

The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement

CAP 1513

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About this document

This document sets out our policy in relation to the recovery of costs associated with obtaining planning permission for the new runway and capacity expansion at Heathrow Airport. These costs are termed Category B costs.

We have developed this policy following two rounds of public consultation: an initial proposals consultation published in July 2016 ([CAP 1435](#)) and final proposals published in November 2016 ([CAP 1469](#)). In addition we had consulted on the principle of risk sharing arrangements for planning costs in earlier public consultations in March 2015 ([CAP 1279](#)) and September 2015 ([CAP 1332](#)).

This Policy Statement is complementary to our decision to modify Heathrow Airport Limited's (HAL's) licence¹ to permit up to £10 million per year of efficient Category B costs to be recovered. It deals with Category B costs that are in addition to the £10 million of efficient costs already allowed for in the licence modification.

We are issuing this Policy Statement now in order to give reasonable certainty with respect to the regulatory treatment of this important category of costs. We will make proposals to modify HAL's licence to put these proposals into effect later in the process, as part of a full package of amendments to support the development of the capacity expansion.

¹ Available from this page: <http://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Economic-licensing-of-Heathrow-Airport/>.

Chapter 1

Executive summary

- 1.1 This Policy Statement sets out our decisions on the regulatory treatment of the costs Heathrow Airport Limited (HAL) will incur in seeking planning permission to develop a new northwest runway and capacity expansion at Heathrow Airport. These are termed Category B costs (or planning costs).
- 1.2 The Government has identified the north-west runway at Heathrow as its preferred option for airport capacity expansion in the South-East of England. Our starting point is that consumers' interests would be furthered by the timely development of additional capacity and that we should put in place regulatory arrangements to incentivise efficient and timely delivery.
- 1.3 We have made it clear in our January consultation on our priorities and timetable for developing the regulatory framework for HAL² that it must, as a matter of priority, develop a scheme design that furthers the interests of consumers and that it must do so by engaging in a transparent and effective way with airlines and others stakeholders on the potential options, their costs and value for money. This emphasizes the importance of planning and thoroughly exploring an appropriate range of options to ensure that the final design is affordable and fit for purpose. Nonetheless, the planning costs associated with this process are substantial and so it is also important to encourage efficiency in this category of spending and to avoid wasteful expenditure.
- 1.4 We are also mindful that HAL, the airlines, and Secretary of State have all recently expressed support for making sure that future airport charges are maintained as close to current levels as practicable during and after the capacity expansion programme. HAL has committed as an early priority to work with the airlines and other stakeholders to explore whether there are

² See [CAP 1510: Economic regulation of the new runway and capacity expansion at Heathrow airport: consultation on CAA priorities and timetable](#).

design options that would see future charges rise by no more than inflation in any year. As we explained in our January consultation, it is important that HAL's business plans are both affordable and financeable, and that we develop the regulatory framework in a way that supports affordability and financeability as far as possible in accordance with our duties.

- 1.5 In finalising our policy on Category B planning costs, we have considered carefully the above factors, responses to our November 2016 proposals on the treatment of these costs, and our statutory duties.

Changes made to our November 2016 proposals

- 1.6 We had four responses to our final proposals. These were from HAL, International Airlines Group (IAG), London (Heathrow) Airline Consultative Committee/Airport Operators Committee (LACC/AOC) and Virgin Atlantic Airways (VAA).
- 1.7 The primary concerns of airlines were:
- the timing of the recovery of allowances for costs (with the airlines expressing the view that cost recovery should not commence until the capacity expansion is in place); and
 - the incentives for efficiency and allocation of risks created by our proposals for regulatory incentive mechanisms.
- 1.8 HAL expressed concern about the calibration of the regulatory incentive mechanisms and that we had said in our proposals that “we reserve the right to decide that HAL will be able to recover less than 85% of Category B costs, if there is clear and compelling evidence that HAL has unilaterally withdrawn from the planning process”.
- 1.9 In addition to reaffirming the importance of HAL planning carefully and thoroughly, exploring an appropriate range of options to ensure that the final design is affordable, financeable and fit for purpose, we are making the following changes to our earlier proposals:

- in deciding on how regulatory depreciation should be recovered, to focus on an approach which will enable us to ensure consistency with our wider decisions on the appropriate path of HAL's charges in the future (which should encompass both affordable charges for airlines and the financeability of HAL's forecasts of efficient expenditures). Recovery will not commence until after the outcome of the DCO process is known, the risk sharing adjustments have been applied and the amount to be recovered (in excess of the £10 million per year) is known;
- to address concerns that our risk sharing mechanism might incentivise HAL to spend excessively, to introduce a review point if cumulative efficiently incurred Category B costs have exceeded, or appear likely to exceed, £265 million (including the £10 million per year already included in charges). This figure represents the estimate for planning costs that HAL has shared with the airlines. If efficiently incurred Category B costs approach this level, we may conduct a review of our policy for the recovery of Category B costs in excess of £265 million. The CAA's decision whether to conduct any review of this policy, and the scope of any review, will have regard to the expected materiality of any Category B costs in excess of the £265 million and any emerging evidence on the efficiency of spending;
- to reduce any inappropriate regulatory uncertainty which might undermine investor confidence, we are clarifying our statement on what happens to cost recovery in the event that HAL withdraws from the planning process. We want to make clear that we would seek to reduce the amount that HAL can recover below the 85% threshold set out in the risk sharing arrangements only in certain limited circumstances where there was compelling evidence that HAL had unilaterally withdrawn from the planning process. We would not expect to reduce planning cost recovery below the 85% threshold where HAL could demonstrate that it had used all reasonable endeavours to continue with the capacity expansion programme; and

- we have refined our proposals for governance arrangements as explained in Chapter 5 to complement the evolving arrangements between the airport and airlines on the role of the Independent Funds Surveyor (IFS) in the planning processes.

1.10 As noted below and in the following chapters, there are also a number of areas where we have kept our position largely unchanged from our final proposals.

Summary of the CAA's policy

1.11 Our final policy decision is that Category B costs should be defined as costs which are directly associated with, and solely for the purposes of, seeking planning consent for the delivery of new runway capacity, including through the Development Consent Order (DCO) process.

1.12 Category B costs incurred over £10 million per year should be capitalised and rolled into HAL's existing Regulatory Asset Base (RAB). These costs should be clearly identified as they are added to the RAB in order to allow the CAA and stakeholders to track and scrutinise the level of costs incurred.

1.13 Category B costs over £10 million per year should be subject to the following cost recovery arrangements:

- a 105/85 risk-sharing mechanism, which allows a 5% addition to costs incurred if a DCO is granted, but limits recovery to 85% of the costs incurred if a DCO is not granted;
- the starting date for, and profile of, regulatory depreciation for Category B costs in the RAB will be set consistently with broader considerations on the affordability of charges and the financeability of HAL's expenditure programmes; and
- HAL should receive a return on planning costs included in the RAB to cover its weighted average cost of capital (WACC) at the level determined in its price control settlements from time to time.

- 1.14 Category B costs incurred, including those recovered through the licence modification that we made on 21 December 2016, will be subject to ongoing governance processes and efficiency tests. To complement the existing IFS arrangements, where appropriate, a planning-focused Independent Planning Cost Reviewer (IPCR) will provide advice to the CAA on the efficiency of Category B costs. The CAA will make a final decision on the level of planning costs to be added to the RAB.
- 1.15 As noted above, we have clarified our position on the unilateral withdrawal of HAL from the planning process.
- 1.16 HAL should make the materials and reports produced for the planning process available to the CAA, the airline community and other stakeholders as soon as practicable. HAL should consult with the airline community at the outset on the rules and principles for classifying any such information as confidential and how this should be shared with stakeholders.
- 1.17 Our policy on Category B costs may be reviewed if efficiently incurred Category B costs have exceeded, or appear likely to exceed, £265 million. The CAA's decision whether to conduct any review of this policy, and the scope of any review, will have regard to the expected materiality of any Category B costs in excess of £265 million and any emerging evidence on the efficiency of spending.
- 1.18 Full details of our policy on Category B planning costs are set out in the following Chapters. We will deal with wider incentives in our June consultation.
- 1.19 We are issuing this Policy Statement now in order to give reasonable certainty with respect to the regulatory treatment of this important category of costs. We will make proposals to modify HAL's licence to put these proposals into effect later in the process, as part of the full package of amendments to support the development of the capacity expansion.

Our duties

- 1.20 In developing this Policy Statement, we have had full regard to our statutory duties under the Civil Aviation Act 2012 (CAA12) which are summarised in Appendix 1.

Structure of this document

- 1.21 The structure of this Policy Statement is as follows:
- Chapter 2: Recovery mechanism for eligible costs
 - Chapter 3: Definition of eligible costs
 - Chapter 4: Risk-sharing arrangements
 - Chapter 5: Promoting efficiency and transparency
 - Appendix 1: Our duties under CAA12