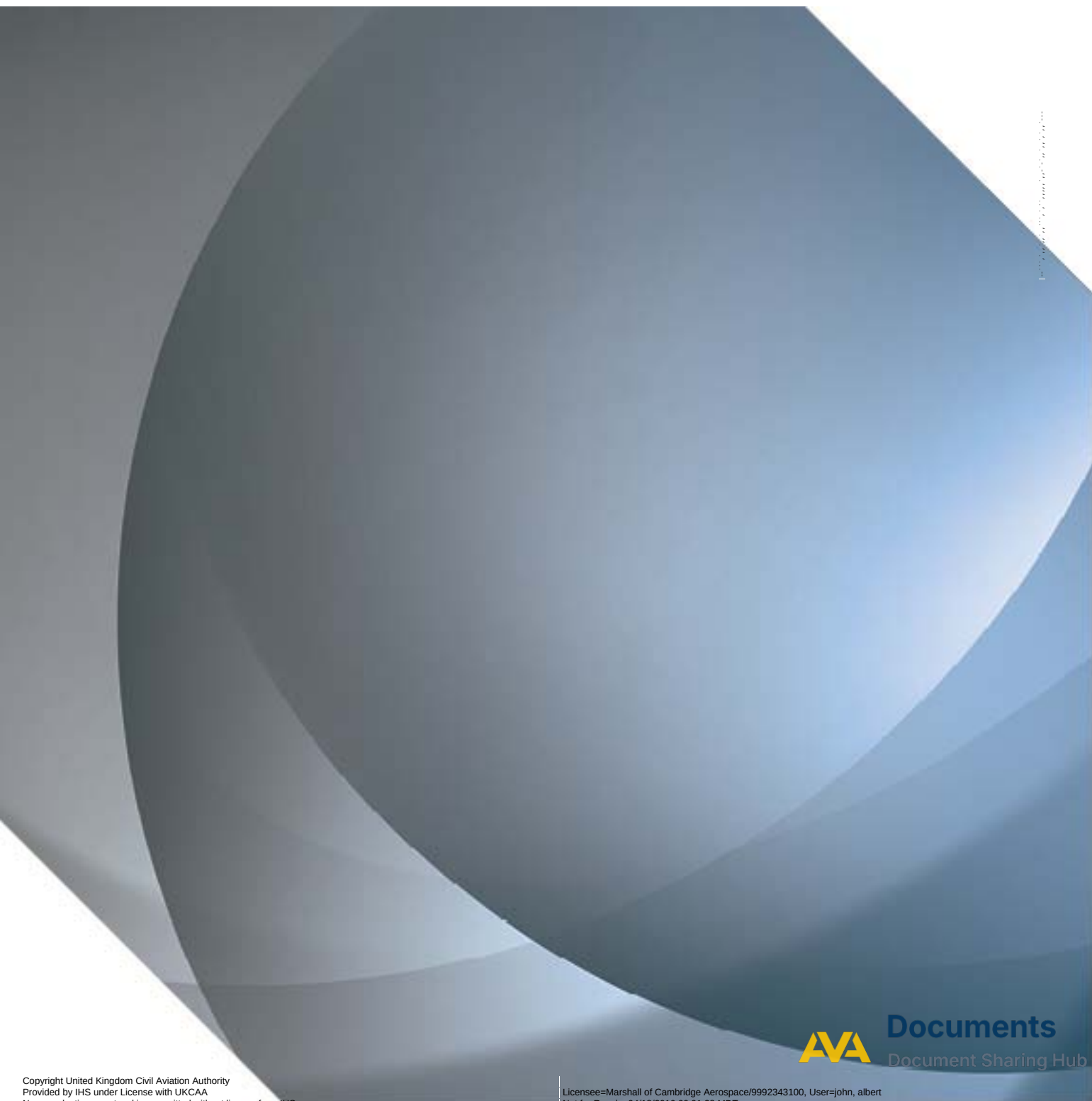


Economic regulation of new runway capacity – Update

CAP 1332



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Introduction

Our regulatory policy on capacity expansion at Heathrow or Gatwick was outlined in March 2015¹. We are now planning our possible next steps under a scenario of an imminent Government decision that capacity is needed and a preferred option is identified. Our current plans are to publish one or more consultation documents in the coming months to build and expand on the regulatory principles outlined in March. This will help ensure that the regulatory regime is clear and robust and will support the timely delivery of any new capacity.

The objective of our consultation(s) will be to provide more specific details on how we may, if required, regulate new capacity. We currently envisage the consultation(s) will focus on issues such as:

- the treatment of planning costs;
- the long-term nature of capacity expansion;
- adjusting the successful airport operator's weighted average cost of capital (WACC) to reflect any increase in its risk as a result of undertaking capacity expansion;
- the treatment of surface access costs;
- promoting delivery;
- compensation to third parties, for example, in relation to noise, blight or other compensation paid to local communities; and
- the extent to which costs can be dealt with by commercial agreement between the airport operator and its airline customers.

Where it appears that there is a need to develop specific elements of our policy (such as in relation to the treatment of planning costs) more urgently than others, we will seek to bring forward consultation on those issues earlier than others.

We have outlined below our current thinking with respect to each of these issues and an indication of how this thinking may develop, followed by an overview of a potential consultation process. The consultation process will be rigorous and aim to obtain views from a wide range of stakeholders on the issues we need to consider.

Developing our policy and approach will also require an assessment of the relative costs and benefits for each issue and careful consideration of all the relevant factors and circumstances. These are likely to include, for example, the prevailing state of the UK economy and financial markets (which are not, and cannot be, known at this time), as well as our duties under the Civil Aviation Act 2012 (the 2012 Act).

1 Civil Aviation Authority, Economic regulation of new runway capacity, CAP 1279, March 2015, available at: <http://www.caa.co.uk/docs/33/CAP1279%20Economicregulationofnewrunwaycapacitynon-confidential.pdf>

1. Treatment of planning (or Category B) costs

Our current policy view on planning costs is set out in our March 2015 policy document. This is that airport operators and their airline customers should, in the first instance, look to agree risk-sharing agreements for planning costs dealing with the associated risks. These may include, for example, the risk that planning costs are larger than expected (and more than £10 million per annum) and the risk that planning permission is not granted and these costs have to be written off.

We see planning as a cost which users can reasonably be expected to carry in full or in part. The £10 million per annum threshold that we have set is intentionally lower than the amount we expect to be incurred by an airport operator. We consider that this arrangement will create a strong incentive for an airport operator to reach an agreement with its airlines on risk sharing.

To avoid a repeat of situations that have occurred in the past, where users have had to bear the planning costs of a project that did not proceed, we consider that risk sharing arrangements for these costs should be agreed between the airport operator and its airline customers.

We will, therefore, look to an airport operator and its airline customers to agree to risk sharing arrangements where costs are expected to exceed £10 million per annum. However, where the airport operator and its airline customers cannot agree to risk sharing arrangements, we will consider how to set these arrangements. In doing this, we would be guided by principles such as:

- the party best placed to manage each risk should manage the associated costs;
- a sufficient level of risk needs to be allocated to each party to ensure engagement in, and ongoing support for, the project; and
- risk-sharing arrangements should be as comprehensive as possible.

We recognise that the promoters of runway expansion projects have indicated that the treatment of planning costs is a specific policy area where they would like to see our policy develop more fully within a relatively short timescale. At present, we are considering possible options for a specific consultation process on planning costs and envisage our regulatory decision becoming effective within 7 to 8 months after the Government decision:

- Shortly after the Government decision, we intend to publish a short note on the process and timetable for any agreements to be entered into between the successful airport operator and its airline customers;
- We would then conduct a 3 month process of encouraging discussions between the airport operator and airlines on risk sharing arrangements;
- If no (or limited) progress has been made on risk sharing arrangements, we will request information and updates from the airport operator and airlines. This will take place towards the end of Month 3 of the process;