative to the CAA's financial projections prepared as part of the Q6 review) and to assess whether charges are reasonable.</li> </ul> </li> <li>• GAL will not publish separate regulatory accounts.</li> <li>• To ensure there continues to be the provision of sufficient information for airlines to understand whether charges are reasonable, GAL will ensure that the scope of disclosure in its statutory accounts is maintained to be consistent with that of its most recent accounts (i.e. GAL's Report &amp; Financial Statements for the year ended 31 March 2012) in so far as it relates to the operating costs, revenues, fixed asset base, depreciation and capital expenditure. If GAL's statutory accounts do not meet these requirements, GAL will ensure a separate audited statement meeting this standard will be provided confidentially to airlines and the CAA.</li> <li>• GAL proposes to publish annually a statement of GAL's assessment of the value of its asset base. This will set out the underlying assumptions and calculations, including: the initial asset based (carried forward from the end of the prior year); depreciation; additions; disposals; indexation factors; other adjustments that may be relevant; and the closing asset base (carried forward to the start of the next year). The material provided, together with the audited financial statements, will enable stakeholders to verify the calculation.</li> <li>• GAL will provide such further financial information required (if any) to ensure compliance with the Airport Charges Regulations 2011.</li> </ul>
<b>Financial information in relation to Specified Activities, PRM Service, and Check-in &amp; Baggage facilities</b>	<ul style="list-style-type: none"> <li>• GAL will provide to users of the Specified Activities, PRM Services, Check-in &amp; Baggage Facilities, and the CAA, by 31 December in each year a statement of actual costs and revenues in respect of each of the specified activities for the year ending the previous 31 March.</li> </ul>

## Final Airport Commitments

Section F	Operational and financial resilience commitments
<b>Operational resilience</b>	<p>GAL will develop and maintain an operational resilience plan which will set how GAL intends to operate an efficient and reliable airport to the levels required by the Commitments or otherwise agreed with users and, in particular, how it will secure the availability and continuity of airport operation services, particularly in times of disruption. GAL will consult annually on the resilience plan with all interested parties including the CAA.</p> <p>In pursuance of the above obligation GAL will by [1 October 2014] publish one or more plan(s) or other documents setting out the principles, policies and processes by which it will comply with Condition [●]. Such plans and any amendments will have regard to any relevant guidance issued by the CAA.</p> <p>Prior to publishing any plans or other documents under Condition [●]. GAL shall consult all relevant parties on those plans or documents.</p> <p>GAL shall so far as is reasonably practicable coordinate and cooperate with all relevant parties at the airport to meet the requirements of this operational resilience commitment and shall at least once a year hold a meeting to which all relevant parties or organisations representing them shall be entitled to attend to discuss any issues pertinent to this operational resilience commitment.</p> <p>The Conditions of Use shall require all providers of air transport services and groundhandlers to comply with rules of conduct relating to minimum service provision and in particular to actions to be taken during periods of disruption.</p> <p>During periods of service disruption GAL shall use reasonable endeavours to coordinate the communication of operational information and to ensure the provision of timely, accurate and clear information about its operations to users of air transport services as well as information as to their rights under denied boarding regulations.</p>
<b>Financial resilience</b>	<p>The Conditions of Use will include the following financial resilience obligations to users:</p> <ul style="list-style-type: none"> <li>• The Directors of GAL will provide an annual confirmation of adequate financial resources to operate the airport and provide the Core Services; and</li> <li>• GAL shall not amend, vary, supplement or modify or concur in the amendment, variation, supplementation or modification of any of the finance documents in respect of credit rating requirements (whether in each case in the form of a written instrument, agreement or document or otherwise) (a “Variation”) unless it has given prior written notice thereof to the CAA. GAL shall, as soon as reasonably practicable: <ul style="list-style-type: none"> <li>- notify the CAA of the possibility of any such Variation; and</li> <li>- provide a summary of the executed change.</li> </ul> </li> </ul> <p>The provisions of this Condition shall not apply to any administrative or procedural variation.</p>
<b>Continuity of Service Plan</b>	<p>GAL shall prepare and at all times maintain a continuity of service plan. The plan shall describe such legal, regulatory, operational and financial information that an administrator, receiver, or new management might reasonably be expected to require, in addition to the aerodrome manual and other statutory or regulatory documents which GAL is required to maintain, in order for it to efficiently carry out its functions and to remain compliant with its aerodrome licence. GAL shall supply such continuity of service plan to the CAA by 1 October</p>

## Final Airport Commitments

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	2014 and shall make such reasonable amendment to the form, scope and content of the plan as the CAA may reasonably require. GAL shall provide the CAA with details of any material variations to the continuity of service plan.
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**Table A – Airport Service Quality Targets (Rebates & Bonuses)**

	Standard "i"	Metric	Rebate Level	Maximum potential rebate (both terminals, unless noted)
<b>(i)</b>	<b>Passenger satisfaction measures</b>			<b>0.80%</b>
1	Departure Lounge Seat Availability	Moving Average QSM Score	3.8	0.20%
2	Cleanliness		4.0	0.20%
3	Way-Finding		4.1	0.20%
4	Flight Information		4.2	0.20%
<b>(ii)</b>	<b>Security</b>			<b>2.60%</b>
5	Central Passenger Search	Times <5 Minutes and Times ≤15 Minutes	95% 98%	1.00%
6	Central Passenger Search	Day when single time slice > 30 Minutes	Single event per day	(0.05% per day) 0.70% max per month
7	Transfer Passenger Search	Times <10 Minutes	95%	0.20%
8	Staff Search (Terminals & Crew)	Times <5 Minutes	95%	0.35%
9	External Control Posts Search	Times <15 Minutes	95%	0.35%
<b>(iii)</b>	<b>Passenger operational measures</b>			<b>1.05% (ST) 1.55% (NT)</b>
10	Passenger Sensitive Equipment (General)	% Time Available	99%	0.05%
11	Passenger Sensitive Equipment (Priority)	% Time Available	99%	0.50%
12	Inter Terminal Transit System	% Time 1 Car Available and % Time 2 Cars Available	99% 97%	0.50% (NT)
13	Arrivals Reclaim (Baggage Carousels)	% Time Available	99%	0.50%
<b>(iv)</b>	<b>Airline operational measures</b>			<b>1.60%</b>
14	Outbound Baggage	OBP*	99%	0.70%
15	Stands	% Time Available	99%	0.05%
16	Jetties	% Time Available	99%	0.30%
17	Pier Service	Moving annual average % passengers pier served	t.b.d	0.50%
18	Fixed Electrical Ground Power	% Time Available	99%	0.05%
<b>(v)</b>	<b>Aerodrome congestion term</b>			<b>0.70%</b>
19	Airfield congestion / availability	t.b.d	t.b.d	0.70%
	<b>Total</b>			<b>7.25% (NT) 6.75% (ST)</b>

**Notes:**

Item 6: Day when single time slice greater than 30mins. Daily penalty is 0.05%, max. 0.70% per month.

Item 14: OBP = "Overall Baggage Performance" as described in GAL/ACC letter to CAA of 7 August.

Item 17: Target to be agreed and subject to airline adherence with stand planning rules.

The Conditions of Use will incorporate the detailed measurement and exemptions process. This will be based upon the Q5 process and take into account the content of the GAL/ACC letter to CAA of 7 August in relation to service quality targets.

**Table B – Airline Service Quality Targets**

<b>Standard “k”</b>	<b>Metric</b>	<b>Target Level</b>	<b>Airline Rebate Percentage</b>
Check-in performance – queue time	Times <30 Minutes	95%	1.00%
Arrivals bag performance – last bag on carousel	Times <50 Minutes (long-haul) Times <35 Minutes (short-haul)	95%	0.50%

The check-in performance metric is not routinely measured, although the use of automated queue measurement in South Terminal security indicates that this is feasible. GAL will consult with the Gatwick AOC to determine the appropriate approach for implementing such a measurement.

Attachment 1	Illustrative bases of Pricing Principles
<p><b>Pricing principles</b></p>	<p>GAL will provide users, from time to time, with a summary of the pricing principles it has adopted in setting the airport tariff and entering into bilateral contracts. These pricing principles do not form part of the Commitments, but for information, at this time, GAL believes the following are relevant:</p> <ul style="list-style-type: none"> <li>• In general, prices should be set:           <ul style="list-style-type: none"> <li>- to generate expected revenue for a service that is at least sufficient to meet the costs of providing the service;</li> <li>- to include a return on investment in assets, commensurate with risks involved; and</li> <li>- to provide incentives to reduce costs or improve productivity</li> </ul> </li> <li>• There will be price differentiation between different users of the infrastructure, based on commercially objective rationales, including, but not limited to:           <ul style="list-style-type: none"> <li>- responding to competition for airlines and passengers;</li> <li>- enhancing passenger service including through improved airline performance;</li> <li>- efficiently managing demand and promoting efficient investment in and use of airport infrastructure, in particular the airfield through greater intensity of use of peak-period slots, extending slot season-lengths, and increasing off-peak operations;</li> <li>- reducing the risk of a reduction in, or securing a commitment to, existing traffic volumes;</li> <li>- incentivising, or securing a commitment to, traffic volume growth;</li> <li>- recognising differential contributions to ancillary commercial activities and revenues;</li> <li>- encouraging or securing an increase in ancillary commercial activities and revenues;</li> <li>- incentivising or securing cost reductions; and</li> <li>- promoting diversification of routes/destinations and market segments.</li> </ul> </li> </ul>

# YOUR LONDON AIRPORT *Gatwick*

## **Appendix 2: Revised Conditions of Use**

*Attached overleaf*

# Gatwick Airport: Conditions of Use



Gatwick Airport Limited  
West Sussex, RH6 ONP

Telephone: 0844 335 1802 (General)

The registered office for this company is at:  
5th Floor  
Destinations Place  
South Terminal  
Gatwick Airport  
West Sussex, RH6 ONP



## Preface

(This is not part of the Conditions of Use)

This edition replaces the Conditions of Use circulated on []

Conditions of Use, including the airport charges for Gatwick Airport and price and service commitments by Gatwick Airport Limited are contained in this booklet.

Gatwick Airport Limited: Conditions of Use

These Conditions are effective from 1<sup>st</sup> April 2014

For any queries regarding invoicing please contact Gatwick Credit Control Department (see 2.3.12), any other enquires should be addressed in the first instance to Gatwick Airport Chief Financial Officer's office:

For the attention of the Chief Financial Officer,  
Gatwick Airport Limited,  
South Terminal, 5th Floor, Destinations Place,  
West Sussex,  
RH6 ONP,  
United Kingdom



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## 1.1 Definitions of terms

- 1.1.1 'Airport Charges' means charges for the landing and taking off of aircraft, the parking of aircraft and the departure of passengers.
- 1.1.2 'Air Transport Movement' means a flight carried out for hire and reward. This comprises all scheduled flights operated according to a published timetable where carriage is offered to the public whether loaded or empty and all flights where the capacity is contracted to another person, including empty positioning flights.
- 1.1.3 'Aircraft's Ascertained NOx Emission' means the product of the Engine NOx Emission as set out in the GAL Emission Database and the number of engines on the aircraft.
- 1.1.4 'Conditions of Use' means Conditions 1 to 10 and the Schedules and Appendices of this document.
- 1.1.5 'Designated remote stand' means a non-pier served stand or a pier served stand to or from which coaching of passengers is unavoidable due to the airport's operational restrictions
- 1.1.6 'Dispute' means any difference or dispute between the parties to these Conditions of Use arising out of or in connection with these Conditions of Use, MDIs, GADs or the Operator's use of the airport.
- 1.1.7 "Engine NOx Emission" means the figure expressed in kilograms for emissions of oxides of nitrogen for the relevant engine derived from ERLIG recommended sources and which in the case of Jet aircraft engines of 26.7n thrust or more are based on the standardised ICAO landing and take off cycle as set out in ICAO Annex 16 Volume II published in Document 9646 AN1943 (1995) as amended. This data can be accessed at: [www.caa.co.uk/default.aspx?categoryid=702&pagetype=90](http://www.caa.co.uk/default.aspx?categoryid=702&pagetype=90). In the case of Non-Jet aircraft engines the figure shall be that provided by the engine manufacturer or if no such figure is provided then as provided in the emissions value matrix. This data can be accessed at the Website: <http://noisedb.stac.aviation-civile.gouv.fr/>  
In the absence of any of the above sources then the figure shall be that which Gatwick Airport Limited may reasonably determine.
- 1.1.8 'Expert' means a solicitor or barrister with at least 8 years professional experience in the field of aviation law and appointed in relation to any Dispute in accordance with Condition 2.1.13.
- 1.1.9 'Flight' has the same meaning as in the Air Navigation (No.2) Order, 2000, as amended.
- 1.1.10 'Flight Classification' means classification within the following categories:
- 1.1.10.1 'Domestic Flight' means a flight where the airports of both take-off and landing are within the United Kingdom, Channel Islands or the Isle of Man (excluding off shore oil or gas rig) and there is no intermediate landing outside these areas.
- 1.1.10.2 'International Flight' means all flights other than Domestic Flights.
- 1.1.11 'GAL Emission Database' means the database maintained by Gatwick Airport Limited of Engine NOx Emission of aircraft operating at the airport covered by these Conditions of Use.
- 1.1.12 'General or Business Aviation' means any air traffic not falling into any of the following categories:
- 1.1.12.1 scheduled air services;



- 1.1.12.2 non-scheduled air transport operations for hire or reward in the case of passenger air transport operations where the seating capacity of the aircraft used exceeds 10.
- 1.1.12.3 any traffic engaged on the Queen's Flight or on flights operated primarily for the purpose of the transport of Government Ministers or visiting Heads of State or dignitaries from abroad.
- 1.1.13 'International Terminal Departing Passenger' means any Terminal Departing Passenger whose final destination is a place outside the United Kingdom, Channel Islands, Republic of Ireland or the Isle of Man. This definition will be applied in all cases for determining departing passenger charges notwithstanding that such a passenger may be travelling on a domestic flight as defined in Condition 1.1.10.1 above.
- 1.1.14 'Domestic Terminal Departing Passenger' means any Terminal Departing Passenger whose final destination is a place within the United Kingdom, Channel Islands, or Isle of Man (excluding off shore oil or gas rig) and there is no intermediate landing outside these areas.
- 1.1.15 'Irish Terminal Departing Passenger' means any Terminal Departing Passenger whose final destination is a place within the Republic of Ireland (excluding off shore oil or gas rig) and there is not intermediate landing outside these areas.
- 1.1.16 'Jet aircraft' means an aircraft other than a helicopter having a turbo jet or turbo fan engine.
- 1.1.17 'Legislation' means
- 1.1.17.1 all Acts of Parliament; and
- 1.1.17.2 all Statutory Instruments; and
- 1.1.17.3 any regulations or directions made pursuant to such Acts of Parliament or Statutory Instrument; and
- 1.1.17.4 all directly applicable EU Regulations; and
- 1.1.17.5 all regulations and requirements of any competent authority in each case as the same are amended, re-enacted or otherwise in force from time to time.
- 1.1.18 'Maximum Take Off Weight' in relation to an aircraft means the maximum total weight of the aircraft and its contents at which the aircraft may take-off anywhere in the world in the most favourable circumstances in accordance with the Certificate of Airworthiness in force in respect of the aircraft.
- 1.1.19 'Non-Jet aircraft' means an aircraft which is not a jet aircraft.
- 1.1.20 'Operator' in relation to an aircraft means the person for the time being having the management of that aircraft.
- 1.1.21 'Passenger' means any persons carried on an aircraft with the exception of the flight crew and cabin staff operating the aircraft flight.
- 1.1.22 'Schedule of Charges' means the Schedule of Charges annexed to as Schedule 1.
- 1.1.23 'Term' means the period from 1 April 2014 to 31 March 2021.



- 1.1.24 'Terminal Arriving Passenger' means any passenger aboard an aircraft at the time of landing other than a Transit Passenger.
- 1.1.25 'Terminal Departing Passenger' means any passenger aboard an aircraft at the time of take-off other than a Transit Passenger.
- 1.1.26 'Time of Landing' means the time recorded by NATS as the time of touch down of an aircraft.
- 1.1.27 'Time of Take off' means the time recorded by NATS as the time when the aircraft is airborne.
- 1.1.28 'Transfer passenger' means a passenger arriving at and departing from the Airport on a different aircraft or on the same aircraft under a different flight number, whose main purpose for using the airport is to effect a transfer on a single ticket within 24 hours.
- 1.1.29 'Transit Passenger' means a passenger who arrives at the airport in an aircraft and departs from the airport in the same aircraft, where such an aircraft is operating a through flight transiting the airport, and includes a passenger in transit through the airport who has to depart in a substituted aircraft because the aircraft on which the passenger arrived has been declared unserviceable.
- 1.1.30 'UTC' means Universal Time (Co-ordinated)

## 1.2 Interpretation

- 1.2.1 Reference to a 'Certificate of Airworthiness' shall include any validation thereof and any flight manual or performance schedule relating to the aircraft.
- 1.2.2 References to 'Chief Executive Officer' of Gatwick Airport Limited shall include a nominated deputy.
- 1.2.3 Headings are for ease of reference only and shall not be taken into account in interpreting these Conditions of Use.
- 1.2.4 Words denoting the singular shall include the plural and vice versa and words denoting any gender shall include any other gender.
- 1.2.5 If any provision of these Conditions of Use is or becomes for whatever reason invalid illegal or unenforceable it shall be divisible from the remainder of these Conditions of Use and shall be deemed to be deleted from them and the validity of the remaining provisions of these Conditions of Use shall be not be affected in any way.
- 1.2.6 Gatwick Airport Limited has previously issued directives entitled Managing Director's Instructions (MDIs); these have been renamed Gatwick Airport Directives (GADs). The re-naming of each MDI will take place as that MDI comes up for review. MDIs remain in full force and effect until either rescinded or replaced by a GAD; it is the responsibility of each person or entity bound by these Conditions of Use to ensure that they are acquainted with the terms of relevant MDIs and GADs. In these Conditions of Use the terms MDI and GAD are used interchangeably.

## 2 Conditions



The use of the airport is subject to the following conditions:

## 2.1 General

### Applicability and Enforceability of Conditions of Use

- 2.1.1 Gatwick Airport (the "Airport") is managed by Gatwick Airport Limited.
- 2.1.2 The publication of these Conditions of Use constitutes an offer by Gatwick Airport Limited to permit the use of its facilities on the terms set out herein. The use of any facilities at the airport whether airside or landside other than as a passenger constitutes acceptance of these Conditions of Use. It is intended that these Conditions of Use constitute a contract as between Gatwick Airport Limited and each and every Operator [or in relation to obligations relevant to them, other users](#) using the facilities at the airport [other than as passengers](#).

### Variation

- 2.1.3 Gatwick Airport Limited may at its sole discretion vary amend or add to these Conditions of Use and any such variation, amendment to, or addition may be promulgated by means of a GAD save that no variation which has effect before 1<sup>st</sup> April 2021 may be made to the following Conditions and Schedules:
- Condition 1.1.2-3 (Term)
  - This Condition 2.1.3 (Variation)
  - Conditions 2.1.12-2.1.21 (Dispute Resolution)
  - Condition 5 (Price Commitment)
  - Condition 6 (Service Standard Commitment)
  - Condition 7 (Continuity of Service and Financial Resilience Commitment)
  - Condition 8 (Investment and Consultation Commitment)
  - Condition 9 (Financial Information Commitment)
  - Schedules 2, 3 and 4 other than [in accordance with the variation provisions contained in paragraph 6 of Schedule 2 and in paragraph 7-5 of Schedule 3](#).

### Compliance

- 2.1.4 Operators shall comply with the local flying restrictions and remarks published from time to time in the AD section of the United Kingdom AIP, NOTAMS and the current Air Navigation Order and Regulations.
- 2.1.5 Operators shall comply with instructions, orders or directions including MDIs and GADs published from time to time by Gatwick Airport Limited, which may supplement vary or discharge any of the terms and conditions of use set out herein.
- 2.1.6 Operators shall comply with, and shall ensure that their servants and agents comply with, all applicable Legislation in relation to their operations at the airport and their aircraft's approach to and departure from the airport.
- 2.1.7 Operators shall comply with data requests issued by Gatwick Airport Limited for the purposes of invoicing and reconciliations.



**Insurance**

- 2.1.8 The Operator shall take out and maintain passengers and third party liability insurance in respect of each of its aircraft at the airport in at least the sum specified by the CAA (or if greater any other competent authority or such amount as Gatwick Airport Limited shall reasonably specify) in respect of any one event.

**No Waiver**

- 2.1.9 No failure or delay by Gatwick Airport Limited to exercise any right or remedy under these Conditions of Use will be construed or operate as a waiver of that right or remedy nor will any single or partial exercise of any right or remedy preclude the further exercise of that right or as a waiver of a preceding or subsequent breach.
- 2.1.10 Any express waiver granted by Gatwick Airport Limited shall be construed strictly on its terms and shall not imply or require that any further or additional waiver will be given in respect of similar future matters.

**Indemnity**

- 2.1.11 The Operator shall indemnify and keep indemnified Gatwick Airport Limited against all costs losses damages demands expenses and claims arising as a direct or indirect result of any breach of these Conditions of Use or the requirements of any MDI or GAD.

**Dispute Resolution Procedure**

- 2.1.12 Either party shall refer any Dispute to an Expert for determination by serving notice in writing to that effect on the other party. The notice shall contain sufficient particulars of the Dispute to be referred to an Expert.
- 2.1.13 The parties shall agree the identity of the Expert to be appointed. In default of agreement, within ten working days of the date of service of a notice referring a Dispute to an Expert for determination, the Expert shall be appointed on the application of any party to the President of the Law Society or the Chairman of the Bar Council.
- 2.1.14 The Expert shall not act as an arbitrator and the provisions of the Arbitration Act 1996 shall not apply.
- 2.1.15 The Expert shall determine the Dispute referred to him impartially and acting reasonably. The Expert will establish the procedural rules to be applied to the determination which must include the following steps:
- 2.1.15.1 each party will be entitled to make submissions to the Expert;
  - 2.1.15.2 the Expert may request any party to provide him with any further information as he may require in order to determine the Dispute provided any such information is made available to the other party to comment;
  - 2.1.15.3 all communications between a party and an Expert shall be copied to the other party;
  - 2.1.15.4 any failure by a party to respond to any request or direction by the Expert shall not invalidate the Expert's determination.



- 2.1.16 Unless a shorter period is agreed between the parties at the time of the Expert's appointment, a fully reasoned written determination must be delivered to the parties within 21 working days of the Expert's appointment.
- 2.1.17 The fees and expenses of the Expert shall be borne by the parties in equal shares unless the Expert determines otherwise. Each party shall be solely responsible for bearing its legal and other costs arising out of any reference of a Dispute to an Expert.
- 2.1.18 Any decision of the Expert shall be binding until the Dispute is finally determined by legal proceedings or by agreement.
- 2.1.19 Neither party shall make any application to a competent court in relation to the conduct of the determination or the Expert's determination or the Dispute after ninety days from the date of the Expert's determination or, in the event the Expert has failed to reach a decision, the date on which the Expert should have reached a determination.
- 2.1.20 The dispute resolution procedure set out in Conditions 2.1.12 to 2.1.19 above is without prejudice to, and does not impact upon, Gatwick Airport Limited's right to exercise its power to detain aircraft for the non-payment of Airport charges, pursuant to the Civil Aviation Act 1982. Gatwick Airport Limited may at all times exercise that power without recourse to this dispute resolution procedure
- 2.1.21 The dispute resolution procedure set out in Conditions 2.1.10 to 2.1.19 above shall not prevent either party from seeking urgent relief by applying to a competent court for injunctive relief.

### **Governing law and Jurisdiction**

- 2.1.22 These Conditions of Use, MDIs and GADs shall be governed by and construed according to the laws of England and Wales.
- 2.1.23 Gatwick Airport Limited and the Operator irrevocably agree that the Courts of England and Wales shall have exclusive jurisdiction in respect of any Dispute.

### **Wake Vortices**

- 2.1.24 Operators shall be responsible for injury and damage to property sustained as a result of wake vortices generated by their aircraft.

### **Liability**

- 2.1.25 Neither Gatwick Airport Limited, nor its servants or agents shall be liable for the loss of or the damage to any aircraft, its parts or accessories or any property contained in the aircraft, occurring while the aircraft is on the airport or is in the course of landing or taking-off at the airport, arising or resulting directly or indirectly from any act, omission, neglect or default on the part of Gatwick Airport Limited or its servants or agents unless done with intent to cause damage or recklessly and with knowledge that damage would probably result.
- 2.1.26 Neither Gatwick Airport Limited nor its servants or agents shall have any liability to an Operator whether in contract tort, negligence breach of statutory duty or otherwise for any loss, damage costs or expenses of any nature whatsoever incurred or suffered by that Operator of an indirect or consequential nature including without limitation any economic loss or other loss of turnover, profits, business or goodwill.



- 2.1.27 Gatwick Airport Limited provides no warranty as to the continued use and operation of the airport and may at any time or from time to time at its sole discretion close or restrict access to the public to the airport or any part thereof without incurring any liability to the Operator.

### Conflict

- 2.1.28 In the event of any conflict between these Conditions of Use and the terms of another written contract between Gatwick Airport Limited and a third party then to the extent that the conflict is apparent on the face of the documentation the terms of that other written contract shall prevail over these Conditions of Use.

## 2.2 Operational

### Slots

- 2.2.1 No Operator shall be permitted to operate to or from Gatwick Airport without first obtaining a slot from Airport Coordination Limited (ACL).
- 2.2.2 If in the opinion of Gatwick Airport Limited an Operator regularly or intentionally fails to adhere to an allocated slot (either arrival or departure) for reasons which are not beyond its control, then having first given the Operator an opportunity to make representations, Gatwick Airport Limited may adopt such measures as it deems appropriate to ensure that the Operator adheres to its allocated slots, such measures may include Gatwick Airport Limited prohibiting the Operator or particular services of the Operator from [operating at](#) the airport for a fixed period of time.

### Peak congestion

- 2.2.3 Any Operator of General or Business Aviation, or whole plane cargo services, who operates at Gatwick Airport without the prior permission of Gatwick Airport Limited during such periods of peak congestion, as have been notified by NATS in the United Kingdom AIP or a subsequent supplement, for the airport, may be prohibited by Gatwick Airport Limited from operating during such periods of peak congestion for a minimum period of 30 days, unless in the opinion of Gatwick Airport Limited the aircraft was required to land at the airport because of an emergency or other circumstance beyond the control of the Operator.

### Use of Chapter 2 aircraft

- 2.2.4 Operators should note that civil subsonic jet aircraft with a take off mass of 34,000kg or more (or with more than 19 passenger seats) operating to the UK are required to be certificated as Chapter 3 or Chapter 4 in accordance with the Aeroplane Noise Regulations 1999. Aircraft not meeting this requirement are prohibited from operating to any UK airport unless granted an exemption by the UK Civil Aviation Authority (see [www.caa.co.uk/erg/avpolicy](http://www.caa.co.uk/erg/avpolicy)).

### Service and ground handling

- 2.2.5 Operators are required to either self handle or appoint third party Ground Handling Agents, to deliver operational performance in accordance with the minimum airline service standards defined in the current Service Standards GAD. These standards will be consulted on prior to implementation at the Airport Users Committee at Gatwick Airport.





- 2.2.6 In the circumstances of a diversionary aircraft arriving at Gatwick Airport, Operators are required to adhere to the current Aircraft Diversions Procedures MDI to ensure passengers and aircraft are handled effectively. The GAD includes the charge payable should Gatwick Airport Limited be required to facilitate handling of aircraft.
- 2.2.7 There is a Passenger with Reduced Mobility (PRM) Service provided at Gatwick Airport. Please refer to the current PRM GAD and General Advice Notice for information regarding this service including the requirement for pre-notification by Airlines. Pricing current at the date of issue of these Conditions of Use is attached as an appendix IV to the Schedule of Charges.

### **Policing**

- 2.2.8 Where a flight destination or carrier is identified as being at significant or high risk the Operator shall pay a charge as notified by the Chief Executive Officer equating to the cost of any policing cost additional to the services normally provided at the airport for carriers or destinations at lower levels of risk.

### **Noise supplements**

- 2.2.9 At Gatwick Airport, aircraft departures which infringe noise thresholds or aircraft of Operators that flagrantly or persistently fail to operate in accordance with Noise Preferential Routes (NPR's) prescribed for the airport, both as measured by the noise and track monitoring system operated by Gatwick Airport Limited, may be subject to supplemental charges promulgated in MDIs or GADs.

## **2.3 Payment**

- 2.3.1 The Operator shall pay the appropriate charges for landing, taking-off and parking of an aircraft, as set out in the Schedule of Charges. The Operator shall also pay for any supplies, services or facilities provided to him or to the aircraft at the airport by or on behalf of Gatwick Airport Limited at the charges determined by Gatwick Airport Limited. All charges referred to in this paragraph shall accrue on a daily basis and shall become due on the day they were incurred and shall be payable to Gatwick Airport Limited on demand and in any event before the aircraft departs from the airport unless otherwise agreed by Gatwick Airport Limited (which agreement may be withdrawn at any time at the discretion of Gatwick Airport Limited) or unless otherwise provided in the terms for payment included in the invoice for such charges.
- 2.3.2 Payments shall be made without deductions (including taxes or charges). If the applicable law requires any tax or charge to be deducted before payment the amount shall be increased so that the payment made will equal the amount due to Gatwick Airport Limited as if no such tax or charge had been imposed.
- 2.3.3 All sums payable to Gatwick Airport Limited are exclusive of VAT which shall, where applicable, be paid in addition at the rate in force at the relevant tax point.
- 2.3.4 All sums due which are not paid on the due date shall bear interest from day to day at the annual rate of the higher of 8%, or the sum of Bank of England base rate plus 3% margin, from the date when such sums were due until the date of payment (both dates inclusive).
- 2.3.5 All new aircraft Operators to Gatwick Airport Limited (being an Operator that has had no flying operation at the airport for the previous two consecutive seasons to the season being requested) are required to lodge a deposit equivalent to 3 months of operations by that aircraft Operator (based on



anticipated numbers and type of flight planned). The deposit may be reviewed after 12 months at the written request of the aircraft Operator, and will be refunded at Gatwick Airport Limited's discretion. A formal explanation will be presented to the aircraft Operator in the event the deposit is still retained by Gatwick Airport Limited following the refund request. When the Operator ceases to operate any flights from the airport for more than two consecutive seasons the deposit will be refunded subject to the right of Gatwick Airport Limited (which is hereby reserved) to set off against any such deposit any appropriate charges that have not been settled in accordance with the above provisions. In exceptional cases the Airport Chief Financial Officer may at his/her discretion waive the requirement for the 3 month deposit.

- 2.3.6 In the event of an Operator currently operating at Gatwick Airport failing to meet the terms of payment for Airport Charges such that the debt incurred exceeds £10k greater than 30 days overdue (at any point within the prior 3 months) then that Operator will be required to lodge a deposit with Gatwick Airport Limited equivalent to a maximum of 3 months of operations by that aircraft Operator (based on anticipated numbers and types of flight planned). Gatwick Airport Limited's Chief Financial Officer may set the level of deposit required at his/her discretion up to the maximum 3 months value, and in exceptional circumstances may waive the deposit requirement.
- 2.3.7 Under the Civil Aviation Act 1982, Gatwick Airport Limited has the power to detain aircraft where default is made in the payment of Airport Charges. The power relates to aircraft in respect of which the charges were incurred (whether or not they were incurred by the person who is the Operator of the aircraft at the time the detention begins) or to any other aircraft of which the person in default is the Operator at the time the detention begins.
- 2.3.8 The Operator agrees that Gatwick Airport Limited shall be entitled to exercise the rights of detention set out at Condition 2.3.7 above or pursuant to the Civil Aviation Act 1982.
- 2.3.9 In the event of:
- 2.3.9.1 the taking of any step in connection with any voluntary arrangement or any other compromise or arrangement for the benefit of any creditors of the Operator; or
  - 2.3.9.2 the making of an application for an administration order or the making of an administration order in relation to the Operator; or
  - 2.3.9.3 the giving of any notice of intention to appoint an administrator, or the filing at court of the prescribed documents in connection with the appointment of an administrator, or the appointment of an administrator, in any case in relation to the Operator; or
  - 2.3.9.4 the appointment of a receiver or manager or an administrative receiver in relation to any property or income of the Operator; or
  - 2.3.9.5 the commencement of a voluntary winding-up in respect of the Operator, except a winding-up for the purpose of amalgamation or reconstruction of a solvent company in respect of which a statutory declaration of solvency has been filed with the Registrar of Companies; or
  - 2.3.9.6 the making of a petition for a winding-up order or a winding-up order in respect of the Operator; or
  - 2.3.9.7 the striking-off of the Operator from the Register of Companies or the making of an application for the Operator to be struck-off; or



2.3.9.8 the Operator otherwise ceasing to exist; or such any event or procedure analogous to the same happening in respect of the Operator in the jurisdiction governing the Operator's corporate affairs

Then there shall be deemed to be a default in the payment of any Airport Charges which are extant as at the date of such event or procedure shall be deemed to be in default for the purposes of Section 88 of the Civil Aviation Act 1982.

2.3.10 The Operator shall not, without the express written consent of Gatwick Airport Limited, be entitled in respect of any claim he may have against Gatwick Airport Limited or otherwise to make any set off against or deduction from the charges provided for in these Conditions of Use. He must pay such charges in full pending resolution of any such claim.

2.3.11 All charges not falling within Condition 2.3.1 above shall be payable within 14 days of service of an invoice. Gatwick Airport Limited shall provide seven days' notice of any intention to withdraw credit facilities but these may be withdrawn immediately upon notice if Gatwick Airport Limited is of the opinion that any act of insolvency (including but not limited to those set out at Condition 2.3.9 above) has or is about to take place in relation to an Operator.

2.3.12 Any queries relating to invoices should be raised with Gatwick Airport Limited's Credit Control Department within 10 days of the invoice date. Relevant contact numbers are shown on our invoices and statements.

## 2.4 Data

2.4.1 The Operator shall comply with the data requirements as set out in Schedule 4 (Data Requirements) to these Conditions. Gatwick Airport Limited shall be entitled to publish any such information for the purpose of comparing the Operator's on time performance and arrivals baggage performance in such format as it may from time to time determine.

## 3 Airport charges

### 3.1 Charges on landing and take-Off

3.1.1 The relevant charges for the landing and the take-off of aircraft as set out in Appendix I of the Schedule of Charges are payable.

3.1.2 The charge on landing and take-off will be assessed and payable on the basis of the aircraft's Maximum Take Off Weight and the aircraft noise certification standard, as recorded by Gatwick Airport Limited on 1 April of each year. The Maximum Take Off Weight will be banded as shown below and charged accordingly as outlined in Appendix 1 of the Schedule of Charges:

3.1.2.1 Less than 16 metric tonnes

3.1.2.2 Greater than or equal to 16 metric tonnes and less than or equal to 50 metric tonnes

3.1.2.3 Greater than 50 metric tonnes

### Chapter 3 base charge

3.1.3 The Chapter 3 base charges on landing or take off as set out in the Schedule of Charges, will apply to aircraft over 16 metric tonnes, which meet the noise certification standards of ICAO Annex 16 Chapter 3. When applying for these base charges, documents attesting that the aircraft complies with Chapter



3 noise certification standards must be produced. If they are not, the aircraft may be treated as a Chapter 2 aircraft for charging purposes.

- 3.1.4 All aircraft not exceeding 16 metric tonnes will automatically qualify for the Chapter 3 base charges and therefore no application need be made under Condition 3.1.3.

**Chapter 2 charge**

- 3.1.5 The Chapter 3 base charge on landing or take off, calculated in accordance with the Schedule of Charges, will be increased to three times for aircraft failing to meet Chapter 3 noise certification standards as a minimum and by any non certificated aircraft.

- 3.1.6 Relevant documentation should be sent to:

Head of Finance Operations  
 Gatwick Airport Limited  
 5th Floor, Destinations Place,  
 Gatwick Airport,  
 West Sussex, RH6 ONP

**Chapter 3 high charge**

- 3.1.7 Aircraft deemed to be Chapter 3 high aircraft in accordance with the provisions of Condition 3.1.8 will be subject to a charge on landing or take-off of 150% of the Chapter 3 base charge, unless the Operator of the aircraft can provide to Gatwick Airport Limited satisfactory noise certification data which demonstrates that the aircraft noise performance is 5 or more EPNdB below Chapter 3 certification limits prescribed in Volume 1, Part II, Chapter 3 of Annex 16 to the Convention on International Civil Aviation based on the arithmetic sum of the differences between certificated levels and the Chapter 3 noise limits at the approach, lateral and flyover points.

- 3.1.8 Chapter 3 aircraft of the following types will be deemed Chapter 3 high:

AN124	BAC1-11	Boeing 707/720B
Boeing 727-100/200	Boeing 737-200	Boeing 747-100/200/300/SP
Douglas DC-8/50/62/63	Douglas DC-9/30/40/50	Douglas DC10-10
Fokker F28	IL-62M	IL- 86
TU-134A	TU-154M	YAK-42

- 3.1.9 Gatwick Airport Limited will use its discretion in levying this charge pending submission of any certification data as outlined in Condition 3.1.7 and, if an aircraft qualifies for the Chapter 3 base charge, in consideration of retrospective claims for the lower charge.

**Chapter 3 minus charge**

- 3.1.10 This charge will apply to those jet and non-jet aircraft in excess of 16 metric tonnes which, on BOTH ARRIVAL AND DEPARTURE, have a Quota Count of 0.25, 0.5 or 1, or are exempt, as described under Section 3 of the London/Gatwick Noise Restriction Notice, currently published as a supplement to the UK AIP by the Civil Aviation Authority on behalf of the Department for Transport.
- 3.1.11 The above supplement is revised twice a year, and until an aircraft type is included in the supplement, Gatwick Airport Limited will use its own discretion in classifying the Quota Count of that aircraft type.



In the event of this happening, no subsequent retrospective claim for a lower charge on landing or take-off will be considered by Gatwick Airport Limited.

#### Chapter 4 charge

3.1.12 This charge will apply to those jet and non-jet aircraft in excess of 16 metric tonnes which

3.1.12.1 were first put into service on or after 1 January 2006 and meet the noise certification standards of ICAO Annex 16 Chapter 4. Documents attesting that the aircraft complies with Chapter 4 noise certification standards must be provided to Gatwick Airport Limited, or

3.1.12.2 can demonstrate that they meet the noise certification standards of ICAO Annex 16 Chapter 4. Documents showing the noise certification values for sideline, flyover and approach, attesting that the aircraft complies with Chapter 4 noise certification standards must be provided to Gatwick Airport Limited.

#### Emissions charge

3.1.13 An additional NOx emissions charge applies to all aircraft over 8,618kg (based on the aircraft ascertained NOx emission), on landing and take-off as outlined in Appendix I of the Schedule of Charges.

#### Air Navigation Services charge

3.1.14 There is no separate charge for Air Navigation Services (ANS).

### 3.2 Charges on terminal departing passengers and non passenger flights

3.2.1 The relevant charges payable by an airline per Terminal Departing Passengers are set out in Appendix 1 of the Schedule of Charges.

#### Minimum charge on departure

3.2.2 There is a minimum charge on departure for all flights at Gatwick Airport as set out in the relevant Appendix 1 of the Schedule of Charges. A "Minimum Departing charge per ATM" is applied to flights (including non-passenger flights), where an Operator's departing passenger charge drops below the minimum charge threshold. This charge is in addition to any take-off fee that may be payable.

#### Arrivals / departures from remote stands

3.2.3 Where a flight arrives or departs from a stand which is a designated remote stand, a rebate to the charge on Terminal Departing Passengers will be allowed as set out in the Schedule of Charges, based on the number of Terminal Arriving Passengers and Terminal Departing Passengers using remote stands. Such rebate will not apply:

3.2.3.1 to the extent that it reduces the charges on departing passengers to below the level of the relevant minimum charge on departure set out in the Schedule of Charges; or

3.2.3.2 where a remote stand has been requested by an Operator or its handling agent rather than being required by Gatwick Airport Limited for operational or pier segregation reasons; or



3.2.3.3 where a stand which is not a remote stand has been made available, but has been declined by an Operator or its handling agent.

### Security charge

3.2.4 There is no separate charge for security.

## 3.3 Aircraft parking charges

3.3.1 The relevant charges for aircraft parking as set out in Appendix I of the Schedule of Charges are payable.

3.3.2 The charges for parking of aircraft at the airport will be assessed and payable on the basis of the Maximum Take Off Weight as recorded by Gatwick Airport Limited on 1st April of each year. For the purposes of calculation of aircraft parking charges the Maximum Take Off Weight has been divided into the following three bands:

3.3.2.1 Less than 50 metric tonnes

3.3.2.2 Greater than or equal to 50 metric tonnes and less than or equal to 200 metric tonnes

3.3.2.3 Greater than 200 metric tonnes

3.3.3 Parking charges will be based on the total number of five minutes or part thereof that an aircraft has been parked on areas designated as airport company parking areas.

3.3.4 These charges will apply whether the aircraft is secured to the ground or to a structure on the airport or is left on the ground unsecured.

3.3.5 A peak charge will apply to an aircraft which occupies a pier served stand between 0600 UTC (GMT) and 1159 UTC (GMT) from 1st April to 31st October. During this period of time each minute will count as three minutes for the purpose of the calculation of parking charges.

3.3.6 Parking charges will accrue from the time the aircraft is "on block" until the aircraft is "off block" as recorded by the IDAHO system.

3.3.7 Parking is free between the hours of 2230 and 0459 UTC (GMT) from 1st April to 31st March.

3.3.8 The Chief Executive Officer of the airport has discretion to decide in the light of particular circumstances at the airport to abate or waive the charges set out in the Schedule of Charges in relation to the parking of aircraft at certain times and periods or on certain parts of the airport. In this event, the Chief Financial Officer will supply the details of the terms and conditions of the abatement or waiver of the charges on the request of any Operator who parks aircraft at the airport and the Operator may apply to the Chief Financial Officer for these terms and conditions.

3.3.9 The Chief Executive Officer of Gatwick Airport Limited may at any time order an aircraft Operator either to move a parked aircraft to another position or remove it from the airport. Failure to comply with the order within the period specified in it will render the Operator liable to a special charge, equivalent to eight times the standard parking charges set out in the Schedule of Charges, for every hour or part of an hour during which the aircraft remains in position after the period specified in the order has expired.

3.3.10 No abatement or waiver of the parking charges will be granted except in accordance with the terms of Conditions 3.3.8 and 4.3.1.



### 3.4 Charges for Specified Activities, PRM, Check-in and Airside Coaching

- 3.4.1 Operators and other users shall pay charges for Utilities, Bus and Coach access, Staff car parking, Staff ID passes and Airside Operators Licence at the rates set out in the relevant appendices within the Schedule of Charges.
- 3.4.2 Gatwick Airport Limited shall ensure that those charges referred to in Condition 3.4.1 and the charges levied by Gatwick Airport Limited for airside parking and cable routing are set at levels which are fair, reasonable and non-discriminatory.
- 3.4.3 At least three months prior to making any amendments to those charges referred to in Condition 3.4.2 above, Gatwick Airport Limited shall provide Operators with relevant information (including cost information, where relevant) and assumptions adequate to verify the basis upon which the amended charges have been calculated.
- 3.4.4 By 31 December in each year Gatwick Airport Limited shall provide Operators and other users with a statement of actual costs and revenues in respect of each of the services and activities referred to in Condition 3.4.2 for the year ending the previous 31 March.

#### PRM charges

- 3.4.5 Operators shall pay charges in relation to PRM services at the rates set out in the Appendix IV of the Schedule of Charges and the Chief Executive Officer reserves the right to make such changes to these rates as he thinks fit following consultation with airlines, which will be promulgated by issue of a GAD.
- 3.4.6 PRM charges are based on an Operator's pre-notification performance as supplied by the PRM service provider. Pending receipt of such notification Operators shall pay the charges on a provisional basis as if less than two hours-notice had been given in respect of each departing passenger. At Chief Executive Officer's discretion the provisional charges may be based on the Operator's historic performance. PRM charges are levied on each of an Operator's departing passengers. The proportion that the number of an Operator's PRMs in each pre-notification band (as set out in Appendix IV of the Schedule of Charges) bears to the Operator's total number of PRMs is applied to the Operator's total number of departing passengers to provide the number of departing passengers in each relevant pre-notification band for charging purposes.
- 3.4.7 Gatwick Airport Limited will undertake reconciliation against the provisional payment following the end of each calendar month, based on pre-notification performance through data provided by the Inform system of the PRM service provider. Any rebate or additional charge will be calculated and made on the basis of such reconciliation.
- 3.4.8 PRM pricing will be kept under review throughout the 2014/15 period and may be varied by an issue of a GAD.
- 3.4.9 By 31 December in each year Gatwick Airport Limited shall provide Operators with a statement of actual costs and revenues in respect of each of the PRM services for the year ending the previous 31 March.

#### Check in and baggage charges

**NOTE: THIS WILL REQUIRE REVISION WHEN LATEST CONSULTATION IS COMPLETED.**



- 3.4.10 Operators shall pay the charges for Check in and baggage as set out in Appendix V of the Schedule of Charges.
- 3.4.11 The following definitions apply for the purpose of calculating the Check in and Baggage Charges payable in accordance with Appendix V of the Schedule of Charges.
- 3.4.11.1 "Departing Passenger using check in facilities" means a departing passenger using check-in facilities at the airport to complete passenger acceptance which includes those passengers who are issued a boarding card whether at a traditional check in desk or at a CUSS terminal or equivalent at the airport. It also includes departing passengers who completed check in off airport but completed a visa check at the airport. The "departing passenger using check in facilities" charge is not applicable for departing passengers who completed check in off airport, and are transfer passengers or passengers with hand luggage who go straight to security or passengers with hold baggage using bag drop only.
- 3.4.11.2 "Departing Hold Bag" means each bag or item that is processed at check in desk or a bag drop facility for onward carriage in the hold of an aircraft.
- 3.4.11.3 "Transfer bag" means each bag or item that is processed on behalf of a Transfer Passenger.
- 3.4.11.4 "Departing ATM" means a departing scheduled or charter flight carrying passengers who are not solely transit passengers.
- 3.4.11.5 "Departing Passenger" means each passenger on the Departing ATM with the exception of a Transit Passenger.
- 3.4.12 Check in and baggage charges are calculated on the basis of the data supplied pursuant to paragraph 4 of Schedule 5. Pending receipt of such data Operators shall pay the charges on a provisional basis as if all departing passengers were "Departing Passenger using Check in facilities". At Chief Executive Officer's discretion the provisional charges may be based on the Operator's historic performance.
- 3.4.13 Gatwick Airport Limited will undertake reconciliation against the provisional payment following the end of each calendar month based on data submitted by the Operator. Any rebate or additional charges will be calculated and made on the basis of such reconciliation.
- 3.4.14 If, an Operator fails to supply the data pursuant to paragraph 4 of Schedule 5 within 60 days of the end of any month rebates will only be paid at the discretion of the Chief Executive Officer.
- 3.4.15 By 31 December in each year GAL shall provide Operators with a statement of actual costs and revenues in respect of the Check in and baggage services for the year ending the previous 31 March

#### **Airside Coaching charges**

- 3.4.16 Operators shall pay the charges agreed between Operators and the airside coaching provider for airside coaching as set out in Appendix VII of the Schedule of Charges.
- 3.4.17 In the event of an Operator failing to pay any charges payable under Condition 3.4.16 when due Gatwick Airport Limited shall be entitled to set off against any amount so due any rebate due to the Operator pursuant to Condition 3.2.3.

## **4. Rebates**





## 4.1 Training flights

- 4.1.1 The Chief Executive Officer of Gatwick Airport Limited has discretion to negotiate agreements at special rates for flying training programmes to be carried out at the airport.
- 4.1.2 The Chief Executive Officer may determine special rates for programmes of test and training flights by helicopters.

## 4.2 Positioning flights

- 4.2.1 The Chief Executive Officer of the airport has discretion to grant a 100% rebate of the charge on landing of aircraft positioning empty for public transport flights. For this purpose, a public flight shall be any flight operated for hire or reward by an aircraft with a Maximum Take Off Weight in excess of 16 metric tonnes or such a flight by a smaller aircraft, where carriage is offered to the public on a regular basis according to a published timetable. This rebate will not be granted on flights resulting from a diversion because of bad weather.
- 4.2.2 Prior written application for permission to make the flight and for the grant of the rebate must be made to the Chief Financial Officer.

## 4.3 Other rebates

- 4.3.1 The Chief Executive Officer of Gatwick Airport Limited has the discretion to abate or waive landing, departing passenger or parking charges for any specified category of traffic and/or when they consider it is in the interest of Gatwick Airport Limited to encourage the development of traffic at the airport.

## 5. Price Commitment

- 5.1 Gatwick Airport Limited agrees to comply with the price commitments set out in Schedule 2 throughout the Term.

## 6. Service Standards Commitment

- 6.1 The Airline Service Standards are set out in Appendix II to Schedule 3. An Operator that has not met the applicable Airline Service Standards Target Level as set out in Appendix II to Schedule 3 will have its entitlement to Core Service Rebates reduced, in accordance with paragraph 3 of Schedule 3.
- 6.2 The Core Service Standards are set out in Appendix I to Schedule 3.
- 6.3 The Core Service Rebate is the amount payable by Gatwick Airport Limited to Operators paying Core Service Charges and operating exclusively pursuant to the Conditions of Use ([referred to in Schedule 3 as "Qualifying Operators"](#)), for a failure by it to meet the Core Service Standards Rebate Level as set out in Appendix I to Schedule 3 and calculated in accordance with Schedule 3 paragraphs 1 and 2. In any Relevant Year the Service Rebate Percentage shall not exceed 7% of revenue from Core Service Charges payable by Operators operating exclusively pursuant to the Conditions of Use in that year.
- 6.4 The Core Service Rebate shall be paid quarterly, within one month of the end of each quarter (being June, September, December, March). The rebates shall be calculated by terminal [\(with the exception of airfield availability which will be calculated at an airfield level and the same percentage applied to](#)



[both terminals](#)) by month and allocated to the Operators that used the terminal pro-rata with the Core Service Charges payable in that month.

[6.5 Rebates payable within a relevant year will be based on a forecast of Core Service Charges revenue for that year, for each terminal. To the extent that actual revenues differ from forecast revenues, rebates will be recalculated and under- or over- payments of rebate will be reconciled and paid or invoiced \(as appropriate\) within 1 month of the publication by Gatwick Airport Limited of its annual report & accounts.](#)

## 7. Continuity of Service Plan, Operational and Financial Resilience

- 7.1 Gatwick Airport Limited shall prepare and at all times maintain a continuity of service plan. The plan shall describe such legal, regulatory, operational and financial information that an administrator, receiver, or new management might reasonably be expected to require, in addition to the aerodrome manual and other statutory or regulatory documents which Gatwick Airport Limited is required to maintain, in order for it to efficiently carry out its functions and to remain compliant with its aerodrome licence. Gatwick Airport Limited shall supply such continuity of service plan to the CAA by 1 October 2014 and shall make such reasonable amendment to the form, scope and content of the plan as the CAA may reasonably require. Gatwick Airport Limited shall provide the CAA with details of any material variations to the continuity of service plan.
- 7.2 Gatwick Airport Limited will develop and maintain an operational resilience plan which will set how it intends to operate an efficient and reliable airport to the levels required by the Core Service Standards or otherwise agreed with users and, in particular, how it will secure the availability and continuity of airport operation services, particularly in times of disruption. Gatwick Airport Limited will consult annually on the resilience plan with all interested parties including the CAA.
- 7.3 In pursuance of the above obligation Gatwick Airport Limited will by 1 October 2014 publish one or more plan(s) or other documents setting out the principles, policies and processes by which it will comply with Condition 7.2. Such plans and any amendments will have regard to any relevant guidance issued by the CAA.
- 7.4 Prior to publishing any plans or other documents under Condition 7.2. Gatwick Airport Limited shall consult all relevant parties on those plans or documents.
- 7.5 Gatwick Airport Limited shall so far as is reasonably practicable coordinate and cooperate with all relevant parties at the airport to meet the requirements of this operational resilience commitment and shall at least once a year hold a meeting to which all relevant parties or organisations representing them shall be entitled to attend to discuss any issues pertinent to this operational resilience commitment.
- 7.6 All providers of air transport services and ground handlers shall use all reasonable endeavours to cooperate with Gatwick Airport Limited in implementing the plan(s) and shall take the actions allocated to them in the plan(s) during periods of disruption.
- 7.7 During periods of service disruption Gatwick Airport Limited shall use reasonable endeavours to coordinate the communication of operational information and to ensure the provision of timely, accurate and clear information about its operations to users of air transport services as well as information as to their rights under denied boarding regulations.



- 7.8 The Directors of Gatwick Airport Limited will provide an annual confirmation of adequate financial resources to operate the airport and provide the Core Services; and
- 7.9 Gatwick Airport Limited shall not amend, vary, supplement or modify or concur in the amendment, variation, supplementation or modification of any of its finance documents in respect of credit rating requirements (whether in each case in the form of a written instrument, agreement or document or otherwise (a "Variation") unless it has given prior written notice thereof to the CAA. Gatwick Airport Limited shall, as soon as reasonably practicable notify the CAA of the possibility of any such Variation; and provide a summary of the executed change. The provisions of this Condition shall not apply to any administrative or procedural variation.

## 8. Investment and Consultation Commitment

- 8.1 Gatwick Airport Limited shall maintain the airport to comply with all applicable safety and environmental requirements and to maintain and develop the infrastructure of the airport to enable the Core Service Standards to be met. In complying with the immediately preceding obligation Gatwick Airport Limited shall invest at least £700m (Seven ~~n Hundred million pounds) during the Term.~~ ~~n Hundred million pounds) during the Term.~~
- 8.2 Gatwick Airport Limited will undertake consultation in relation to the capital investment to be undertaken during the Term in accordance with the provisions of Schedule 4.

## 9. Financial Information Commitment

- 9.1 To ensure there continues to be the provision of sufficient information for Operators to understand whether charges are reasonable, Gatwick Airport Limited will ensure that throughout the Term it provides either through its statutory accounts or through a separate audited statement a level of disclosure in relation to operating costs, revenues, fixed asset base, depreciation and capital expenditure equivalent to the level of disclosure in its statutory accounts for the year ended 31 March 2012.
- 9.2 During each year of the Term Gatwick Airport Limited shall publish a statement of its assessment of the value of its asset base. This will set out the underlying assumptions and calculations, including: the initial asset based (carried forward from the end of the prior year); depreciation; additions; disposals; indexation factors; other adjustments that may be relevant; and the closing asset base (carried forward to the start of the next year).

## 10. Contacts

### 10.1 General

Registered name and address:  
Gatwick Airport Limited  
5th Floor, Destinations Place, South Terminal  
West Sussex RH6 ONP United Kingdom

General enquiries: +44 (0) 844 335 1802  
Website: [www.gatwickairport.com](http://www.gatwickairport.com)

### 10.2 Airport Charges and Specified Pricing



For all charges and pricing related enquiries please use the contact details outlined below. The 2013/14 charges have been consulted on with Operators and other Non-Airline organisations operating at Gatwick. For any questions relating to the consultation process or the level of charges referred to in Appendices I – VI above, please contact:

Tania Rameswaran: (tania.rameswaran@gatwickairport.com) / 01293 501 214

### 10.3 General Operational

For all operational enquiries please use the contact details outlined below, for the relevant person.

- 10.1 For questions relating to the Bus & coach operation:  
Jeremy Bennett: (jeremy.bennett@gatwickairport.com) / 07802 931 877
- 10.2 For questions relating to Check-in & Baggage:  
Terminal Duty Manager: 01293 507446
- 10.3 For question relating to Environment and Schemes to encourage alternative modes of transport:  
Tom Denton: (tom.denton@gatwickairport.com) / 01293 501 369
- 10.4 For questions relating to Staff ID Passes:  
Maria Mayhew: (maria.mayhew@gatwickairport.com) / 01293 504 363
- 10.5 Electricity, Water and Sewerage and Gas:  
Martin Bilton: (martin.bilton@gatwickairport.com) / 01293 503 045
- 10.6 Fixed Electric Ground Power:  
Keith Robson: (keith.robson@gatwickairport.com) / 07775 78 8906
- 10.7 Staff Car Parking:  
Dianne Reynolds: (dianne.reynolds@gatwickairport.com) / 01293 501 119
- 10.8 Airside Licences:  
Airdat.org: (info@airdat.org / 01227 200 066)

### 10.4 PRM

#### 10.4.1 Assistance for passengers:

South Terminal Landside Internal: 507618 (External Contact : 01293 507618)

South Terminal Airside Internal: 698574 (External Contact : 01293 508574)

North Terminal Landside Internal: 692007 (External Contact : 01293 502007)

North Terminal Airside Internal: 694313 (External Contact : 01293 504313)

#### 10.4.2 Operational matters

1st Contact	Duty Managers	PRM Duty Manager	07767 003 906
1st escalation	Wayne Saunders	PRM Operations Manager	07767 005 069
2nd escalation	GMC Leaders	gmc.leaders@gatwickairport.com	

### 10.5 Data Delivery: traffic.charging@gatwickairport.com



**10.6 AOC:** Ian Envis : (envistribe@msn.com) / 07785 231 936

**[10.7 ACC: Jo Rettie \(jorettie@mac.com\) / 0785231936](mailto:jorettie@mac.com)**

**10.7 Passenger Feedback:** Jamie Moore: (jamie.moore@gatwickairport.com) / 01293 503009



**NOTE CHARGES ARE 2013/14 AND INCLUDED FOR ILLUSTRATION****Schedule 1 (Charges effective from 1st April 2014****Appendix I: Schedule of airport charges effective from the 1st of April 2014****(a) Standard Charges**

Charging element	Weight	Noise Cert	2013/14 charges Landing	2013/14 charges Take-Off	
<b>Summer peak</b>	All weights	Chapter 2 and non certificated	£2,656.54	£2,656.54	
		Chapter 3 high	£1,328.27	£1,328.27	
		Chapter 3 base	£885.51	£885.51	
		Chapter 3 minus	£796.96	£796.96	
		Chapter 4	£752.68	£752.68	
<b>Summer off peak</b>	Less than 16 metric tonnes	Any noise certification	£257.63	£257.63	
		Chapter 2 and non certificated	£871.94	£871.94	
	Greater than or equal to 16 metric tonnes and less than or equal to 50 metric tonnes	Chapter 3 high	£386.44	£386.44	
		Chapter 3 base	£257.63	£257.63	
		Chapter 3 minus	£231.86	£231.86	
		Chapter 4	£218.98	£218.98	
	Greater than 50 metric tonnes	Chapter 2 and non certificated	£871.94	£871.94	
		Chapter 3 high	£435.97	£435.97	
		Chapter 3 base	£290.65	£290.65	
		Chapter 3 minus	£261.58	£261.58	
	<b>Winter</b>	Less than 16 metric tonnes	Any noise certification	£257.63	£257.63
			Chapter 2 and non certificated	£871.94	£871.94
Greater than or equal to 16 metric tonnes and less than or equal to 50 metric tonnes		Chapter 3 high	£386.44	£386.44	
		Chapter 3 base	£0.00	£0.00	
		Chapter 3 minus	£0.00	£0.00	
		Chapter 4	£0.00	£0.00	
Greater than 50 metric tonnes		Chapter 2 and non certificated	£871.94	£871.94	
		Chapter 3 high	£435.97	£435.97	
		Chapter 3 base	£0.00	£0.00	
		Chapter 3 minus	£0.00	£0.00	
Chapter 4		£0.00	£0.00		
<b>Helicopter</b>			£145.60	£0.00	
<b>NOx emission charge</b>			£2.63	£2.63	
<b>Charging element</b>			<b>2013/14 charge</b>		
<b>Passenger flights</b>	Domestic charge per departing passenger		£8.05		
	International charge per departing passenger		£12.27		
	Irish charge per departing passenger		£9.89		
	Minimum charge per departing ATM		£218.95		
	Remote stand rebate arriving and departing passengers (all passengers)		-£2.76		
<b>Non passenger flights</b>	Minimum charge per departing ATM		£218.95		
<b>Parking</b>	Fixed charge per 5 minutes <50 metric tonnes		£2.64		
	Fixed charge per 5 minutes ≥ 50 and ≤ 200 metric tonnes		£5.28		
	Fixed charge per 5 minutes >200 metric tonnes		£7.92		
	Summer peak period multiplier (06:00 – 11:59 UTC)		x3		



Summer peak period 0600 – 1159 UTC (GMT) and 1700 – 1859 UTC (GMT), 1st April to 31st October.  
 Summer off peak 1st April to 31st October, all times other than those designated as peak.  
 Winter 1st of November to March 31st

## (b) Premium Service Charges

None

### Appendix II: Utilities charges

Utilities	Prices	Units
Electricity	£0.1485	per KWh
Water	£2.980	per cubic metre
Gas	£1.1707	pence per Therm
Fixed Electrical Ground Power (FEGP)	£7.95	per hour

### Appendix III: Bus and coach charges

Bus and Coaching	Prices	Units
Scheduled	£5.39	per movement
Chartered	£14.96	per visit

### Appendix IV: PRM charges

PRM pre-notification bands	Prices	Units
Less than 2 hours or no notification	£0.80	Per departing passenger
Less than 24 hours notification but greater than or equal to 2 hours notification	£0.38	Per departing passenger
Greater than or equal to 24 hours notification	£0.23	Per departing passenger

### Appendix V: Check in and baggage charges

An Operator of a scheduled or chartered ATM with Terminal Departing Passengers shall pay the following charges with respect to Check in and Baggage.

Metric of use	Prices	Unit charge
Departing Passenger using check-in facilities	£0.170	per passenger
Departing Hold Bag	£0.482	per bag
Transfer Bag	£0.243	per bag
Departing ATM	£18.05	per ATM



Departing Passenger	£0.446	per passenger
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### Appendix VI – Staff Car Parking, Airside Operators Licence and Staff ID charges

Staff car parking / airside Operators licence	Prices
Staff car parking	£496 per pass per year (including £10 transport levy)
Airside Operators licence	£640 per licence per 2 year period

Staff ID passes	Prices	Notes	
Restricted Zone Permanent Passes	RZ Pass Issue and Vetting	£85.19	Charged on application
	RZ Pass Issue and vetting and one re-submission	£97.97	Re-submission following avoidable error with original submission
	RZ Pass Issue and vetting and two re-submissions	£170.38	Re-submission following an avoidable with original submission
	RZ Pass Issue, TUPE, Change of details, five year re-issue, lost or stolen replacement	£42.59	TUPE, change of details, five year re-issue
	RZ damaged / defaced pass	£85.19	Use of pass for any other purpose than for which it was issued

Restricted Zone Temporary Passes	RZ 30 day escorted pass issue and five year vetting	£36.96	Charged on application
	RZ 30 day escorted pass issue and twelve month vetting	£85.92	Charged on application
	RZ 30 day escorted pass Lost/Stolen replacement	£36.96	
	RZ 1-5 day escorted pass issue, re-issue, lost or stolen replacement	£25.00	

Landside and Controlled Area Passes	Landside and controlled area pass issue, re-issue, lost or stolen replacement	£42.59	Charged on application
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Vehicle passes	Permanent vehicle pass	£26.31	
	Temporary vehicle pass	£10.00	

Charges for un-surrendered passes	Un-surrendered RZ and landside pass Un-surrendered RZ 30 days escorted pass Un-surrendered RZ 1-5 day escorted pass	£61.76	After 60 days
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### Appendix VII: Airside Coaching Charges

Units	Prices
Per Pax	£[2.19]





Per Crew	£[14.36]	
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## Schedule 2 Price Commitment

1 For the purposes of this Schedule, the following definitions apply:

- 1.1 'Aggregate Blended Revenue' or ' $R_t$ ' is the sum in a Relevant Year of:
- 1.1.1 revenue arising from Core Service Charges and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of the published airport tariff set out in the Conditions of Use; and
  - 1.1.2 revenue arising from charges equivalent to the Core Service Charge and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of Bilateral Contracts
- but excluding revenue from any other charges not included within the definition of Core Service Charges or Selected Ancillary Service Charges whether levied under the terms of these Conditions or under the terms of Bilateral Contracts or separate commercial arrangements.
- 1.2 'Aggregate Core Revenue' or ' $T_t$ ' means the sum in a Relevant Year of:
- 1.2.1 revenue arising from Core Service Charges and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of the published airport tariff set out in the Conditions of Use; and
  - 1.2.2 revenue arising from charges equivalent to the Core Service Charge and Selected Ancillary Service Charges for relevant commercial passenger services operated under the terms of Bilateral Contracts, but substituting for the actual revenue received the revenue that would have been received if such services had been offered and charged under the terms of the Schedule of Charges set out in the then applicable Conditions of Use
- but excluding revenue from any other charges not included within the definition of Core Service Charges or Selected Ancillary Service Charges whether levied under the terms of these Conditions or under the terms of Bilateral Contracts or separate commercial arrangements.
- 1.3 'Bilateral Contracts' means any contract relating to Airport Charges payable between an Operator and Gatwick Airport Limited other than the Conditions of Use.
- 1.31.4 'Core Services' means such services and facilities in connection with the landing, parking or taking off of aircraft at the airport as were provided as at 1<sup>st</sup> April 2013 in consideration of charges levied under Appendix I (Schedule of airport charges) of the Gatwick Airport Conditions of Use effective from 1<sup>st</sup> April 2013 including those charges determined by reference to number of passengers on board the aircraft, any separate charge for aerodrome navigation services and charges levied on aircraft passengers with their arrival at, or departure from, the airport by air.
- 1.41.5 'Core Service Charges' means those charges referred to in Appendix I of the Schedule of Charges as may be varied from time to time with the exception of any charges levied in respect of whole plane cargo flights, positioning flights and general and business aviation.
- 1.51.6 'Core Yield' means the Aggregate Core Revenue divided by the total number of Passengers using the airport in any Relevant Year.
- 1.61.7 'Blended Yield' means the Aggregate Blended Revenue divided by the total number of Passengers using the airport in any Relevant Year.



- ~~'B<sub>t</sub>' is the bonus per passenger earned in any Relevant Year, if any, being the amount of the Service Bonus earned in that year calculated in accordance with paragraph 4 of Schedule 3 divided by (Q<sub>t</sub>).~~

1.71.8 'Cumulative Gross Revenue Difference' or 'CGRD<sub>t</sub>' is calculated as follows:

$$\text{CGRD}_t = (T_t - Q_t \cdot \text{GY}_t) + \text{CGRD}_{t-1} (1 + I_{t-1}) \text{ and where}$$

$$\text{CGRD}_{2013/14} = 0$$

1.9 'Cumulative Net Revenue Difference' or 'CNRD<sub>t</sub>' is calculated as follows:

$$\text{CNRD}_t = (R_t - Q_t \cdot \text{NY}_t) + \text{CNRD}_{t-1} (1 + I_{t-1}) \text{ and where}$$

$$\text{CNRD}_{2013/14} = 0$$

1.10 'Indicative Net Yield Profile' for a Relevant Year or 'NY<sub>t</sub>' is calculated as follows:

$$\text{NY}_t = U_t + B_t + S_t$$

1.11 'Indicative Gross Yield Profile' for a Relevant Year or '(GY<sub>t</sub>)' is defined as:

$$\text{GY}_t = W_t + B_t + S_t \quad \text{GY}_t = W_t + S_t$$

1.12 'I<sub>t-1</sub>' means the annual percentage interest rate equal to the sum of:

1.12.1 the average of the UK 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 September in t-1 to the end of August in the Relevant Year; and

1.12.2 if the CNRD<sub>t-1</sub> or the CGRD<sub>t-1</sub> to which the indexation rate is being applied has a positive value, 3%, otherwise, 0%.

1.13 Selected Ancillary Service Charges means charges for other services provided by Gatwick Airport namely;

- Staff ID
- airside licences
- FEGP (net of the cost of electricity)
- Airside Parking
- Hydrant Refuelling

1.14 'Q<sub>t</sub>' means the total number of Passengers using the airport in a Relevant Year.

1.15 'Relevant Year' or 't' means the period of twelve months ending on 31 March in each year and 't-1' means the year immediately preceding 't'.

1.16 'RPI<sub>t-1</sub>' means the percentage change in the Retail Price Index between that published with respect to August in year t-1 and that published with respect to the immediately preceding August.

1.17 "S<sub>t</sub>" means the permitted security cost per passenger in relevant year t, if any, being: the aggregate of:

1.17.1 90% of the amount by which the increase, or decrease, in security costs at the airport in year t, which arise as a result of a change in required security standards at



the airport, exceeds £1.75m; and

- 1.17.2 the cost of installing new hold baggage screening equipment in order to meet the requirements of the Department for Transport, the European Commission or other aviation security regulator consulted on by Gatwick Airport Limited in accordance with the capital investment programme consultation process. The cost in year t will be calculated by amortising the capital costs and associated funding costs over the assessed life of the equipment, in equal annual amounts.

divided by ( $Q_t$ ):

- 1.18 'U<sub>t</sub>' is the underlying net yield in Relevant Year t, calculated as follows:

$$U_t = U_{t-1} (1 + RPI_{t-1} + X) \text{ where } U_{2013/14} = \text{£ } [td8.894]$$

[Airports Charges yield uplifted to include yield from

Selected Ancillary Specified Service Charges]

- 1.19 "W<sub>t</sub>" is the underlying gross yield in Relevant Year t, defined as:

$$W_t = W_{t-1} (1 + RPI_{t-1} + X + 1\%)$$

and,

$$W_{2013/14} = U_{2013/14}$$

- 1.20 'X' is 0.5%

- 2 The amount by which the actual Core Yield differs from the Indicative Gross Yield Profile in a Relevant Year will generate a revenue difference which, over the course of the Term, will give rise to the Cumulative Gross Revenue Difference (CGRD<sub>t</sub>). Gatwick Airport Limited shall ensure that the Cumulative Gross Revenue Difference does not exceed :

2.1 £10 million in any Relevant Year during the Term; and

2.2 nil at the end of the Term.

- 3 The amount by which the actual Blended Yield differs from the Indicative Net Yield Profile in a Relevant Year will generate a revenue difference which, over the course of the Term, will give rise to the Cumulative Net Revenue Difference (CNRD<sub>t</sub>). Gatwick Airport Limited shall ensure that the Cumulative Net Revenue Difference does not exceed nil at the end of the term.

- 4 The Indicative Net Yield Profile and the Indicative Gross Yield Profile represent the intended yield profiles of Gatwick Airport Limited in setting the Core Service Charges. They are indicative only and actual yield profiles may vary due to unanticipated circumstances, deliberate business decisions including responses to market conditions or to adjust for prior year under or over recoveries.

- 5 GAL shall set the Core Service Charge in any Relevant Year with the intent that the Core Yield in that year shall not exceed the Core Yield in the prior year by more than RPI + 10% unless it is required to do so to attain ~~a CGRD<sub>2020/21</sub> equal to zero.~~ ~~a CGRD<sub>2020/21</sub> equal to zero.~~

- 6 Any amendment to the Indicative Gross Yield Profile may be made by Gatwick Airport Limited if:

- 6.1 consent to that amendment is given in writing by:



- 6.1.1 Operators carrying at least 67% of passengers (in the 12 months immediately preceding the date on which Gatwick Airport Limited notified Operators of the proposed amendment to the Indicative Gross Yield Profile) on airlines operating at the airport paying the Core Service Charge [or under Bilateral Contracts \(where such contracts adopt the airport tariff as a reference price index\)](#) and
- 6.1.2 by Operators representing at least 50% of the Operators responding in writing; or
- 6.2 following the completion of the work of the Airports Commission the Government supports the development of a second runway at Gatwick Airport, to allow for the recovery of the reasonable costs (capital, operating and financing) of applying for planning permission for a second runway and the subsequent development of the second runway and associated airport infrastructure. Any amendment to the Gross Yield Profile for recovery of such costs will [have regard to follow](#) any policy guidance that may be issued by the CAA in relation to the recovery of costs of new runway development for price regulated airports.
- 7 When undertaking the annual consultation on airport charges, Gatwick Airport Limited will publish the Cumulative Gross Revenue Difference and the Cumulative Net Revenue Difference for prior years (updating using actuals data when available), and estimates of the Cumulative Gross Revenue Difference and the Cumulative Net Revenue Difference for the current year and the following year (including underlying assumptions and estimated data).
- 8 Gatwick Airport Limited shall notify the CAA and all Operators at the airport at least 2 years prior to the end of the Term of its intention with regards to the continuation of commitments, if any, on pricing, service standards, continuity of service, operational and financial resilience, investment consultation and financial information.
- [9 Gatwick Airport Limited shall make available Core Services to all Operators at the Core Service Charges rate as amended from time to time.](#)
- [10 Subject to complying with paragraph 9 above Gatwick Airport Limited may offer enhancements or additions to the Core Services either under Bilateral Contracts or at charges separate from the Core Service Charges.](#)



**Schedule 3 Service Commitments**

1. The Core Service Rebate to ~~an~~ Qualifying Operators in the aggregate ‘a’ in month ‘j’ shall be calculated as:

$$Core\ Service\ Rebate_{t,j} = Service\ Rebate\ Percentage_{t,j} \cdot Annual\ Core\ Service\ Charge_t$$

Where:

Annual Core Service Charge<sub>t</sub> =

in respect of terminal “t”, in relevant financial year ending 31 March, the annual revenue arising from Core Service Charges for relevant commercial passenger services operated by Qualifying Operators under the terms of the published airport tariff set out in the Conditions of Use.

The rebate by each terminal will be allocated to Qualifying Operators that used the terminal pro-rata with the Core Service Charges payable by each Qualifying Operator in relation to that terminal in that month. The deduction to be made from this rebate amount if a Qualifying Operator fails to meet airline standards will be calculated as:

$$Deduction\ from\ Core\ Service\ Rebate_{a,t,j} = Airline\ Standard\ Reduction\ Percentage_{a,t,j} \cdot Core\ Service\ Charges_{a,t,j}$$

$$Deduction\ from\ Core\ Service\ Rebate_{a,t,j} = Airline\ Standard\ Reduction\ Percentage_{a,t,j} \cdot Annual\ Core\ Service\ Charge_{a,t,j}$$

Deduction from Core Service Rebate<sub>a,t,j</sub> = Airline Standard Reduction Percentage<sub>a,t,j</sub> · Annual Core Service Charge<sub>t</sub>. For the avoidance of doubt, the deduction only operates to reduce the Core Service Rebate (if any) payable by GAL to a Qualifying Operator; it cannot result in a payment due from the Qualifying Operator to GAL.

$$Core\ Service\ Rebate_{a,j} = \sum_t Net\ Rebate\ Percentage_{a,t,j} \cdot Core\ Service\ Charge_{a,t,j}$$

Where:

$$Net\ Rebate\ Percentage_{a,t,j} = Service\ Rebate\ Percentage_{t,j} - Airline\ Standard\ Rebate\ Percentage_{a,t,j}$$

Core Service Charge<sub>a,t,j</sub> = Core Service Charges payable by each Operator “a”, in respect of terminal “t”, in relevant month “j”

2. The Service Rebate Percentage in month ‘j’ for each terminal ‘t’ shall be calculated as follows:

~~For each terminal t, the Service Rebate Percentage for the month j shall be calculated as:~~

$$Service\ Rebate\ Percentage_{t,j} = \sum_{standard\ i} 2 \cdot \frac{p_{i,t}}{12} \cdot x_{i,t,j}$$

$$Service\ Rebate\ Percentage_{t,j} = \sum_{standard\ i} p_{i,t} \cdot x_{i,t,j}$$

Where:



$p_{i,t}$  = the maximum potential Core Service Standard rebate percentage ~~per month~~ for standard “i”, for terminal “t”, as set out in Appendix 1 to this Schedule

$x_{i,t,j} = 0$  if the standard “i”, for terminal “t”, in month “j” is greater than or equal to the Core Service Standard rebate level, as set out in Appendix 1 to this Schedule ~~then  $x_{i,t,j} = 0$~~

~~1~~ if the standard “i”, for terminal “t”, in month “j” is less than the Core Service Standard rebate level, as set out in Appendix 1 to this Schedule, ~~then~~

$x_{i,t,j} = 1$ ;

or

~~in relation only to Selected Passenger Facing Measures~~, 1.25, ~~in relation only to Selected Passenger Facing Measures~~, if the relevant standard “i”, for terminal “t”, in months “j” and in each of the ~~five six~~ immediately preceding months (i.e. “j-1”, “j-2”, “j-3”, “j-4”, “j-5”, ~~“j-6”~~) is or was less than the Core Service Standard rebate level, as set out in Appendix ~~1~~ to this Schedule ~~3~~. Provided that the maximum aggregate Service Rebate Percentage payable in relation to all Selected Passenger Facing Measures shall not exceed 2.85% in any financial year ending 31 March; ~~or~~

~~0~~, if prior to month “j” there have been any six or more months in a relevant financial year ending 31 March in which the standard “i”, for terminal “t” was less than the service rebate level, as set out in Appendix 1 to this Schedule. This provision applies in precedence to, and overrides, the provisions above providing for the calculation of  ~~$x_{i,t,j} = 1$  or 1.25~~.

•

For the purposes of this calculation, the Selected Passenger Facing Measures comprise: Departure Lounge Seat Availability; Cleanliness; Way-Finding; Flight Information; Central Passenger Search (times < 5 minutes, times < 15 minutes); Passenger Sensitive Equipment (General); Passenger Sensitive Equipment (Priority); and Arrivals Reclaim (Baggage Carousels).

3. Airline Standard Reduction Percentage for each airline “a” shall be calculated as:

$$\text{Airline Standard Reduction Percentage}_{a,t,j} = \sum_{\text{standard } k} r_{k,t} \cdot z_{k,t,j}$$

$$\text{Airline Standard Reduction Percentage}_{a,t,j} = \sum_{\text{standard } k} r_{k,t} \cdot z_{a,t,j,k}$$

Where:

$r_{k,t}$  = the potential Airline Service Standard Reduction Percentage per month for standard “k”, for terminal “t”, as set out in Appendix ~~II~~ to this Schedule.

$z_{k,t,j} = 0$  if the standard “k”, for terminal “t”, in month “j” is greater than or equal to the Airline Service Standard Target Level, as set out in Appendix ~~II~~ to this Schedule; or

1 if the standard “k”, for terminal “t”, in month “j” is less than the Airline Service Standard Target Level, as set out in Appendix ~~II~~ to this Schedule.



4. Gatwick Airport Limited shall be under no obligation to pay the Core Service Rebate to an Operator which has failed to pay Gatwick Airport Limited any amounts due and owing under these Conditions of Use.

#### **Amendment**

5. Any amendment to the Airline Service Standards or the Core Service Standards may be made by Gatwick Airport Limited following consultation with the Gatwick Airline Operators Committee and the Gatwick [Airline-Airport](#) Consultative Committee if consent to that change is given in writing by:

- 5.1 Operators carrying at least 67% of passengers (in the 12 months immediately preceding the date on which Gatwick Airport Limited notifies Operators of the proposed amendment) travelling through the airport on airlines operating at the airport paying the Core Service Charge or operating under ~~B~~bilateral ~~C~~contracts which have not waived or replaced these Core Service Standards provisions and by

- 5.2 by Operators representing at least 50% of the Operators responding in writing.

#### **Monitoring**

6. Gatwick Airport Limited shall monitor and publish [on the Gatwick Airport website and in the terminals](#) a monthly report in relation to certain airport-wide activities including:

- 6.1 The Core Service Standards
- 6.2 The ~~Operator-Airline~~ Service Standards
- 6.3 PRM service and notification
- 6.4 On-time performance (departures and arrivals)
- 6.5 Immigration performance; and
- 6.6 [ACI](#) Airport Service Quality [ranking](#).

7. If Gatwick Airport Limited fails to meet any Core Service Standard for any six consecutive months it will prepare an improvement plan to address the failure and will consult with the Gatwick Airline Consultative Committee and the CAA on its proposals and will then implement the improvement plan.





### Schedule 3 Appendix I Core Service Standard (Rebates)

*Note agreement on all measures and exceptions still to be finalised with AOG*

	Standard "i"	Metric	Rebate Level	Relevant time over which performance counts for rebates	Maximum potential rebate (both terminals, unless noted)
<b>(i)</b>	<b>Passenger satisfaction measures</b>				<b>0.80%</b>
1	Departure Lounge Seat Availability	Moving Average QSM Score	3.8	As per agreed document to be referenced	0.20%
2	Cleanliness		4.0		0.20%
3	Way-Finding		4.1		0.20%
4	Flight Information		4.2		0.20%
<b>(ii)</b>	<b>Security</b>				<b>2.60%</b>
5	Central Passenger Search	Times <5 Minutes and Times ≤15 Minutes	95% 98%	As per agreed document to be referenced	1.0%
6	Central Passenger Search*	Day when single time slice > 30 Minutes	Single event per day	As per agreed document to be referenced	(0.05% per day) (0.7% max per month)
7	Transfer Passenger Search	Times <10 Minutes	95%	As per agreed document to be referenced	0.20%
8	Staff Search(Terminals and Crew)	Times <5 Minutes	95%	As per agreed document to be referenced	0.35%
9	External Control Posts Search	Times <15 Minutes	95%	As per agreed document to be referenced	0.35%
<b>(iii)</b>	<b>Passenger operational measures</b>				<b>1.05% (ST) 1.55% (NT)</b>
10	Passenger Sensitive Equipment (General)	% Time Available	99%	As per agreed document to be referenced	0.05%
11	Passenger Sensitive Equipment (Priority)	% Time Available	99%	As per agreed document to be referenced	0.50%
12	Inter Terminal Transit System	% Time 1 Car Available and % Time 2 Cars Available	99% 97%	As per agreed document to be referenced	0.50% (NT)
13	Arrivals Reclaim (Baggage Carousels)	% Time Available	99%	As per agreed document to be referenced	0.50%
<b>(iv)</b>	<b>Airline operational measures</b>				<b>1.60%</b>
14	Outbound Baggage	OBP**	99%	As per agreed document to be referenced	0.70%
15	Stands	% Time Available	99%	As per agreed document to be referenced	0.05%
16	Jetties	% Time Available	99%	As per agreed document to be referenced	0.30%
17	Pier Service	Moving annual average %	tbd	As per agreed	0.50%



		passengers pier served		<a href="#">document to be referenced</a>	
18	Fixed Electrical Ground Power	% Time Available	99%	<a href="#">As per agreed document to be referenced</a>	0.05%
(v)	<b>Aerodrome congestion term</b>				<b>0.70%</b>
19	Airfield congestion / availability	<a href="#">[t.b. maximum cumulative movements deferred following a material event which has a material impact]</a>	<a href="#">[t.b. d3***]</a>	<a href="#">As per agreed document to be referenced</a>	0.70%
	<b>Total</b>				<b>7.25% (NT) 6.75% (ST)</b>

\*In a day when the single time slice is greater than 30 minutes the maximum daily penalty is 0.05% with a maximum monthly penalty of 0.70%

\*\* OBP means Overall Baggage Performance as described in the joint GAL/ACC letter to the CAA of 7<sup>th</sup> August 2013.

\*\*\* [Refer to Gatwick Airport Manual of Measurement of satisfaction, security queues and availability for detail.](#)

~~For the purpose of calculating~~ [Calculation of](#) the passenger satisfaction measures, the security queues, the Passenger operational measures and the Airline operational measures [shall be undertaken in accordance with the “Gatwick Airport Manual of Measurement of satisfaction, security queues and availability” annexed to these Conditions which may be amended from time to time by agreement between Gatwick Airport Limited, the Gatwick Airline Operators Committee and the Gatwick Airport Consultative Committee](#) ~~the provisions of Appendix II of this Schedule shall apply.~~



### Schedule 3 Appendix II Measurement of satisfaction, security queues and availability

- 1 “QSM” is The Quality of Service Monitor survey which shall be used to assess passenger satisfaction and conducted using the following approach:
- 1.1 The QSM will be based on the results of survey interviews with not less than 18,000 passengers (departing & arriving interviews combined) per year at Gatwick; and
- 1.2 the interviews obtained shall reflect quotas based on the expected profile of passengers travelling through the airport, set by:
- country of destination for departing interviews; and
  - country of origin for arriving interviews.
- 1.3 In instances where the country quota is high, the sample may have a sub-quota for individual airport destinations.
- 1.4 The QSM scores shall be calculated through a weighted average of the individual scores, weighted by actual traffic statistics for the month.
- 1.5 Departing passengers shall be interviewed at the gate/gate area, immediately prior to boarding the aircraft.
- 1.6 Arriving passengers shall be interviewed on the Arrivals Concourse just before leaving the terminal building.
- 1.7 Selection of passengers to take part in the survey shall be random and unbiased.
- 1.8 During the course of a month, interviewing shall be conducted in both terminals on a selection of mornings/afternoons and weekdays/weekend days.
- 1.9 The following interviewing procedures shall apply:
- 1.9.1 *Introduction*
- The interviewer states “I am now going to ask you a series of questions which require you to rate your answers on the same rating scale”. The showcard is then displayed with the following responses on it: Extremely poor (1), Poor (2), Average (3), Good (4), Excellent (5)
- Departure lounge seat availability*
- “Now, thinking about the departures lounge, how do you rate the ease of finding a seat?”
- 1.9.2 *Way finding*
- A weighted average of the QSM scores for the three way-finding questions, weighted by the proportion of passengers using each form of way-finding: “How easy for you was it to find your way around within this terminal?” (question asked of departing passengers); “Have you been between terminals today? How would you rate the ease of finding your way?” (question asked of departing passengers); “How easy was it to find your way around within this terminal?” (question asked of arriving passengers)
- 1.9.3 *Flight Information*
- A simple average of the QSM scores for the three flight information questions which are asked of departing passengers
- “Flight information (screens and boards only) how do you rate the ease of finding?”
  - “Flight information (screens and boards only) how do you rate the ease of reading?”
  - “Flight information (screens and boards only) how do you rate the ease of understanding the information?”
- 1.9.4 *Cleanliness*
- A weighted average of the QSM scores for five cleanliness questions, weighted by the proportion of passengers using each type of facility. “Where was your boarding card issued to you for today’s flight?”
- How do you rate the level of cleanliness?” (question asked of departing passengers); “Now thinking about the departures lounge, how do you rate the cleanliness?” (question asked of departing passengers); “How would you rate the cleanliness of the arrivals concourse?” (question asked of arriving passengers); “I am going to read out a list of the services/facilities which you may have used or wanted to use in this terminal today. How do you rate the toilet facilities level of cleanliness?” (question asked of arriving passengers)



2 “Queue Length” shall be the time taken for a passenger to move from the back of the security queue or in the case of the South Terminal from the automated access control gates to the first divest station of the roller bed after the X-ray machine from which shall be deducted an agreed unhindered walk time from the start point of the queue measurement to the end point. This measurement shall be taken every 15 minutes.

3 “Availability” of relevant facilities is defined for element I in month j as:

$$\text{Availability}_{ij} = 100 \cdot \left( 1 - \frac{\sum_{k=\text{assets in } i} TU_k}{n_k T} \right)$$

• Where:

- Availability<sub>ij</sub> is the percentage availability of element i in month j;
- n<sub>k</sub> is the number of assets included in element i;
- TU<sub>k</sub> is the time that asset k is unavailable as set out below;
- T is the total relevant time in month j.

The time that an asset is unavailable shall be measured from the time when a fault is reported by automatic back indication or by inspection or by a third party report (subject to the exclusions in paragraph 4).

4 The following sets out the limited circumstances when time will not be required to be counted towards the time when equipment is unavailable or when other standards are not met:

4.1 specific stands, jetties and FEGP to accommodate annual and five yearly statutory inspections, where this work is done in consultation with the airport AOC, and the period specified in advance, the exclusion not to be more than two days over any year (measured from 1 April–31 March) for any particular relevant asset. If works extend beyond any notified period, then any additional downtime would count against the serviceability standard;

4.2 specific passenger sensitive equipment or arrivals reclaim baggage carousels to accommodate planned maintenance, where the work is done in consultation with the airport AOC, the period is specified in advance, the work falls in a dead band month as defined in paragraph 4.2.1 below, and the exclusion is not more than 30 days over any year (measured from 1 April–31 March) for any particular relevant asset. If works extend beyond a notified period, then any additional downtime would count against the serviceability standard. (If a specific asset is measured against both the general PSE standard and the priority PSE standard this exclusion applies to both).

4.2.1 A relevant dead band month is:

4.2.1.1 November,

4.2.1.2 January,

4.2.1.3 February, or

4.2.1.4 March (where Easter Sunday falls on or after 7 April), or

4.2.1.5 a month agreed to in writing for the relevant asset or element and terminal by the airport operator and the AOC.

4.3 security queues for two hours following evacuations;

4.4 closure of passenger sensitive equipment (lifts, escalators, moving walkways) in areas immediately adjacent to security queues where it is considered by the relevant Airport managers that their continued use is likely to lead to unacceptable health and safety risks due to increased congestion;

4.5 stands taken out of service to accommodate high security flights;

4.6 closure of stands to ensure passenger safety during evacuation, emergency or safety incidents and relevant passenger sensitive equipment subject to the AOC agreeing after the event that such passenger service equipment was in the immediate vicinity of the stands or the incident;



- 4.7 — downtime where equipment is automatically shut down by fire alarm activation and the fire alarm activation is not due to a system fault with the fire alarm;
- 4.8 — passenger sensitive equipment where downtime is due to the activation of an emergency stop bottom or break glass, limited to equipment where there is back indication of serviceability and limited to 10 minutes for each occurrence in the case of false alarms;
- 4.9 — downtime to accommodate fire risk assessed deep cleans where an assessment of the equipment's condition has shown that a deep clean is needed to ensure a safe operation can be maintained and to reduce the risk of fire;
- 4.10 — equipment downtime due to damage of, or misuse to, baggage carousels, jetties, stand equipment (e.g. lighting) or fixed electrical ground power units likely to have been caused by airlines or their agents or to passenger sensitive equipment where an airline or airline agent has accepted responsibility or where the AOC agrees with the airport in writing that the likelihood is that the damage has been caused by an airline or its agent;
- 4.11 — downtime where a fault has been reported by airlines or their agents, but, when the engineers attend the site, no fault is found and the equipment is working;
- 4.12 — equipment or stands taken out of service whilst a major investment project is undertaken in the vicinity where this is done in consultation with users and the timing of work has been determined after consultation with the terminal's AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target; and
- 4.13 — equipment or stands taken out of service for replacement or major refurbishment work, i.e. 're-living' work when the timing of work has been determined after consultation with the terminal's AOC, and the period specified in advance. If work extends beyond this period, then the additional downtime will count against the serviceability target
- 4.14 — security process and equipment trials that are carried out for a predetermined period that has been agreed by Gatwick Airport Limited and the AOC are excluded for the period of the trial.
- 4.15 — failure by airlines to comply with airport stand planning rules in relation to the use of stands including failure to use pier served stands in preference to non-pier served stands.

### **Schedule 3 Appendix III – Airline Service Standards**

Standard "k"	Metric	Target Level	Reduction Percentage
Check-in performance – queue time	Times <30 Minutes	95%	1.0%
Arrivals bag performance – last bag on carousel	Times <50 Minutes (long-haul) Times <35 Minutes (short-haul)	95%	0.50%

The check-in performance metric is not routinely measured, although the use of automated queue measurement in South Terminal security indicates that this is feasible. Gatwick Airport Limited will consult with the Gatwick AOC to determine the appropriate approach for implementing such a measurement.



## Schedule 4 (Capital Investment Consultation)

### 1. Definitions

For the purposes of this Schedule the following definitions apply:

- 1.1 'Major Development Projects', means those individual projects or individual programmes of projects in excess of £10m (excluding the Asset Stewardship Programme) and the Second Runway Project;
- 1.2 'Minor Development Projects' means those individual projects or individual programmes of projects less than £10m (excluding both the Asset Stewardship Programme and Second Runway Project); and
- 1.3 'Asset Stewardship Programme' means all asset maintenance and replacement projects in the following asset groups: Airfield, Commercial, IT, Facilities and Compliance/Risk.
- 1.4 'Commercial Return Project' is any project with associated commercial revenues that has a positive Net Present Value not taking into account incremental Airport Charges.
- 1.5 'A Dedicated Airline Project' is a project undertaken for the benefit of one or more specified airlines and which is remunerated by a separate commercial arrangement or specific airport charge payable by users of the project
- 1.6 'ACC' means the Gatwick [Airline-Airport Coordination-Consultative](#) Committee

### 2. Airline consultative groups

- 2.1 Consultation with the airlines will need to be undertaken at a number of different levels, with groups formed appropriately:
  - 2.1.1 ACC: to consider strategic matters involving the medium- to long-term development of the airport;
  - 2.1.2 Capital sub-committee of ACC: to consider tactical matters involving the delivery by GAL of the capital development programme; and
  - 2.1.3 Working groups (informal and formal): to consider operational impacts of projects on the day-to-day activities of the airlines operating at the airport. These working groups (where required) will be project specific, involve affected airlines, and may require a formally constituted working group for significant projects requiring a high degree of airline input into the design and execution planning (e.g. check-in transformation).

### 3. Master Plan

Before publishing a revised Master Plan for the Airport GAL will consult with Operators and the ACC as well as other business partners and the local community.

### 4. Capital Investment Programme

- 4.1 GAL will publish annually a rolling five year Capital Investment Programme (CIP). Before publishing the CIP GAL will consult with the ACC [and with the Gatwick Passenger Advisory Group](#) such consultation to address:
  - 4.1.1 the principal business drivers behind the airport's development strategy, including service levels;
  - 4.1.2 forecast traffic demand and associated demand for airport capacities and services;



- 4.1.3 the capacities that the airport intends to provide, taken in the context of forecasted demand; and



- 4.1.4 the cost of the capital investment programme, and the resulting effect on the asset base of the airport.
- 4.2 The forecast cost of the capital investment programme will:
  - 4.2.1 summarise expenditure on each of the Major Development Projects;
  - 4.2.2 summarise aggregate expenditure on the Asset Stewardship Programme (across all five elements);
  - 4.2.3 summarise aggregate expenditure on Minor Development Projects;
  - 4.2.4 be at a level of detail that reflects the planning horizon and Tollgate status for projects, with those in the short-term being more granular and certain than those in the final years of the forecast; and
  - 4.2.5 provide an explanation as to any material differences between the latest forecast and both the prior year forecast and the forecast incorporated in the CAA's [2014](#) price control review.

## 5. Individual Major Development Project consultation

- 5.1 As part of the annual Capital Investment Programme consultation with the ACC, GAL will consult with airlines in relation to Major Development Projects (with the exception of Commercial Return Projects and Dedicated Airline Projects) covering:
  - 5.1.1 high-level options for the development of Major Development Projects and the trade-offs involved between alternatives;
  - 5.1.2 the outputs that are expected to be delivered in terms of service, capacity, operating cost, and revenue;
  - 5.1.3 scope, programme and cost of the project required to deliver the business objectives; and
  - 5.1.4 the business case for the project.
- 5.2 GAL will consult with the Capital sub-committee of the ACC in relation to the Major Development Projects at Tollgate 2, Tollgate 3, and Tollgate 4. This will require meetings on a more frequent basis than annually.
- 5.3 Following Tollgate 4, progress with the delivery of Major Development Projects will be reviewed by the Capital sub-committee of the ACC as part of its annual Capital Investment Performance Review (see below).

[5.4 GAL will consult with the Gatwick Passenger Advisory Group in relation to Major Development Projects at appropriate times in the life cycle of such projects.](#)

## 6. Annual Capital Investment Performance Review

- 6.1 GAL will meet annually with the Capital sub-committee of the ACC [and members of the Gatwick Passenger Advisory Group](#) to review GAL's delivery of the Capital Investment Programme, specifically:
  - 6.1.1 in relation to the following 12 months:
    - 6.1.1.1 the schedule and expenditure for each Major Development Project;
    - 6.1.1.2 the priorities and aggregate expenditure of the Asset Stewardship Programme across each of the five broad elements (separately identifying individual projects in excess of £1m).
    - 6.1.1.3 the expenditure on Minor Development Projects (separately identifying individual projects in excess of £1m).
  - 6.1.2 in relation to the preceding 12 months, works undertaken and progress with:
    - 6.1.2.1 each Major Development Project;





- 6.1.2.2 Minor Development Projects (separately identifying individual projects in excess of £1m); and
- 6.1.2.3 Asset Stewardship Programme across each of the five broad elements (separately identifying individual projects in excess of £1m).



## Schedule 5 (Data)

### Reference data

1. The Operator shall, or shall ensure that it's appointed handling agent, furnish on demand, and in such form as Gatwick Airport Limited may from time to time determine:
  - 1.1 fleet details including Maximum Take Off Weight (MTOW in kilograms as per Condition 1.1.18), noise characteristics of each aircraft owned or operated by the Operator and engine specifications and associated NOx levels (as per Condition 1.1.7)
  - 1.2 new and amended ownership or registration details to be advised before the 20th of the month preceding first usage
  - 1.3 scheduled time of operation (in UTC) of all flights from point of origin to Gatwick Airport with flight durations greater than 4 hours
  - 1.4 flight plan call signs matched to flight number

This data will be used to determine the level of charges due pursuant to Condition 3. If an Operator believes that any charges have been demanded in error it shall notify Gatwick Airport Limited no later than three months after the date of the invoice making the relevant charge. No investigation into alleged erroneous charging may be made in respect of late claims.

- 1.5 All Operators are required to complete the "All Up Weight Return" form as requested by Gatwick Airport Limited so that it may update our records for charging purposes.

### Payload Data

2. The Operator shall, or shall ensure that it's appointed handling agent, furnish on demand, and in such form as Gatwick Airport Limited may from time to time determine:
  - 2.1 information relating to the movement of its aircraft or aircraft handled by the agent at the airport within 24 hours of each of those movements. This will include the information about the total number of terminal and transit passengers (including children and infants) and the total weight of cargo and mail (expressed in Kilograms) embarked and disembarked at the airport
  - 2.2 details of the Maximum Take Off Weight in respect of each aircraft owned or operated by the Operator.
  - 2.3 details of the Aircraft's Ascertained NOx Emissions in respect of each aircraft owned by the Operator.
  - 2.4 the name and postal address, phone and fax numbers, IATA/ICAO prefix and SITA address of the Operator who is to be invoiced.

### Operational Data

- 3.1 The Operator shall also provide or ensure that its handling agent provides to Gatwick Airport Limited details of all aircraft operations by the timely transmission of complete and accurate operational data preferably by automatic electronic means using (and conforming to) IATA messaging and communications standards. The required operational data includes:
  - 3.1.1 aircraft registration (including aircraft substitutions)
  - 3.1.2 variations to schedule (including flight number, aircraft type, route and scheduled time of operation)
  - 3.1.3 estimated times of operation



- 3.1.4 actual times of arrival (on runway)
- 3.1.5 actual times on and off stand and time of ATC clearance to start engines and push back
- 3.1.6 stand departure delays greater than 15 minutes including complete delay codes
- 3.1.7 turnaround linked flight numbers and registrations (including changes)
- 3.1.8 advance passenger details – forward booking information
- 3.1.9 baggage information messages (BIM’s): BTM, BSM, BPM, BUM, BNS, BCM
- 3.1.10 misconnected baggage information – MSF world tracer report

3.2 The following standard IATA messages should be used:

MVT	AIRCRAFT MOVEMENT MESSAGE	IATA AHM	780 (NI, ED, AD, AA)
LDM	LOAD MESSAGE	IATA AHM	583
SLS	STATISTICAL LOAD SUMMARY	IATA AHM	588
DIV	AIRCRAFT DIVERSION MESSAGE	IATA AHM	781
ASM	ADHOC SCHEDULED MESSAGE PROC	IATA AHM	785 Chapter 5 (cni)
PSM	PASSENGER SERVICE MESSAGE	IATA RP	1715
PTM	PASSENGER TRANSFER MESSAGE	IATA RP	1718
BSM	BAGGAGE SERVICE MESSAGE	IATA RP	1745
MSF	WORLD TRACER FAULT STATION LOG		

3.3 Gatwick Airport Limited IT systems recognise and strictly apply the following IATA standards and any other codes will not be accepted:

Standard for MESSAGE FORMATS	IATA AHM	080
Standard for MESSAGE CORRECTIONS	IATA AHM	081
AIRPORT CODES	IATA AHM	010
DELAY INFORMATION CODES	IATA AHM	011
Form of INTERLINE BAGGAGE TAG	IATA RES	740

3.4 Messages to be sent as follows:

Address LGWPA7X           MVT, LDM, SLS, DIV,ASM  
 Address LGWPA7X           PTM, MSE, PSM and forward booking information  
 SITA MDS (Message Distribution Service)   all Baggage Information Messages (BIM’s)

3.5 All Operators are asked to submit pre-notification data for their PRM passengers in the following way.

SITA address for INFORM:           LGWOCCR  
 Email address for INFORM:        If you do not have a SITA, OCS will have another real time option of pre-booking passengers for the PRM service at Gatwick by using email as follows:  
 Email address:                        LGWPRMControlCentre@ocs.co.uk

Format of the SITA/email needs to be in a recognised IATA format, the subject must start with PAL or CAL. The format detailed below should be followed as this is automatically picked up by the system:

PAL  
 ZB742/03 SEP LGW PART 1  
 1 HARRIS/RUTH. R/WCHR  
 END PAL



If passenger pre-notification is sent via email the email subject line must begin with either the words PAL or CAL. The body of the email must immediately begin with the PAL or CAL, with no salutations or line breaks. PRM email address is detailed above.

The SSR codes which are acceptable and will ensure correct allocation within the "Inform Allocation System" are detailed below. Please adhere to this list when notifying of a PRM passenger.

WCHR	Passenger cannot walk long distance, but can ascend/descend stairs
WCHS	Passenger cannot walk long distance, is unable to ascend/descend stairs but can move inside the cabin unaided
WCHC	Passenger unable to walk at all, cannot ascend/descend stairs and cannot move inside the cabin. Will need to be lifted in and out of seat on board the aircraft.
BLND	Passenger is blind or visually impaired
DEAF	Passenger is deaf or hearing impaired
DPNA	Passenger has a mental or sensory disability
PETC	Passenger is travelling with an assistance dog
STCR	Passenger is being transported in a medical stretcher on-board the aircraft. These passengers are often travelling with medical personnel and will be meeting a pre-arranged ambulance or transport
WCMP	To be used in addition to another SSR code, this will indicate passenger has their own wheelchair or mobility aid which is Manually Powered
WCBD	To be used in addition to another SSR code, this would indicate the passenger is travelling with their own wheelchair or mobility aid which is Battery powered with a Dry cell
WCBW	To be used in addition to another SSR code, this will indicate passenger is travelling with their own wheelchair or mobility aid which is Battery powered with a Wet cell
WCLB	To be used in addition to another SSR code, this will indicate passenger is travelling with their own wheelchair or mobility aid which is powered by a Lithium ion Battery

#### Check In Desk information

4. All Operators are required to submit within 14 days of the end of each month the details of "Departing Passenger Using Check in facilities" for that month, using the template obtainable from Gatwick Airport Limited. Details to be provided are outlined below.
  - 4.1 Departing passenger using check in facilities at the airport to complete passenger acceptance, using one of the following methods:
    - Traditional check in desk (attracts the "Departing Passenger Using Check in facilities")
    - CUSS terminal (attracts the " Departing Passenger Using Check in facilities")
    - Bespoke self-service at the airport (attracts the " Departing Passenger Using Check in facilities ")
  - 4.2 Departing passenger checking in off airport but completes a visa check at the airport to complete passenger acceptance (attracts the " Departing Passenger Using Check in facilities")
  - 4.3 Departing passenger checking in off airport and:
    - Bag drop only (does not attract the " Departing Passenger Using Check in facilities ")
    - Straight through to security (does not attract the " Departing Passenger Using Check in facilities ")
    - Transfer passenger (does not attract the " Departing Passenger Using Check in facilities ")



Please submit the completed template within 14 days of completion of the month, via email to [tania.rameswaran@gatwickairport.com](mailto:tania.rameswaran@gatwickairport.com)

#### Data verification

- 5.1 Gatwick Airport Limited may request, within 60 days of departure, copies of aircraft load sheets to enable verification of all details with respect to the passengers carried on any or all flights departing from that airport during a specified period and extracts from aircraft flight manuals to enable verification of aircraft weight, noise characteristics and the engine NOx emissions level. The Operator shall, following a request in writing made by Gatwick Airport Limited, supply it with the original copies of such documents.
- 5.2 Where the Operator, or its handling agent, fails to provide the information required in paragraph 2 of this Schedule (payload data) within the period stipulated herein Gatwick Airport Limited shall be entitled to assess the charges payable hereunder by the Operator by reference to the maximum passenger capacity of the aircraft, the Maximum Take Off Weight and the maximum NOx emissions level of the aircraft type.

#### Data delivery

5. Queries regarding data delivery should be addressed to: Email: [traffic.charging@gatwickairport.com](mailto:traffic.charging@gatwickairport.com)



# YOUR LONDON AIRPORT *Gatwick*

## **Appendix 3: Cost of capital**

*Response attached overleaf*

# Response to final proposals: cost of capital

## Note prepared for Gatwick Airport Ltd

October 31st 2013

### 1 Introduction

Following the initial proposals (IPs) published in April,<sup>1</sup> the CAA published its final proposals (FPs) in October for the economic regulation of Gatwick Airport.<sup>2</sup>

These centre around the Commitments framework proposed by Gatwick, but also undertake a RAB based approach in order to determine whether the Commitments constitute a fair price (the 'Fair Price Comparator'). While there is an upwards revision in the weighted average cost of capital (WACC) for the determination of the 'Fair Price Comparator', there are a number of important reasons why the WACC is still too low. The most significant point is the failure to recognise that greater competition faced by Gatwick should be compensated for in a higher asset beta and a higher rate of return. It cannot be reasonable for the CAA and its advisers to accept that Gatwick has faced greater risk and greater volatility of revenues, but not to allow it a higher rate of return through a higher asset beta. Similarly, while the CAA has agreed to raise the cost of debt allowed for in the price control there is insufficient recognition that Gatwick's cost of debt is higher than Heathrow's. It is important that greater recognition be given to the higher risks faced by Gatwick compared with Heathrow and that this difference is reflected in the asset beta and the cost of debt, and consequently in a WACC which adequately reflects the difference in the risk profile of the two airports. Oxera does not consider that the proposed WACC differential of 35bp is sufficient.

The main revisions made by the CAA since the IPs are as follows:

- the cost of debt for Gatwick has been increased by 30bp and is consistent with the overall cost of debt proposed in Gatwick's submission to the CAA;

<sup>1</sup> CAA (2013), 'Economic regulation at Gatwick from April 2014: initial proposals', April.

<sup>2</sup> CAA (2013), 'Economic regulation at Gatwick from April 2014: final proposals', October.

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- the risk-free rate (RFR) range has been revised upwards by 25bp, whereas the equity risk premium (ERP) estimate has been decreased by 25bp, leaving the top end of the range for the total equity market returns (TMR) unchanged, at 6.75%. However, the total market return used in the CAA’s point estimate of the cost of equity has increased to the top end of the range.

The overall impact of these changes leads to a point estimate of the pre-tax real WACC of 5.95% (ie, 30bp higher than the IPs).<sup>3</sup> This is 105bp lower than the estimate of 7.0% obtained by taking Gatwick’s submission and adjusting for the lower future tax rates announced in the March 2013 Budget.

In addition to the points regarding the asset beta and cost of debt, the CAA has underestimated the WACC for the following reasons:

- the CAA has not addressed Oxera’s straightforward point regarding calculation of the pre-tax cost of equity; rather, it has introduced new issues that were not consulted on in the IPs;
- however, the CAA’s revised view on an appropriate allowance for the TMR is a better reflection of current forecasts for interest rates and levels uncertainty in capital markets. Nevertheless, a higher estimate of the TMR could be justified in light of the ongoing uncertainty.

The following sections expand on all of these points.

## 2 Asset beta

### **The proposed asset beta does not reflect the significant increase in Gatwick’s risk**

The CAA’s overall conclusion is that there has been no change in Gatwick’s systematic risk profile since Q5, despite significant changes in the commercial environment.

Gatwick and Oxera have submitted extensive analysis of the changes in Gatwick’s risk exposure since the Q5 price control review and how this feeds into the cost of capital. The FPs contain one paragraph on the discussion of Gatwick’s risk arguments, in contrast to four pages on the issue of skewness.<sup>4</sup> PwC has also not properly engaged with the fundamental question of how competition affects Gatwick’s cost of capital, dismissing it as a ‘point in the range’ argument. Given the clear change in circumstances at Gatwick compared with a more stable position at Heathrow, this is entirely inadequate.

In order to ascertain the risks faced by Gatwick over Q6, Oxera and Gatwick undertook a forward-looking analysis of a range of credible but low-probability volume risk scenarios faced by the three designated airports over the period 2014–19, to understand the range of potential outcomes for profitability. This analysis suggested an increase in systematic risk for Gatwick Airport of 15–25% relative to the period preceding Q5. The recent announcements of long-term framework deals for growth between Stansted Airport and, easyJet and Ryanair

<sup>3</sup> CAA (2013), ‘Economic regulation at Gatwick from April 2014: final proposals’, October.

<sup>4</sup> Oxera (2013), ‘How does competition affect Gatwick’s cost of capital in the period beyond Q5?’, March 18th.



suggest that one of the scenarios anticipated in this analysis is more likely now than when the analysis was undertaken last year, proving a greater competitive threat to Gatwick.<sup>5</sup>

The CAA acknowledges that volume risk is systematic risk and that the airport operators' exposure to this is different from that of traditional utilities.<sup>6</sup> Furthermore, it notes the following observations made by its advisers:

PwC noted that it was clear that the absolute level of volatility for airports was higher during Q5 as evidenced by volatility in demand, this reflected inherent risk exposure for these airports from operating during a recession, however, this was also true for the wider market which went through a period of significant market volatility. PwC commented that while *absolute* risk had markedly increased over Q5, investors' view of HAL and GAL's *relative* risk positioning compared to the market had not necessarily worsened, and in fact it could be argued that it had actually improved for example as reflected in HAL and GAL's resilient performance in the challenging macroeconomic conditions during Q5.<sup>7</sup>

Oxera agrees with the observations of the CAA and its advisers to the extent that there has been an increase in absolute volatility over Q5. But, importantly, the increase in volatility has been greater at Gatwick than at Heathrow or Stansted, as demonstrated by Gatwick and Oxera.<sup>8</sup> In contrast, PwC provides no evidence to support its claim regarding investors' views about the relative risk of the London airports. Furthermore, the comparison of the market-to-asset ratios of Heathrow and Gatwick is consistent, with equity investors pricing an increase in the risk of Gatwick relative to Heathrow.

Overall, the CAA's conclusion—that all of the increase in risk is entirely diversifiable and that there has been no impact on systematic risk and the cost of equity—is not a credible interpretation of the evidence advanced by Gatwick and Oxera.

### 3 Cost of debt

#### **The overall cost of debt does not reflect the risk of Heathrow relative to Gatwick**

The CAA has provided Heathrow and Gatwick with the same allowance for the cost of debt; this is incorrect and hence not credible. Greater recognition needs to be given to the higher risks faced by Gatwick compared with Heathrow and this difference needs to be reflected in the cost of debt. If the CAA's methodology is appropriate, this would suggest a cost of debt allowance greater than 3.2% for Gatwick.

The CAA's point estimate of Gatwick's overall cost of debt is 3.2% (up from 2.9% in the IPs). This is the same number as in Gatwick's submission.<sup>9</sup> However, it is not acceptable that the same allowance has been proposed for Heathrow. Gatwick's cost of debt allowance should be greater than Heathrow's, for the reasons mentioned below.

<sup>5</sup> Oxera (2013), 'What is the cost of capital for Gatwick Airport beyond Q5?', methodology and estimation, prepared for Gatwick Airport, January 31st.

<sup>6</sup> CAA (2013), 'Estimating the cost of capital: a technical appendix to the CAA's Final Proposal for economic regulation of Heathrow and Gatwick after April 2014', October, para. 7.59.

<sup>7</sup> CAA (2013), 'Estimating the cost of capital: a technical appendix to the CAA's Final Proposal for economic regulation of Heathrow and Gatwick after April 2014', October, para. 7.55.

<sup>8</sup> Oxera (2013), 'What is the cost of capital for Gatwick Airport beyond Q5?', methodology and estimation, prepared for Gatwick Airport, January 31st.

<sup>9</sup> Ibid.

First, Heathrow has a higher corporate credit rating (ie, A-) than both Gatwick (BBB+) and the target credit rating by the CAA of BBB/BBB+, despite Heathrow's higher gearing.

Second, the cost of Heathrow's embedded debt as estimated by the CAA includes the cost of class B (junior debt). In contrast, the cost of Gatwick's embedded debt has been estimated with reference to the four senior bonds issued by Gatwick.<sup>10</sup> As of September 30th 2013, Heathrow's gearing based on senior debt alone was 68%, and including junior debt increases gearing to 78%.<sup>11</sup> A consistent treatment for Gatwick would recognise that it also has the potential to gear above the notional gearing assumption by issuing more expensive junior debt; on this basis, the higher costs should be recognised by increasing the cost of debt allowance for Gatwick.

Third, the CAA does not distinguish between Gatwick and Heathrow in its weighting of the costs of embedded and new debt. This does not reflect the different circumstances of the two airports. Gatwick is a smaller company than Heathrow, with less flexibility to adopt a rolling refinancing programme, which is why it has raised long-term bonds. As a result, Gatwick does not have a refinancing requirement within Q6. Given the CAPEX projections and the likely debt issuance by the two airports, Gatwick's embedded debt costs merit a higher weight than Heathrow's (ie, greater than 0.7) to reflect the different financing requirements of the two airport operators.

#### **Debt fees and new issue premium**

The CAA makes a 20bp allowance for debt arrangement and commitment fees, which seems appropriate and consistent with the allowance for fees requested by Gatwick and Oxera.<sup>12</sup> As an aggregate allowance, this is consistent with the CAA's own precedent in Q5, allowing for a small increase due to the impact of the financial crisis.

With regard to the new issue premium (NIP), the CAA makes the following observation:

In respect of the remaining 30% (the new debt), the CAA considers that if any NIP exists on the new debt then it is unlikely to have a material effect on the WACC.<sup>13</sup>

The CAA's analysis is inconsistent with estimates of the NIP provided by RBS, which suggest that the NIP could be up to 25bp.<sup>14</sup> Applying this to the cost of new debt would have a material impact, increasing the pre-tax WACC estimate by approximately 5bp.

<sup>10</sup> Furthermore, in their submission, Gatwick and Oxera demonstrated that all of Gatwick's debt was raised efficiently. See Oxera (2013), 'What is the cost of capital for Gatwick Airport beyond Q5?', methodology and estimation, prepared for Gatwick Airport, January 31st.

<sup>11</sup> Heathrow (2013), 'Heathrow (SP) Limited (formerly BAA (SP) Limited): Results for nine months ended 30 September 2013', available at [http://www.heathrowairport.com/static/HeathrowAboutUs/Downloads/PDF/Debt\\_investor\\_presentation\\_9m2013\\_\(final\).pdf](http://www.heathrowairport.com/static/HeathrowAboutUs/Downloads/PDF/Debt_investor_presentation_9m2013_(final).pdf), last accessed October 24th 2013.

<sup>12</sup> The CAA had previously incorrectly reported that Oxera used an estimate of 15bp for fees. CAA (2013), 'Economic regulation at Gatwick from April 2014: initial proposals', April, para. 10.133.

<sup>13</sup> CAA (2013), 'Estimating the cost of capital: a technical appendix to the CAA's Final Proposal for economic regulation of Heathrow and Gatwick after April 2014', October, para. 6.74.

<sup>14</sup> Based on analysis received from The Royal Bank of Scotland.

## 4 Tax

### **The calculation of the pre-tax cost of equity is incorrect**

The CAA acknowledges the error relating to the calculation of the pre-tax cost of equity. However, it then misconstrues this as being related to the difference between statutory and effective tax rates.

The point raised by Gatwick and Oxera does not concern effective and statutory rates. It pertains to the methodology used to provide the tax uplift to the cost of equity. Tax, whether based on a statutory or an effective rate, represents a nominal cash flow. In the case of Gatwick, there is different treatment of depreciation in the regulatory accounts and the tax accounts. In the former, depreciation is indexed to inflation to determine the required revenue and hence the price cap. In the latter, it is based on historical-cost asset values. The rate of inflation creates a difference between these two, and generates a tax liability that is not provided for in the way the CAA is proposing to calculate the pre-tax cost of equity. Applying the tax uplift to real rather than nominal returns is mathematically inconsistent with the way the airport pays tax.

The CAA makes further arguments, stating that airport operators have benefited from falling tax rates, and that Gatwick is not paying corporation tax and is unlikely to do so in the near future. These arguments are completely unrelated to those pertaining to the tax uplift and do not provide any grounds to dismiss the proposal put forth by Gatwick and Oxera.

In any case, with reference to the arguments concerning the application of statutory or effective tax rates, it is understood that Gatwick's effective tax rate is expected to converge to the statutory rate in the early part of Q6.<sup>15</sup>

## 5 Total market returns

### **The assumed TMR is broadly appropriate, given capital market uncertainty**

The CAA's upward revision of the TMR is supported by the volatility observed in capital markets since the CAA's IPs, as well as by the regulatory determination by the ORR.<sup>16</sup> However, the CAA omits any reference to Ofgem's March 2013 strategy decision for RIIO-ED1, which proposed an upper bound of 7.5% for the TMR range (midpoint of 7.0%).<sup>17</sup>

Heightened uncertainty in capital markets persists, following the US Federal Reserve's announcement to withdraw quantitative easing and the ongoing US government budget crisis, combined with uncertainty regarding economic growth. Furthermore, UK government yields have risen since April 2013, as recognised by the CAA. In light of this, a 6.75% estimate of the TMR appears reasonable, although higher estimates would also be consistent with ongoing capital market uncertainty and regulatory precedent.

<sup>15</sup> Based on correspondence from Gatwick.

<sup>16</sup> ORR (2013), 'Periodic Review 2013: Draft determination of Network Rail's outputs and funding for 2014-19', June.

<sup>17</sup> Ofgem (2013), 'Strategy decision for the RIIO-ED1 electricity distribution price control: Financial issues', March 4th.

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### Appendix 4: Traffic

#### 1. Gatwick's position

In response to Chapter 3 (Traffic forecasts) of the final proposals, we note that the CAA final projections are threaded between our most recent forecast (May 2013) and the forecast from the ACC (June 2013). We are pleased that the CAA has recognised the optimism bias in the airlines' higher forecasts. We remain sceptical that the longer term projections made by the CAA are realistic and recent history confirms the risk of regulatory forecasts of traffic being too optimistic.

The current year to date has been volatile and a return to sustained economic growth is by no means firmly established. Increases in routes, based aircraft and load factors, should be tempered by the traffic reductions through airlines ceasing to operate (e.g. US Airways, Air Berlin, Air One, and Hong Kong Airlines) or delaying commencement of operations at Gatwick.

It is our opinion that the short term turbulence we, and a number of our airline customers, are currently experiencing may extend into the medium term, which would cause traffic growth to revert to our longer term projections, based on top down econometric data. Therefore, we are surprised that the CAA projections diverge from ours in the medium to long term, particularly as there is medium term uncertainty in the distribution of passengers across the London market. This uncertainty is, as we have argued before, likely to be increased by enhanced competition from Stansted, as reflected in its recent conclusion of growth-oriented contracts with its major airlines. The potential for some form of mixed mode operation at Heathrow cannot yet be ruled out.

We consider that the ACC and CAA have overstated the benefit to traffic growth of the easyJet purchase of the Flybe slot pairs, given uncertainty around base location of the aircraft used by easyJet, potential cannibalisation of existing traffic and uncertain load factors. Definitive information on the use of these slots has been slow to emerge. We also note that the CAA has acknowledged our point on slot times, load factors and seasonality ratios, when analysing this increase in traffic.

In light of the above and general economic uncertainty, including in Europe, we remain cautious over longer term growth prospects. The ability under a Commitments framework to conclude commercial deals with airlines should assist in mitigating some of the short and medium term traffic risks, we and our airline customers face although, as such, are not relevant to forecasting for traffic under a RAB regime which is the focus of the current exercise.

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### Appendix 5: Capital expenditure and consultation

#### 1. Gatwick's position

Gatwick welcomes the CAA's inclusion in the RAB-based price calculation of most of the projects that were put forward in our RBP and updated in our response to the CAA's initial proposals. However, we are concerned that the CAA's reductions to budgets and in the scope of some projects do not take proper account of the points that Gatwick has made in response to the CAA's consultants' reports and are not therefore soundly based. Moreover, the CAA has proposed reductions in scope without apparently analysing data on capacity, operational needs or passenger insight – all of which need to be brought to bear on the formulation of capex proposals.

Although agreeing with Gatwick that a number of projects are clearly in the passengers' interests, the CAA has proposed a reduced budget compared with that proposed by Gatwick for these projects when calculating its "fair price" comparison. If we were to follow the CAA's proposals we would have carefully to consider whether such projects would remain viable as the CAA's calculations of the costs of projects are unrealistic. The 'fair price' therefore understates the cost of the investment required and in a RAB world would result in scope reduction with reduced benefit delivered to passengers and airlines alike.

#### 2. Specific comments on the CAA's final proposals

There are a number of areas where Gatwick has already responded to the CAA in previous consultations but where we continue to disagree with the conclusions drawn by the CAA and its consultants, as an input to the "fair price":

- **SDG Benchmarking data – 4.25 Page 62 - 63:** Without sight of the comparisons used, it is difficult to know how to verify the benchmarking that SDG has undertaken. Although the CAA believes that the benchmarking is valid, the basis for this belief has not been set out. As a result the CAA's acceptance of SDG's results lacks transparency and balance. From our knowledge of other UK airports there is no close comparator to Gatwick as none have the unique combination of diverse mix of traffic, seasonality or intensity of operation from limited facilities - all factors which impact the ability to procure resource and efficiently to deploy it.

Further, we would challenge the legitimacy of the analysis. The consultants have not disclosed which projects at which airports our projects have been benchmarked against. Without this information we are unable to test what real opportunities might or might not exist in our procurement and delivery activities. We do not believe that this data would be confidential but no attempt has been made, alternatively, to provide anonymised data sets, giving factors such as scale, location, intensity of operation, working windows etc.

More specific comments on the SDG work:

- PAS55 in part, provides a tool to balance the need for asset maintenance with the optimum time to replace assets. As such, Gatwick cannot understand SDG's view that

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alternative or more cost effective solutions haven't been identified. Correctly identifying the optimum point for asset renewal is a fundamental part of PAS55; prior to this maintenance will be undertaken as required. Our processes also consider the efficiency of delivery of the renewals, combining opportunities associated with other capital schemes and relevant interdependencies with operational protocols. Again, the CAA should provide specific examples so that we can explore whether genuine opportunities exist;

- Gatwick notes that the CAA continues to propose “core stretch targets” as, in its view, they are more appropriate. SDG has provided so little direct evidence of how these targets can be achieved that it is not clear how the CAA has reached its view about their appropriateness. There also appears to be continued misunderstanding of project estimating. We reiterate that at tollgate 2 stage there will be unscoped works within projects as they are yet to be fully developed. Unscoped works and risk are not the same, as seems to be implied by SDG's comments. For example, unscoped works in a chiller replacement project may include an allowance for the length of pipe run required – whereas a risk item might be the discovery of asbestos in the area where the pipe run needs to be located; and
- The valid point that Gatwick has made regarding the on costs of non-airport specific assets has again been ignored by the CAA and SDG. Even if an asset is non-airport specific, e.g. boilers, the fact that it is located in a 24hr, 365 day operational environment means that the on-costs associated with their replacement will be higher than in a non-airport environment – as the supervision, airside location, general airport security and, potentially, short or unsocial hours of the working window will all increase cost.
- **HBS Costs – 4.27 Page 65:** The CAA's commentary on HBS appears not to have taken account of Gatwick's comprehensive response to the SDG report. We highlighted in our response that SDG's alternative options were very high level, did not include all the scope required and in one instance was not feasible. Therefore, the potential cost savings identified for this project by SDG are not soundly based;
- **Davis Langdon review – P66-67:** Gatwick stands by the detailed comments it made in response to DL's two reports which explained which of their conclusions we did not support and why. Gatwick is disappointed by the comprehensive lack of proper account being taken of our points;
- **Capital costs for last 2 years of commitments period (4.65, p82):** We have a breakdown for 2019/20 and 2020/21, which we provided in the RBP. The only change to these figures was for the ST IDL Capacity project, which we provided via an updated business case in June 2013. It is not therefore correct for the CAA to state that we refused to supply these figures;
- **ST IDL Capacity (table, p83):** ST IDL Capacity is not forecast to be completed by 2018/2019, so the total sums recorded in the table are incorrect and the table needs to be updated to include this project. £18.18m has been budgeted for 2019/20 and £15.82m for 2020/21 (2013/14 prices). We request that the CAA corrects this error in the final decision document;

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- **Consultation (p192/245):** We note the CAA's concern that Gatwick might not deliver outputs that are in the passengers' interests. We believe that our consultation processes with both the Airport Consultative Committee and the Passenger Advisory Group; and our track record of investing in the passengers' interests as part of our drive to improve service to compete with other airports, are evidence that this concern is superfluous. A current example of Gatwick acting in passengers' interests is our intention of making the investment in NT Borders, creating capacity and installing more auto gates which speed passengers through the immigration process. All of our evidence points to this investment being in passengers' best interests. The ACC does not support this project while the CAA supports a much reduced scope addressing only the general condition of the area and its services; and
- **Sufficiency of consultation (p262):** We welcome the CAA's comment that the consultation processes set out in Gatwick's commitments framework are sufficient.



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### Appendix 6: Operating costs

#### 1. Introduction

Gatwick does not agree with the CAA's assessment of our operating costs projections. Overall, we consider that the CAA's treatment of opex is poorly evidenced and the judgements made are unbalanced. Moreover, some of the conclusions drawn are based on errors of fact and the overall assessment of opex contains elements of double counting of efficiencies from different sources.

The most significant misjudgement is the scale of the cuts assumed by the CAA under the banner of staff benefits. The CAA's target for wage efficiency is £16m per annum by 2018/19 in real terms from today's level. This number includes a £2.8m stretch as a result of the CAA adopting a mid-point between the lower and higher opex bands. The benefit the CAA expects from frontier shift also needs to be attributed to Gatwick's staff costs as most of Gatwick's non-staff costs are driven by external parties and are in most part uncontrollable. Therefore, Gatwick needs to find an additional £6m per annum by 18/19 on top of the £16m already calculated by the CAA from a bottom up perspective. As well as this, and on top of the previous reductions, the CAA has then overlaid a further saving for pension efficiencies, which seeks to lower our pension costs by £4.8m per annum by 2018/19. Overall, the CAA is proposing an unachievable cut of £26.8m per annum on staff benefits by 2018/19. Gatwick will demonstrate throughout this appendix the magnitude of this task and clearly show why this is unachievable.

Overall, there are five primary areas where we believe our opex costs have been treated incorrectly by the CAA:

- The CAA's treatment of our staff costs overestimates the feasibility of affecting change to achieve rapid staff cost efficiencies;
- Elements of the CAA's treatment of Gatwick's pension costs are inappropriate;
- The CAA's implementation of frontier shift ignores the fact that substantial elements of opex are uncontrollable and therefore frontier shift in those areas effectively becomes an additional staff efficiency;
- The CAA's top down benchmarking contains analytical defects, and overestimates the scope for efficiency at Gatwick; and
- The CAA's bottom up benchmarking of opex is of poor quality.

Under each of these subheadings we re-visit the CAA's arguments for the opex efficiency and re-state our case on these points. In some cases we have included new evidence. We also highlight clearly the inherent risk in achieving such severe cuts, even if they were justified, in only a 5 year timeframe.



## 2. The CAA's treatment of our staff costs overestimates the feasibility of affecting change to achieve rapid staff cost efficiencies

In our response to the CAA's initial proposals, we stated our two main significant concerns about the implications drawn from the IDS study:

- 1) Failure to recognise benchmarking limitations; and
- 2) Achievability of key conclusions.

The CAA has disregarded our points under both of these headings, and we would refer the CAA back to page 57 of our response document for our full arguments. However in summary, the CAA is not making any allowance for statistical noise within the IDS benchmarking which was included transparently in the similar IDS study undertaken for the CAA in the last price control review for NERL. The CAA states that it would be inappropriate to disregard individual job roles when assessing total company staff costs. Gatwick is not suggesting that individual job roles should be dismissed but that observations under each job role category that fall within 10% of the median should be disregarded for the purpose of calculating efficiencies. This approach is entirely consistent with IDS' report for the CAA as part of the NERL price control review. For clarity, it is worth quoting the relevant paragraph in full:

*"In understanding the results, a variation from the market median by +/- 5 per cent should be seen as 'paying at the market rate'. The variation only becomes significant if it is more than +/- 10 per cent. Consequently, variations of up to +/- 10 per cent should be seen as being within the market range."*

The clear implication of this is that variations in individual pay rates within +/-10 per cent cannot be included in any calculation of efficiency potential. For those jobs where pay exceeds 10 per cent, it is only that element above 10 per cent that should count. The CAA and IDS have not explained why an approach, consistent with the statistical uncertainties around pay benchmarking, that was used for the NERL review has not been used for the Gatwick review. This is clearly a matter of regulatory consistency for the CAA and of methodological and professional integrity for IDS.

Second, leaving aside for the moment IDS' overall conclusion on percentage wage efficiency, the CAA has made an error in converting this percentage to an overall potential staff cost reduction. The CAA has taken Gatwick's gross staff costs in 2011/12 of £141million and applied IDS' wage efficiency percentage. This overstates the benefit as it includes staff costs that are attributable to our capital programme and subsequently capitalised. The CAA has already overlaid a capex efficiency on our on-costs, so applying a reduction in both our capital and opex allowance leads to a double counting of this efficiency.

Third, again leaving aside questions over the figures, Gatwick is concerned that the CAA has overestimated the feasibility of making changes to our staff and pension policies. As we have outlined previously, Gatwick recognises that we inherited legacy staff arrangements from the previous owners of the airport, and we are working hard to bring these more into line with benchmarks. We do not believe that these actions have been given proper weight by the CAA and we would refer the CAA back to page 58 of our response document to the CAA's initial proposals for more detail. However, we are very concerned also that the CAA has not considered sufficiently the pace at which changes

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can be made to wage and pensions arrangements and, contrary to their own past regulatory precedent, the CAA has not considered or permitted any allowance for the transitional or redundancy costs that are entailed in any radical change to the labour force. The next section puts forward evidence that shows that the speed of proposed wage reductions is clearly unrealistic.

### *Pace of implementing wage reductions*

First, we find it surprising that the CAA believes that it is possible to reduce staff costs by 20% by applying a nominal wage freeze for 5 years. This is entirely unrealistic:

- 1) A proposed pay agreement at 2% nominal for 2013/14 and 2014/15 has not yet been agreed between Gatwick and our unions and is now going to dispute resolution through ACAS. This provides an indication of the difficulties faced in dealing with these issues and the challenge that the CAA should ascribe to requiring labour-related changes;
- 2) Effectively reducing our staff's standard of living by such a large amount over 5 years would undoubtedly lead to industrial action and place unnecessary risk on our operation and our service to passengers;
- 3) The CAA's own benchmarking indicated that non-operational staff reward is in line with the general market. A blanket wage freeze across all roles would leave Gatwick exposed in many key support areas from a skills, talent and leadership perspective; and
- 4) The CAA has elsewhere made optimistic assumptions about the recovery of the economy, which is evident in its assessment of Gatwick's commercial revenue and passenger projections. Under these assumptions, it is unrealistic and inconsistent to expect no nominal wage growth throughout this 5 year period.

Second, we have modelled a number of sensitivities on our staff costs using a set of theoretical assumptions endorsed by the CAA and its consultants in the final proposals. Each of these scenarios indicates that a wage cut of £22m per annum by 2018/19 is implausible without allowing for significant one-off restructuring costs:

### **Scenario 1 – Implement new security officer starter rates**

Under this scenario, we consider the theoretical benefit generated from introducing new starter rates for security officers. As we stated in our business plan, this remains an aspirational objective for Gatwick. Nevertheless, our recent pay negotiations, in which we have sought to introduce a new starter rate, have so far failed to reach an agreement with trade unions and this is now going to dispute resolution through ACAS. This demonstrates the challenge of implementing this goal.

In our calculation in the table below, we have taken our base security wage costs and simplistically modelled the effect of introducing new security starters at a rate of 15% below current rates. We have applied a natural market attrition rate of 13% as per the CAA's assessment, because the CAA comments that Gatwick's rate is 6 percentage points below the market, due to the retention stimulus from above-market pay. Again for simplicity, we have assumed that security wage costs remain flat in real terms during the 5 year period, which implies unchanged headcount and flat wage rises, in line with RPI.

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**Table: Scenario 1 modelling – implementing new security officer starter rates**

£'000s in real 2013/14 Prices		2012/13	2014/15	2015/16	2016/17	2017/18	2018/19
<b>Actual 2012/13 Staff Costs (used as a base for this analysis)</b>							
Security Staff Costs		67,180					
Non-Security Staff Costs		63,096					
<b>Total Staff Costs</b>		<b>130,276</b>					
Security Staff Costs (Excl Pension)	<A>	58,359					
Non-Security Staff Costs (Excl Pensions)	<B>	53,683					
<b>Assumptions</b>							
<ul style="list-style-type: none"> <li>• New starter rates assumed to be 15% lower than current new starter rates</li> <li>• Stretch attrition rate of 13% assumed in line with market avg (GAL 6% pt below market average)</li> </ul>							
<b>Calculation</b>							
Security Wage Costs - if no starter rate implemented	<A>		58,359	58,359	58,359	58,359	58,359
Security Wage Costs - old rates rolled fwd			50,772	44,172	38,430	33,434	29,087
Security Wage Costs - new rates rolled fwd			6,449	12,059	16,940	21,186	24,881
<b>Blended Total Wage Costs</b>	<C>		<b>57,221</b>	<b>56,231</b>	<b>55,370</b>	<b>54,620</b>	<b>53,968</b>
<b>Max wage saving from implementing new starter rates</b>	<A> - <C>		<b>1,138</b>	<b>2,128</b>	<b>2,989</b>	<b>3,739</b>	<b>4,391</b>

Source: Gatwick data and CAA assumptions.

Under these CAA assumptions, the maximum potential wage saving would only reach just over £4m per annum by 2018/19, which represents a significant shortfall to the CAA's wage efficiency target of £22m. Even if the attrition rate was increased to 50% per annum, which would lead to a 100% turnover of the entire security population by 2018/19, this would only generate savings in the region of £8m-£9m by 2018/19. Critically, this ignores significant one-off costs that would be associated with increasing staff turnover to 50% per annum and the associated inconvenience to passengers of dealing with an increasingly inexperienced workforce. As a general point, the critical nature of security staff to airport operations and to passenger safety and the high costs of training, suggest that it is anyway inappropriate to be simplistically reading across from a market turnover rate (let alone anything higher) to security operations without considering whether this is the best way of achieving the balance between cost and security. The CAA does not appear to have carried out this analysis.

### Scenario 2 – Sub-inflation pay settlements

This scenario models the wage reduction in real terms that results from sub inflation pay settlements for all Gatwick staff. The analysis employs SDG's assumption of wage growth within its study: *Gatwick's maintenance and other opex*, which was fully endorsed by the CAA.

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**Table: Scenario 2 modelling – sub-inflation pay settlements**

£'000s in real 2013/14 Prices		2014/15	2015/16	2016/17	2017/18	2018/19
<b>Calculation - Sub inflation pay settlements</b>						
Wage Costs (after new security officer starter rates)	<B> + <C>	110,904	109,914	109,053	108,304	107,652
Pay Settlement (% below inflation)		2%	1%	1%	1%	1%
% Cumulative Wage cost saving - real terms		2.0%	3.0%	4.1%	5.1%	6.1%
Max. wage cost reduction from sub RPI wage settlements		<b>1,109</b>	<b>2,209</b>	<b>3,304</b>	<b>4,398</b>	<b>5,491</b>

Source: Gatwick data and SDG assumptions, endorsed by the CAA.

The analysis shows a wage saving of just over £5m per annum by 2018/19. Again, this demonstrates a significant shortfall to the CAA's wage efficiency target of £22m per annum.

Gatwick believes that both of these scenarios, which use the CAA's assumptions, are unrealistic and impose undue risk to the operation of the business. Even under these unrealistic conditions, Gatwick is still unable to effect change quick enough to deliver the CAA's wage efficiency target by 2018/19.

Finally, the CAA states that by reducing staff absence rates from 10 days per staff member per annum to a benchmark of 6 to 8 days, Gatwick could save £1m per annum. We consider this to take insufficient account of the specialised nature of an airport. Currently, our annualised short term absence rate is around 5 days per staff member per annum. Based on the IDS report, the short term absence rate for manual workers appears to be between 4.4 and 5.6 days, suggesting that our short term absence rates are in line with benchmarks. Our sick absence issue arises from the nature of work undertaken at the airport which has a high, inherent absence risk due to the prominence of manual jobs that can generate physical and mental stress. This limits significantly the ability of Gatwick to achieve absence rates in line with the benchmarks for long term absence. While we acknowledge that Gatwick has room to improve its absence rates, and we have taken targeted action to do this, we believe the benefit is significantly less than the CAA calculates, for the reasons stated above.

### 3. Elements of the CAA's treatment of Gatwick's pension costs are inappropriate

Gatwick has significant concerns with the CAA's pension proposals relating to: (i) future service pension costs; (ii) past service deficit funding; and (iii) the pension commutation payment to the BAA scheme. Many of these concerns have been raised previously with CAA, but are reiterated below, given Gatwick's fundamental disagreement with the CAA's analysis and proposals in some areas.

#### *Future service pension costs*

The CAA's final proposals state that "...based on these changes and applying Gatwick's actuarial valuation assumptions, GAD estimated that an appropriate allowance for DB [defined benefit] pension costs would be 20% to 22% of pay. GAD also stated that a rate towards the lower end of this range would be appropriate to align the costs estimated by the 2010 actuarial valuation. The CAA has taken account of GAD's advice and assumed a contribution rate of 20% through Q6. This results in an efficiency of £3.4 million per year by 2018/19." The final proposals are predicated on the Government

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Actuarial Department's ("GAD") advice that Gatwick's future service pension costs could be reduced from 30% to c.20-22% of pensionable pay, by increasing the scheme's retirement age from 60 to 65 and changing the accrual rate from 54ths to 60ths.

Gatwick is concerned by CAA's final proposals and the potential impacts for the beyond Q5 "fair price" calculation for several reasons. First, the final proposals fail to recognise that the scheme is closed to new entrants and will effectively 'sunset' over the longer term. As stated previously, this is critical to an analysis of the airport's overall longer term opex base and the focus Gatwick has brought to managing effectively future pension costs to an appropriate level.

Second, the benchmarking analysis conducted by GAD refers to the ONS Occupational Pension Schemes Annual Report 2011. Again, like the IDS/Hymans benchmarking analysis, this comparator set includes a significant number of pension schemes of various sizes and from various industries, not all of which are reasonable comparators for Gatwick, thereby distorting the relative positioning of Gatwick's benefits. In addition, the data is significantly out-of-date. Gatwick highlighted both of these concerns in its response to the CAA's initial proposals and its consultants' reports. The significant negative movements, from a pension funding perspective, in both corporate bond yields and inflation during 2012 and 2013 render this old data irrelevant for benchmarking future service pension costs. It is also important to note that these movements, which increased the cost of providing defined benefit ("DB") pensions, are outside the control of management.

Third, as outlined in the Revised Business Plan ("RBP"), Gatwick has implemented a number of reforms to reduce the future cost and risk of pension provision. The airport continues to manage its pension costs actively within the parameters of ensuring operational resilience of a key national infrastructure asset. Achieving efficiency savings in pension costs is not just a simple actuarial calculation. The potential to reduce the contribution rate to 20% as proposed by the CAA is predicated on "*....hypothetical benefit changes...*" rather than a cost reduction strategy grounded in commercial and HR realities. Management operates the airport as an efficient asset, on a strategic basis, for the benefit of passengers and airlines, rather than cherry-picking cost reduction initiatives based on pure mathematical calculations.

Gatwick's forecast DB scheme contribution rate is 30% throughout the five year period beyond Q5. The CAA's final proposals represent a 30% cut to this contribution rate, applied immediately from 1 April 2014 (i.e. first day beyond Q5). This is entirely unrealistic. Even if 20 per cent was the right number, the underlying changes required cannot be achieved overnight, not least given their scale. There are transitional issues which an objective cost assessment needs to recognise. In reality, any efficiency savings would need to be considered and implemented over a period of time, and more importantly, the trade-offs between achieving cost savings and risks to operational resilience and performance need to be understood and mitigated where possible (i.e. avoiding industrial action or other service disruption). The CAA and GAD have given absolutely no consideration to commercial and HR realities in determining either an appropriate contribution rate or a suitable time period over which to implement any pension schemes changes.

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Fourth, in the CAA's final proposals for Heathrow an allowance for DB contributions of 23%-24% is provided<sup>2</sup>. The allowance for future service pensions cost was calculated by GAD based on baseline costs of 33% of pay reduced for certain scheme efficiencies (i.e. NRA increased to age 65 and the accrual rate based on 1/60ths instead of 1/54ths)<sup>3</sup>. This methodology is consistent with GAD's approach to calculating an estimate of Gatwick's future service pension costs. However, since the defined DB pension scheme arrangements at Heathrow are effectively identical to the Gatwick scheme because both schemes originated from the former BAA DB scheme, we would expect the CAA to explain why Heathrow is afforded a contribution rate of 24% by the CAA for future service pension costs, but the allowance for Gatwick is only 20%. This differential, amounting to a 20% greater allowance for Heathrow, is not explained in either the CAA's final proposals or by GAD's reports.

Finally, we note that GAD has reached a view on what an "efficient" pension cost might look like, by assuming that a more "average" benefit structure is adopted (i.e. NRA increased to age 65 and the accrual rate based on 1/60ths instead of 1/54ths) and applying the GAPP funding assumptions. GAD estimates that this would result in an employer future service cost of c.20-22% of pay.

Gatwick believes that such an alternative approach to assessing an efficient pension cost must consider not only an 'average' benefit structure, but also 'average' funding assumptions. In the table below, we have applied these assumptions to GAD's estimate of future service cost (i.e. 20-22%). As a starting point (scenario 2 below), we have calculated the future service cost if the assumptions were set in line with average data published by the Pensions Regulator ('tPR') (and set out in Appendix E of the GAD report). Then, we have considered other possible sensitivities (scenario 3 and 4 below) with more prudent assumptions than the average assumptions published by tPR, but could still be considered to be within an 'average' range. For example, when compared to tPR data, the assumptions adopted in scenario 3 would still fall outside of the upper quartile. The data to assess where scenario 4 would lie is not available, but Gatwick considers these assumptions to fall within a reasonable range. The calculations below are based on adjusting GAD's initial contribution rate range of 20% - 22% p.a.

**Table: Scenarios for changes to DB pension scheme contributions**

Scenario	Scenario description	Contribution rate
1	Estimated future service cost under GAD approach (revised benefit structure and GAPP funding assumptions)	20% p.a. - 22% p.a.
2	As above, but based on average funding assumptions (as published by tPR and set out in Appendix E of GAD report)	22.5% p.a. - 25% p.a.
3	Funding basis equal to tPR funding basis (set out in Appendix E of GAD report), but pre- and post-retirement discount rates reduced by 0.25% p.a.	24.5% p.a. - 27% p.a.
4	Funding basis equal to tPR funding basis (set out in Appendix E of GAD report), but the long term trend in future improvements to longevity increased by 0.25%	23% p.a. - 25.5% p.a.

Source: Gatwick, the Pensions Regulator and GAD.

Please note that the indicative figures quoted above have been based on data provided by GAD and high level actuarial calculations.

<sup>2</sup> CAA's final proposals for Heathrow; paragraph 6.64.

<sup>3</sup> GAD's review of pension costs for Heathrow Airport; paragraph 5.3.

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Adopting the above ‘average’ benefit structure and ‘average’ funding assumptions would increase Gatwick’s contributions over and above their current level.

Considering the above scenarios, the apparent discrepancy with Heathrow, and most importantly the lack of achievability in the timescales given by the CAA for achieving pension efficiencies, the CAA has significantly underestimated Gatwick’s future service pension costs. Based on these factors, Gatwick maintains that the contribution rates per the RBP are reasonable and represent a fair reflection of future service pensions costs in the beyond Q5 period.

### *Past service deficit*

The final proposals state that “.....the CAA has accepted GAD’s conclusion that in principle deficit costs should be included in the opex allowance based on the latest available full or interim pension funding valuation. Gatwick’s estimate is based on different assumptions, which have not been justified. Excluding Gatwick’s deficit cost estimate reduces the opex allowance by £1.4 million by the end of Q6.”

Gatwick welcomes the CAA’s acceptance that pension deficit costs should be included in the “fair price” calculation. However, Gatwick is disappointed that the CAA does not support the recognition in the calculation of the £ deficit projected by Gatwick in its RPB, but refers to the £ deficit per the interim actuarial funding update at 30 September 2012. In October 2013, the scheme’s actuary performed a high level assessment of the scheme deficit as at 30 September 2013 (i.e. the next full actuarial valuation date) based on existing scheme funding principles and allowing for changes in market conditions to that date. These calculations indicate a deficit of £ to £ in the scheme as at 30 September 2013.

These calculations do not allow for any potential changes in the valuation methodology that may be agreed as part of the 2013 valuation or any actual experienced items compared to those expected (e.g. movements in membership, longevity, salary increase experience, etc.). A more prudent approach to the valuation methodology or inputs could have a materially adverse impact on the scheme deficit, for example a 5% decrease in the funding level would increase the above deficit by £.

The RPB included a deficit of £ and Gatwick maintains that this is not unreasonable given:

- More recent funding updates have shown a much greater deficit (i.e. £ to £ as at 30 September 2013); and
- The assumptions used to calculate the deficit are less prudent than those used by Heathrow and the average pension scheme (see Appendix E of GAD’s Report). More prudent assumptions would produce a considerably higher deficit.

Further, the next full actuarial valuation of Gatwick’s pension will be conducted as at 30 September 2013. Gatwick believes that the deficit level to be recovered during the period beyond Q5 should in principle be the deficit calculated within this full actuarial valuation. In practice, this will not be available in time for the CAA’s January 2014 decision. In these circumstances, it is incumbent on the CAA to recognise that the situation relating to funding has changed since the interim update of 30



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September 2012, rather than relying on information that is clearly out of date. In order to reflect an accurate level of pension deficit funding costs in the period beyond Q5 this is the only reasonable and rational option in Gatwick's opinion. Such an approach would also be more consistent with the CAA's final proposals for Heathrow, which make an allowance for future events (i.e. commutation payments from Stansted and Edinburgh) in calculating Heathrow's pension deficit to be funded throughout its Q6 period.

As noted above, in October 2013, Gatwick received an estimate from the scheme's actuary indicating that the deficit in the scheme as at 30 September 2013 is  $\pounds$  to  $\pounds$  based on market data, as at that date and the assumptions consistent with the 2010 full actuarial valuation.

In summary, the CAA's "fair price" in its final proposals would not be sufficient to recover the contributions most likely to be required from Gatwick in the period beyond Q5 (on the latest, 30 September 2013 data) to recover a deficit in the scheme. This is inconsistent with the CAA's view that airport users should meet total pension costs including deficit contributions (and therefore also benefit from any surplus) subject to those costs being efficiently incurred.

### *Commutation payment to the BAA scheme*

In its final proposals, "...the CAA has accepted GAD's recommendations that the commutation payment should be included in Gatwick's Q6 allowance in full. The CAA has included the full payment of £104.7 million in Gatwick's opening RAB." Gatwick welcomes the CAA's proposal to include the full commutation payment in the RAB and that the CAA recognises that the commutation payment reduced substantially the payments that had to be made by the new defined benefit scheme established by the airport on the date of sale and its future risks.

However, Gatwick has two concerns with the CAA's final proposals in relation to: (i) the amount included in the CAA's calculation of Gatwick's opening RAB; and (ii) the period over which Gatwick should be allowed to recover the commutation payment.

First, the commutation payment included in the CAA's calculation of Gatwick's opening RAB is incorrect. The payment was made in 2010 and should be adjusted for inflation to 2011/12 prices (i.e. consistent with the methodology applied to all other elements of the RAB calculation). Therefore, the commutation payment value per Gatwick's opening RAB should be £112.5m. This will also require the depreciation allowance (see below) to be adjusted accordingly.

Second, the CAA's final proposals increase Gatwick's depreciation allowance by £7m for 15 years to reflect the inclusion of the commutation payment in the RAB. The CAA's justification for this 15 year period is "...to account for the size of the payment...". However, scale is not an appropriate basis for a recovery policy. The airport had proposed previously that it should be allowed to recover this asset over a 10 year period from the time the payment was made. This is in line with the normal period over which a company would fund a pension deficit and is a more appropriate basis for recovery than suggested by the CAA. As part of the RAB methodology, there should also be an interest adjustment based on Gatwick's cost of capital, for amounts unrecovered since the payment date.



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#### 4. The CAA's implementation of frontier shift ignores the fact that substantial elements of opex are uncontrollable and therefore frontier shift in those areas effectively becomes an additional staff efficiency

Gatwick has a number of technical arguments against the inclusion and scale of the CAA's frontier shift benefit from CEPA's analysis and the CAA's proposals. These points are explained in the section below.

In addition to the issues we have previously identified with CEPA's methodology, Gatwick would question the practical achievability of the savings suggested by the analysis. In particular, staff costs are the only cost category that could feasibly achieve the £6m per annum saving proposed by the CAA. This is because staff costs are the only sizeable cost category that is controllable and internally sourced, where Gatwick could achieve a saving on this scale. Before taking account of this frontier shift benefit, the CAA has already imposed £20.8m of staff cost savings which, as discussed above, are unrealistic. Therefore, it is unclear how an additional £6m per annum of staff cost savings could be achieved.

#### *Critique of CEPA Assessment*

In our response to the CAA's initial proposals, we included a report by Oxera on the CEPA analysis of top down efficiency assessments commissioned by the CAA. Oxera highlighted a number of issues with the CEPA report which meant that relying on it as evidence would systematically overestimate the prospects for efficiencies at Gatwick.

Given that we provided this feedback, we are disappointed that the CEPA analysis retains most of its weaknesses. In particular, it fails to adjust for structural issues - the breakup of BAA and security cost arising from changes in the security regime. However, we note that CEPA now thinks that the scope for efficiency is tempered by Gatwick's high service quality and performance since ownership change.

Overall, given the problems associated with the CEPA report, we do not consider that it represents useful evidence to calculate the "fair price".

#### *The CAA's process*

In the final proposals, the CAA dismissed some of the comments we submitted from Oxera on the basis that "*It {CEPA} also stated that their report had undertaken the sensitivities suggested by Oxera and that some of Oxera's comments appeared to be based on an earlier draft version of the report, which was no longer relevant.*"<sup>4</sup>

We were surprised by these statements from the CAA and CEPA. CEPA stated that Oxera prepared its report based on a version of the CEPA report dated "April 2013". This is incorrect. The Oxera comments are based on a "March 2013" report with the label "Final Report" on the front cover and "Final Public" in the file name. This appears to be the same version as the CAA also reference in

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<sup>4</sup> In its report "Response to Oxera's note on 'scope for efficiency gains at Gatwick' – TFL, LEMS and output price indices" CEPA states that "... it appears that Oxera has (i) quoted from an early, non-published draft of our report that was shared with the designated airports for comment and (ii) has used the quote out of context."

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footnote 73 of the initial proposals. Therefore, we consider these comments by the CAA and CEPA to be incorrect and the full content of the Oxera note to be relevant as comments on the CAA's initial proposals.

### *Comments on the CEPA responses: Real unit operating expenditure*

We note that CEPA acknowledges that it should have made explicit adjustments for quality and security, which it has not done in its analysis. Given these factors, CEPA suggests that its estimates are likely to be biased upwards.

CEPA agrees that capacity constraints are important. However, the consultants do not undertake any sensitivity analysis looking at how Gatwick compares to other airports with high capacity utilisation.

### *Comments on the CEPA responses: Frontier shift*

Oxera suggested an adjustment for catch-up efficiency of 25% should be applied to the estimation of Frontier shift. While Ofgem has used the approach adopted by CEPA, elsewhere this methodology is considered to be flawed and Oxera has argued this strongly on behalf of electricity networks<sup>5</sup>. Even CEPA limited the credibility of the approach when it provides a health warning that the estimates will include a degree of catch-up efficiency, within the data source used to estimate frontier shift (EU KLEMS)<sup>6</sup>. A recently completed academic study investigated this issue and found that around 25% of productivity growth based on this data is actually catch-up<sup>7</sup>. Therefore, catch-up efficiency represents the same inefficiency identified in the bottom-up benchmarking. This means that in applying If the both CEPA's analysis and the results of other efficiency consultants, there is a clear risk that the CAA is double counting the level of efficiencies<sup>8</sup>.

## **5. The CAA's top down benchmarking contains analytical defects, and overestimates the scope for efficiency at Gatwick**

We note that the CAA has updated its dataset and we welcome its recognition that Gatwick is now slightly below the average level for opex per passenger. However, rather than recognising that should affect the conclusions that it had previously drawn, the CAA is still maintaining its conclusions that there is scope for further savings but basing this on comparisons with individual airports in the sample. Benchmarking of this kind, with only limited adjustments and a limited understanding of the data, makes individual comparisons problematic and therefore an insufficient basis for drawing regulatory conclusions.

We also remain concerned that the CAA is double counting efficiencies between both: (i) functional and staff cost assessments, and (ii) between top down and bottom up assessments. We are

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<sup>5</sup> Oxera (2013), 'The potential for frontier shift in electricity distribution', June, prepared for Electricity North West Limited.

<sup>6</sup> Timmer, M., O'Mahony, M. and Van Ark, B. (2007), 'EU KLEMS Growth and Productivity Accounts: Overview', November, available at: [http://www.euklems.net/data/overview\\_07ii.pdf](http://www.euklems.net/data/overview_07ii.pdf) (accessed July 10th 2009).

<sup>7</sup> Giraleas, D. (2009), 'Productivity growth in the EU: Comparisons between growth accounting and frontier-based approaches', European Workshop on Efficiency and Productivity Analysis.

<sup>8</sup> CEPA argues that these short-term levels of inefficiency 'cancel out'. This seems unlikely as the majority of efficiency gains will reduce the unit costs and hence the average changes in unit costs are likely to be negative rather than zero.

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disappointed that the CAA has not addressed this issue, and it remains an important defect as the CAA is still identifying separate assumed reductions both for individual opex items (such as staff costs) and the nebulous theoretical 'frontier shift'.

### *The CAA's top-down benchmarking*

Based on its analysis, the CAA highlights that opex at Copenhagen, Zurich and Edinburgh airports is relatively efficient when compared to Gatwick, while at the same time these airports outscore Gatwick in terms of service quality. We consider that this analysis suffers from significant shortcomings. Correcting for these suggests that the CAA's analysis was biased.

We have examined further the top down benchmarking analysis undertaken by the CAA and consider that it suffers from a number of defects in addition to those we have identified previously<sup>9</sup>. The CAA adjusts for input costs using national GDP per capita, as a proxy for wage levels. Unfortunately, this conceals regional variations within countries and therefore renders the calculations incorrect. This is particularly problematic in the case of Gatwick, which draws its employment from the South East of England, an area which has a GDP per capita 26% higher<sup>10</sup> than the EU average, compared to just 12% higher for the UK<sup>11</sup>. When the CAA's analysis is adjusted using official regional GDP per capita data from Eurostat, rather than improving efficiency and reducing adjusted opex per passengers by 38% (from £8.14 in 2005 to £5.05 in 2012), Copenhagen has reduced adjusted opex by 18% from 2005 to 2010. In addition, using regional GDP per capita data also suggests that Copenhagen started from a higher base, hence reducing adjusted opex per passenger from £10.23 in 2005 to £8.43 in 2010<sup>12</sup>. This means that while Copenhagen has indeed been improving efficiency over the time period, it is still catching up with Gatwick when analysed using more granular data.

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<sup>9</sup> This is set out in CAP1060 "CAA Airport Operating Expenditure Benchmarking Report 2012"; and data provided 18/10/2013 "Airport Opex Benchmark Model – 2013 – for public.xlsx".

<sup>10</sup> It should be noted that the GDP per capital of Inner London alone is 328% higher than the EU average.  
[http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/1-21032013-AP/EN/1-21032013-AP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/1-21032013-AP/EN/1-21032013-AP-EN.PDF)

<sup>11</sup> Regional GDP per capital analysis is complicated by the fact that national output is not always produced in the same region where people live. This tends to overstate wealth in areas where the work is undertaken, and understate it in residential regions. Eurostat highlights that this is a particular issue around capital regions. To correct for this and generate a more appropriate measure for the Gatwick labour market we have calculated the GDP per capita for the area covered by South East by adding the GDP of Inner London; Outer London; Surrey, East and West Sussex; Hampshire and Isle of Wight; Berkshire, Buckinghamshire and Oxfordshire; Bedfordshire and Hertfordshire; Essex and Kent. This was then divided by population of these regions. For consistency the same adjustments has also calculated for the other comparator airports:

- Copenhagen: "Hovedstaden" [i.e. central Copenhagen], Sjælland and Sydsverige;
- Munich: Oberbayern;
- Amsterdam: Netherlands;
- Zurich: no local region data, using Switzerland;
- Dublin: no local region data, using Ireland;
- Edinburgh: South East Scotland;
- Glasgow: South West Scotland;
- Aberdeen: North Eastern Scotland;
- Birmingham: West Midlands; Herefordshire, Worcestershire and Warwickshire; Shropshire and Staffordshire; and
- Manchester\*: Greater Manchester; Lancashire; South Yorkshire; West Yorkshire; Derbyshire and Nottinghamshire (\* Ideally this sample would also have included Cheshire and Merseyside, however lack of Eurostat data meant these had to be excluded).

<sup>12</sup> Eurostat provides GDP per capita data on a Purchasing Power Parity basis and also correct for the price level in the local economy, which the World Bank data used by the CAA does not. If the regional effect is isolated from the PPP adjustment the then Copenhagen has a slightly lower opex per passenger (in 2010/11) than Gatwick on a per passenger basis. The difference is however only half of that identified by the CAA, with Copenhagen's costs approximately equal to Stansted. Gatwick remains more efficient than both Dublin and Edinburgh on this basis.

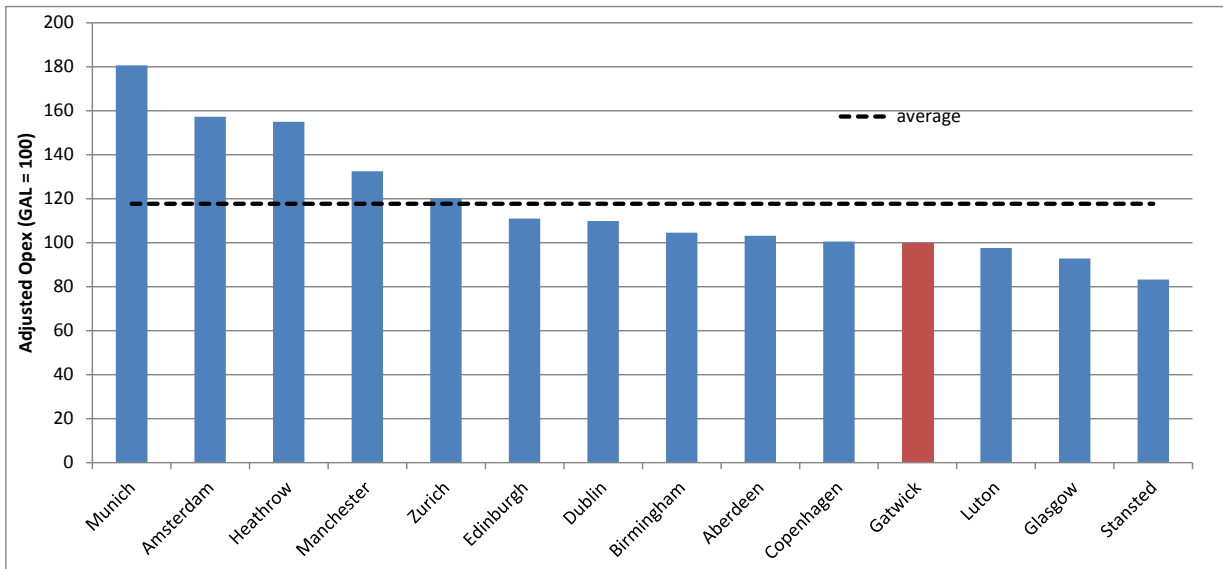
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When the same analysis is repeated for the other airports in the CAA’s sample using the CAA’s own data<sup>13</sup>, then Gatwick is only outperformed by Stansted, Luton and Glasgow. In addition, Gatwick has approximately the same adjusted opex per passenger as Copenhagen, and outperforms Amsterdam, Dublin, Zurich, Munich, Aberdeen, Birmingham, Edinburgh, Heathrow and Manchester.

We note that in addition to the correction of staff costs, the CAA also makes adjustments to other opex and non-wage staff costs based on country *Purchasing Power Parity* data. While possibly not of the same magnitude, we note that this could also have the effect of skewing results within countries. For example, the ONS found that relative price levels in the South East were 2% above the UK average, London 8% above, while Scotland and the North West were 1% and 2% below, respectively<sup>14</sup>.

**Figure: Factor cost adjusted opex at airports (CAA sample)**



Source: CAA, eurostat data, Gatwick analysis.

This updated analysis contradicts the assertion made by the CAA that “there should be scope for further catch-up efficiency at Gatwick... based on direct comparison with more efficient airports within the sample”<sup>15</sup>. [.....

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<sup>13</sup> The only airport excluded from the CAA’s sample was Hong Kong. We outlined why we considered a comparison with Hong Kong airport to be of limited relevance in our response to the initial proposals.

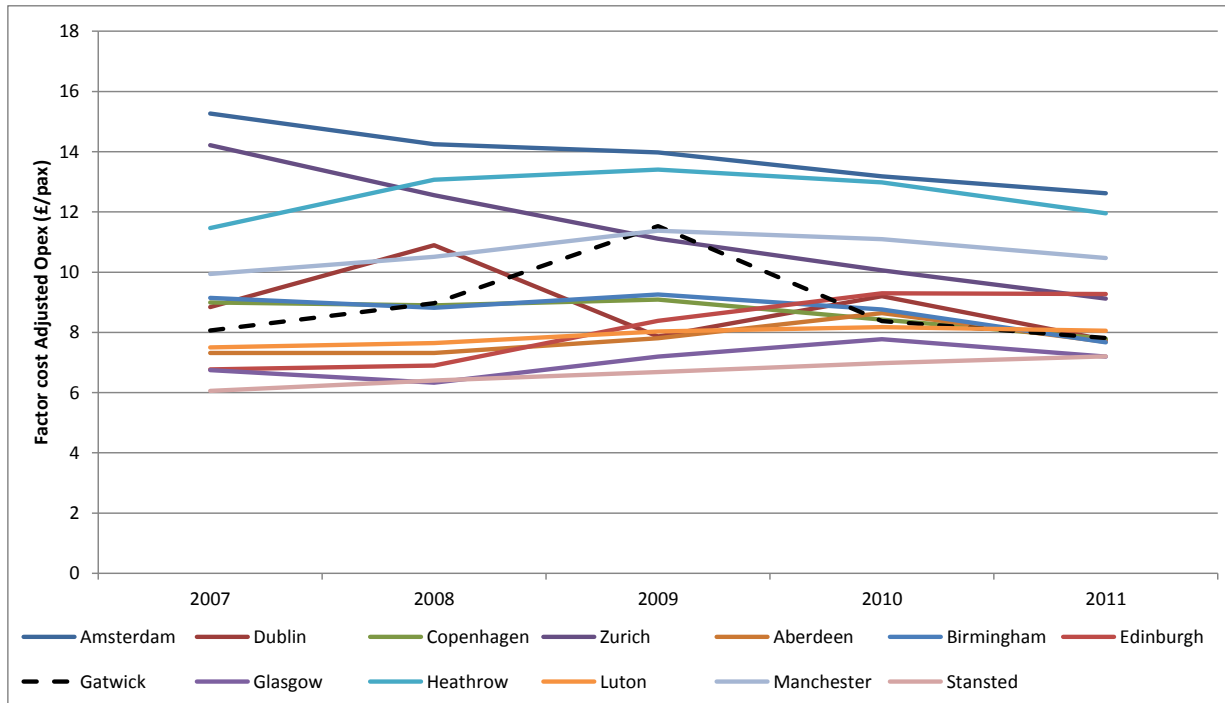
<sup>14</sup> ONS: UK Relative Regional Consumer Price levels for Goods and Services for 2010. <http://www.ons.gov.uk/ons/rel/cpi/regional-consumer-price-levels/2010/uk-relative-regional-consumer-price-levels-for-goods-and-services-for-2010.pdf>

<sup>15</sup> CAA CAP 1102 page 89.

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Figure: Evolution of factor cost adjusted opex at airports (CAA sample)<sup>16</sup>



Source: CAA, eurostat data, Gatwick analysis.

The narrative above about Gatwick’s relative efficiency is consistent with the substantial improvements made by Gatwick since the separation from BAA, including achieving a reduction in opex of 32% relative to the peak in 2009/10 and 3% compared to 2007. This compares to Heathrow, where costs have increased by 4% in the same period. Despite inheriting many legacy arrangements from BAA, Gatwick has been able to achieve this performance through innovation. For example, we have significantly improved our security product, where the investment in the South Terminal security and improvements in rostering and scheduling has delivered enviable performance. We have also achieved reductions through the adoption of best practice processes, such as using lean and six sigma concepts and have delivered opex saving through re-scoping of the capital plan to deliver more efficient solutions, reducing rates and cleaning costs. This has been accomplished while delivering a steadily improved service<sup>17</sup>.

Further still, the CAA argued that “airports with high proportions of low cost passengers tend to have lower operating cost.” We believe that this statement is simplistic and such costs need to be considered within their appropriate context. For example, some airports have facilities either designed exclusively for, or adapted to, the use of some of the low cost carriers, making them unattractive for others<sup>18</sup>. This includes facilities such as the ‘Go’ pier at Copenhagen, the Terminal 2

<sup>16</sup> Regional GDP/capita from Eurostat only has data up until 2010, adjustment for 2011 has been undertaken using the 2010 adjustment factors as a proxy.

<sup>17</sup> Please see Chapter 11 of our Revised Business Plan “Connecting London to the World; A new deal at London Gatwick” for further details.

<sup>18</sup> It is noteworthy that ‘Norwegian Air Shuttle’ (considered a LCC by CAA) does not tend to use the ‘Go’ facilities at Copenhagen.

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part at Barcelona or the former low cost terminal at Singapore Airport<sup>19</sup>. The varied and evolving nature of our traffic, competition with the other London airports and high utilisation of our infrastructure means that such a narrow service proposition for some, or all of our facilities, would be suboptimal. Indeed, the CAA's views on infrastructure specialisation are inconsistent with those of key airlines using Gatwick which have highlighted the single bundle of services offered and that the business models of so called FSCs and LCCs have increasingly been converging, with former LCCs increasingly targeting premium passengers. Moreover, at Gatwick, a large proportion of our opex is of a fixed and/or external nature (i.e. NATS, Police, rates, security costs<sup>20</sup> and utilities); these costs are not directly driven by our airline and passenger mix.

### *Comparisons between Gatwick and Copenhagen*

The CAA points to the similarities between Gatwick and Copenhagen airports, noting in particular the similar level of ATMs, gates and proportion of international passengers, even with a larger number of terminals and runways. While these high level observations may be correct, in practice there are factors which limit the comparability of the two airports and which have clear implications for opex:

- Terminal 1 in Copenhagen handles only Domestic traffic, which in 2012 represented 1.8m passengers, about 8% of traffic;
- Terminals 2 and 3 (as well as the 'Go' pier) are separate only in terms of the check in area. They share a common security search area, IDL, baggage, borders and arrivals facilities;
- Unlike Gatwick, Copenhagen airport has no segregation between arriving and departing passengers, as arriving passengers exit from gates into the IDL, mixing with departing passengers. Taken together with the small size and entirely domestic traffic of Terminal 1 this means that Copenhagen is effectively a one terminal airport; and
- Compared to Gatwick, the three runways at Copenhagen make for a significantly less congested and less complicated airfield operation. This has implications for the cost of operating and maintaining the airport.

Gatwick recognises that Copenhagen is a highly rated airport and we consider it to be a good comparator for some purposes, such as service quality, which is why we are now pleased to be outperforming Copenhagen on that score. However, the factors above highlight that greater care is

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<sup>19</sup> We understand that the low cost terminal originally opened in 2006 close in 2012 to make room for a new terminal with higher capacity and a better service offering.

<sup>20</sup> We note on security flow rates that the CAA argues that BA's policy of allowing two separate cabin bags 'on balance' suggests the number of images per passenger increase and overall pressure on security flow rates at Heathrow is greater than at Gatwick. We dispute this:

- There are airlines at Gatwick which also apply the two bag policy, including BA and Norwegian;
- easyJet has recently introduced new hand baggage sizing policies linked to the type of ticket and whether passengers wish to be "guaranteed" the bag is not placed in the hold. This was due to the very intensive use of the hand luggage space on easyJet planes. To the best of our knowledge we do not believe the same issues have arisen with hand luggage on BA planes. In our view this strongly suggests that the CAA's reasoning is flawed. The tightly packed luggage that is more prevalent on easyJet flights is generally slower to process through security checks; and
- Business passengers, of which Heathrow currently has a somewhat greater proportion, tend to travel more frequently, be used to the security arrangements and be quicker and easier to process.

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needed when assessing the differences in operating costs, in particular given that our analysis suggests that the CAA is overstating the efficiency of Copenhagen airport.

### *Comparisons with airlines*

In our response to the CAA's initial proposals, we noted that comparisons of efficiency between easyJet and Gatwick were unlikely to be informative due to the significant growth easyJet had seen over the comparison period, in terms of fleet size, aircraft size and stage lengths. We argued that a more established organisation did not have the same scope to achieve growing opex efficiency over time as one which is growing rapidly.

The CAA defended its opex change comparison between Gatwick and easyJet, noting that the two shared similar labour markets, as well as security requirements. The CAA considered that the main difference is the level of competition. It also dismissed our argument that the rapid growth and structural changes at easyJet could affect the analysis, noting that comparisons with Ryanair and BA produce the same conclusions.

We believe that these new arguments presented by the CAA in defence of its comparison with easyJet are flawed, for the following reasons:

- Gatwick is not an airline. The majority of Gatwick staff work in airport security. We do not employ cabin crew. Comparisons between easyJet and Gatwick are not valid;
- easyJet employs many of its staff in cheaper locations around Europe, whereas Gatwick staff are employed in London and the South East. As we outlined in our response to the initial proposals, easyJet has grown substantially during the period, and it is also important to note that its non-Gatwick operations have grown faster than the Gatwick operations. Hence, insofar as the two were at all comparable to begin with, these changes are making easyJet progressively less comparable to Gatwick over time;
- Comparison with Ryanair shares the same weakness as the comparison with easyJet in terms of growth. Ryanair grew from 13 aircraft in 2000 to 45 aircraft in 2004 to 303 in 2013. The equivalent numbers for easyJet are around 18 in 2000, 100 in 2004 to 200 in 2013. However, it is also noteworthy that in terms of capacity Ryanair's expansion is greater, both in terms of the number of aircraft, and due to the size of the individual aircraft being greater;
- Comparison with BA is also problematic. Over the period BA divested some businesses, including BA Connect and was subject to substantial and very public industrial relations problems;
- The security demands on an airport are of a different order of magnitude compared to those of airlines;
- Airlines have been able to increase their efficiency by getting their customers to do more for themselves (i.e. online check in, replacing agents with online booking systems etc.). Similar opportunities have not been open to airports; and



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- We do not consider that the CAA's assertion that one of the largest differences between the airline and airport sectors is the level of competition is relevant for Gatwick. Gatwick's competition with other airports in London and the South East, as well as around Europe, is very real and obvious to our passengers. Hence, we do not consider there to be any relevant difference between easyJet and Gatwick in this regard.

Gatwick continues to regard the CAA's comparison with airlines to be irrelevant – and therefore misleading - for the purpose of assessing the efficiency of opex at Gatwick.

### *AT Kearney analysis*

The CAA dismisses Gatwick's AT Kearney *inside-out* form of top down opex benchmarking study on the grounds that it was commissioned for a different purpose (i.e. to benchmark Gatwick's IT and support costs). We consider this argument made by the CAA to be irrelevant and note that AT Kearney uses the same robust benchmarking methodology whether the purpose is benchmarking total opex or just support costs.

Gatwick would like to remind the CAA of AT Kearney's benchmarking methodology and why we consider it to be superior to the airport benchmarks that the CAA has employed:

- AT Kearney uses only information that it has collated itself, through rigorous checking of the comparability of functions within each benchmarked area (this is referred to as "inside-out" benchmarking). This essentially means that AT Kearney visits every company for a period of several weeks, taking the most granular snapshot of the airport's internal accounting data and KPI's, and then matching each of the individual data lines to their database structure using a set of consistent definitions. Hence, the analysis of Gatwick compares our functions with the inside-out data from other airports;
- The AT Kearney benchmarks create real comparability by using an holistic approach and standardised data collection:
  - It standardises cost inputs split by activities and types and it ensures consistency by using a large set of precise definitions set in AT Kearney's Global Competitive Benchmark manual;
  - Harmonisation is undertaken, to adjust for country specific levels, such as exchange rate differences and national/regional output factors; and
  - Airport activity is normalised by relevant output levels (i.e. opex per passenger, security throughput per lane etc.).
- Absolute data confidentiality ensures that airports provide data at the most granular level knowing that it will be treated in absolute confidence;
- It does not use data from any public sources, which are often misinterpreted and misused; and



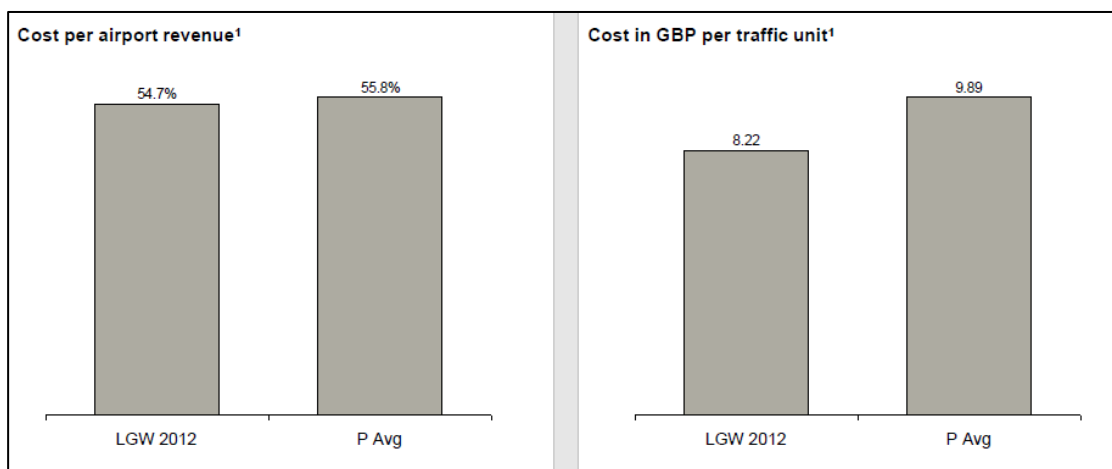
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- AT Kearney’s methodology has proven itself for over 10 years and is executed continuously, not only in aviation, but also significantly in telecoms, where it has become the industry norm in Europe.

At the top down level, AT Kearney reviewed Gatwick’s total operating costs for 2012/13 against its panel. This analysis revealed that Gatwick was 2% more efficient than comparable airports when total costs are normalised by revenue and 17% more efficient when normalised by passengers and cargo (“traffic unit”), as shown in the figure below:

**Figure: AT Kearney’s total operating cost benchmarking**



Source: AT Kearney (see Appendix 6); 1. Without groundhandling costs

We believe there is no justification for excluding AT Kearney’s outputs from the overall conclusions, and the greater rigour of the analysis means they should be given more significance than the other top down studies.

## 6. The CAA’s bottom up benchmarking of opex is of poor quality

We have provided multiple sets of comments on the CAA’s bottom up consultant reports during the review. While many of our concerns have not been considered appropriately or acted upon, we provide specific new comments below.

### *SDG other opex, and maintenance and renewals studies*

Gatwick is disappointed that “Overall SDG concluded that the responses to the initial proposals did not raise any new evidence or arguments that had not been considered in earlier phases of the study. SDG did not propose any changes to their efficiency estimates.” We remain extremely concerned that the CAA and SDG have failed to address the comments we have made throughout this process, and with the cavalier and dismissive attitude adopted towards the evidence we have submitted.

Throughout its final proposals, the CAA appears to use language such as: “The CAA accepts that no benchmarking sample is perfectly comparable to Gatwick...” with some frequency. We recognise that any benchmarking exercise presents challenges to the party undertaking it, that choices need to be

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made, and that perfect comparability cannot always be assured. However, we would have expected the overall results to be developed with much greater caution, given the wide area the CAA and its consultants attempt to cover with this exercise. The efficiencies assumed in the CAA's "fair price" calculation in our opinion represent a significantly skewed and unduly aggressive approach.

Further, we note that the CAA argued that *"Many of the efficiencies proposals are based on the application of less conservative assumptions in the business plan including the use of official forecasts of policy for utility and police cost growth. The CAA considers that this is appropriate and Gatwick has not provided adequate explanation for different assumptions applied in its business plan."* Gatwick disagrees with the CAA that this is the case:

- Gatwick has provided detailed explanations, specific to Gatwick, in support of our utility, police, NATS, Cleaning and PRM cost forecasts while, despite our repeatedly asking for supporting information, many of SDG's efficiencies remain unevidenced; and
- Overall we consider that SDG's other opex report has not considered the evidence we have provided and continues to rely on assertions rather than evidence.

The most serious misjudgements were in the areas of NATS, police and cleaning:

- **NATS:** We believe that there is upward pressure on price due to scope and capability risk (including from Gatwick's approach to improving runway utilisation), ATCO wage cost risk and the fact that there are only a small number of suitable substitutes. SDG's own benchmarking indicates Gatwick's current rate to be favourable. Yet SDG cite procurement strategy as likely to be able to counter any price inflation. Such procurement at other airports has not resulted in a change of operator and hence, both SDG's reasoning is weak and its expectations are over-optimistic;
- **Police:** The Winsor review of police pay indicates a re-distribution of pay calibrated on level of specialism as opposed to length of service. As the police deployed at Gatwick have one of the highest degrees of specialist skills (e.g. firearms, anti-terrorism, dog handling), this will be highly relevant to future pay pressures at Gatwick. Therefore, we believe this warrants an assumption of modest real-terms increase in police pay in line with this long term trend. SDG's generic view – police salary costs will follow standard public sector pay targets of 1% nominal to 2014/15, then 2% thereafter – does not reflect the specifics of Gatwick as it should; and
- **Cleaning:** SDG's benchmarking made no attempt to normalise for service cleaning standards. In our experience, improvement in cleaning standards cannot be achieved through process improvements or innovation, but is driven primarily by additional resource. Our high expectations of cleaning standards, coupled with higher levels of customer service, support Gatwick's view that the reward structure should increase at a higher rate than the minimum wage – not least given that the minimum wage has recently declined significantly in real terms.

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We consider that SDG and the CAA have consistently provided an unbalanced view by making no attempt, qualitatively or quantitatively, to normalise for service quality. SDG does not offer substantive, fact-based evidence to support their conclusions and does not give detailed examples of how it considers efficiencies can be achieved. We would expect this from a bottom up analysis of this type.

Overall, we are disappointed the CAA did not use this last iteration to salvage any objective value from this report, instead relying on SDG simply to dismiss Gatwick's points.

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### Appendix 7: Commercial revenue

#### 1. Introduction

The CAA has accepted SDG’s assessment of Gatwick’s commercial revenue per passenger in its entirety, which we believe is a serious misjudgement. Despite spending considerable time and resource with SDG to put forward our business plan evidence, they continually seem to misunderstand and misinterpret our business, and the market conditions in which we operate, leading to a serious overstatement of our projected income. In particular, we are frustrated by the lack of fact-based and granular evidence to support their arguments, and of specific examples as to how their increased projections can be achieved.

Although most of our arguments are directed towards SDG’s analysis, we highlight one material flaw in the CAA’s own analysis. The CAA makes an over-simplistic assumption that all of Gatwick’s commercial revenue is proportional to passengers. We explain why this is incorrect and leads to a serious overstatement of revenue. We then demonstrate why the CAA should not fully accept their consultant’s view of Gatwick’s commercial revenue. Under each of the commercial categories of retail, car parks and property, we re-state SDG’s point of view and arguments, and afterwards provide our evidence refuting these points and explain, in most cases, why they are implausible. We then go on to re-state our view, which has remained consistent throughout this process, along with our fact-based evidence. In some cases we have added new evidence that reinforces our arguments, as new data emerges during this process.

#### 2. Variability of revenue projections with passengers

In taking SDG’s revenue per passenger projections and adjusting for a new passenger forecast, the CAA is implicitly acknowledging that all three areas of retail, car parks and property are directly proportional to passenger numbers. Given the extent to which the CAA has raised its passenger projections above Gatwick’s forecasts, this assumption is too crude and leads to a material overstatement of Gatwick’s revenue. We look at each of the commercial areas in order of materiality:

- **Retail:** Retail consists of a wide range of categories and has a large set of revenue drivers. Some drivers are directly linked to terminal passenger throughput; others are indirectly linked to passenger numbers and therefore less sensitive to changes. Advertising and telecoms revenue, for example, would fall into the latter bracket. It is therefore incorrect to consider passenger-revenue elasticity at a total retail level, as the CAA has done in its Final Proposals.  
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.....] Similarly, retail categories such as WDF and specialist shops are very sensitive to the mix of EU to non-EU sales. As well as this, car rental and taxis are sensitive to the mix of non-UK originating passengers. As the CAA has not provided the mix of those

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passengers incremental to Gatwick's plan, we do not believe the CAA can correctly conclude that retail revenue will rise directly in line with passengers. Overall, the adoption of this over simplistic assumption poses an £8m risk to Gatwick over the 5 year period;

- **Car Parks:** Given Gatwick's passenger projections, and the challenges of delivering a positive return within the BQ5 period due to capacity only being needed in the peak summer months, our final BQ5 car parks plan did not include any new capacity projects. It should be noted that our car parks are now essentially full over the peak summer months and as a result there is no opportunity to grow volumes. Our analysis indicates that, while it is possible to manage the mix of business to grow average yields during this period, this will only realise half the revenue growth compared to a straightforward volume growth scenario. This represents a further downside risk to Gatwick's BQ5 business plan of £3.0m over the 5 year period, which was not captured either in our business plan or the SDG report. As we have previously argued, our plan included a balanced mix of both upside and downside risk. On the basis of the CAA's passenger projection, this downside risk would continue to grow to an unacceptable level of £7.0m over the 5 year period; and
- **Property:** Both the CAA and SDG have themselves acknowledged that only an indirect relationship exists between property revenue and passengers. The CAA stated most conclusively in its own analysis on p336 of its consultation document on 'Gatwick Market Power Assessment – May 2013' that there is a zero per cent sensitivity of property revenue to passengers. SDG also acknowledge in paragraph 2.161 of their final report on the assessment of Gatwick Commercial Revenue (Stage 3) that there is a weak link between property revenue and passengers, and property revenue was presented in their report on a per-passenger basis for comparability purposes only. Gatwick would argue that for each of the individual sectors of property – offices, CIP, airfield, industrial and hotels – there are much greater forces than pure passenger numbers that drive revenue. In the example of hotel revenue, which is circa 3% of Gatwick's property revenue, revenue above the minimum guarantee level will be driven by the extent of competition within the off and on airport hotel sector. Likewise, office accommodation will be driven by external market demand, and only in a small part by new airlines, which are themselves only associated with part of the revenue growth. In the case of CIP revenue, this will be driven by airline type and customer mix. Gatwick therefore believes there is only a very limited sensitivity of property revenue to passenger volume and this tends to zero when considering impacts in the short to medium term. We therefore request the CAA lower its property revenue assumptions by £7.5m over the aggregate BQ5 period.

### 3. Retail

Gatwick does not believe that SDG have presented a balanced view of the retail opportunity at the airport throughout the BQ5 period. Furthermore, we do not believe that our feedback has been properly taken into account, and that the issues that we have raised consistently with SDG through a number of meetings and written reports have largely been ignored. We have a real concern that the SDG work that has been endorsed by the CAA is resulting in retail revenue projections that are unachievable. Our key concerns are made clear below:

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- **Underestimating the impact of Tobacco Display Legislation on tobacco sales:** Gatwick has identified comparable cases where similar legal changes have been made in support of our assumption of a marked decline in tobacco revenue. We have also provided analysis that indicates that there is already a downward pressure on ST sales from tobacco containment. We therefore consider that we have provided robust evidence to substantiate Gatwick's position whereas SDG have failed to provide sufficient basis for their alternative assumption. [Risk to Gatwick during BQ5 - £11.4m];
- **Unsubstantiated assumptions that the decline in bookshop sales can be arrested:** We have given evidence of our current trading showing a continual decline in year-on-year sales (IPP year to date -10.4%) as well as providing negative indicators from external research on traditional book sales versus e-books. We have also pointed out that bookshop sales inflation is driven by CPI not RPI, which on its own would drive a £0.02 income per passenger decline over the 5 years to 2018/19. [Risk to Gatwick during BQ5 - £4.0m];
- **Unsubstantiated claims that an additional 1% margin can be driven from World Duty Free Group or other concessionaires:** SDG have put forward some high level suggestions that this can be achieved through contract extensions, more lenient payment terms and relaxation of tax free pricing. All of these options are either unachievable, relatively immaterial and carry with them risks to Gatwick in terms of longer term value loss and confusion of our pricing proposition with further reputational risk. [Risk to Gatwick during BQ5 - £6.2m]; and
- **Failure to take into account margin improvements that Gatwick has already made within the speciality shop category:** We have provided evidence that shows that our plan already includes significant specialist margin increases either through churn, or within our assessments of our IDL developments. These Gatwick stretch targets are in themselves very much at risk, before any overlays are imposed by the CAA. This is evident from current negotiations with new partners to fill the ST IDL redeveloped space – three retailers have pulled out of advanced stage talks citing more attractive conditions on the high street as their reason. [Risk to Gatwick during BQ5 - £1.1m].

The cumulative impact of the above points represents a risk that Gatwick retail revenues have been overstated by £25.2m over the BQ5 period. Throughout the review that SDG have undertaken, Gatwick has met with them on several occasions and provided significant evidence that has been ignored in favour of unsubstantiated assumptions that have little or no fact based evidence behind them.

Below we have set out our position on each of the points summarised above.

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### *Underestimation of the impact of the Tobacco Display Act on sales*

Gatwick is disappointed that SDG have not amended their projections for tobacco revenues (-12% to -20%) impact. This assumption is entirely based on feedback from Dublin and Birmingham airports. With respect to the data from Birmingham Airport, SDG accepted the analysis and conclusions of a very short trial that looked into the decline in sales when all tobacco products were moved to their new 'Tobacco Display Area' (TDA). A trial of this nature was evidently short term, as it was quickly proven that this configuration had a significant detrimental impact on tobacco sales (indicated by the swift return of the tobacco products to a location outside of the TDA). Therefore, this analysis only helps to inform a conclusion that there is a severe negative effect; it cannot however lead to a statistically valid conclusion that the reduction is -20%. Similarly, we do not believe any conclusions that are relevant to Gatwick can be drawn from SDG's analysis of Dublin Airport. The differences in law, customer demographics, and the exceptional economic circumstances during the period of the analysis mean any conclusions lack credibility. In addition to this, it is not clear what provisions were made to control other variables, as well as what steps were taken to normalise the data, which again makes comparability between the two airports impossible.

World Duty Free Group and the UK Travel Retail Forum share our view that there is a significantly greater risk to the tobacco business from 2015 (-50%). The display ban becomes mandatory in 2015 and, in addition to this, there is a substantial risk of additional new legislation around the world aimed at reduction in the use of tobacco (similar to the import limits imposed by the Australian government). SDG suggest that we can simply find other products that would replace the lost revenue caused by the decline in tobacco sales but makes no suggestion as to what these categories may be. WDF is already incentivised to offer a wide range of products. The presumption that there is an alternative product category available with similar or marginally lower yield than tobacco is flawed. Any new product category would be likely to have the same, or lower, yield than the current WDF offering, otherwise WDF would, rationally, already be offering it at the expense of a less profitable category. It should also be recognised that Tobacco delivers a high margin exacerbating the risk to revenue of reduced tobacco sales.

### *Unsubstantiated claims that the decline in bookshop sales can be arrested*

There is no evidence to support SDG's assumption that revenue per passenger will remain flat in real terms to the end of BQ5. Gatwick has provided SDG with the following information on our performance in the bookshop category:

- [.....✂.....  
.....].

Since March, Gatwick has seen a further worsening in performance in the bookshop category:

- [.....✂.....  
.....].
- [.....✂.....  
.....].

# YOUR LONDON AIRPORT *Gatwick*

We continue to work closely with the WH Smith management team to mitigate the decline in this category, which is due to the fundamental changes in customer behaviour and spending patterns. These are the facts of Gatwick performance in the bookshop category over the last 18 months despite significant work undertaken in partnership with the WH Smith board to protect the business. SDG have no facts to support their view and their findings should therefore be disregarded. Like for like income in this category is undoubtedly in decline; it is simply not realistic to assume that income per passenger can be maintained in real terms through to the end of the BQ5 period.

This picture is further supported in the preliminary statement for the year ending 31st August 2013 from WH Smith PLC. This statement is the very latest information on their performance as these figures were released on 10th October 2013. WH Smith Travel total sales for the year were flat and like-for-like sales were down 4%. Flat sales were only possible as they had opened a further 30 new stores in the UK during the year. WH Smith do refer to improved gross margins but this will not benefit Gatwick airport as income is derived from a percentage to sales, which are declining on a like for like basis for their travel business and for Gatwick. This is further evidence that demonstrates the clear facts on how this category is performing and again is something that SDG have failed to investigate in an appropriate manner.

*An unsubstantiated notion that an additional 1% margin can be extracted from WDF, or from other speciality and catering margins*

[.....  
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SDG's view that the airport can achieve higher margins from our retail concessionaires than those included in the Revised Business Plan for BQ5 appears to be based on the idea that Gatwick could grow margins from new and existing space throughout the next regulatory period. This assertion by SDG is completely unfounded.

[.....  
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SDG also introduces a suggestion that margins could be improved through offering longer term contracts. Where appropriate, we have already done this. Given the nature of the fashion category we believe we have a good mix of contract lengths that offer a balance between security of margin and opportunity to churn space (although there is no guarantee that this will lead to a revenue improvement). Of the 22 stores mentioned above, contract lengths are listed below:

- [.....✂.....];
- [.....✂.....];
- [.....✂.....]; and
- [.....✂.....];

The contract lengths above clearly show that we will have limited opportunity to improve terms during the next regulatory period. This is not confined to the South terminal. In the last year we have opened 15 new stores in the North Terminal with terms that extend well into the next regulatory period. It should also be recognised that if it is decided to “churn” a store, then there is often a loss of income whilst a site is closed for construction work required to open the new store.

Again, SDG’s assessment that there is an opportunity to improve catering margins in the NT is not based on any analysis or evidence. [.....  
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.....] Overly long contract lengths would work against that.

SDG have also worked on the assumptions that it would be very easy for Gatwick to fill new retail space with the right mix of brands as soon as stores become available for lease. We have already highlighted significant risks to this assumption. Gatwick said in February 2013 that the economic climate is driving changing deals in the UK high street. Earlier this year Gatwick had a prospective new retail partner withdraw from a new store proposition on airport as they have been able to find space available on the high street that delivers a stronger commercial proposition. The reason for this is that landlords externally are becoming increasingly willing to give significant incentives to ensure their properties are occupied. These include:

- Rent Free periods;
- Capital Contributions; and
- No Minimum Guarantees.

Whilst sales densities will not be as strong as on the airport the costs and risks are significantly lower. This could see more retailers reviewing their strategy and therefore the deals that they are prepared to enter into with Gatwick. [.....  
.....✂.....  
.....] We do not have ready replacement tenants and therefore these units will not be generating revenue planned from 1st December 2013. The delay in opening viable stores is likely to be at least 6 months and there is no guarantee that we will achieve margins that were as strong as those quoted in the Revised Business plan for the period BQ5.

# YOUR LONDON AIRPORT

## *Gatwick*

We note that SDG make some further suggestions that we could achieve better margins through relaxing payment terms such as allowing concessionaires to pay quarterly in arrears or relaxing tax free pricing in selected categories. These suggestions are completely unfounded and carry considerable financial and reputational risk to Gatwick. We also note that this is yet another example of assertions with no evidence based assessment behind them, which, if adopted, would expose Gatwick to an unacceptable level of risk. Despite this Gatwick has continued to provide SDG with fact based analysis as set out above. Yet SDG choose to continue to defend a position which has no sensible rationale.

#### 4. Car parking

The latest report from SDG contains the same errors that we highlighted in previous versions, with views still based on supposition rather than evidence, a refusal to take into account views and evidence presented by Gatwick, the continued use of arbitrary single point analysis to illustrate wider points, and the drawing of simplistic conclusions from benchmarking comparisons that the data simply does not support. Our feedback and evidence to SDG has consistently been noted and then ignored, and most of the points raised below have been highlighted to SDG on a number of previous occasions.

In summary, our key concerns are presented below along with the value of their impact:

- The assumption that it is possible to generate additional revenue by raising long-stay roll-up prices. [Risk of £0.4m over aggregate BQ5 income plus a further risk of £2.0m over same period to reflect the consistent trend over the last three years of a 20% year-on-year decline that was not captured in Gatwick's business plan];
- The use of over-simplistic single-point benchmarking to suggest that we are under-pricing our long stay car parking in peak periods [Risk of £2.9m over aggregate BQ5 income];
- The assumption that licence agreements from the off-airport approved operator scheme will deliver up to £1.2m p.a. [Risk of £2.1m over aggregate BQ5 income];
- The assumptions used to generate the income from forecourt enforcement are unrealistic, and do not take into account the costs of enforcement. [Risk of £2.9m over aggregate BQ5 income]; and
- The increase in income from e-commerce does not reflect the cost to Gatwick of providing a free Wi-Fi service under the current long-term contract (running to the end of the BQ5 period), which will cost the airport between £0.1m and £0.3m. [Risk of £0.8m over aggregate BQ5 income].

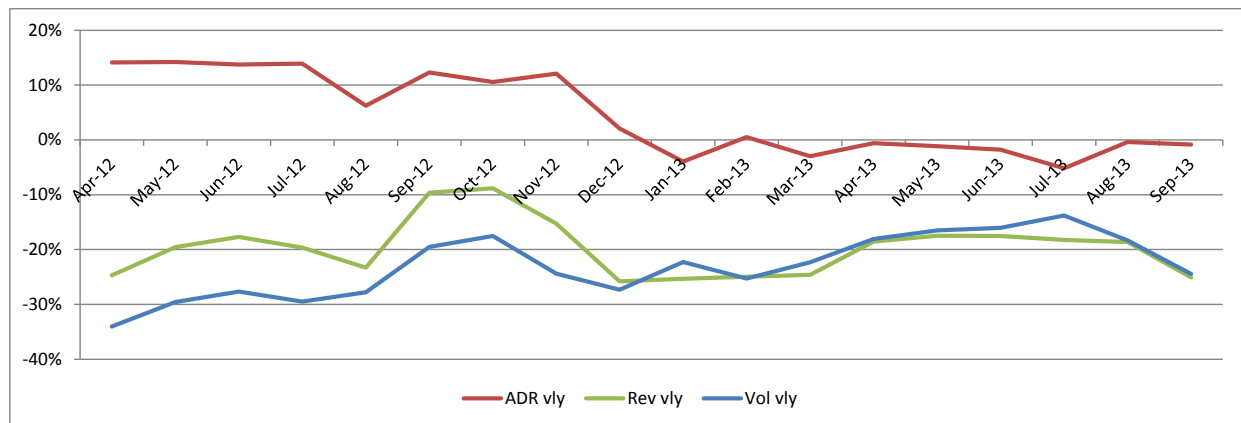
The cumulative impact of the above points represents a risk that Gatwick car park revenues have been overstated by £12.0m over the BQ5 period. Below we have set out our position on each of the points summarised above.

# YOUR LONDON AIRPORT *Gatwick*

## *The increase in revenue from higher long-stay roll-up prices is unjustified*

Our original business plan assumed an unchanged mix of roll-up and pre-book customers in our long-stay car parks. Since this was submitted, long-stay roll-up revenue has declined consistently every month by an average of -20% year on year, with long-stay roll-up revenues in the year to Sep 2013 being (£0.9m) lower than the year to Sep 2012. This trend was unaffected by a £1.50 per day price increase in Dec 2011, with increased yields being balanced by a greater volume decline. These impacts can be seen in the figure below, where this price increase resulted in ADR (average daily rate) growth throughout 2012 but higher year-on-year volume decline during the same period. From Jan 2013 onwards, ADR year-on-year was flat, and the volume decline less marked as a result. However, the revenue trend was constant.

**Figure: Comparison of average daily rate, volume and revenue growth across from 2012/13 to date**



Source: Gatwick.

SDG state that they “continue to believe an increase in price for long-stay roll-up is achievable” implicitly with no impact on volumes and have forecast an incremental £0.1m p.a. against business plan.

SDG does not give any evidence to support this contention, merely quoting higher prices on sale at selected other airports (Manchester / Edinburgh). They do not give any evidence that these higher price points have resulted in revenue growth.

We have pointed out to SDG on a number of occasions the evidence of actual decline in the long-stay roll-up market observed factually over the last 3 years, providing them with the revenue data to illustrate the fact. SDG have chosen to both ignore this evidence, and overlay their belief that this trend can not only be stopped, but reversed, by implementing price increases that have in the past merely accelerated decline in volume.

To re-iterate, we request that the long-stay roll-up projection is reduced by £0.4m over aggregate BQ5 income, and then reduced further to reflect our consistent trend over the last three years of a 20% year-on-year decline (a further £2.0m aggregate over BQ5).

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*The claim that income can be improved by increasing pre-book long-stay pricing is unsubstantiated* SDG state that they “remain convinced that there are opportunities to increase prices at Gatwick for pre-booking in peak periods”, generating an incremental £2.9m over aggregate BQ5 income. Their basis for this belief is that our products are closer to terminal than off-airport operators, and on a sample price comparison for one booking date and one entry date.

We have explained our pricing strategy to SDG in some detail, pointing out that we already raise prices for each product in the peak to the maximum level we are able, consistent with this being revenue optimal to our best analysis. This will vary considerably by product, as they have different characteristics in terms of customer demand, and different requirements in terms of capacity availability.

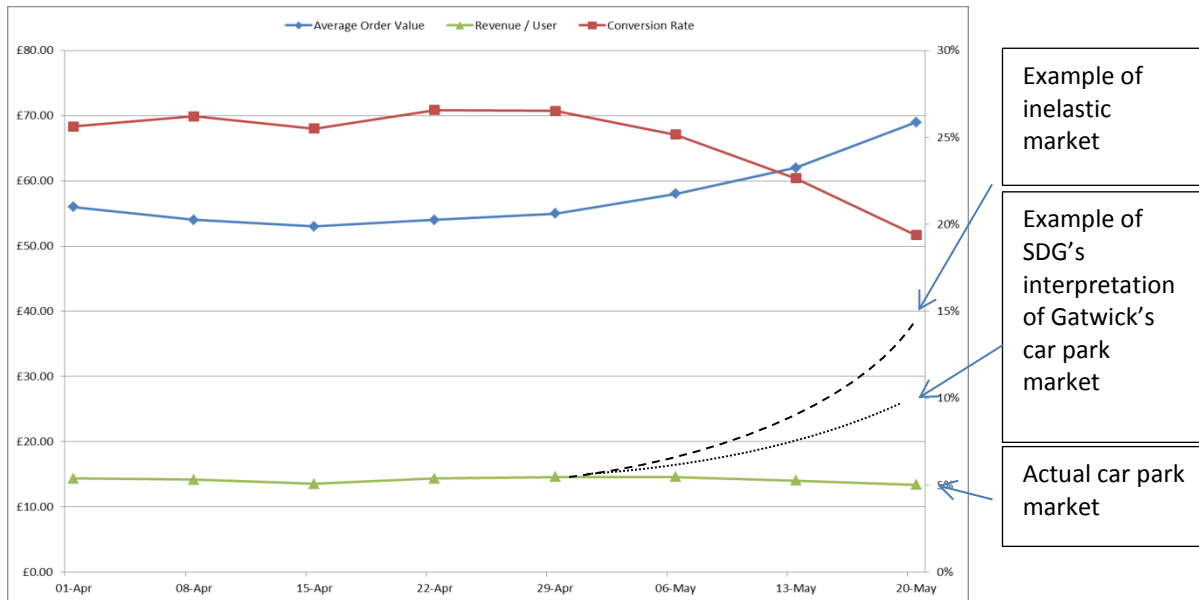
For example, this summer (Jul-Sep 2013) we increased price (average daily rate) for our “Summer Special” long-stay product in North Terminal by 10% year on year, and saw volume (stay days) decline by -34%. This was a deliberate strategy, as we were reducing capacity in Summer Special to re-purpose for the higher yielding Valet North storage. However, it illustrates clearly the price sensitivity of the market – even a modest 10% price increase (i.e. £6-£8 for a week’s parking) resulted in a volume decline of over three times that magnitude.

By contrast, in our Long Stay North product (which was full the previous year and therefore could only grow revenue through increasing yield) we increased price by an average of 9%, and saw volumes remain flat (they were not able to grow) and revenues increase by 9%.

These results simply illustrate what we have explained to SDG on a number of occasions, that it is not possible simply to have ‘one price strategy’ in relation to off-airport operators, and that we do not systematically over or under-price in the pre-book market, but rather manage price to optimise revenue for the range of products as a whole. We also look to optimise the amount of space allocated to each product in order to maximise overall profitability per square foot of car park estate. Gatwick also presented to SDG evidence on the difficulty of generating top line revenue growth due to the level of off and on-airport competition. SDG ignored this and continued to believe that Gatwick was a price leader, which implies that the competition will simply follow Gatwick’s price changes. This is absolutely not the case, as raising prices do not equate to a revenue increase. We have re-presented the graph from our response to the Initial Proposals, which shows the elastic nature of the car park market in which we operate. It shows the period leading up to the Easter holidays this year where as capacity became constrained, Gatwick raised its prices. In the graph, average order value is used as a proxy for price and the revenue per user refers to the overall revenue per unique website visitor of Gatwick’s booking engine. As the chart shows, raising prices reduces demand and, as a result, has no effect on the overall revenue per unique visitor. This demonstrates the elastic nature of the car park market, due in large part to ample off-airport capacity.

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**Figure: The elastic nature of the car park market**



*The forecast revenue from the off-airport approved operator scheme is unachievable and the assumptions do not represent reality*

SDG states that they believe we will generate an incremental £700k rising to £1200k p.a. from charges to meet and greet (M&G) operators as part of our “Approved Operator” scheme. Whilst they state a number of assumptions, they provide no detail as to how these assumptions translate to the incremental income figures they quote.

This was an area with a high degree of uncertainty, as the scheme was only introduced in Jul 2013, so our feedback to SDG was either based on our forecasts, or the very first few weeks’ data from the scheme.

At the time of writing, the scheme has been in place for 3 months. During this period the scheme has generated £150k in income from fees from approved operators, which we anticipate annualising to approximately £500k for the 12 month period. Given that all the major operators are already signed up to the scheme, and we have been told by Trading Standards that they do not anticipate any further significant operators signing up any time soon, we do not see any rationale for this figure increasing significantly in real terms through the BQ5 period.

Note that any incremental car park income from non-approved M&G operators, and the costs of marshalling the forecourts, is considered in the next point.

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*The income generated from forecourt enforcement is unrealistic, and does not include the costs of enforcement*

We have provided data that shows negligible net benefits as a result of this activity, which reinforces that our motive for this initiative was to relieve congestion and provide a better passenger experience on our forecourts.

Since the introduction of the approved operator scheme and associated enforcement of forecourt pick-up activity into the short-stay car parks, we have seen an approximate £112k of revenue in the short-stay car parks over a 3 month period. However, this has been offset by £94k in increased marshalling costs (to enforce the forecourt policy), and reduced pre-book short-stay income of £75k (as we have had to reduce pre-book capacity in order to ensure sufficient space is available for roll-up customers).

Additionally, we can add in incremental short-stay parking income from non-approved meet and greet operators, which have run at £128k over the first 3 months, which we anticipate annualising to approximately £400k over 12 months.

The net impact of the scheme on short-stay parking income, taking all these factors into account, has therefore been £72k over 3 months, or approximately £200k over the full year. This compares with the £800k p.a. that SDG have assumed.

*The cost of providing a free Wi-Fi service under the current long-term contract has been ignored*  
SDG state that they believe that e-commerce revenues related to car parks can be developed to 0.5% of parking revenues, quoting services such as lounges, security, car wash, insurance and foreign exchange.

We have pointed out to SDG that we already sell car wash, lounges, premium security and foreign exchange on our website, and will be introducing travel insurance shortly, and that these numbers were already in our base business plan.

[.....  
..... ✂ .....  
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### 5. Property

We have previously provided detailed responses as to why SDG's recommendations of property revenue (subsequently endorsed by the CAA) are unachievable. These points have all been disregarded. In summary, across all products the key issues of concern remain:

- The UK economic position and the impact this has and is having on the property business nationally;
- Change in airline mix resulting in smaller property requirements for airlines operating at Gatwick;
- The aviation related restriction preventing Gatwick from letting to a wider market place; and
- Significant competition with Crawley. Crawley currently has in excess of 550,000 sq.ft. of void office accommodation equating to over five years supply. Grade A rents are circa £23 per sq.ft. with significant capital contributions and rent free periods offered.

We have seen some improvement in the UK's short term economic prospects since the Revised Business plan and some recovery in the local property market mainly as a result of spill from growth in London. Nevertheless, this recovery must be seen in the context of the substantial overhang of vacant property and the depressing effect from continuing changes in long term holdings whether by airlines looking to improve efficiency or public sector bodies subject to continued and enduring financial pressures. We therefore continue to remain critical of SDG's assessment of potential letting growth in the areas of Concorde House, Ramp accommodation, and ad-hoc contractors' accommodation, as well as additional turnover rent growth in the hotel sector. Our key concerns are as follows:

- SDG's assumption for re-letting Concorde House is unachievable [Risk of £2.4m over aggregate BQ5 income];
- SDG suggest that an additional turnover rent could be achieved from Bloc and Hampton by Hilton hotels. [Risk of £1.7m over aggregate BQ5 income];
- SDG incorrectly assume that additional ramp accommodation over and above Gatwick's business plan will be provided during the BQ5 period. [Risk of £1.0m over BQ5 aggregate income].
- SDG incorrectly infer that Gatwick has made no allowance for additional lettings associated with contractor accommodation. This overlay is a double count of monies already in Gatwick's plan. [Risk of 0.5m over BQ5 aggregate income].

The cumulative impact of the above points represents a risk that property revenues have been overstated by £5.6m over the BQ5 period, which is on top of the £7.5m overstatement as a result of the CAA increasing property revenue directly in line with its forecast increase in passenger numbers. Below we have set out our position on each of the points summarised above.

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*SDG's assumption for re-letting Concorde House is unachievable.*

The magnitude of the surplus office stock in the market has not been properly recognised. Gatwick currently has excess office accommodation, not unlike any town or city in the UK, in the region of 45,000 sq.ft. We do not believe that this will be lettable for the reasons already given above, outlined clearly in our business plan, and explained clearly in our response to SDG's draft final report. Such a situation, if it continues, may indeed give rise to a need to demolish an office block to avoid unnecessary costs such as void rates.

SDG previously recognised the impacts of the "aviation related" restriction; however, their optimism about removal of this restriction and then attracting new tenants is unjustified given the excess supply that already exists in Crawley.

To demonstrate this and reinforce our previous comments, the Concorde House opportunity details have been circulated via the Estate Agents clearance house and marketed on Estates Gazette Property link and our Agents web site since June. Particulars have been downloaded ten times resulting in one viewing for a 10,000 sq.ft. requirement. In addition, we have had a further 15,000 sq.ft. requirement view. On both occasions the property once viewed has been disregarded.

SDG also do not recognize the change of airline requirements, whereby new start-up airlines at Gatwick will only take up small lettings space of between 400 – 1,000 sq.ft. Concorde House does not lend itself to small lettings of sub 700 sq.ft. and therefore future potential tenants are limited.

In addition, existing business partners are consolidating to achieve efficiencies, [.....  
.....✂.....]. We have also seen the consolidation of statutory bodies with continual Government pressure to reduce operational costs; at Gatwick we are envisaging further reductions occurring across the portfolio of circa 20%.

In summary, it is difficult to see how there could be a hurdle set on property revenues which requires Gatwick to buck the market and reverse trends experienced locally. We therefore request that the CAA remove £2.4m of aggregate BQ5 income, or justify the new sources of this additional demand.

*SDG's assumption of additional turnover rents from the hotel sector is unrealistic and ignores market forces*

SDG do not recognise the magnitude of the additional supply of on-airport accommodation entering into the market with the introduction of circa 1,100 new rooms from Bloc, Hampton by Hilton, and Premier Inn, and the market response that will transpire from both off-airport and on-airport operators. Against this background, SDG have actually assumed an increase in turnover rents even by comparison with their own Final Report, with no apparent justification. Gatwick's assumption of earning the minimum guaranteed rent over the next 5 years is entirely plausible.

SDG has suggested that an additional turn over element for the hotels could be achieved. [.....  
.....✂.....], the hotel operators will be new to the market and will take some time to establish their business. Also, the magnitude of the



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additional supply of on-airport accommodation has been ignored by SDG. Circa 1,100 new rooms from Bloc, Hampton by Hilton, and Premier Inn will be introduced, which in effect releases almost 0.5 million of additional room capacity in the market per annum, and would accommodate approximately 1.0 million passengers. Against this background, SDG has ignored the market response that will transpire from both off-airport and on-airport operators. Therefore, Gatwick's assumption of earning the minimum guaranteed rent over the next 5 years is entirely plausible.

### *A further provision of ramp accommodation above Gatwick's plan is incorrect*

The letting assumption of 10,000 sq.ft. made by SDG represents 10% letting of the total ramp space over the BQ5 period. The trend over the previous four years shows circa 20,000 sq.ft. being occupied and 33,000 being vacated, leaving a net loss of 13,000 sq.ft. in the period. Within the Gatwick business plan we have assumed no vacations. There is therefore a real risk that ground handlers and airlines will want to consolidate further and as a result we will see a higher level of vacations.

SDG make reference to Pier 5 being refurbished and new space being created on Pier 6. The reference to Pier 5 refurbishment is incorrect, as the refurbishment works relate to passenger areas and segregation, not to the property accommodation. SDG have incorrectly assumed that the reintroduction of the Pier 5 ramp accommodation is incremental – in reality Gatwick is just making available the accommodation that was temporarily removed, and there is no net gain in space.

With regard to Pier 6 a small amount of ramp accommodation has been added to the scope of the project to support the airlines operating from this Pier as this is remote from existing ramp accommodation. We fully expect that, should this accommodation be occupied for operational reasons, space on one of the other Piers will be vacated, leaving Gatwick income neutral. Indeed, it is worth noting that the accommodation lost as a result of the Pier 1 redevelopment (9,000 sq.ft.) is not being replaced in the scope of the new Pier 1. The net impact on ramp accommodation as a result of Pier 6 increase and Pier 1 closure is a loss off 3,500 sq.ft. of lettable accommodation.

In justifying levels of demand for ramp accommodation, SDG compare our pier facilities with cargo facilities owned by Segro. These two spaces are not comparable as the unit sizes let by Segro are above 8,000 sq.ft. as opposed to Gatwick's pier units that are only circa 200 sq.ft. We also disagree with SDG's simplistic view that a reduction in rents will attract additional tenants. A reduction of rents could lead to all existing occupiers terminating their existing agreements and seeking to negotiate new deals at lower levels. It is worth remembering that all ramp accommodation is leased on an indefinite tenancy with a rolling break clause for the tenants of three months. The risk therefore is that reducing the rents to let more space could overall end up in a negative position. Furthermore, there is a limited market for airside accommodation whereas Segro space can be run as a landside operation.

In summary, Gatwick do not believe that any additional ramp accommodation could be let due to the change in airline mix resulting in smaller property requirements, consolidation of ground handlers, and the restricted market relating to airside operations.

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### *Ad-hoc income from contractor's accommodation is double counted*

Gatwick has already allowed for a level of contractor accommodation income in our existing plan, which will be a stretch in itself (£0.5m of aggregate BQ5 income). Within the base business plan, there is an assumption that existing lettings to contractors will remain. It is unlikely, given the nature of projects over the BQ5 period, that any significant additional contractor lettings will be achieved over those already in the plan.

We do not support the additional rental income associated with the letting of further contractor's facilities and ask that the additional £0.5m be removed.

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### Appendix 8: Licence marked up

#### 1. Introduction

This appendix provides Gatwick's suggested changes to the CAA's proposed licence, without prejudice to Gatwick's strong opposition to the CAA's market power 'minded to' decision and the regulator's current intention to impose licence conditions. Gatwick's changes are shown in tracked changes to the CAA's proposed licence, below.

#### 2. Marked up licence

Part A: Scope and interpretation of the Licence

A1 Scope

A1.1 The CAA has made a market power determination under section 7 of the Act on [date] that means, for the purposes of section 3 of the Act, Gatwick Airport Limited (the Licensee) is the operator of a dominant airport area at a dominant airport.

A1.2 The Airport is London Gatwick

A1.3 The Airport Area is those areas, as defined in sections 66 and 67 of the Act that comprise:

- a) the land, buildings and other structures used for the purposes of the landing, taking of, manoeuvring, parking and servicing of aircraft at the airport, [excluding the aircraft maintenance facilities];
- b) the passenger terminals; and
- c) [the cargo processing areas.]<sup>143</sup>

A1.4 The CAA, in exercise of the powers conferred by section 15 of the Act, hereby grants to the Licensee this Licence authorising the Licensee and those persons listed in section 3(3) of the Act, to require a person to pay a relevant charge in respect of airport operation services that it provides at the Airport, subject to the conditions of this Licence.

A1.5 This Licence shall come into force on 1 April 2014 and shall continue in force until revoked in accordance with Condition B2 of this Licence.

A2 Interpretation

A2.1 Unless specifically defined within this Licence or in the Act or the context otherwise requires, words and expressions used in the Conditions shall be construed as if they were an Act of Parliament and the Interpretation Act 1978 applied to them. References to an enactment shall include any statutory modification or re-enactment thereof after the date of the coming into effect of this Licence.

<sup>143</sup> The CAA will make a final decision on the areas to be excluded when it has reviewed the relevant documentation from Gatwick and undertaken further work on the market power assessment.

A2.2 Any word or expression defined for the purposes of any provision of Part I of the Act shall, unless the contrary intention appears, have the same meaning when used in the Conditions.

A2.3 Any reference to a numbered Condition or Schedule is a reference to

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the Condition or Schedule bearing that number in this Licence, and any reference to a paragraph is a reference to the paragraph bearing that number in the Condition or Schedule in which the reference occurs.

A2.4 In construing the provisions of this Licence, the heading or title of any Condition, Schedule or paragraph shall be disregarded.

A2.5 Where the Licensee is required to perform any obligation by a specified date or within a specified period and has failed so to perform, such obligation shall continue to be binding and enforceable after the specified date or after expiry of the specified period, but without prejudice to any rights or remedies available against the Licensee under the Act or this Licence by reason of the Licensee's failure to perform by that date or within the period.

A2.6 The provisions of sections 74 and 75 of the Act shall apply for the purposes of the publication or sending of any document pursuant to this Licence.

### A3 Definitions

A3.1 In this Licence:

- a) the Act means the Civil Aviation Act 2012;
- b) the CAA means the Civil Aviation Authority.

### Part B: General Conditions

#### B1 Payment of fees

B1.1 The Licensee shall pay to the CAA such charges and at such times as are determined under a scheme made under section 11 of the Civil Aviation Act 1982 in respect of the carrying out of the CAA's functions under Chapter I of the Act.

#### B2 Licence revocation

B2 The CAA may revoke this Licence in any of the following circumstances and only in accordance with sections 48 and 49 of the Act;

a) if the Licensee requests or otherwise agrees in writing with the CAA that the Licence should be revoked;

b) if:

(i) the Licensee ceases to be the operator of all of the Airport Area; or

(ii) the Airport Area ceases to be a dominant area; or

(iii) the Airport ceases to be a dominant airport;

c) if the Licensee fails:

(i) to comply with:

1. an enforcement order (given under section 33 of the Act);

or

2. or an urgent enforcement order (given under section 35 which has been confirmed under section 36); or

(ii) to pay any penalty (imposed under sections 39, 40, 51 or 52 of the Act) by the due date for any such payment,

where any such a failure is not rectified to the satisfaction of the

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CAA within three months after the CAA has given notice in writing of such failure to the Licensee, provided that no such notice shall be given by the CAA before:

1. the proceedings relating to any appeal under section 47 of the Act brought in relation to the validity or terms of an order or the CAA's finding or determination upon which it is based are finally determined; or (as the case may be); or
2. the proceedings relating to any appeal under sections 47 or 55 of the Act brought in relation to the imposition of a penalty, the timing of the payment of the penalty or the amount of the penalty are finally determined.

Part C: The price commitment conditions

C1 Price commitments

C1.1 The Commitments are conditions of this Licence and shall be set out

in ~~a Schedule to~~ the Conditions of Use. [GATWICK COMMENT: THEY ARE IN THE BODY OF THE COU AS WELL]

C1.2 Obligations placed on third parties in the Commitments, ~~and the Licensee's pricing principles set out in the Commitments,~~ shall not be

treated as conditions of this Licence. [GATWICK COMMENT: PRICING PRINCIPLES WILL NOT BE INCLUDED IN THE COU BY WHICH IT IS SUGGESTED THE COMMITMENTS ARE DEFINED]

~~C1.3 In complying with this Condition C1 the Licensee shall, so far as reasonably practicable, do so in a manner designed to further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services.~~

Modification of the Commitments

C1.4~~3~~ The Licensee shall not modify the Commitments otherwise than in the circumstances set out in the modification provisions of the Commitments.

C1.5~~4~~ The modifications that can be made under Condition C1.4~~3~~ are modifications set out in the modification provisions of the Commitments.

C1.6~~5~~ Modifications can be made to the Commitments under Condition C1.4~~3~~ at any time.

Definitions

C1.7 In this Condition C1:

(a) the Commitments means the ~~commitments contractual obligations made given~~ by the Licensee to providers of air transport services at Gatwick Airport ~~and in the case of certain obligations also to other users of Gatwick Airport~~ as ~~contained in the following provisions of the Conditions of Use as~~ agreed by the CAA ~~and to be effective~~ from the date this licence comes into force and ~~as~~ amended from time to time under Conditions C1.3 to C1.5 of this Licence namely:

Condition 2.1.2 (Applicability and Enforceability of Conditions of Use

Condition 2.1.3 (Variation)

Conditions 2.1.12-2.1.21 (Dispute Resolution)

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Condition 5 (Price Commitment)

Condition 6 (Service Standard Commitment)

Condition 7 (Continuity of Service and Financial Resilience Commitment)

Condition 8 (Investment and Consultation Commitment)

Condition 9 (Financial Information Commitment)

Schedules 2, 3 and 4. The Commitments do not include any obligations placed by the Licensee on third parties ~~or the Licensee's pricing principles~~; and

(b) the Conditions of Use means the Gatwick Airport Conditions of Use, published by the Licensee.

Part D: Financial Conditions

D1 Financial Resilience

Certificate of adequacy of resources

D1.1 The Licensee shall at all times act in a manner calculated to secure that it has available to it sufficient resources including (without limitation) financial, management and staff resources, to enable it to provide airport operation services at the Airport.

D1.2 The Licensee shall submit a certificate addressed to the CAA, approved by a resolution of the board of directors of the Licensee and signed by a director of the Licensee pursuant to that resolution. Such certificate shall be submitted within four months of the end of the Licensee's financial year and shall include a statement of the factors which the directors of the Licensee have taken into account in preparing that certificate. Each certificate shall be in one of the following forms:

(a) "After making enquiries based on systems and processes established by the Licensee appropriate to the purpose, the directors of the Licensee have a reasonable expectation that the Licensee will have available to it, after taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, any amounts of principal and interest due under any loan facilities and any actual or contingent risks which could reasonably be material to their consideration, sufficient financial and other resources and financial and operational facilities to enable the Licensee to provide airport operation services at London Gatwick Airport of which the Licensee is aware or could reasonably be expected to make itself aware it is or will be subject for a period of ~~two years~~eighteen months from the date of this certificate."

(b) "After making enquiries based on systems and processes established by the Licensee appropriate to the purpose, the directors of the Licensee have a reasonable expectation, subject to what is said below, that the Licensee will have available to it, after taking into account in particular (but without limitation) any dividend or other distribution which might reasonably be expected to be declared or paid, any amounts of principal and

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## *Gatwick*

interest due under any loan facilities, and any actual or contingent risks which could reasonably be material to their consideration, sufficient financial and other resources and financial and operational facilities to enable the Licensee to provide airport operation services at London Gatwick Airport of which the Licensee is aware or could reasonably be expected to make itself aware it is or will be subject for a period of two yearseighteen months from the date of this certificate. However, they would like to draw attention to the following factors which may cast doubt on the ability of the Licensee to provide airport operation services at London Gatwick Airport for that period.....”

(c) “In the opinion of the directors of the Licensee, the Licensee will not have available to it sufficient financial or other resources and financial and operational facilities to provide airport operation services at London Gatwick Airport of which the Licensee is aware or of which it could reasonably be expected to make itself aware or to which it will be subject for a period of two yearseighteen months from the date of this certificate.”

D1.3 The Licensee shall inform the CAA in writing as soon as practicable if the directors of the Licensee become aware of any circumstance which causes them no longer to have the reasonable expectation expressed in the then most recent certificate given under Condition D1.2(a) or (b).

D1.4 The Licensee shall obtain and submit to the CAA with each certificate provided under Condition D1.2 a report prepared by its Auditors stating whether or not the Auditors are aware of any inconsistencies between, on the one hand, that certificate and the statement submitted with it and, on the other hand, any information which they obtained during their audit of the relevant year end accounts of the Licensee.

D1.5 If the Licensee or any of its linked companies (or, where applicable the Directors and Officers of any of those undertakings) seeks, or is advised to seek, advice from an insolvency practitioner or any other person relating to

(a) the Licensee’s financial position or ability to continue to trade; or  
(b) that linked company’s financial position or ability to continue to trade, only to the extent that it would affect the Licensee’s financial position or ability to continue to trade,  
the Licensee must inform the CAA within 3 working days.

Restriction on activities

D1.6 The Licensee shall not, and shall procure that its subsidiary undertakings shall not, conduct any business or carry on any activity other than **[GATWICK COMMENT: AS WE HAVE COMMENTED WE DO NOT THINK THIS IS NECESSARY IN VIEW OF BOND COVENANTS]:**

(a) the Permitted Business; and/or  
(b) any other business or activity for which the CAA has given its

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written consent for the purposes of this Condition, such consent not to be unreasonably withheld or delayed.

Ultimate holding company undertakings [GATWICK COMMENT: WE DO NOT BELIEVE THIS PROVIDES ANY PROTECTION AGAINST ABUSES OF SMP IDENTIFIED BY CAA]

D1.7 The Licensee shall procure from each Covenantor a legally enforceable undertaking in favour of the Licensee in the form specified by the CAA that that Covenantor will:

- (a) refrain from any action, and procure that every subsidiary of the Covenantor (other than the Licensee and its subsidiaries) will refrain from any action, which would then be likely to cause the Licensee to breach any of its obligations under this Licence;
- (b) promptly upon request by the CAA (specifying the information required) provide to the CAA (with a copy to the Licensee) information of which they are aware and which the CAA reasonably considers necessary in order to enable the Licensee to comply with this Licence.

D1.8 Such undertaking shall be obtained within seven days of the company or other person in question becoming a Covenantor and shall remain in force for so long as the Licensee remains the holder of this Licence and the Covenantor remains a Covenantor.

D1.9 The Licensee shall:

- (a) deliver to the CAA, within seven days of obtaining the undertaking required by Condition D1.8, a copy of such undertaking;
- (b) inform the CAA as soon as practicable in writing if the directors of the Licensee become aware that the undertaking has ceased to be legally enforceable or that its terms have been breached; and
- (c) comply with any direction from the CAA to enforce any such undertaking.

Definitions

D1.10 In this Condition D1:

- (a) the Covenantor means a company or other person which is at any time an ultimate holding company of the Licensee. [GATWICK COMMENT: DEFINITION MAY NEED AMENDING SUBJECT TO IDENTIFICATION OF RELEVANT ENTITY]
- (b) a linked company means any company within the Licensee's Group where the financial position of that company or its inability to continue to trade would have an adverse effect on the Licensee's financial position or ability to continue to trade;
- (c) Permitted Business means:
  - (i) any and all business undertaken by the Licensee and its subsidiary undertakings as at 1 April 2014;
  - (ii) to the extent that it falls outside Condition D1.10(c)(i), the business of owning, operating and developing the airport and associated facilities by the Licensee and its subsidiary undertakings (including, without limitation, any and all airport operation services, provision of facilities for and connected



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with aeronautical activities including retail, car parks, advertising and surface access and property development letting and management development thereof [GATWICK COMMENT: THIS IS AS PER BOND COVENANT DEFINITION]; and (iii) any other business, provided always that the average over the term of the Commitments of any expenses incurred in connection with such businesses during any one financial year is not more than 2% of the value of the RAB [GATWICK COMMENT: TO BE DEFINED] at the start of the financial year.

# YOUR LONDON AIRPORT *Gatwick*

## Appendix 9: Leigh Fisher analysis

*Response attached overleaf*



OCTOBER | 2013

# The CAA's Use of the Leigh Fisher Report

Report for Gatwick Airport Limited

CRITICAL THINKING AT THE CRITICAL TIME™

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## 1. Introduction

1.1 In its recent consultation on market power at Gatwick airport the UK Civil Aviation Authority (CAA) set out its 'minded to' position to conclude that Gatwick Airport Limited (GAL) has Substantial Market Power (SMP) and should continue to be subject to price cap regulation over the 2014-19 period.

1.2 In forming its 'minded to' positions the CAA has apparently relied heavily on a report by Leigh Fisher (LF) as part of its assessment of whether GAL has market power or not:<sup>1</sup>

*"To further inform the CAA's understanding on price it commissioned Leigh Fisher to undertake work on benchmarking airport charges at Heathrow, Gatwick and Stansted, against suitable comparator airports, which where possible, were operating in a competitive market.*

*The CAA considers that the benchmarks used in this analysis are appropriate and can help inform the discussion of the competitive price at Gatwick. ...*

*Leigh Fisher's analysis shows ... that the aeronautical revenue per passenger at Gatwick is marginally above the average of comparator airports and about £2 above the subset of airport operators that are subject to lighter regulation." (Emphasis added)*

1.3 The CAA has recognised the key role of the competitive price level to an assessment of market power. The LF report is one of two pieces of analysis on which the CAA based its conclusion that the current regulated price is not significantly below the competitive price level. GAL has already raised its concerns with the CAA about the work undertaken by Europe Economics on Long Run Incremental Cost (LRIC) and about the exercise performed by LF for CAA and the inferences CAA has drawn from that exercise.

1.4 The CAA has recently made some – but not all - of the supporting data used by LF in

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<sup>1</sup> CAA (2013) "Consultation on Gatwick market power assessment", May, pp81-82.

its analysis available to GAL.<sup>2</sup> Additionally, the CAA has recently reiterated its belief that the LF analysis provides a “useful indicator” of (or in LF’s words, enables “reasonable inferences ... [to] be drawn” on) competitive price levels at GAL and has also published an Addendum Note produced by LF in August 2013 (which seeks to address the comments various stakeholders have made on its original (April 2013) report).<sup>3</sup>

**1.5** In light of these new developments, FTI Consulting LLP (FTI) has been commissioned by GAL to review and comment on the CAA’s use of the LF report and the LF report itself, and LF’s Addendum Note taking into account (where relevant) the updated evidence and discussion provided by CAA.

**1.6** In this report we set out a number of reasons, based on our own independent review of the CAA’s ‘minded to’ positions and of the LF report, why the CAA’s reliance on, and interpretation of, LF’s work is not robust and why the LF study itself is flawed and does not provide any useful information (‘reasonable inferences’ or otherwise) about the competitive price level at GAL.<sup>4</sup> Specifically, the CAA’s use of the LF report is inappropriate because:

- the report has been used by the CAA for a purpose for which it was never intended: the CAA used the report to draw inferences about competitive prices at GAL, but LF never attempted to estimate a competitive price;
- the exercise which the CAA wishes to undertake is conceptually flawed and is not capable of providing sufficiently robust evidence about the competitive price (either a point estimate or a range) at GAL; and

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<sup>2</sup> The CAA provided GAL with Excel spread sheets from LF which purport to illustrate how LF has selected the comparator airport group based on its initial regression analysis and then how benchmark prices are constructed by combining information for the various airports in the comparator set. This data has been provided to FTI by GAL. We note that some of the information used by LF has been redacted from the versions of the spread sheets provided to GAL.

<sup>3</sup> See CAA (2013) “Economic regulation at Gatwick from April 2014: final proposals”, October, which states, for example, “the CAA continues to consider that comparator benchmarks provide a useful indicator of the possible range for the competitive price”, p217. See also LF (2013) “Comparing and Capping Charges at Regulated Airports – Addendum Note”, 12 August 2013 e.g. p5 states “definitive conclusions on spot charge levels should not be drawn without further work, although we suggest that reasonable inferences on competitive price can be drawn from the identified ranges to inform the CAA’s work”.

<sup>4</sup> By way of background, a short summary of the methodology employed by LF is provided in Appendix 1.

- even if the exercise LF attempted to perform was capable – if perfectly executed – of identifying a benchmark competitive price against which GAL could be compared, the conclusions of the LF report, and the inferences CAA draws, fail to recognise the considerable uncertainty surrounding the analysis.

**1.7** We explore these issues in more detail in this report, drawing on the additional data and evidence that has recently become available.

## 2. The CAA's reliance on LF's report is conceptually inappropriate

- 2.1 As noted above, the CAA ultimately relies on the LF report to determine a benchmark price against which GAL's charges can be compared as an input to CAA's determination of whether GAL has market power, which in turn informs CAA's assessment of whether GAL needs to continue to be subject to economic regulation.
- 2.2 However, the LF report was not produced for this purpose. LF stated very clearly that the work it undertook "has focused on answering the question '*Is it possible to benchmark prices at comparable airports in order to regulate charges at LGW?*'"<sup>5</sup>
- 2.3 LF also stated that it had been "developing a prototype analysis". It is clear from this statement, particularly taken with that above, that LF's report related to the development of an approach, albeit one which should not be regarded as fully developed or tested, to see if it could provide benchmarks which are sufficiently robust to enable regulated charges to be set on the basis of them. Clearly, if a methodology could be produced which did yield benchmarks which were sufficiently robust to allow a regulator to use them as a basis for setting regulated charges, then the answer to the question referred to in paragraph 2.2 above would be "Yes".
- 2.4 What LF did was to attempt to identify *whether it is possible* to estimate a benchmark price for a particular airport by examining prices at other airports. This is not the same as estimating a competitive price in a particular airport's market, nor is it the same as estimating the regulated price that a regulator should set.
- 2.5 The LF report does not, however, explicitly answer the question. In its conclusions, LF recognised that its approach had some shortcomings and that further work was required on the methodology before it would be fit for purpose. Specifically, LF noted "while this report has not sought to hide the difficulties inherent in this approach, both with the analysis itself and also in acknowledging that there are challenges to be overcome before it can be used for regulatory purposes, we believe that the project suggests that comparing airport charges can at least inform the regulatory process".<sup>6</sup> More recently LF went on to note "definitive conclusions on spot charge levels should not be drawn without further work ... [but] ... we suggest that reasonable inferences on competitive price to inform the CAA's work can be drawn from the identified

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<sup>5</sup> See Leigh Fisher (2013) "Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report", p4, 19 April.

<sup>6</sup> See Leigh Fisher (2013) "Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report", p44, 19 April



ranges for each airport”.<sup>7</sup>

- 2.6** It is clear that the objective of the report was not to identify the actual benchmark price that CAA should rely upon for the purposes of setting a price control or determine what the price might be in a competitive market. LF makes clear that the work completed by it is not yet ready even to be used for setting a price control.<sup>8</sup> Moreover, LF does not explain – in any of the reports it has published - why ‘reasonable inferences’ about competitive prices can be drawn from its work or how such inferences should be drawn. Indeed, it is difficult to see how a study that – in the author’s own words – is not ready to “be used to set a price cap” can still provide a robust input to the CAA’s work on its regulation or indeed that regulation is needed.
- 2.7** That the CAA has gone on to use the output from the LF paper to identify a competitive price in LGW’s market is a clear extension of the LF work beyond its intended limits, its reported conclusions and – as we return to below – the limits to which the work could ever reasonably be extended.
- 2.8** We note that Manchester Airports Group (MAG) and Yarrow and Starkie have also expressed concerns about the LF report being used for a purpose for which it was not intended.<sup>9</sup> For example, Yarrow and Starkie state “[LF] do not themselves consider their report to have addressed the issue of a competitive price”.
- 2.9** If the LF report had intended to identify a competitive price for GAL, then it would have failed to achieve that aim. This is not only because of flaws in the methodology that LF employ – a theme we return to below – but because the very exercise itself is conceptually inappropriate. Firstly, the airports identified as benchmarks would need to be in the same market as GAL (or at least a very similar market) for any inference about the competitive price to be relevant to the situation at GAL, but any assessment of which airports are within a particular market will always be open to challenge. Secondly, examining the prices charged by other airports cannot provide a robust measure of the competitive price at GAL because, inter alia, it would be necessary to understand whether the prices charged at other airports reflected a competitive price for those airports.

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<sup>7</sup> See LF (2013) “Comparing and Capping Charges at Regulated Airports – Addendum Note”, 12 August 2013, p6.

<sup>8</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p4, 19 April.

<sup>9</sup> See, for example, Manchester Airports Group (2013) “Civil Aviation Authority Stansted Market Power Assessment: Interim Response of M.A.G. to the CAA’s ‘minded to’ document”, Annex B, 24 May and Professor George Yarrow and Professor David Starkie (2013) “Review of the CAA’s Stansted Market Power Assessment”, p43, 24 May.

- 2.10** To address the second challenge, the extent of competition each airport faces, and whether the airport was seeking to price at a competitive level (or above or below), would need to be assessed and taken into account. However, it is not straightforward (if possible at all) to determine whether other airports charge competitive prices, due to other influences on their pricing. Prices at unregulated airports could reflect many factors and could be above or below the competitive price. Prices at regulated airports are set by a regulator and will only reflect a competitive market price if the regulator aims to set such a price and it has been successful in doing so. For example:
- regulated prices may not always reflect fully demand for capacity; competitive prices may therefore be higher than regulated prices without there being any abuse of market power;
  - market/competitive prices may be above regulated prices if the regulator has decided that it is appropriate to use the regulatory process to transfer locational rents from the airport owner/operator to airport users; and
  - the regulation of other airports in the same market may also potentially cause distortion of the observed prices if the regulated prices are not set at the competitive price level.
- 2.11** The European Commission has recognised the difficulty with making comparisons between the prices charged at different airports as a basis to “establish a true market price for services provided by airport managers”.<sup>10</sup> It is unclear if or how the CAA has taken this guidance into consideration when reaching its conclusions; certainly the CAA has not referred to the statement or explained why its analysis (or that of LF) overcomes the European Commission’s concerns.
- 2.12** Moreover, the LF analysis focused on assessing a benchmark price only up to and including 2010 (or 2011 if the preliminary analysis in the supplementary report is taken into account), yet CAA’s ultimate objective is to determine regulated prices for the period 2014-19. The usefulness of information already several years out of date for the purpose of setting future price limits is obviously questionable.

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<sup>10</sup> See European Commission (2013) “DRAFT EU Guidelines on State aid to airports and airlines”, pp13-14.

### **3. The CAA's interpretation of the LF report is inappropriate**

**3.1** Even leaving to one side the fundamental difference between the purpose for which the LF report was prepared and the purpose to which it has been used by the CAA, the CAA's reliance on the LF report is inappropriate because:

- the uncertainty around LF's "prototype analysis" is not appropriately taken into account by the CAA, which believes that LF's analysis provides a "useful indicator" of the competitive price level at GAL, even though the range of estimates provided by LF does not appropriately reflect the uncertainty around both the exercise of estimating a benchmark price and the specific methodology adopted by LF (which involves numerous estimates, assumptions and judgments); and
- the CAA places too much weight on LF's analysis of average aeronautical revenues per passenger to the exclusion of alternative measures of revenues and charges.

**3.2** We discuss each of these points in further detail below.

**The uncertainty around LF's analysis is not appropriately taken into account by either LF or the CAA**

**3.3** The CAA's use of the LF "prototype analysis" is inappropriate because the inherent uncertainty surrounding the methodology and the analysis are not reflected appropriately in either the LF report's conclusions, or in the CAA's interpretation of the LF report.

**3.4** Sources of uncertainty include:

- the selection of comparators was based on econometrics applied to a small sample of potential comparators, resulting in a low degree of confidence in the conclusions. Consequently, the analysis and the comparator set used may not comprise all of the most appropriate comparators (or equally it may include some inappropriate ones);
- the process for selecting comparators relied on subjective and arbitrary assumptions;
- the calculation of the average aeronautical revenue per passenger was subject to a number of assumptions and estimates;
- LF's method for calculating a representative tariff for each airport relied on assumptions about exchange rates and inflation that could be challenged; and
- LF used a simple unweighted average of charges across the selected comparator airports (i.e. each airport in the sample was afforded the same weight, regardless of its size), but there are other ways of weighting the information that are equally

(or more) justifiable and would have produced different results.

- 3.5 The issues with the econometrics are discussed later in this paper. We comment on the other points in more detail below.

*Construction of the comparability index*

- 3.6 Having undertaken a range of econometric analyses, LF calculated a ‘comparability index’ for each airport based on the difference between each airport and GAL for each criterion and the p-values produced in the econometric study. As discussed later in Section 4, these p-values cannot be considered robust.

- 3.7 However, there are also issues with the way in which LF constructed the comparability index itself. In particular, whether a particular airport is ultimately included in the set of comparators for GAL depended on:

- an arbitrary definition of bandings (<20%, 20-30%, 30-40%, 40%+) which were used to determine a score for each airport for each criterion (these scores were then weighted by the p-values); and
- the cut-off range (which LF sets at 2.5 times GAL’s score), which was also arbitrarily determined.<sup>11</sup>

- 3.8 Alternative definitions of the bandings and cut-off range would have been equally justifiable and would have influenced the results. While we recognise the need for LF to make some decisions about these parameters – within the constraints of its chosen methodology – it would have been appropriate to recognise that a range of choices could have been justified and reflect this into the range of estimates for the benchmark price.

- 3.9 To illustrate this point we have conducted sensitivity analysis – a standard procedure when relying on assumptions for which a range of potential values could have been appropriate - on LF’s approach to constructing the comparability index. Specifically, we have considered which airports would fall into GAL’s comparator set if:

- the cut-off range was revised from the 2.5 times GAL’s score assumed by LF; and
- the banding ranges were revised.<sup>12</sup>

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<sup>11</sup> We note that RBB Economics (2013) “Benchmarking Stansted’s airport charges”, 24 June, p4 also commented on LF’s “subjective” choice of the ‘cut off’ range.

<sup>12</sup> Sensitivity analysis of the cut-off range was undertaken using data supplied by LF. However, the data supplied by LF was not sufficient to allow sensitivity analysis of the banding ranges. To do this sensitivity analysis we have used the data from Figure 4 of LF’s report as a starting point. In the course of our work we have identified that this data, used for the regression analysis, has

3.10 The results are summarised in Tables 1 and 2 below.

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been subjected to a number of adjustments before being used to construct the comparability index. These adjustments include using multi-category versions of binary variables in the regression e.g. the ownership variable is a binary variable in the regression, but comprises four categories for constructing the comparability index. A number of other data points used in the regression appear to have been overridden with 'no data' for the purposes of constructing the comparability index e.g. a number of observations for the journey time variable differ between the two exercises.

**Table 1: Sensitivity analysis on 'cut off factor' for comparability Index**

Cut off factor (Multiple of GAL score)	2	2.25	2.5	2.75	3
Implied cut-off	9.68	10.89	12.10	13.31	14.52
Nr of airports selected	1	3	11	18	32
Airports	Birmingham	Birmingham Luton Stansted	Birmingham Luton Stansted Barcelona Heathrow Newcastle Milan Vienna Madrid Glasgow Edinburgh	Birmingham Luton Stansted Barcelona Heathrow Newcastle Milan Vienna Madrid Glasgow Edinburgh Sydney East Midlands Leonardo da Vinci Brisbane Leeds Bradford Melbourne Hong Kong	Birmingham Luton Stansted Barcelona Heathrow Newcastle Milan Vienna Madrid Glasgow Edinburgh Sydney East Midlands Leonardo da Vinci Brisbane Leeds Bradford Melbourne Hong Kong Amsterdam Belfast Zurich Pisa Munich Orly Ciampino Bremen Brussels Dublin Dusseldorf Frankfurt Liverpool Manchester

**Table 2: Sensitivity analysis on ‘bandings’ for comparability Index**

Scenario	1	2	3	4	5
Criteria scale 1	20%	20%	10%	30%	20%
Criteria scale 2	30%	30%	20%	40%	40%
Criteria scale 3	40%	40%	30%	50%	60%
Nr of airports selected	9	5	0	10	9
Airports selected	Birmingham Edinburgh Stansted Luton Vienna Newcastle Heathrow Glasgow Madrid	Birmingham Edinburgh Stansted Luton Vienna		Birmingham Edinburgh Stansted Luton Vienna Newcastle Heathrow Glasgow East Midlands Zurich	Birmingham Edinburgh Stansted Luton Vienna Newcastle Madrid Melbourne Brisbane

Note: Because the data in Figure 4 of LF’s report does not include Barcelona and Milan airports, the analysis shown here will always understate the number of airports selected by at least two. Consequently, the main inference to draw from this analysis is that the number of airports selected is sensitive to the assumptions made, rather than focus on the absolute number of airports selected in these scenarios.

**3.11** The analysis illustrates that LF’s approach is highly sensitive to the (arbitrary) assumptions they have made in the course of constructing their comparability index. And given the vastly different sets of comparator airports arising from different input assumptions, it is very likely that the benchmark price identified for GAL would have been different, potentially significantly so.

*Adjustments to estimate aeronautical revenue per passenger*

**3.12** The adjustments which LF made to reported revenues (which include some revenue not related to passenger flights) to calculate aeronautical revenue per passenger were also somewhat subjective:

- the estimate of revenue from landing charges for cargo flights was based on an estimate of the average size of the cargo aircraft operating at each airport; and
- air traffic control revenues for some of the airports were based on data from other airports.

**3.13** The types of adjustments that LF made are necessary as matters of principle to produce robust results, but the practical method employed – and the assumptions made – are debateable. The uncertainty around these assumptions would need to be robustly allowed for in any range of benchmark airport prices identified.

#### *Adjustments for currency and inflation*

- 3.14 LF made adjustments for both exchange rates and inflation to facilitate comparisons of data across airports. The need for these adjustments is uncontroversial, but the method employed can be debated. LF recognised that different approaches are possible and also recognised that each approach requires a number of assumptions to be made e.g. “the outcome will be affected by the particular date at which one sets the exchange rates”.<sup>13</sup> However, despite recognising that different approaches could have been taken and would have influenced the results (even if perhaps only by a small amount), this uncertainty has not been taken into account in LF’s analysis e.g. by estimating a range of benchmark prices instead of a point estimate.

#### *Sensitivity analysis*

- 3.15 Notwithstanding the substantial number of assumptions and estimates underpinning LF’s analysis, in its most recent supplementary report LF stated:<sup>14</sup>

*“We would reiterate that any approach to benchmarking is by definition open to different interpretation and it is very easy to assemble a different set of comparators in order to draw different conclusions. However that does not in our view mean that the use of benchmarking as part of the CAA’s process does not have validity, it simply reinforces the fact that any conclusions should be drawn carefully. As we note in the report, definitive conclusions on spot charge levels should not be drawn without further work, although we suggest that reasonable inferences on competitive price can be drawn from the identified ranges for each airport to inform CAA’s work.”*

- 3.16 The range that LF refers to is a +/- 15% range around its central estimates which it described as follows:<sup>15</sup>

*“The analysis has shown that how the index is calculated can have a small impact on the overall index so that different types of averaging yield results in a range of up to +/- 10% and different approaches to the calculation of a benchmark price, e.g. per passenger or per*

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<sup>13</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p20, 19 April.

<sup>14</sup> See Leigh Fisher (2013) “Comparing and Capping Charges at Regulated Airports: Addendum Note”, 12 August, p5.

<sup>15</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p46, 19 April.



*aircraft, can yield results with a variation of up to +/- 5%. Statistical effects and data approximations are also likely to result in uncertainties of +/- 5-10%. Assuming all of these uncertainties are independent, the overall uncertainty is effectively the root mean square of the individual uncertainties and would therefore be expected to be of the order of +/-10-15%.*

...

*At present it is not possible to specify the precise range of this uncertainty but +/- 10% to +/- 15% would appear to be a reasonable indicator”*

- 3.17** The question obviously arises as to whether the range proposed by LF is sufficient, taking into account the number of assumptions, estimates and conceptual issues surrounding the exercise it has tried to perform (which we have described in this report). In this regard, we note that LF simply assumed these “statistical effects and data approximations” will add a small amount to the range of estimates. Moreover, LF assumed that the various uncertainties are independent, but no evidence has been presented to support this supposition.
- 3.18** Given that LF was developing a prototype analysis for the purposes of answering the question referred to in paragraph 2.2 above, such a high-level approach appears to be reasonable and is consistent with the comments made by LF in its conclusions regarding the inherent uncertainties of any statistical technique further work required. However, the existence of such apparently untested assumptions and the comments made by LF regarding the robustness of the methodology are of much greater importance if the study is to be used to inform conclusions which are different from the stated original purpose of the study and potentially of much greater significance.
- 3.19** Recognising these issues, undertaking a more extensive sensitivity analysis and/or adopting a wider range around any central estimate would arguably have been more consistent with the substantial number of assumptions and estimates underpinning LF’s results. However, LF undertook very limited sensitivity analysis in its original report and the +/- 15% range it proposed is not robustly related to the limited sensitivity analysis it did undertake.
- 3.20** Perhaps most crucially, LF’s analysis of the impact of using different weights to calculate the benchmark price considered only flight capacity and frequency data and not total revenues or passengers. We also note that the results LF presented for capacities and frequencies rely on data for 2003, 2007 and 2011 only (and interpolations for years in between), which may have introduced further measurement error into the calculations.
- 3.21** Because only a limited amount of sensitivity analysis has been possible, it is not

possible to conclude whether the central estimate LF presented – which estimated a benchmark based on a simple average across the comparator airports – is in fact towards the centre of the range of reasonable estimates.

**3.22** However, we note, for example, that based on 2010 data reported in Figure 4 of LF’s report a passenger weighed average of aeronautical revenue per passenger for the airports in GAL’s comparator set suggests a price of £9.92 per passenger, around 40% above the value LF’s analysis suggested as a central estimate for the benchmark price.

**3.23** Further sensitivity analysis using passenger numbers, aeronautical revenues or total revenues as weights has not been possible based on the data in the LF report, or even on the LF data supplied to GAL by the CAA (and then by GAL to FTI), since:

- the data in the report does not include information that might reasonably be used as weights (e.g. total revenue, aeronautical revenue), and in any case the data reported is only for 2010; and
- information that might have been used as weights has been redacted from the LF data provided to GAL by the CAA.

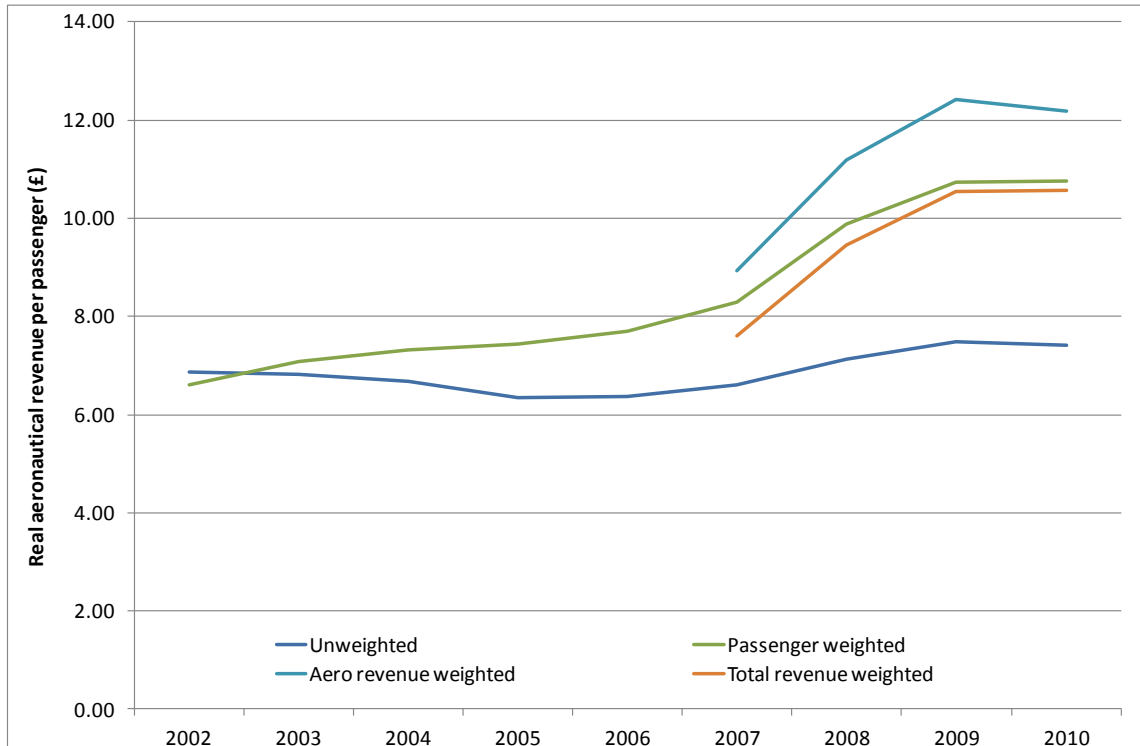
**3.24** Consequently, to conduct our own sensitivity analysis we have collected information on passenger numbers, aeronautical revenues and total revenues for the airports in the comparator set for GAL identified by LF.<sup>16</sup> In some cases we have not been able to obtain the required information for all the airports in all the years, but we present the results based on the data we have been able to collect below.<sup>17</sup>

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<sup>16</sup> We have collected passenger numbers data for 2002-11 for the various airports from the CAA, AENA, Vienna International Airport and Aessaeroporti websites. Revenue data has been collected for various years from financial statements. Revenues were converted to GBP constant 2011 prices using the same indices that LF used in their report (which were provided to us). We note that the data we have collected on passenger numbers for 2010 is not identical to the data LF report for passenger numbers for 2010, but the reason for any discrepancy is unclear.

<sup>17</sup> We have not been able to identify total revenue or total aeronautical revenue data for Milan, Barcelona or Madrid airports, so these airports are excluded from the sensitivity analysis conducted using those weights. The airports are included in the passenger-weighted estimates.

**Figure 1: Implied benchmark prices based on alternative weights**



Source: FTI analysis of CAA, AENA, Vienna International Airport, Aessaeroporti, financial statements and LF data.

- 3.25** The results illustrate very clearly that a simple average of average aeronautical revenue per passenger data generates a much lower implied benchmark price than weighted averages based on passenger numbers, aeronautical revenues or total revenues. This evidence suggests that LF’s focus on an unweighted average may have understated an appropriate benchmark price and that the +/- 15% range used by LF might be too narrow to reflect a reasonable degree of uncertainty around its approach. We note that the passenger-weighted and aeronautical revenue-weighted averages are similar for recent years and that both imply benchmark prices around 30% higher than the unweighted average used by LF.
- 3.26** The sensitivity analysis also suggests that LF’s central estimate was actually towards the low end of a reasonable range of estimates, which implies it is not appropriate to use a +/- range around that value.
- 3.27** All of these factors suggest that the benchmark price estimated by LF, and relied on by CAA, may have been too low and towards the low-end of a plausible range.

The CAA should have cross-checked the selection of comparator airports

- 3.28** Notwithstanding the substantial uncertainty attending LF's analysis, the CAA does not appear to have cross-checked the set of comparator airports identified through the LF study with alternative approaches or – for example – the set of airports that industry participants, or GAL itself, actually use for benchmarking against GAL. Additionally, it is not clear whether the CAA has considered whether some of the airports identified should have been excluded and/or whether additional airports should have been included based on a first principles 'real world' assessment of how alike the airports are – an assessment which would have allowed any obvious outliers, as a minimum, to be excluded from the comparator set and could have identified which airports identified by the econometric approach needed further consideration before confirming their inclusion.
- 3.29** Some of the factors the CAA should have taken into account include:
- whether the pricing strategies of some of the comparators differ to GAL. For example, the CAA should have considered whether any of the airports have been setting low prices in order to build up a critical mass of traffic or attract traffic to fill spare capacity;
  - whether some airports set lower aeronautical charges taking into account expected non-aeronautical revenues;
  - whether there are differences in the way the airports operate; and
  - whether there are differences in the cost base of some of the comparators.
- 3.30** The prices at regional UK airports, compared to London airports, are likely to be lower – all else equal – because of differences in the input costs (particularly labour) that those airports face. This would affect Birmingham, Edinburgh, Newcastle and Glasgow airports within the set of comparators identified by LF for GAL, making simple, un-weighted comparisons to these airports less meaningful.
- 3.31** We also note that MAG has made similar points to the above in its submissions to the CAA, suggesting a number of airports may have had lower charges due to short term pricing strategies, historical pricing agreements or because of differences in input costs and the absence of a requirement to meet the costs of policing.<sup>18</sup>
- 3.32** Had the CAA carried out a 'real world' assessment of the comparator airports proposed by LF, the CAA may have included more obvious comparators such as Manchester, Zurich, Munich, Brussels, Dublin and Paris Orly instead of some of the

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<sup>18</sup> See Manchester Airports Group (2013) "Civil Aviation Authority Stansted Market Power Assessment: Interim Response of M.A.G. to the CAA's 'minded to' document", Annex B, p7, 24 May, which refers to Liverpool, Leeds, EMA, Luton and Birmingham airports in this context.

smaller UK regional airports like Birmingham and Newcastle that were included. The use of a different set of comparator airports would obviously have potentially influenced the results and the CAA should have recognised this possibility and factored it into the way it interpreted LF's work, noting the inherent uncertainty around the LF analysis.

**The CAA places too much weight on LF's analysis of average aeronautical revenue per passenger**

- 3.33** The CAA appears to focus exclusively on LF's analysis of aeronautical revenue per passenger in reaching its conclusions. However, regard should have been given to other measures of charges and revenues.
- 3.34** In a competitive market an airport operator would seek to maximise its total profit, not just the profit from aeronautical activities. Consequently, tariffs and charges for aeronautical activities would be set taking into account expected revenues and profits from non-aeronautical activities. As a result, the CAA's focus purely on aeronautical revenues might produce a distorted assessment of pricing behaviour; the apparent aeronautical charges at a particular airport might appear too high or low when compared to other airports because of the different level of yield anticipated from non-aeronautical activities.
- 3.35** Published tariffs are also capable of providing some insight into relative pricing across airports, notwithstanding that there may be differences between published tariffs and charges actually levied (which would also take into account any discounts offered by the airports). We note in the current context that LF's analysis of average aeronautical revenues per passenger produced quite different results to the analysis of published tariffs. We note that this difference might be because other airports may offer greater discounts to their published tariffs than GAL does and that this need not have anything to do with an exercise of market power by GAL. Rather, it is entirely consistent with the other airports either (i) being unregulated and able therefore to publish tariffs that are paid by only the minority of users; or (ii) being less tightly regulated than GAL and consequently more able to offer discounts on published tariffs. In either case the comparator airports would be in a position to offer discounts to the published tariffs which a more tightly regulated airport, such as GAL, is not able to match.

#### **4. The methodology employed by LF is inappropriate**

**4.1** There are a number of aspects of LF's methodology which affect the robustness of the results, even as they relate to the original stated objective of LF's work.<sup>19</sup> These include:

- the criteria used to select comparator airports;
- the robustness of the econometrics employed;
- the robustness of other aspects of the analysis; and
- the types of price comparisons made.

**4.2** The LF analysis employed an econometric model to make its final selection of comparator airports, but the process began by determining and then applying a qualitative assessment criteria. A number of issues with the econometric analysis are returned to below, but before that we discuss some issues with the qualitative selection criteria.

##### **Issues with the criteria used for selecting comparator airports**

**4.3** The criteria applied by LF to select comparator airports excluded a number of fundamentally important drivers of airport charges which may have distorted the ultimate set of airports selected and biased the results of LF's analysis. Most importantly, the following factors were not taken into account by LF:

- quality of service;
- input costs; and
- investment cycles.

**4.4** The merit of excluding each of these factors is discussed below.

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<sup>19</sup> The LF report recognises that there are issues and potential weaknesses with its methodology and reflects this fact in the text of the report.

#### *Quality of service*

- 4.5 LF excluded quality of service from its selection criteria because “it is the match of service quality to the customer’s requirements that is more properly assessed rather than the absolute comparison between different service levels delivered in potentially different market segments”.<sup>20</sup>
- 4.6 However, insofar as better quality costs more to produce, absolute quality levels affect prices and therefore should be a criterion to identify suitable comparators. Airports might also compete by offering different bundles of service levels and prices, which might render a direct comparison of prices (without taking differences in quality into account) misleading. Further, there does not appear to be a reason to exclude this criterion on practical grounds since “the match of service quality to the customer’s requirements” is a variable that could be created using interactive dummies and then included into econometric modeling (if that was deemed to be the most appropriate method for selecting comparators).

#### *Input costs*

- 4.7 LF excluded inputs costs as a potential criterion because “one of the aims of the study is to compare prices across airports to establish whether this could be used to regulate charges at GAL and Stansted, so including input costs in the choice of benchmarks effectively goes against this consideration (one of the key advantages in regulating using benchmarked charges is that it avoids the cost and complexity of a detailed consideration of input costs)” and “the inclusion of such input costs could risk creating a circular argument whereby inefficient inputs costs drive and justify higher prices”.<sup>21</sup>
- 4.8 Although LF is right to have pointed out that inefficient costs cannot simply be allowed to flow through to any benchmark price identified through this exercise, particularly if the benchmark prices are to be used for the purposes of setting regulated charges, there is a difference in the cost of key inputs for GAL compared to many other airports and this difference needs to be reflected in the analysis somewhere because airport prices, like all prices, do reflect input costs.

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<sup>20</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p9, 19 April. We note that LF has repeated this last claim in its most recent supplementary paper: see Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Addendum Note”, 12 August, p4.

<sup>21</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p10, 19 April. We note that LF has repeated this last claim in its most recent supplementary paper: see Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Addendum Note”, 12 August, p4.

- 4.9** We note that a practical objection might be raised that it is difficult to separate efficient and inefficient input costs (and only take into account the efficient costs), but it does not seem reasonable to completely exclude measures of input costs when it is likely that only a small portion of the costs actually incurred by airports are inefficient. Since airports operating under incentive-based price regulation or in a competitive market have incentives to operate as efficiently as possible it seems unreasonable to dismiss consideration of costs on the implied basis that enough of the input costs of other airports are inefficient to distort the analysis by more than any distortion introduced by including a small element of inefficient cost (if the inefficient costs cannot be excluded from the cost input data in some other way).
- 4.10** If a choice has to be made between excluding input costs completely, and including an imperfect measure of efficient costs, then the latter would seem preferable. To do otherwise would be to ignore the fact that a substantial portion of input costs (e.g. wage rates, electricity prices, rates and other forms of local taxes, construction costs, land costs etc.) are to a large degree – though not entirely – beyond management control.

*Investment cycles*

- 4.11** Investment programmes at airports tend to be characterised by a combination of on-going renewal and incremental improvements or capacity enhancement projects and irregular, but long-lived, large investments which have a much more significant impact on capacity.
- 4.12** . However, LF made no attempt to take into account that the various airports may be at different points in their respective investment cycles. For example, some airports may be investing heavily to develop their airports and attract business, while others may have limited capital investment requirements beyond the maintenance of existing infrastructure, potentially with implications for prices depending on how the investments are remunerated. Some airports may seek to recoup their investments relatively quickly by increasing prices, while others may have their prices regulated in a way that spreads investment costs over many years.



- 4.13** The reasons LF advanced for excluding the investment cycle from its criteria are not entirely convincing.<sup>22</sup> While the availability of data is an empirical issue, LF's proposition that investment cycles were unlikely to significantly impact on prices observed in any one year also needs empirical investigation because it is theoretically plausible that investment cycles do in fact have a material impact on prices. The impact of T5 at Heathrow Airport is one example of investment cycles and major projects within such cycles impacting prices even where the impact of the investment was spread over an extended period.

*Other comments*

- 4.14** LF's exclusion of the various factors identified above may be the result of its broad approach to identifying comparators. LF used an Inherent, Structural, Systemic or Realised (ISSR) framework for identifying comparators, but did not include any Systemic or Realised criteria.<sup>23</sup> LF's assessment that Systemic criteria "cannot be made subject to objective comparisons" might be too much of a generalisation, but more importantly the exclusion of Realised criteria – which could include input costs, quality of service and investment cycles – likely means that important differences between airports are overlooked. Some of these criteria will likely be reflected in observed prices, such that excluding them from the selection process could lead to a distorted set of comparator airports.

*Issues with the robustness of the econometrics employed*

- 4.15** LF used an OLS regression model to identify the key drivers of aeronautical revenue per passenger across a set of airports. We return to the appropriateness of the way this exercise has been conducted below, but at a high level there are two fundamental critiques that can be made:

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<sup>22</sup> See Leigh Fisher (2013) "Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report", p10 which states "one might expect the investment cycle not to directly impact on airport charges in any one year" and Leigh Fisher (2013) "Comparing and Capping Airport Charges at Regulated Airports: Addendum Note", 12 August, p4, which states "aside from concerns on the availability of reliable, consistent data for the long list of airports ... it is the match to customers' requirements rather than an absolute comparison that we consider to be appropriate".

<sup>23</sup> See Leigh Fisher (2013) "Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report", p7, 19 April which states "Systemic criteria tend towards being those that are process-driven or are factors that are more readily influenced by the organisation in question" and "Realised criteria result from the Inherent, Structural and Systemic criteria (for example operational efficiency or factor costs) – so can often be considered to be outcomes".

- given that the observed average aeronautical revenue per passenger (used as a dependent variable) may not provide a robust measure of the competitive price at each airport used in the analysis, it is unclear how benchmarking against the prices at these airports can possibly generate a robust estimate of the competitive price at GAL; and
- the analysis LF undertook implicitly assumed that the outputs of each airport are homogenous, whereas the outputs are actually likely to be differentiated. A hedonic price analysis, which would have allowed for differences in the products (services) airports provide to have been properly taken into account, would have been a preferable methodology for LF to adopt. We explore this issue in more detail in Appendix 2.

**4.16** Over and above these fundamental conceptual issues, there are a number of problems with the way LF applied its chosen econometric model to select comparators. In constructing a comparability index, LF used (one minus) the P-values on the coefficients of the model as weights, while the coefficients themselves “have not been used as weights because the elasticity (or relative force with which each criterion drives the aeronautical revenue per passenger) is accounted for through the difference scores”.<sup>24</sup> There are a number of issues with LF’s decision to rely on p-values instead of coefficients for this purpose – which are explored in Appendix 3 – and there are also several reasons to question the robustness of the P-values generated from the regression analysis, as summarised in Table 3 below.

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<sup>24</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p15, paragraph 2.6.1.

**Table 3: Issues with P-values derived from LF's regression analysis**

Factor	Discussion	Impact
Multicollinearity	Most of the explanatory variables included in the regression are insignificant, which suggests that several of the explanatory variables included are likely to be highly correlated with one another. <sup>25</sup>	If variables are collinear, as appears to be the case, then the t-ratios would be biased and the P-values used to weight the criteria when selecting comparators are incorrect.
Omitted variables	The R <sup>2</sup> of the regression indicates that 45% of the variability of the dependent variable is not explained by this model. The effect of important variables has been overlooked. <sup>26</sup>	If the variables excluded were correlated with those included, then the coefficients, t-ratios and P-values would all be incorrect.
Heteroscedasticity	It is common in cross-sectional data for the variance of the error term not to be constant, but LF do not present any statistics to show that heteroscedasticity is not present.	If heteroscedasticity is present then the t-ratios and P-values would be incorrect.
Absence of normality	The assumption of normality is required for the t-ratios to be correct. This assumption may not be met given the small sample size.	If normality is not present then the P-values would be incorrect.
Small sample size	The sample size is very small, increasing the uncertainty around the modeling.	This may mean the P-values are incorrect.
Functional form	The functional form of the model has not been subject to test.	An inappropriate functional form may lead to incorrect (biased) coefficients and P-values.

<sup>25</sup> In this regard we note that LF indicate that they “did identify multi-collinearity and assessed the best parsimonious specification of the model, but it had very few variables left”, which suggests that multi-collinearity has affected the regression results: see Leigh Fisher (2013) “Comparing and Capping Charges at Regulated Airports: Addendum Note”, 12 August, p7.

<sup>26</sup> For example, as noted elsewhere in this report, service quality (for example) has not been taken into account, nor have differences in input costs (e.g. relatively high labour costs in SE England compared to other locations).

- 4.17** In the round, these factors mean that the P-values cannot be regarded as robust or unbiased. Consequently, the weights that LF has used to construct its 'comparability index' and select comparator airports are likely to be wrong. And if a different set of weights were used a different set of comparators would have been selected and the benchmark price estimated by LF could have been significantly different. Moreover, the +/- 15% range proposed by LF does not capture this fundamental flaw in its methodology and consequently no robust inferences about competitive price levels can be drawn from the range they propose.

#### **Issues with the price comparisons LF made**

- 4.18** Having undertaken its analysis to select a set of comparator airports for a single year (2010) LF then constructed a measure of the weighted average aeronautical revenue per passenger across those airports for each year of a ten year period.
- 4.19** However, looking at dynamic price trends in a static basket of comparators is wrong: the basket of comparators has been identified with a cross-section of data, but (as LF itself acknowledged) the basket of comparators is likely to change over time. If LF's analysis was repeated for different years it would likely select a different set of comparators in each year and the current 'competitive price' would be distorted. While whether the implied 'competitive price' would have been higher or lower is an empirical matter, it is not appropriate to simply ignore this issue: as a minimum LF and the CAA ought to have reflected this additional uncertainty into their conclusions.
- 4.20** Further, as noted earlier, there are reasons to place more weight on analyses of published tariffs and of total revenue per passenger (rather than just aeronautical revenue per passenger) than LF has done.

## 5. Conclusions

5.1 FTI has been commissioned by GAL to assist it review and respond to the CAA's use of a report by LF (April 2013) examining the potential for benchmarking of prices at other airports to provide information about the competitive price level at GAL. We have been specifically commissioned to address these issues taking into account LF's latest supplementary report (August 2013) and additional data that has been provided to GAL by CAA that was used by LF in their work.

5.2 The CAA has relied on the April 2013 report by LF (taking into account LF's attempt to address stakeholders' comments on the April 2013 report in an August 2013 supplementary report) to justify a conclusion that GAL's charges have been above the competitive market price. However, the CAA's reliance on this report and the conclusions that it draws from it are inappropriate on several grounds:

- the report has been used by the CAA for a purpose for which it was never intended: the CAA used the report to draw inferences about competitive prices at GAL, but LF never attempted to estimate a competitive price, instead it aimed to undertake a "prototype analysis" which "focused on answering the question 'Is it possible to benchmark prices at comparable airports in order to regulate charges at LGW?'"<sup>27</sup>
- the exercise which the CAA wishes to undertake is conceptually flawed and is not capable of providing sufficiently robust evidence about the competitive price (either a point estimate or a range) at GAL. In particular, we note that it is certainly not straightforward, and perhaps not possible at all, to estimate a competitive price for GAL by looking at prices at other airports – which may or may not be pricing at a competitive level in their own markets– and some of which do not operate in the same market as GAL (or at a minimum market which are similar).
- even if the exercise LF attempted to perform was capable – if perfectly executed – of identifying a benchmark competitive price against which GAL could be compared, the conclusions of the LF report based on its actual analysis, and the inferences CAA draws, fail to recognise the considerable uncertainty surrounding the LF analysis. In particular, the LF methodology relies on numerous assumptions – some of them arbitrary – and estimates, most of which could be debated and challenged and equally plausible alternatives substituted. Yet, no attempt has been made at a proper sensitivity analysis which reflects these uncertainties. Setting out – and relying on – a robustly justified range of estimates for the benchmark price LF's study identifies is the minimum that should have been undertaken. However,

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<sup>27</sup> See Leigh Fisher (2013) "Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report", p4, 19 April.

because of the numerous assumptions, estimates, judgements and conceptual issues surrounding the work undertaken by LF (which, as discussed in this paper, go well beyond the econometric analysis and include issues such as whether the central estimate LF present can in fact be regarded as towards the centre of a plausible range), the range of estimates they present cannot be regarded as robust or as enabling ‘reasonable inferences’ about the competitive price at GAL to be drawn.

**5.3** The combination of these issues means that:

- 1.** the LF report should not have been relied upon by the CAA to assess (or to draw ‘reasonable inferences’ about) a competitive price at GAL and should be discounted from its analysis; and
- 2.** the CAA should base its assessment of GAL’s competitive price – and market power – on other evidence, or at a minimum on a wider range of estimates (derived from a corrected version of the LF methodology) which appropriately recognises that properly reflects the numerous assumptions, judgements and uncertainties that inform that approach.

## Appendix 1 Summary of LF's methodology

- A1.1** To identify a set of comparator airports for each of Gatwick, Stansted and Heathrow LF first identified a 'long list' of potential comparator airports. The 'long list' was selected based on data availability, the project team's experience and consultation with stakeholders. 54 airports were included, most of which were in the UK or Europe. This list was narrowed down for the three London airports based on an econometric model of the relationship between aeronautical revenue per passenger and the following factors affecting airport prices:
- airport size (number of passengers);
  - size of the catchment area (population);
  - journey time by car to next principal city;
  - availability of alternative airports;
  - runway utilisation;
  - percentage of scheduled flights flown by network carriers;
  - percentage of seat capacity going to international flights;
  - percentage of passengers who are on transfer;
  - average seat capacity per aircraft, and
  - whether the airport's ownership is private.
- A1.2** All of the airports on the 'long list' were used in the model except where required data was not available.
- A1.3** The model was estimated using 2010 data; because of data limitations only 33 airports were included in the econometric analysis.
- A1.4** A 'comparability index' was constructed based on the results of the econometrics, weighting together scores for each criterion based on how close each comparator airport was to Gatwick, Stansted or Heathrow. The weights used to construct the three indices were given by (one minus) the P-values of the coefficients of each of the factors listed above. Once the scores for each criterion were aggregated for each airport, a 'short list' of comparator airports was identified for each of the three London airports. The 'short list' was different for each of Gatwick, Stansted and Heathrow, although there was some overlap.
- A1.5** A benchmark price was then estimated for each of the London airports for the period 2002-10 by taking a simple average of the aeronautical revenue per passenger (in each year) at each of the short listed airports. Alternative comparisons were considered, such as averaging published tariffs across the comparator airports, but the approach based on aeronautical revenue per passenger was LF's preferred approach. To compare aeronautical revenue per passenger across the various airports LF converted 'raw' figures into a constant price base and currency.

- A1.6 Aeronautical revenue per passenger at Gatwick, Stansted and Heathrow were then compared to the respective benchmark price over the 2002-10 period. Inferences were then drawn about whether each of the London airports was charging above, below or at the benchmark price.

## Appendix 2 Hedonic Price Analysis

- A2.1 Airports are differentiated products and in order to compare their prices one needs to create a “representative” price index rather than compare their prices directly. For example, if runway utilisation affects costs (and therefore prices) then an airport with higher utilisation will have higher prices. Simple price comparisons will conclude that the airport is “more expensive”, but the impact of this factor needs to be accounted for before drawing such a conclusion.
- A2.2 A hedonic price analysis would allow for differences in the products (services) airports provide to be taken into account more robustly, but does not appear to have been carried out by LF or considered by the CAA. We note that in their conclusions, LF discuss the possible use of a hedonic-like analysis to generate benchmark prices directly, rather than first selecting a set of comparators and then simply compare their average prices.<sup>28</sup> However, LF refers to such model as alternative to its methodology, rather than recognising that this would be a superior approach. While the data requirements for a hedonic analysis – which would involve a time series of data - are greater than for a simple OLS regression which relies on a single year of data, we would contend that the increase in the robustness of the results generated by using a hedonic approach would be sufficient to justify the investment in procuring the necessary data. In contrast, as we have discussed elsewhere in this paper, there are too many issues with LF’s methodology to make it adequate for the purpose of identifying a competitive price.

## Appendix 3 Issues with the use of p-values instead of coefficients

- A3.1 The coefficients of an econometric model measure the impact of each explanatory variable (of each factor) on the variable that the model seeks to explain. In this case, the coefficients measure the impact of each of the factors listed in Appendix 1 on average revenues per passenger. Since the coefficients are obtained using a sample of airports, they are estimates of the true value of the impact, A statistical test (the t ratio, or significance test) is necessary to ascertain whether the true value is zero; in other words, to assess whether the estimated coefficient measures a true effect or not.

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<sup>28</sup> See Leigh Fisher (2013) “Comparing and Capping Airport Charges at Regulated Airports: Updated Final Report”, p45, paragraph 8.3. We note that LF appear to suggest a hedonic price analysis would be preferable to the approach they have taken: see Leigh Fisher (2012) “Comparing and Capping Airport Charges at Regulated Airports”, 5 December, p42.



- A3.2** For each coefficient, the P-value of the significance test answers the following question: “if the true value of the effect I have estimated was in fact zero, what would be the probability of obtaining a test result as large as the one that I have obtained from my sample?” The smaller this probability, the higher is the confidence in the fact that the true effect is in fact different from zero.
- A3.3** Put differently, the P-value quantifies the strength of the evidence in favour of the hypothesis that the true effect for which one has an estimate is in fact different from zero. It is customary for P-values of 5% or less to be considered as indicative of statistical significance (i.e. to lead the investigator to conclude that the true effect is not zero); values of 10% are also used, especially when models are run with small samples. Values in excess of 10% are usually taken as indicating that the true effect of the factor that is being considered is in fact zero.
- A3.4** Given the above discussion, using P-values as weights is questionable. If P-values in excess of 10% indicate an underlying true effect of zero, then the coefficient of that effect should not be taken into account at all, because what the P-value tells us is that the true effect is zero, according to standard interpretation. We note that LF’s model includes ten drivers of airport charges, as shown in Appendix 1. Only two of these are statistically significant at the 10% level: the percentage of scheduled flights flown by network carriers and the percentage of seat capacity going to international flights. All the other drivers are highly insignificant. This is troublesome and it suggests that the model is not reliable.

# YOUR LONDON AIRPORT *Gatwick*

## **Appendix 10: SLG Economics analysis**

*Response attached overleaf*

Memorandum

# Comments on the SLG report on the distribution of rents

Justin Coombs, John Lisle, David Shaharudin

30 October 2013

## 1. Introduction

The Civil Aviation Authority (“CAA”) has commissioned a report by SLG Economics Limited (“SLG”) to review the distribution of rents between airports, airlines, passengers and cargo users at Heathrow and Gatwick (“the SLG report”).<sup>1</sup> The SLG report reaches several conclusions including, for example, that regulation produces lower prices which allows airlines to offer lower prices to consumers.<sup>2</sup>

We have been asked to review the SLG report and comment upon the robustness of the arguments and the conclusions. The overall conclusion that the CAA has drawn from the SLG report is that lower airport charges will be largely passed on to consumers.<sup>3</sup> However, we have found that the SLG report makes several unsubstantiated claims and draws incorrect conclusions, which puts the CAA’s inference in doubt. For example, contrary to the SLG report, we find that:<sup>4</sup>

- airlines will often face a fixed vertical supply curve (section 2);
- even if the supply curve was not fixed, a change in charges may have no impact on the optimal fare (section 3);

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<sup>1</sup> SLG Economics Ltd (2013) *Q6 review of the distribution of economic rent between airport, airlines and passengers and cargo users at Heathrow and Gatwick: A Report for the CAA by SLG Economics Ltd.*

<sup>2</sup> The SLG report, p. 7.

<sup>3</sup> CAA (2013) *Economic regulation at Gatwick from April 2014: Final proposals*, para. 2.12 (“the CAA report”).

<sup>4</sup> For the sake of brevity, this report only addresses some of those points in the SLG report for which we disagree.

- the evidence does not show airlines have been passing through to their passengers the benefit of reductions in their operating costs (section 4);
- an increase in charges is likely to lead to airlines switching (section 5 and 6); and
- the secondary slot trading market might not be fully efficient so there are likely to be benefits from a better allocation of capacity if airports to levied charges at the market clearing level

For these reasons we do not think the evidence before the CAA and considered by SLG supports the SLG report's conclusions. Instead, the points above suggest that a change in airport charges from their current level may to a large extent merely transfer rents between the airport and airlines with little direct impact on passenger fares. This is consistent with the results of a 2012 Compass Lexecon paper and previous CAA analysis regarding airline yields that found airlines achieve the highest yields at Heathrow, then Gatwick, then Stansted and Luton.<sup>5</sup> This in turn raises the concern that the CAA report is not based on robust reasoning.

## 2. The airlines are capacity constrained

The CAA has concluded in its 'minded to' analysis that Heathrow and Gatwick are both capacity constrained and this was a significant factor in the CAA finding that these airports have SMP. SLG was commissioned by the CAA to (among other things) assess how airport capacity constraints affect the sharing of rents between upstream and downstream customers. This is an important question to help determine whether regulation will lead to a reduction in fares for passengers or will mainly shift rents between airports and airlines.<sup>6</sup> The SLG report observes that if the airline supply curve is fixed, then there is no benefit to airlines from lowering price as they would not be able to carry more passengers.<sup>7</sup> However, the SLG report finds that airline capacity is not fixed, on the basis that British Airways had a load factor of 78.3% in 2011 and 79.9% in 2012.<sup>8</sup> It concludes that airlines must face an upward sloping supply curve.

We do not agree with this assessment, which begs the obvious question: if airlines could increase their load factors in response to a change in airport charges why do they not do so already? The reason is because for many flights they do not have any meaningful spare capacity. First, the load factors of easyJet are more likely to be relevant to Gatwick (since it

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<sup>5</sup> Compass Lexecon (2012) *A model of airport competition*.

<sup>6</sup> See for example Compass Lexecon (2012) *A model of airport competition*, para. 1.13.

<sup>7</sup> The SLG report, p. 6.

<sup>8</sup> The SLG report, p. 6.

is Gatwick's largest customer) and these are higher at around 90%.<sup>9</sup> Second, using annual load factors will underestimate load factors during most periods of operations. Airlines do not have consistent load factors on every flight and route. Once an airline has decided to fly a route the marginal cost of carrying an extra passenger is very low. This allows airlines to use yield management to maximise revenues: they price very low when there are many seats available and price high when there are few seats left. This strategy means that during peak periods airlines will be close to full capacity.<sup>10</sup> At other periods airlines may operate flights with low load factors. They operate these flights to either retain the slot or to move aircraft (e.g. return aircraft to their bases to maintain the schedule). These flights lower the annual average load factor and can create the impression that airlines have spare capacity when in practice they may be largely capacity constrained on many flights.

### 3. A reduction in charges may have a limited impact on the optimal fare

SLG economics claims that "one would expect a large part of any exogenous reduction in airport price to be passed on to passengers".<sup>11</sup> This claim is made on the basis that there is competition in the airline sector and so any airline that fails to pass through reductions in charges will lose out to other airlines which do pass on the benefit of the cost change.

Clearly, if airlines are capacity constrained they will have no incentive to pass on any reduction in airport charges. However, even if it were accepted that airlines had some spare capacity, it is not clear whether changes in airport charges would affect optimal fare levels.

Short run pricing decisions (such as those made by an airline's yield management system) are normally influenced by changes in *variable* costs rather than changes in *fixed* costs.<sup>12</sup> SLG's analysis therefore implicitly assumes that a change in airport charges will affect an airline's per-passenger marginal cost, which will in turn influence fares. This may not be the case. If instead, the charges only affect costs at the level of each flight, it will not change the optimal profit-maximising fare. Gatwick's airport schedule of charges includes charges at both the level of the aircraft and at the level of the passenger.<sup>13</sup> Per-flight charges include landing, taking off, and parking. Per-passenger charges include security and baggage

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<sup>9</sup> See: [http://corporate.easyjet.com/investors/monthly-traffic-statistics/2013/september.aspx?sc\\_lang=en](http://corporate.easyjet.com/investors/monthly-traffic-statistics/2013/september.aspx?sc_lang=en), viewed on 14 October 2013.

<sup>10</sup> For example, easyJet targets "100% sold out on the day". easyJet 17 September 2008 Investor Presentation, p. 23.

<sup>11</sup> The SLG report, p. 7.

<sup>12</sup> For example the European Commission states: "cost efficiencies that lead to reductions in variable or marginal costs are more likely ...[than fixed costs] to result in lower prices for consumers". European Commission (2004) *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings*, C31/03, para. 80.

<sup>13</sup> GAL Gatwick Airport: Conditions of Use 2013/2013 Including Airport Charges effective 1<sup>st</sup> April 2013, p. 26-27.

handling. It is only a change in per-passenger charges that might affect an airline's per-passenger marginal costs and therefore the optimal fare. Even an increase in per-passenger-charges might not affect fares if the airline is pricing to demand rather than costs and fares already exceed its per-passenger marginal cost.

#### **4. The “empirical evidence” does not show airlines have been passing on falls in costs**

The SLG report claims that “looking at the empirical evidence over the last 10 years, both costs and air fares have fallen in real terms while there has been strong growth in GDP (a good proxy for passenger demand)”.<sup>14</sup> The SLG report concludes from this that airlines have not been able to capture the potential economic rents from growing demand but instead passed cost reductions through to consumers.

We do not agree with this assessment. We stand by the conclusions of a previous Compass Lexecon report which found that a change in airport charges from their current level will simply transfer rents between the airport and airlines with no direct impact on passenger fares.<sup>15</sup> The “empirical evidence” referred to in the SLG report does not in fact support the claimed conclusions for the following reasons.

First, the SLG report does not set out the “empirical evidence” which, it claims, shows that costs and air fares are falling in real terms. However, we have obtained the data that SLG relies on from the CAA. The data does not show costs and fares for all airlines at Gatwick but instead it shows only data for British Airways.<sup>16</sup> Given that British Airways accounts for only 15% of passenger numbers at Gatwick, this empirical evidence does not in itself demonstrate that airfares have fallen in real terms at Gatwick.<sup>17</sup> The analysis is also overly simplistic and incomplete as it fails to make clear the assumptions behind the fares.<sup>18</sup>

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<sup>14</sup> The SLG report, p. 8. The SLG report does not explain why it believes that GDP is a good proxy for demand for airline flights, and it is therefore not clear to us whether or not it is. There are many industry-specific factors that might affect demand for flights such as trends towards cutting business costs and “staycations”, see for example Nick Fletcher “Dividend bonanza as Butlins rides British staycation boom” 19 September 2009 [www.theguardian.com](http://www.theguardian.com). However, as we show, even accepting this assumption, the evidence does not support SLG's conclusions.

<sup>15</sup> If there are capacity constraints and airlines are pricing to demand, we would not expect falls in costs to be passed through to fares. See for example Compass Lexecon (2012) *A model of airport competition*, para. 1.13

<sup>16</sup> CAA “Copy of BA accounts analysis” (Excel workbook).

<sup>17</sup> CAA (2013) *Consultation on Gatwick market power assessment*, Figure 2.3.

<sup>18</sup> For example: what is assumed to be in the fare? How did the growth of LCCs affect British Airways' fares? Did British Airways reduce the quality of its service in order to compete with LCCs? Is this the price the passenger pays or that British Airways classes as its fare, with other ancillaries added? Does it include fuel surcharge, booking fee, air passenger duty? Likewise, when thinking about LCC fares at Gatwick one would need to add booking fees, checked bag fees, air passenger duty etc.

Second, we are surprised that SLG claims there has been “strong growth in GDP”. In 2008 the UK experienced a financial crisis, which led to a severe contraction in GDP. UK growth has remained weak for several years. Over the last ten years the UK economy has grown only 14%.<sup>19</sup> Growth was even more muted on a per capita level, growing only 7%.<sup>20</sup> Even these results are highly dependent on the period examined; for example there was no growth in GDP between 2006 and 2012.

Third, one cannot assume that growth has outpaced airport capacity. Although airports are currently prevented from building new runways there are many ways in which they can over time make small increases in capacity. They can improve terminal operations to increase passenger throughput, make air traffic movements more efficient, and encourage larger aircraft. For example, Gatwick has made many investments over the past ten years to improve its throughput including: building and improving stands; adding terminal extensions and improving security procedures; making ground operations more efficient; and changing the charging structure to encourage larger planes.<sup>21</sup> Gatwick is planning more investments in the future to unlock further capacity.<sup>22</sup> Heathrow is also making improvements.<sup>23</sup> Consequently, Heathrow has increased the throughput of passengers by 11% over the past ten years, while Gatwick has increased its throughput by 16%.<sup>24</sup>

In other words, passenger numbers at Gatwick have actually grown slightly faster than UK GDP over the past ten years. Assuming (as SLG does) that GDP is “a good proxy for passenger demand”, this would imply that the capacity constraint at Gatwick has been slightly relaxed. If we accept SLG’s assumption of a link between GDP and passenger demand, we might therefore expect to see fares falling in real terms, not because of any pass-through of falling costs, but rather because of the slight relaxation of the capacity constraint.

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<sup>19</sup> International Monetary Fund *World Economic Outlook Database: April 2013*. UK real GDP in 2002 was GBP1.26 trillion and in 2012 was GBP1.44 trillion.

<sup>20</sup> International Monetary Fund *World Economic Outlook Database: April 2013*. UK real GDP per capita in 2002 was GBP21,287 and in 2012 was GBP22,809.

<sup>21</sup> See for example GAL “Capital Investment Plan” <<http://www.gatwickairport.com/business-community/developing-gatwick/capital-investment-plan/>>.

<sup>22</sup> Ibid.

<sup>23</sup> See for example HAL *Heathrow Strategic Capital Business* <<http://www.heathrowairport.com/about-us/investor-centre/document-centre/capital-investment-plans/heathrow-strategic-capital-business-plan-2013>>

<sup>24</sup> CAA *UK Airport Statistics*. Heathrow had 63 million passengers in 2002 and 70 million in 2012. Gatwick had 30 million in 2002 and 34 million in 2012.

## 5. An increase in charges will lead to airlines switching airports

The SLG report argues that a 10% increase in airport charges is unlikely to prompt an airline to switch airports. This is because such an increase will have a small impact on an airline's overall costs (a 1-3% increase in costs).<sup>25</sup> The SLG report therefore claims:<sup>26</sup>

*“given average projected profit margins for airlines routes of well over 5% it is unlikely that [a 10% increase in airport charges] would lead to many routes being stopped (although it is the profitability of the marginal route which is key for this decision)”.*

We do not agree with this assessment. First, if (as SLG claims) the market is competitive then an increase in costs of 1-3% is not trivial. If profit margins are only 5% then this increase represents between 20-60% of profits. We would be surprised if airlines did not react to such a serious impact on their profits.

Second, the fact that the “average” profitability of a route is 5% is not relevant to assess the impact of an increase in charges. We instead agree with the second part of the sentence quoted above (which contradicts the first part) that what matters is the profitability of the marginal route. If one was to look at the profitability of an airline's routes, one would find that it varies from route to route. Some are very profitable, but some are only marginally profitable.<sup>27</sup> A small increase in charges will make those marginal routes unprofitable and lead to their closure, and the transfer of the aircraft capacity to alternative routes.<sup>28</sup>

Third, even if there were no marginally profitable routes one cannot assume that no switching will occur. An airline's fleet is fixed in the short run.<sup>29</sup> It will allocate its fleet to maximise profits. An increase in charges at one airport will make another airport relatively more attractive and will lead to the closure of routes. Suppose, for example, that routes based at Gatwick gave easyJet a margin of 5% and routes based at Berlin gave it a 4% margin. An increase in costs at Gatwick of 3% would make Berlin far more attractive. In fact, the same result would apply if routes at Gatwick gave easyJet a margin of 50% and Berlin a margin of 49%. What matters is the opportunity cost of operating an aircraft at different airports, and how a change in airport charges affects that opportunity cost *at the margin*.

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<sup>25</sup> The SLG report, p. 4.

<sup>26</sup> The SLG report, p. 4.

<sup>27</sup> For example, the profit profile of easyJet routes show some routes are very profitable and some are loss making. *easyJet March 2013 investor presentation*, p. 18.

<sup>28</sup> This is stated to be easyJet's strategy. See, for example, paragraph 7.3 of *easyJet announces fleet plans, 18 June 2013*.

<sup>29</sup> Although they can order as many aircraft as they wish, it can take many years to delivery aircraft. For example, airlines have orders at Airbus that will not be delivered until 2031. See CAA (2013) *Consultation on Gatwick market power assessment: CAP 1052*, footnote 327.



## 6. Sunk costs will not stop airlines switching

The SLG report also claims that airlines will not switch due to the “sunk costs involved in their existing investments and the one-off costs involved in switching”.<sup>30</sup> We do not agree with this assessment.

First, the statement is not substantiated. There may be some costs involved in starting a new route such as relocating staff, advertising and low utilisation during early periods. However, what matters is the level of these costs relative to the profit opportunities in other airports. The SLG report provides no such assessment. The SLG claim seems at odds with evidence in the CAA consultation on the Gatwick market power assessment, which has said that sunk costs and switching costs are low for inbound aircraft.<sup>31</sup>

Second, it is not supported by the evidence. Low cost airlines regularly close and open routes. easyJet for example targets a route churn of 5-10% per year.<sup>32</sup> Clearly this takes into account all sunk and switching costs. As easyJet states:

*One of easyJet’s strengths is its flexibility in asset allocation; we can and do move aircraft around our network to ensure we are generating the best possible return on our investments. (easyJet Annual Report 2009)*

Third, airports do not just compete for current routes, they also compete for future airline expansion. When airlines take ownership of new aircraft they must decide where to base them. Sunk costs will not affect that decision, airport charges will.

## 7. The secondary slot trading market may not be efficient

The SLG report claims that “if the secondary slot trading market works well” the market will work efficiently by allocating scarce airport capacity to those airlines that value it most highly.<sup>33</sup> While this may be true in theory, in practice it is unlikely to hold.<sup>34</sup> Airlines will have strategic considerations when selling slots. They may not sell to the highest bidder (i.e. the airline that values it most) but instead to the airline that offers the least competitive threat. Consequently, although the secondary slot trading market undoubtedly can aid the efficient allocation of airport capacity between airlines, one cannot assume that such trading will lead

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<sup>30</sup> The SLG report, p.4.

<sup>31</sup> CAA (2013) *Consultation on Gatwick market power assessment*, para. 6.105, 7.15, 7.83.

<sup>32</sup> easyJet 31 January 2012 *Investor presentation*, p.25.

<sup>33</sup> The SLG report, p. 7.

<sup>34</sup> For example, a report by Steer Davies Gleave finds there is sub-optimal use of capacity at some airports, including a large number of slots being unutilised and a high proportion of small aircraft being used. This is not consistent with an efficient secondary market. Steer Davies Gleave (2011) *European Commission: Impact assessment of revisions to Regulation 95/93*, paras. 8-10.

to an optimally efficient allocation, since slot prices will not necessarily reflect the opportunity cost of a slot.

Allowing airports to set charges at a market-clearing level would be likely to provide more effective price signals and lead to a more optimal allocation of airport capacity than relying on the secondary slot trading market. This would be consistent with the views of other regulators. Ofcom, for example, has taken the view that exposing users of a scarce resource to the full market value is reasonable and leads to efficient outcomes. In a current consultation on licence fees for spectrum, Ofcom identifies that setting prices too low might mean the spectrum is not transferred to the highest value user.<sup>35</sup>

## 8. Conclusions

The SLG report was asked to assess the distribution of rents between airlines, airports and customers. The CAA has relied on the SLG report's conclusions, such as the claim that lower charges will be passed on to consumers. Our review of the paper has identified that many of the arguments are unsubstantiated and it draws incorrect conclusions.<sup>36</sup> In particular, given current capacity constraints at Gatwick, we would expect a change in airport charges from their current level to simply transfer rents between the airport and airlines with no direct impact on passenger fares.

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<sup>35</sup> Ofcom (2013) *Annual licence fees for 900 MHz and 1800 MHz spectrum*, Annex 9.

<sup>36</sup> There are other errors in the SLG report aside from ones discussed in this report which, for the sake of brevity, we have not addressed. For example, the SLG report claims that the single till protects customers from the airport collecting rents from non-regulated products (p. 9). This is not correct. Nothing prevents airports from charging higher prices for non-regulated products. It is simply that the revenues derived from these sales are taken into account when setting regulated charges. The SLG report also claims that the single till "introduces" a feedback loop (p. 9). This is not correct. The single till "reflects" the fact that a feedback loop exists from an airport being a multi-sided platform market.