CAA clarification questions (CAA questions in yellow):

1, the cover letter to the response provides a high level response to the interim points raised by the ACC, EasyJet, BA and Virgin. The CAA provided these responses to GAL so it could take these into accounts in developing its conditions of use. While GAL has provided a full response to the second runway and premium charge issue, it has not provided a response to a number of the other issues raised and simply stated that it proposes to deal with them as part of the conditions of use consultation process. I would like to emphasise that the CAA's proposals for commitments to be backed by a licence require the commitments to be conditions of the licence. The CAA is intending to issue the proposed notice and conditions (which if they confirm the final proposals will include the commitments) on the 9/10 January. The CAA therefore requires a final version of the commitments as they would appear in the conditions of use, well before this date. Please can you provide the dates at which you intend to issue the consultation on the conditions of use and the date at which you expect responses and the date at which you expect to publish the final conditions of use. The CAA is also a public body and in its consultation needs to consider each of the points raised by consultees. Please could you therefore provide an updated conditions of use together with a detailed response to each of the issues raised by the ACC and the airlines in their interim responses by the 13 November response date.

Gatwick provided responses to the points raised by the ACC and airlines interim responses in a covering letter to our response to the CAA's final proposals. Further to that we are also consulting on the conditions of use presently (email to airlines 8/11/13, 16:03).

2, On page 22 the response states that the CAA has not addressed the points made by GAL on the evaluation criteria in its response and states it will not repeat those points. The CAA provided a detailed response to GAL's comments about the use of the fair price and the relationship with the CAA statutory duties on pages 27 to 35 of its response and specific points on the evaluation criteria on the form of regulation on pages 164 to 175. The CAA considers that it has addressed each of the points raised by GAL. Please can GAL set out clearly and precisely which of the points on the evaluation that GAL has previously raised that you consider the CAA has not addressed. If the CAA does not receive this information then it will assume that it has addressed the points raised.

The CAA, in the Final Proposals discusses two specific areas, reflecting Gatwick's comments in response to the Initial Proposals, these being:

- Focus on price protection;
- The CAA's requirement to have regard to the better regulation principles in the performance of its general duty.

The other issue raised in Gatwick's response to the Initial Proposals related to the promotion of competition, which the CAA sought to address separately in Chapter 10.

<u>Price protection</u>

The CAA, in its discussion of price protection the CAA states:

"As set out in paragraph 2.12 the CAA considers reductions in airport charges will benefit passengers through reduced air fares and hence the CAA does not accept GAL's argument that it has mis-specified the concept of price protection."

In our response to the Final Proposals we provided some further views on the issue of price protection and why it is inappropriate for the CAA to focus on its concept of a "fair price" as a relevant benchmark.

In addition, we note that the CAA only asserts that there would be a transmission mechanism of lower airport charges feeding through to lower air fares to passengers. Gatwick has previously submitted independent studies to the CAA to show that in markets with locational value and with capacity constraints, the associated locational and scarcity rents would be shared between the airport and airlines, as opposed to being transferred in entirety to airlines, as is currently the case. We consider that the CAA has, as yet, to satisfactorily respond to our previous submissions and has not demonstrated that reductions in airport charges will benefit passengers, rather than benefit airline shareholders. In addition, as we have previously submitted to the CAA, the current practice of artificially constraining airport charges below competitive price levels could lead to passenger detriment as such an approach allows potentially sub-optimal slot allocations to endure. The CAA has yet to address these points.

CAA performing its general duty

The CAA, in its discussion of better regulation principles and its general duty states:

"When performing its general duty the CAA must have regard to the better regulation principles that:

- regulatory activities should be carried out in a way which is transparent, accountable, proportionate and consistent; and
- regulatory activities should be targeted only at cases in which action is needed.

The CAA considers that the requirement that "regulatory activities should be carried out in a way that is transparent, accountable, proportionate and consistent" is inherently focused on the way that the CAA carries out its activities rather than the outcomes from those regulatory activities. Proportionality will also have an incidental effect on the substance of the measure. While this approach is likely to lead to outcomes that are transparent, accountable, proportionate and consistent, the CAA does not consider that this is the primary focus of this part of its duties.

The CAA considers that for regulatory activities to be transparent, accountable, proportionate, consistent and targeted the CAA needs to take into account the practical implementation issues and stakeholder confidence in any proposals. For example if stakeholders do not have confidence in licence protections then this could lead to numerous cases under the Airport Charges Regulations 2011 (ACR) or competition law as stakeholders seek to protect their rights, which could lead to greater uncertainty, more adhoc regulation and more regulatory intervention overall."

We continue to be of the view that the requirement for regulatory activities to be carried out in a way that is transparent, accountable, proportionate and consistent is more clearly directed to regulatory outcomes as well as process, whereas the focus of the CAA appears to be much more on process than outcome. We also consider that the CAA has yet to adequately explain why stakeholder confidence is, per se, a requirement of this duty, although we can see that such confidence would in general be desirable.

Further, to the extent that stakeholders make complaints to the CAA under the ACRs or competition law, then the future determinations of these cases (if they arise) will, in themselves, increase certainty and confidence. We consider that the fact that there are alternative regulatory mechanisms, which are adequately relied on in many other sectors in the economy, cannot legitimately be relied on by the CAA to justify the imposition of overly burdensome, broad and disproportionate regulation.

3, On page 25 of the response states GAL has made some revisions so the commitments in response to the CAA's concerns in relation to the absence of a shadow RAB. Please can you set out what changes are you proposing to the conditions of use in this area and if these are not included in the current version please can you supply the CAA with the appropriate version of the commitments that does include these provisions.

[please see question 1]

4, On page 33 of the GAL response it states that the CAA has incorrectly excluded the costs of ST IDL capacity for the capex plan for 2019/20 and 2020/21. Please could you provide a breakdown of the capex plan by scheme by year for these two years in 2011/12 prices. The spend for these two years in the final proposals was £353.0 million (2011/12 prices). In your response to the final proposals you proposed an increase related to ST IDL of £34 million (2013/14 prices or £32.10m in 2011/12 prices). Please can you also confirm the total cost of the ST IDL project and a business case for the scheme which includes the Q7 costs.

There was an error in the project sheet which was sent to the CAA. The corrected figures where indicated in our response to the final proposals. For completeness we attach an updated project business case.

5, On page 38 of the proposed conditions of use mentions a Gatwick Airport Manual of Measurement of satisfaction, security and availability, which is annexed to these conditions of use which may be varied from time to time by agreement between GAL and the AOC and ACC. Please can you provide a copy of this Manual together with a confirmation that this is based on Q5, the joint letter of the 7 August or subsequently agreed with the ACC (indicating which elements are based on Q5 and which have been subsequently agreed).

Please see attached. This is not yet signed by the ACC/AOC; but we are in the final stages of meeting and discussing this point and anticipate final agreement imminently.

6, What discussions has GAL had with airlines on the additional 21 slots that it has released for Summer 2014 and what additional pax traffic GAL expects the new 21 slots will bring to the airport, and would these passengers be additional to its earlier forecasts?

The additional slots released for Summer 2014 have resulted from our "ACDM55" or Airfield Peak Capacity Expansion project. This project has involved collaborative working with NSL's tower operation and Gatwick's airfield team, as well as partner airline and ground operators. It has enabled further operational optimisation in the airfield. This long standing project has been discussed with airlines in depth over the last 2 years – as listed below. Importantly, I would highlight that the project has been discussed at the JSG and with Warwick Brady and team from easyJet. The slots are being allocated through the usual ACL process, in compliance with European regulations.

To be clear, ACDM55 has not generated passenger demand – it has created supply to fulfil the demand that has already been expected. As a long standing project, the achievement of additional airfield efficiency will help Gatwick to meet expected traffic demand. Clearly, this project does not add directly to the traffic forecasts.

Some of the airline meetings to discuss ACDM55 have included:

- Q5+1 Capital Programme Launch – 21 July 2011
- Q5+1 Working Group – 23 March 2012
- Q5+1 Working Group – 30 March 2012
- Additional info given to Simon Elliott (as ACC representative) following completion of Q5+1 Working Group – July 2012
- Capital Programme Board – 24 October 2012
- Joint Steering Group – 7 November 2012
- ACDM 55 Procedures Group formed – February 2013
- Eurocontrol introduction to DPIs (Departure Planning Information) – March 2013
- AOC ACDM engagement and monthly newsletter – April 2013
- ACDM 55 snow clearance workshops inc de-icing – June 2013
- ACDM 55 drop in session weekly following opening of Rm 36B ACDM 55 project room – July 2013
- ACDM 55 Steering Group launched AKA "ACDM Airport Partner Project Board" – August 2013
- ACDM 55 e-learning launched – August 2013
- Capital Programme Board – 21 August 2013

7, On page 36 of the response, GAL states that:
"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 Financial Review in the regulatory accounts (quoted below) suggests that capitalised staff costs are included in the 'other cost' line. Please can you clarify how staff cost capitalisation has been recorded in the accounts?
"The Company is directly incurring greater staff and contractor costs than the forecast associated with the capital investment programme post separation, including the separation of the Company's IT environment from BAA. The increase in staff costs associated with aspects of the capital investment programme are offset by the subsequent capitalisation of these costs (recognised in 'other costs' below). The capitalisation of staff costs increased to £20.9 million."

£140.5 million for 2011/12 is our gross staff costs pre capitalisation of staff and contractor costs associated with the capital investment programme. These costs are subsequently capitalised under the opex line item – 'other costs'. We have provided a table to clarify this point:

(2011/12 prices)	2011/12 £m	Notes
Staff Costs <A>	140.5	Gross staff costs including staff and contractor costs associated with capital investment programme
Other Costs <B>	(20.9)	capitalisation of staff and contractor costs, recorded as a subset of "Other Costs"
Net Staff Costs <A> - <B>	119.6	Net staff costs

Net staff costs of £119.6m can be cross-referenced to our January Business Plan, where we presented a number of £126.7m in 2013/14 prices for our staff costs (page 121, Chapter 11 –

Operating costs). This number can be converted to a nominal figure as follows: £126.7 * 0.944 = £119.6m

One point in particular that we would be grateful if you could provide further information is on the additional costs that GAL would incur if Pier 6 South were not undertaken in Q6 or Q7. In earlier correspondence I believe GAL estimated the costs at £30m in Q6 and £14m in Q7.

The ACC, easyJet and BA in their individual responses state that Gatwick accepts that 95% pier service can be achieved in Q6 with efficient stand planning and similar levels of towing as summer 13. This is not true, Gatwick does not believe that 95% pier service can be achieved in these circumstances. In all of our meetings we have been very clear to state that the modelling we have undertaken at the ACC's request includes inputs that we do not think are realistic (i.e. much higher levels of towing, using stands to park Code C aircraft that our forecast data shows will be occupied at the key times by Code E aircraft and proposing a reduction in stand allocation buffers between aircraft movements that would reduce airfield resilience). The forecasts that the pier service levels we are discussing were modelled on were significantly lower than those forecasts proposed by Gatwick in its updated submission on 20th June 13. In turn those forecasts are significantly lower than the ACC's new November forecasts. For the ACC to continue to state that 95% pier service can be maintained (the data was created based on September 2012 forecasts), yet also insist the traffic forecasts are significantly out of date and proposing much higher passenger numbers is not logical. Logically, and taking into account all of the modelling methodology that the ACC has bought into, if it believe truly that the forecasts will reach the levels they say, then it would not be possible to maintain pier service at 95% with the current infrastructure.

Gatwick does not accept the optimistic forecasts of the ACC across the Commitments period and also do not accept their optimistic view of the inputs which show 95% pier service being possible with the current infrastructure. Based on our traffic forecasts, with all other factors remaining equal, Gatwick maintains, as we have consistently stated, that we will need to build Pier 6 southern extension in order to maintain pier service levels above 95%.

The ACC and individual airlines query the cost of circa £30m in Q6 and a further £14m in Q7 of Asset Replacement works, required if the Pier 6 Southern extension is not built, stating no consultation has taken place and that no expert evidence has been provided to back them up. Again, this is not true. At the CPB on 21 February in preparation for airline support for Tollgate 3 for Pier 6 southern extension (support that was formally given at the April JSG), we presented the attached presentation which clearly shows the costs for Q6 should the project not go ahead. The CPB was attended by easyJet, BA, Virgin and ACC representatives. At the time of the presentation we did not have detail for Q7, but had gathered this information by the time the CAA's consultants, Davis Langdon, requested the data later in the year. The capital estimates shared with Davis Langdon were c£29.5m for Q6 and c£14m for Q7, these were based upon benchmark costs.

The respondents also emphasise the drafting confusion in GAL's Pier 6 letter to the CAA. They imply that GAL amended the figures and that the CAA haven't taken the last amendment into account. We can confirm that GAL did not amend the figures and that the CAA were fully aware of the correspondence and were in fact sent a joint email from the ACC and GAL to explain the matter prior to their final consultation proposal being published.

This is the only thing I can find about a legal agreement. This seems to be about encouraging growth to 40mppa rather than limiting but I might have got confused and grateful if you could let me know if there is something in here or elsewhere that limits throughput to that level.

Local planning policy and guidance adopted by Crawley Borough Council provides support in principle for Gatwick to grow to serve up to 40mppa. This policy is underpinned by stringent economic, social and environmental commitments which are secured by way of a S.106 legal agreement entered into by Gatwick with Crawley Borough Council and West Sussex County Council. The policy states that any major development proposal which could potentially give rise to throughputs exceeding 40mppa will require a separate commitments / legal agreement, together with environmental assessment of the additional environmental effects, at which point, further expansion could be turned down – or more likely come with ever more stringent and costly requirements, which will take time to be negotiated.

It is important to note that Gatwick will be keen to ensure local support is maintained for the next runway and this is likely to take precedence over more temporary measures.

This is an additional point on Pier 6 south (which I asked for details of the additional costs that GAL expected to incur in the absence of the scheme in Q6 and Q7). For clarity please could I have details of the breakdown of this expenditure and the justification for this expenditure, for example condition surveys, relevant asset life expiry dates.

The attached presentation has been put together for your benefit. It provides a comprehensive condition report for the taxiways and stand pavement, with current expectations on the year in which pavement would need to be replaced. This assessment is done every 3 years and the analysis in the presentation was conducted in February 2012, but updated for the Pier 6 site in 2013. Further, the breakdown requested is included.