

The recovery of costs associated with obtaining planning permission for new runway capacity: initial proposals

CAP 1435

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Chapter 1

Summary

- 1.1 This document sets out, for consultation, the CAA's initial proposals on the regulatory treatment of the costs associated with Gatwick Airport Limited (GAL) or Heathrow Airport Limited (HAL) obtaining planning permission for the development of new runway capacity. The charges that both airport operators can levy on airlines are subject to economic regulation under the terms of a licence granted by the CAA under the Civil Aviation Act 2012 (the Act).
- 1.2 These initial proposals have been developed in a way that enables them to be applied to any of the three short-listed options currently being considered by the Government for the location for new runway capacity in the south-east of England: namely the Heathrow northwest third runway, Heathrow extended north runway (Heathrow Hub) and the Gatwick second runway.
- 1.3 The Government indicated on 30 June 2016 that a decision on the location of new runway capacity would be made around October 2016. We consider that we should use the available time until then to take views from stakeholders on the regulatory treatment of planning costs.
- 1.4 In preparing these initial proposals we have considered our statutory duties. The Act gives us a primary duty in carrying out its economic regulatory functions under the Act to "further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services".

The process so far

- 1.5 In our September 2015 document¹, we suggested that the airport operator and its airline customers should, in the first instance, look to agree appropriate risk-sharing arrangements around the recovery of planning related costs (we called these ‘Category B’ costs – see chapter 3 for the definition of costs). We considered that allowing time and space for these commercial discussions could result in innovative solutions being developed that can be beneficial for users.
- 1.6 In our February 2016 document², we outlined some basic principles and guidance around the regulatory treatment of Category B costs and we gave the airports and their airline communities an initial three-month window for these discussions to take place. We strongly encouraged both the airport operators and airlines to approach these discussions constructively and in good faith with the aim of trying to seek agreement within the timeframe.
- 1.7 The principles we expected to be taken account of in these commercial discussions included: the precise definition to apply to Category B costs; the mechanisms to secure that any expenditure is efficiently incurred; the way in which the costs should be recovered from airport charges; and how cancellation risk should be treated.
- 1.8 Some engagement between the airports and airlines has taken place since February, and some areas of consensus have emerged, but a comprehensive commercial agreement on the treatment of Category B costs has not been possible. Having observed the progress made over the past months, we have now formed a view that a full commercial agreement is unlikely to be reached. It, therefore, now falls to the CAA to set out a policy position for how these costs should be treated.

¹ CAA, Economic regulation of new runway capacity – Update (CAP 1332), September 2015, available at: www.caa.co.uk/CAP1332.

² CAA, Recovery of costs associated with obtaining planning permission for new runway capacity: policy update (CAP 1372), February 2016, available at: www.caa.co.uk/CAP1372.

Summary of the CAA's initial proposals

- 1.9 In line with our primary duty we consider that a new runway in the south-east of England will further the interests of users of air transport services. Without a new runway, users are likely to suffer from higher prices, reduced choice and lower service quality. The planning process is the first step in the delivery of new runway capacity for the benefit of current and future users.
- 1.10 We consider Category B should be defined as any costs which are directly connected with, and solely for the purposes of, seeking planning consent through the Development Consent Order (DCO) process.
- 1.11 We continue to consider that up to £10 million per year of Category B costs can be automatically recoverable in the form of higher airport charges in the year they are expected to be incurred. This is unchanged from our previous policy statements.
- 1.12 For Category B costs over £10 million per year, we consider these should be capitalised and rolled up into a separate account, referred to in this consultation as the planning Regulatory Asset Base (pRAB). These costs should then be subject to the following cost recovery arrangements:
- A 105 / 85 risk-sharing mechanism, which allows a 5% addition to costs incurred if a successful DCO is granted, but limits recovery to 85% of the costs incurred if a DCO is not granted.
 - Cost recovery on the above basis to start only after the outcome of the DCO process is known.
 - Costs in the pRAB recovered gradually over 10 years if the DCO is granted, but over a shorter period of time of 3 or 4 years if the DCO is not granted, rescinded or withdrawn.
 - A return to cover the weighted average cost of capital (WACC) at the level determined in the Q6 settlement added to any costs accrued into the pRAB, to reflect the financing costs associated with the delayed recovery of these costs for the period after they are incurred.

- Costs should be recovered at Gatwick by modifying the CAA's view of the 'fair price' and Gatwick's average price commitment, while at Heathrow the existing regulatory arrangements would be able to capture the above arrangements.

- 1.13 All Category B costs incurred will be subject to an efficiency test. An Independent Fund Surveyor (IFS) will provide ongoing assessment of the reasonableness of Category B costs incurred, and allow the airport, the airlines and the CAA to identify any expenditure that is inefficient. The airport operator should also make any materials and reports produced for the planning process available to the airline community, the CAA and relevant stakeholders.
- 1.14 We reserve the right to decide that GAL or HAL will be able to recover less than 85% of Category B costs, if there is clear and compelling evidence that the airport operator was responsible for the failure to obtain planning consent or withdraws unilaterally from the process.
- 1.15 We consider that preliminary works and enabling construction (e.g. property relocations and land acquisition) should not be defined as Category B costs and therefore not subject to risk-sharing arrangements. These costs could be treated in a similar fashion to the way the costs of capital projects are handled in Q6, but we will need to understand the level and structure of these costs in more detail before making specific policy suggestions.
- 1.16 We are mindful that the Government location decision could have an impact on planning risk and we may need, as a consequence of the nature and type of the decision, to revisit the upside and downside factors. We will explain the reasons for any changes to the risk-sharing mechanism in our final proposals consultation, which we plan on publishing after a Government location decision.

Structure of this consultation

- 1.17 The remainder of this document is structured as follows:
- Chapter 2: our duties;
 - Chapter 3: definition of eligible costs;
 - Chapter 4: recovery mechanism for eligible costs;
 - Chapter 5: risk-sharing arrangements;
 - Chapter 6: promoting efficiency and transparency; and
 - Chapter 7: impact on airport charges.

Views are invited on this document

- 1.18 We welcome views on the initial proposals set out in this document. Any comments on our proposed approach should be sent to economicregulation@caa.co.uk by no later than noon on **Monday 12 September 2016**. We cannot commit to take into account representations after this date.
- 1.19 If you would like to discuss the issues raised in this document before the deadline please contact Stephen Gifford (stephen.gifford@caa.co.uk).
- 1.20 Representations will be made available on our website. Any material considered confidential should be clearly marked as such. Please note that we have powers and duties with respect to disclosure of information under section 59 of the Act and the Freedom of Information Act 2000.
- 1.21 Having considered any responses, we expect to issue our final proposals and recommend any licence modifications in the period immediately after a Government decision on the location of new runway capacity.