

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

CAP 1435

A large decorative graphic consisting of overlapping, semi-transparent blue and teal shapes that create a gradient effect, occupying the bottom two-thirds of the page.

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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.

Chapter 2

Our duties

- 2.1 The CAA is an independent economic regulator with a primary duty to “further the interests of users of air transport services regarding the range, availability, continuity, cost and quality of airport operation services”. Under the Act, users of air transport services are defined as present and future passengers and those with a right in property carried by the service i.e. cargo owners.
- 2.2 In fulfilling our duties, we must have regard to a number of other factors, of which the most relevant to new runway capacity are:
- the need to secure that each holder of a licence (i.e. the airport operator undertaking runway expansion) is able to finance its provision of airport operation services;
 - the need to secure that all reasonable demands for airport operation services are met; and
 - the need to promote economy and efficiency on the part of each holder of a licence in its provision of airport operation services.
- 2.3 We are required to consider not only the interests of present users of the airports in question, but also future users of air transport services. We also need to ensure that our regulatory activities are transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

Interpretation of our duties in relation to planning / Category B costs

2.4 In formulating our policy for the recovery of Category B costs, we need to balance a number of factors in order to ensure that our policy is consistent with our duties as outlined in the Act:

- The need to ensure that the airport operator undertaking runway expansion is able to finance its provision of services – we consider that it is important to maintain incentives to invest. Development of new runway capacity requires substantial private investment over an extended period of time. Although Category B costs are only a small proportion of the total costs of the project, our proposed treatment of Category B costs could send a positive signal to potential investors that their investment will attract a reasonable return given the risks of the project.
- The need to secure that all reasonable demands for airport operation services are met – we consider that, given the current capacity constrained environment, securing the provision of new runway capacity is crucial to fulfil future demands for services. This is also consistent with our duty to future users.
- The need to promote economy and efficiency on the part of the airport operator undertaking runway expansion – we consider that it is important to protect users from unnecessarily high charges. We propose to achieve this by increasing transparency and strengthening incentives through a risk-sharing mechanism.

2.5 More generally, we have consistently said that new runway capacity is likely to deliver considerable consumer benefits including more choice, lower airfares and higher service quality, in line with our primary duty to further the interests of users.

Chapter 3

Definition of eligible costs

3.1 We have previously set out three broad categories of costs, with different approaches to their recovery. We propose to retain these cost categories, which are defined as follows:

- Category A costs: Airports Commission-related and associated lobbying costs incurred by an airport operator or Heathrow Hub Limited. These are costs that we consider will, in general, be incurred before a Government policy decision on the location of capacity expansion is made;
- Category B costs: capacity expansion costs that are, in general, incurred by an airport operator after a Government policy decision on the location of new capacity and are associated with seeking planning permission; and
- Category C costs: those costs incurred by an airport operator, typically after planning permission is granted, in connection with implementation and construction of new capacity, up to entry-into-operation.

Definition of Category B costs

3.2 The definition and scope of eligible costs for inclusion as Category B costs are costs which are directly connected with and solely for the purposes of seeking planning consent through the DCO process. The definition of the costs that can be included as Category B costs (and those which should be excluded) will need to be very clear and precise, as the proposals will be enacted through the introduction of a new licence condition.

- 3.3 We have set out below our initial proposals on the cost categories which should be included as Category B costs, but this is an area where we would like detailed views from stakeholders. Our initial proposal is that these costs will include:
- planning advice and consultants for master planning;
 - environmental and sustainability advisory and consultancy;
 - legal and professional advice;
 - architectural, structural and engineering design;
 - surveys on land, surface access and the environmental;
 - public consultations for the National Policy Statement (NPS) and the DCO processes; and
 - costs incurred by the IFS.
- 3.4 It is important to stress that as well as being specifically related to the process of applying for and obtaining the DCO, Category B costs must be strictly additional to any costs already included in the Q6 allowance as well as being efficiently incurred, so that the same expenditure will not be remunerated more than once.
- 3.5 Our final proposals and subsequent licence condition will need to set out a clear and precise definition of Category B costs. Where there are any subsequent disagreements on whether specific cost items should be considered as Category B costs, we propose to take into account the IFS's recommendation.

Category A costs

- 3.6 The definition of Category A costs remains broadly the same as previously stated in our February 2016 document and the recovery of *most* Category A costs will not be permitted. We considered that costs solely for the purposes of responding to the Airports Commission, costs spent on influencing Government policy (such as lobbying and publicity, including advertising campaigns), and costs incurred for the engagement

with the government and regulatory authorities are not part of the costs of constructing new capacity, and should be borne by the airport operator.³

- 3.7 Since the publication of the Airports Commission's final report in July 2015, the promoters of the three runway options have continued to engage with the Government. Further work on environmental issues has been undertaken by the Government and we understand that each of the promoters have submitted additional evidence. We consider that these costs incurred by the three promoters since the publication of the Airports Commission's final report and up to the time when a decision by Government on the location of new runway capacity is announced (which has not happened yet) should be classed as Category A.

Category C costs

- 3.8 Category C or construction costs will typically be incurred after planning permission is given through the grant of a DCO.
- 3.9 However, there may be some significant expenditure on preliminary works or enabling construction (e.g. property relocations and land acquisition) before planning permission is given. We have termed these costs as pre-construction costs.
- 3.10 We will need to understand in more detail the level, type and structure of pre-construction costs before developing a specific policy. Any recovery of land acquisition costs would need a detailed mechanism to determine the net costs faced by the airport operator. We plan to consider the regulatory treatment of pre-construction costs shortly after the Government location decision, provided we receive detailed and adequate evidence from the airport operator.

³ One exception is that some costs could be re-categorised as Category B provided that HAL/GAL can make a strong and clear case (subject also to a *de minimis* threshold and an efficiency assessment) that information submitted for the DCO application is not materially different from that submitted to the Airports Commission.

Chapter 4

Recovery mechanism for eligible costs

Automatic recovery of up to £10 million each year

- 4.1 We continue to consider that Category B costs up to £10 million per year should be automatically recoverable in the year they are expected to be incurred. We consider this is in the interests of users as it incentivises the airport operator to start work on securing planning permission immediately after a government decision and before a risk-sharing mechanism is enacted through a section 22 licence modification.⁴ We do not think a risk-sharing mechanism should be finalised and enacted in the licence until the nature of the Government location decision is clear.
- 4.2 We consider that a pass through of £10 million per year will not reduce the incentive for the airport operator to act in an economical and efficient manner. Planning costs are expected to be significantly higher than £10 million a year, with any costs above this threshold incentivised through a risk-sharing mechanism.
- 4.3 We analysed whether the level of £10 million should be increased, as this would increase the certainty for the airport operator on cost recovery. However, we judge that increasing the level would dilute the risk-sharing mechanism which could then reduce the incentive to keep Category B costs low. We consider that this would not be in line with our duty to promote economy and efficiency on the part of the airport operator.
- 4.4 We also examined whether the allowance should be removed, but concluded that it should remain for the same reasons on efficiency and to bring consistency across the two airport operators.

⁴ Under section 22 of the Act, a licence modification requires the CAA to consult on the proposed changes to the licence, allow a reasonable period for stakeholders to make representations, and publish a decision. The relevant modifications to the licence take effect no earlier than six weeks after the CAA publishes the decision.

- 4.5 The £10 million threshold has already been enacted in the licence for GAL as part of the Q6 settlement. Should Heathrow be selected as the preferred location for new runway capacity, we propose to undertake a licence modification to allow HAL to recover the £10 million of costs automatically and to back date this decision to the date of the Government location decision.

Capitalisation of costs in excess of £10 million per year into a ‘planning RAB’

- 4.6 In our February 2016 document, we outlined two broad approaches to recovering Category B costs:
- Capitalisation/slow money – costs added to a pRAB for Heathrow or Gatwick and remunerated back to the airport via depreciation and an allowed return (WACC)⁵; and
 - Pay as you go/fast money – costs treated as operating expenditure and recovered in the year they are expected to be incurred.
- 4.7 We propose that Category B costs above the allowance of £10 million per year should be capitalised and rolled up into a separate ‘planning RAB’ (or pRAB). We consider that this further the interests of users in line with our statutory duties under the Act as it balances the interests of present and future users. Under a pRAB approach, planning costs (and higher airport charges) will not be entirely borne by existing users but spread out over both existing and future users. This is important as many of the benefits of the new runway will flow to future users.
- 4.8 Maintaining a separate pRAB will also allow for a more transparent reporting of the costs of the planning process. We consider this is in the interests of users as a distinct mechanism will allow incentives (e.g. risk-sharing) to be applied to it to incentivise cost efficiency and to encourage the airport operator to secure a positive outcome to the planning process.

⁵ Airport charges would be translated into Gatwick’s existing regulatory system through an increase in CAA’s fair price and GAL’s average price commitment.

The RAB approach is also well known and a well understood method of remunerating capital expenditure (capex) over the life of an asset.

- 4.9 The alternative to a pRAB approach is to recover Category B costs via an immediate addition to airport charges (so-called fast money). We are not in favour of the fast money approach as the impact of Category B costs on airport charges would not be smoothed and more costs would need to be recovered from airlines (and passengers) before planning is secured and before the runway is operational. This would not be in the interests of users as it would not appropriately balance the interests of existing and future users, since the cost burden would largely fall on existing users. A speedy recovery of costs would aid the financeability of the project to some extent but because planning costs only represent around 2% of the total costs this is fairly marginal and would therefore not have any material impact on the airport operators' ability to finance its licensed activities, which is one of our secondary duties.

Cost recovery when planning permission is secured

- 4.10 Our traditional approach to the treatment of capex has been to add any expenditure to the RAB and include a WACC return in airport charges (the 'return on the RAB') from the time it is incurred (even if the asset is not yet in service). It is important to note that the depreciation (the 'return of the RAB') only starts when the asset comes into use.
- 4.11 We consider that the process of seeking planning permission should be treated differently to this traditional approach. Specifically, that cost recovery (both the allowed WACC return and depreciation) should only start when the asset (planning permission) comes into use, that is when the result of planning application is known. Returns earned before this time will be tracked in the pRAB, rather than added to airport charges. We consider that this appropriately balances the interests of current and future users, without a detrimental impact on the ability of the airport operator to finance itself and new runway capacity.

- 4.12 Combining this delay in the recovery of Category B costs with suitable risk-sharing mechanism (see chapter 5) gives an incentive for GAL or HAL to secure planning permission in a timely and cost-efficient way as well as reducing the amount of Category B costs that users pay before planning permission is secured.
- 4.13 In short, if planning permission is secured in say 2021, then the recovery of Category B costs (incurred over the 2017 to 2021 period) via the return of the pRAB (depreciation) and the return on the pRAB (cumulative WACC return) would start to appear in airport charges from 2022.
- 4.14 Although we propose that Category B costs are only recovered when the asset comes into use, stakeholders should not assume that the CAA will also apply this policy to Category C costs. We will be considering the timing and treatment of cost recovery for Category C costs in future consultations.

Cost recovery spread over 10 years

- 4.15 Our initial proposal is that the costs in the pRAB should be recovered over a 10 year depreciation period under the scenario that the DCO is granted. In general, the depreciation period reflects or takes into account the life time of the asset. In the case of planning permission it is difficult to be precise around how long this intangible asset would retain its value. That said, we consider that 10 years is broadly consistent with both the likely construction period and the period between when planning consent might be secured (2020/21) and the latest date by when the Airports Commission said the runway should be operational to avoid significant risks to the UK economy (2030).
- 4.16 In the case where DCO is not granted, we would welcome views on whether Category B costs (subject to the risk allocation mechanism in chapter 5) should be recovered over 10 years or over a shorter period, say 3 or 4 years for example. Spreading the costs over a shorter period would avoid 'stranded costs' sitting in the pRAB for a prolonged period of

time. We consider that it is the generally accepted accountancy practice for unregulated businesses to write off such stranded costs quickly.

Adjustment for the time value of money

- 4.17 Our initial proposal is that the airport operator should earn a return on any Category B costs that are added to the pRAB. This return should be calculated using the WACC at the level determined in the Q6 settlement (i.e. 5.7% for GAL and 5.35% for HAL⁶). We consider that our financing duty implies that the airport operator should be able to recover efficiently incurred costs and that the definition of efficient costs include financing (i.e. the cost of capital).
- 4.18 This means that Category B costs are treated in the same way as any other capex project undertaken in the current Q6 period. The inclusion of the WACC return gives net present value neutrality for GAL and HAL's investors.

⁶ on a pre-tax real basis.

Chapter 5

Risk-sharing arrangements

The principles of a risk-sharing arrangement

- 5.1 The principle behind the introduction of a risk-sharing mechanism is to ensure that both GAL/HAL and the airlines bear some risk in the event that planning permission is not granted, is rescinded or is withdrawn. If stakeholders bear some risk then they will have every incentive to be part of the process, provide ongoing support and help ensure any costs incurred are efficient. This is in the interests of users because it will promote economy and efficiency on the part of the airport operator undertaking runway expansion, protecting users from unnecessarily high charges.
- 5.2 On the airport operator side, the risk-sharing mechanism will also encourage GAL/HAL to engage proactively and positively with local communities and other stakeholders to maintain support for expansion, otherwise it will stand to suffer financially if the DCO is not granted or if Government policy changes occur due to public opinion.
- 5.3 We also consider that airlines should bear some of the risks associated with a failure to obtain DCO or a change of Government policy. Airlines stand to benefit from runway capacity expansion. It will also be in the interests of airlines to be involved in the planning process and input their views to help ensure that any risks are appropriately managed.
- 5.4 As well as incentivising stakeholders, the wider principle behind risk-sharing is the CAA's view expressed in previous publications on the economic regulation of new runway capacity that users should not be expected to bear the whole risk of Category B costs if planning approval is not granted, is rescinded or is withdrawn.⁷ We consider that it is not in

⁷ CAA, Economic Regulation of New Runway Capacity ([CAP 1279](#)), March 2015; CAA, Recovery of costs associated with obtaining planning permission for new runway capacity: policy update ([CAP 1372](#)), February 2016. Both documents are available at:

users interests to be exposed to all planning costs when they gain no benefit in the future if the planning process does not succeed.

Design of the risk-sharing mechanism

- 5.5 Our initial proposal is that a 105% / 85% risk-sharing mechanism should be put in place for Category B costs (above the automatically recovered £10 million per annum). This means that:
- GAL/HAL will recover 85% of any Category B costs incurred above the £10 million threshold if the DCO is not granted; and
 - GAL/HAL will recover an additional 5% on top of any Category B costs incurred above the £10 million if the DCO is granted.
- 5.6 Under this 105% / 85% risk-sharing arrangement, GAL/HAL will face a shortfall of 15% in cost recovery if planning is not granted, is rescinded or is withdrawn. The 5% additional return where planning permission is secured is a counteracting upside to reflect the additional cost risk (or less cost certainty) faced by GAL/HAL when risk-sharing arrangements are put in place.
- 5.7 In defining the proposed risk-sharing mechanism we have taken into account that an airport operator subject to economic regulation faces the following pattern of risk and reward:
- On the upside, GAL/HAL's ability to earn supernormal returns from securing planning consent and delivering airport expansion will be constrained by our economic regulation (assuming that an expanded Gatwick or Heathrow continues to be subject to economic regulation because it retains substantial market power). This means it is unlike most normal commercial developments.

<https://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Approach-to-economic-regulation-of-new-capacity/>.

- On the downside, GAL/HAL faces the prospect of a proportion of costs having to be written off if planning is not achieved or if Government policy changes.

- 5.8 The airport operator's expected value from its investment in Category B costs will take into account its evaluation (i.e. probability and value) of both gaining planning consent and not securing planning consent. If GAL or HAL is faced with the additional risk that it does not recovery all of its efficiently-incurred costs if planning is not successful then we consider that it should also have a reasonable expectation of some upside if planning permission is granted. Otherwise, progress on airport expansion might rely on GAL or HAL investing in a planning application even though its expected return from that investment (taking into account the time-value of money as reflected in the WACC) could be negative.
- 5.9 To reflect this, our proposed risk-sharing mechanism, which offers a 5% premium if the airport operators planning application is successful but only 85% cost recovery if it is not successful, balance the risks and impact on financeability and gives the airport operator a reasonable expectation of cost recovery.
- 5.10 The asymmetric nature of the mechanism where the upside is lower than the downside reflects our consideration of two factors. Firstly, that while the planning success is not in any sense certain, we judge that the chance of permission being granted, after the Government has made a decision on location, is more likely than it not being granted. Secondly, that the airport operator will be able to generate additional value as a result of planning permission being secured and the capacity expansion which follows, notwithstanding the fact that it will remain subject to our economic regulation.
- 5.11 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.

Different scenarios around the reasons for planning failure

- 5.12 In our February 2016 document, we raised the issue of whether there would be merit in having different regulatory treatments by different types of planning failure scenarios, as this would allocate risk efficiently. We specifically outlined three possible scenarios where planning approval is not granted, is rescinded or is withdrawn:
- Scenario 1 – due to factors outside of the airport operator’s control, such as unforeseen difficulties in the planning process, severe worsening economic prospects or other significant incidents that cause traffic to collapse;
 - Scenario 2 – as a direct result of action by the airport operator or the airport operator is deemed the responsible party; and
 - Scenario 3 – Government changes its policy on new runway capacity or wider Government policy changes undermine the business case.
- 5.13 Our initial view is that it would be difficult, in practice, to identify clear reason for the failure of a complex process involving multiple stakeholders. We therefore propose to apply a simple approach to risk-sharing, namely two scenarios of either success or failure.
- 5.14 That said, in order to fulfil our primary duty to users, we consider it necessary to safeguard users from a scenario where the airport operator unilaterally withdraws from the planning process. If there is clear and compelling evidence that GAL/HAL were responsible for the failure to obtain the DCO, then we reserve the right to decide that GAL/HAL will be able to recover less than 85% of the Category B costs incurred. This will further the interests of users as it reduces users exposure to some of the costs that accrue no benefit to them either now or in the future.

Chapter 6

Promoting efficiency and transparency

- 6.1 Expenditure on the planning process should be monitored in a transparent manner to ensure that costs are efficient together with appropriate reporting and assurance. Our initial proposal is that a specific planning IFS should be set up to scrutinise costs and report back to stakeholders and the CAA. Furthermore, that any materials produced by the airport operator for the planning process should be made available to stakeholders.

Use of an IFS

The Heathrow IFS for the Q6 capital programme

- 6.2 An IFS has already been set up at Heathrow to offer advice on capital planning and efficiency for the Q6 period. The IFS is jointly commissioned by HAL and the airline community:
- to provide an on-going assessment of the reasonableness of all decisions on key capital projects and aims to ensure that capital is used effectively to deliver the outcomes determined by the business case; and
 - to monitor the key projects defined according to: scope and complexity; stakeholder impact; strategic importance and capital value.
- 6.3 This capital governance process has been working relatively well and HAL/airlines are already familiar with the process.

Creation of a planning IFS at Gatwick or Heathrow

- 6.4 Our initial proposal is that a planning-focused IFS should be set up at Gatwick/Heathrow with an objective to scrutinise and advise on the Category B costs incurred in the planning process. This will involve setting

up a new IFS at Gatwick/Heathrow or an enhancement to the terms of reference of the existing capital projects focused IFS at Heathrow.

6.5 The IFS at Gatwick or Heathrow will:

- provide an independent view on cost efficiency and drive good behaviours;
- provide real time advice to GAL/HAL on the planning process and scrutinising costs in real time;
- provide advice to the CAA in case there are disagreements on the definition of Category B costs;
- provide periodic reports to GAL/HAL, the airlines and the CAA. These would be at key decision points in the planning process and typically every 3 months;
- verify the need and efficiency of the Category B costs incurred; and
- focus on the processes being followed, the assumptions being made and the overall appreciation of the risks being managed.

6.6 The IFS should be a company with knowledge and experience around the planning process of major infrastructure projects, engineering project design and management, and business case analyses. The IFS should be appointed jointly by GAL/HAL and the airline community in an open and competitive process, with oversight by the CAA.

6.7 In our discussions with stakeholders so far, there appears to be consensus between the airport operators and the airlines that an IFS type arrangement should be used to help monitor efficient spend and report back to stakeholders in a transparent manner.

Transparency around planning materials produced

6.8 Our initial proposal is that GAL/HAL makes relevant materials and reports prepared for the planning process available to the airline community, the CAA and relevant stakeholders as early as practicable. This would help stakeholders to understand the planning process and the decisions that are made. It could also improve the efficiency of the overall design of new capacity by giving key stakeholders expert advice that would then allow

them to suggest ideas and innovations in the planning process and the design of capacity. This is in line with our secondary duty to promote efficiency and economy in the provision of airport operation services.

- 6.9 More generally, we are very keen to encourage GAL/HAL and the airlines to engage collaboratively on the design of the scheme. Whilst the interests of airlines and passengers may not always align, we consider that strong engagement by the airlines will be a necessary condition for delivering a final design and cost for the new runway that is in the interests of users.

Chapter 7

Impact on airport charges

- 7.1 This chapter provides a high-level estimate of how the proposed treatment of Category B costs could affect the level of airport charges.
- 7.2 At Heathrow and under the scenario of a successful planning application, for each £100 million of pRAB costs incurred over the 2017-2021 five year period, remuneration of the pRAB from 2022 would equate to an increase in airport charges of roughly 21 pence per passenger (or a 1.0% increase on the current £22 per passenger charge in the first few years after planning permission).
- 7.3 At Gatwick, the equivalent figure for £100 million of pRAB costs incurred over the 2017-2021 five year period is roughly 48 pence per passenger (or a 5.0% increase on the current £9 per passenger charge in the first few years after planning permission). The higher per passenger increase for Gatwick relative to Heathrow is because the same amount of planning costs used in this illustration is shared over fewer passengers and added to a lower charge.
- 7.4 The automatic pass-through of £10 million per annum translates into an additional 14 pence per passenger at Heathrow (or 0.6% increase on the current £22 per passenger charge). The equivalent figure at Gatwick is an additional 29 pence per passenger (or 3.1% increase on the existing £9 per person charge). Gatwick is higher because the same additional cost is distributed over lower numbers of passengers and added to a lower charge.
- 7.5 Our initial view is that these costs are reasonable and in line with our statutory duties. This is based on our view that the proportionate impact on airport charges is fairly modest, the impact of costs is balanced between current and future users and there is a significant upside to users from planning permission being granted and the new runway being constructed.