



London (Heathrow) Airline Consultative Committee

**LACC/AOC response to the CAA's initial proposals
(CAP 1435) on the recovery of costs associated with
obtaining planning permission for new runway
capacity**

Final – 12 Sept 16

Executive Summary

The Heathrow airline community continues to believe that the recovery of costs for planning purposes should not commence until the new runway is constructed and in service when passengers will receive the benefits. The airline industry remains very disappointed that the CAA is departing from these principles without a clear analytical framework together with the supporting evidence.

We support the concept of a planning RAB but have major reservations regarding the CAA's assumption that planning permission can be treated as an asset which attracts cost recovery. There can be no benefits attached to a planning consent and neither can value be attributed to a planning approval process until the asset comes into beneficial use as a runway and the associated infrastructure.

With regards to risk sharing proposal, it remains difficult to understand why an airport operator should be rewarded for performing its core function and how airlines could be held accountable for risks associated with a failure to obtain DCO or a change in Government policy. The airlines have no control whatsoever over these planning and political risks. Consequently the CAA's desire for airlines to accept 85% of the risks is not one which is credible or in the interests of passengers and therefore needs to be re-assessed.

Introduction

The Heathrow Airline Community responded in April 16 to the earlier paper of the CAA, CAP 1372, regarding the recovery of costs associated with obtaining planning permission for new runway capacity. The key themes of the airline response were as follows:

- It was premature to enter into a discussion regarding planning permission until the Government had taken a policy decision on location
- The nature of the location policy and the conditions attached by the Government regarding the externalities including future institutional arrangements were unknown.
- Consequently the commercial implications for the airline industry, including, the allocation of risk to those parties best able to manage the risks was entirely speculative.

In this response, it was also highlighted that the Heathrow airline community does not support the recovery of costs for planning purposes until the new runway is constructed and in service when passengers will receive the benefits funded from charges, paid at that time, by future passengers/consumers. The airline industry remains very disappointed that the CAA is departing from these principles in the absence of a clear analytical framework together with the supporting evidence. The CAA has, rightly in our view, concluded that a commercial agreement is unlikely to be reached between the airline community and Heathrow Airport Limited (HAL) and has now set out its initial proposal as to how planning costs should be treated. Nonwithstanding, our disappointment with the CAA's intentions, we respond here to the CAA's consultation in a positive and constructive manner with a view to securing an outcome which is equitable to both current and future passengers and the airlines at Heathrow who already pay one of the highest charges in the world

Comments on CAP 1435

1) Issues of process

The CAA has not provided any justification of why it wants to deviate from the process outlined in the previous policy document (CAP 1332). The sequence communicated previously clearly indicates the consultation on treatment of planning cost would take place after a Government decision. The CAA has not provided any rationale for why there is a need revise the sequence. We would urge the CAA to retain consistency with the policy document CAP 1332 and take the decision on treatment of planning costs after any government decision on the location of the new runway capacity. *“Should a Government decision be made in December 2015, we envisage that this process would start in earnest in January 2016 and we may be in a position to publish our decision by late summer 2016. Any decision made could be back dated to allow for recovery of any planning costs already incurred.”* (p. 6)

2) Definition of Cat B costs

The scope of the Cat B costs appears to be sufficient but there are two queries:

- a) Consultations around the National Policy Statement remain a Government responsibility and should not be paid by airlines
- b) The scope of the IFS activities should include provisions for solution options analysis including cost minimisation for any selected scheme

3) **The CAA states that up to £10m per annum Cat B costs will be automatically recoverable.**

Options discussed in paras 4.6-4.9 raise concerns about the objectivity of their selection. The alternative approach that was identified by the airline community in the CAA's previous consultation has not been reflected in the options being considered. We would therefore urge the CAA to re-launch the consultation reflecting an option for treatment of planning costs in line with concerns expressed by the airline community. Specifically, in its consultation the CAA should include an option that does not include any prefunding of planning costs.

Furthermore and as stated previously, we would strongly urge the CAA to develop policy on the basis of evidence. Therefore, we would suggest that each of the identified options for handling planning costs undergo a robust analysis. In light of the primary duty to further the interests of passengers, each of the identified options needs to be assessed based on the extent to which it advances interests of passengers and those with an interest in cargo (the CAA's working definition of consumers). Following such an analysis the options should be ranked in order of preference from a passenger interest perspective. In this context and in setting up such an analysis, it may be most appropriate that a series of workshops or a working group type setting can be used to assist the CAA in undertaking such an evaluation. Crucially, its most fitting that such an assessments is undertaken on the merits of a specific (actual) expansion scenario

rather than in an abstract/theoretical context. Therefore, we would again urge the CAA to retain consistency with its earlier policy document (CAP 1332) and launching an objective and evidence based consultation following the government decision.

As previously stated, the airline industry is opposed to prefunding and queries whether any justification based on the provisions in GAL's license is either sufficient or robust.

4) A planning RAB (pRAB) is the preferred vehicle for recovering costs

We support the concept of a planning RAB but have major reservations regarding the CAA's assumption that planning permission can be treated as an asset which attracts cost recovery both from a Cost of Capital (CoC) (a return *on* the RAB) and depreciation (a return *of* the RAB) perspective. There can be no benefits attached to a planning consent and neither can value be attributed to a planning approval process until the asset comes into beneficial use as a runway and associated infrastructure. As no justification has been provided to justify the CAA's position, we believe that the CAA's thinking is flawed. Other comments include:

- Collection of associated efficient costs should be aligned to the asset life, not just 10 years.
- Moreover, the collection should start only once the asset is built, not just when the planning permission has been granted. Assets coming into use should be viewed from the user perspective and not a planner's perspective, which seems to be the approach being suggested by the CAA
- We query whether a full CoC is generated from this investment. From a passenger point of view there is no intrinsic value in planning consent, as it doesn't deliver a direct benefit: this only occurs when an asset is built and in use. However, whilst planning consent isn't an asset for the passenger, it is for HAL and its shareholders. An airport with planning permission is worth more than an airport without it. Therefore the value of their equity will rise, which constitutes a return to the shareholders. Since, the CAA's primary duty is to the passengers, then it should take the passengers point of view. In this regard, if the CAA determines that a WACC should be attached to the pRAB, then it should do no more than cover HAL's direct financing costs.

5) Recovery of Cat A costs

The CAA states that the recovery of most Category A costs will not be permitted. However there are no clear detailed criteria to determine what is or should not be considered as Cat A costs without a strong case being presented by the project sponsor. Since HAL has forecasted Cat A costs of £30m at the end of 2015, there will be a need to ensure that such costs are subject to an audit to determine the baseline for true and valid Cat B costs and that Independent Funds Surveyor engagement could assist not only for an efficiency assessment but to verify compliance to the agreed criteria. In addition the scope should include both OPEX and CAPEX costs.

6) All Cat B costs will be subject to an efficiency test

Whilst the airline community supports the concept of IFS engagement to provide an independent view on cost efficiency, the learning experience from Q6 suggests that cost certainty only increases when the relevant airline experts engage in the master planning framework leading to initiation of HAL's Lifecycle and gateway management system. Airline engagement at this level has not commenced and whilst the CAA acknowledges that "strong engagement by the airlines will be a necessary condition for delivering a final design and cost", there will be a need to assess all design options and choices for cost minimisation. The CAA may wish to consider the governance arrangements for this phase of the project having taken account of the Q6 capital management process together with criteria for defining inefficient or disallowable costs.

7) CAA's proposed 105/85 risk sharing agreement for planning costs

As noted above, HAL have forecast to spend £30m on Cat A costs by Dec 15 without any incentives or provision in the Q6 capital budget. Consequently the airline community is very disappointed that the airport should be rewarded with an over recovery of 5% for an activity which has already received shareholder consent.

Furthermore on the down side risks, it remains difficult to understand how airlines could be held accountable for risks associated with a failure to obtain DCO or a change in Government policy. The airlines have no control whatsoever over these planning and political risks. Consequently the CAA's desire for airlines to accept 85% of the risks lacks credibility. Airlines will support capacity expansion at Heathrow but only when the total costs, including externalities and planning conditions, are integral to the justification of the business case during the Gateway Lifecycle scrutiny.

In summary regarding Risk sharing:

- If planning permission is secured then we don't see why HAL should be rewarded for doing what should be a core activity (presenting a good planning permission request and get a green light for it). It should be sufficient incentive to be able to receive a reasonable return for this expenditure (i.e. via an allowed WACC).
- Planning failure:
 - o If HAL is not successful then it should bear 100% of the cost for planning activities within its control
 - o If Government changes its mind:

There is a need to develop a hierarchy of which party is best placed to bear government risk.

 - Naturally, the first party to bear that risk should be the government itself. The CAA should point this out in decisions, as it is already assuming, ex-ante, that the government would not do it.
 - The second party that should be best able to manage these risks should be HAL itself.
 - In a competitive market, it is the companies that bear the commercial risk, not their customers. The fact that HAL is a regulated monopoly doesn't mean that its shareholders should be insulated from reasonable commercial risk. In fact it means quite the contrary. If HAL don't bear

these commercial risks, it means that they have no incentive to be careful, to spend wisely, produce value for money, etc – all of which is a bad and, potentially, unacceptable outcome for the passenger.

- Only then, the passenger should be considered, as it has no influence regarding the outcome of the planning consent.
- If CAA wants to depart from this hierarchy, which is what is currently being proposed in the consultation document, it needs to demonstrate that the passenger becoming the risk taker of last resort is actually in the passenger benefit. Until now, no such evidence has been provided.