

# Independent Planning Cost Review on costs relating to the Heathrow Expansion Programme covering the period 2016 and 2017

Heathrow's response

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# Contents

Executive summary .....	3
<i>Minded to</i> decision relating to where the IPCR has not yet been able to confirm they are supported by evidence .....	5
<i>Minded to</i> decision relating to unevidenced costs .....	6

## Executive summary

1. Expanding Heathrow is a once in a generation opportunity. The Department for Transport (DfT) estimates that expanding Heathrow will generate £68 billion<sup>1</sup> in benefit for consumers through lower fares and new flights driven by increased competition and choice from airlines operating from an expanded Heathrow. The CAA, the airlines and Heathrow need to focus on this long-term consumer prize. If we develop the right plan, with the right regulatory framework underpinning it, we will provide what consumers want.
2. The Independent Planning Cost Reviewer (IPCR) reviewed £79.3m of Heathrow's £82.2m submission for 2016 and 2017. Heathrow notes that of the £79.3m of expenditure reviewed by IPCR, the IPCR has to date been able to confirm that has it has seen appropriate evidence for 97% of this expenditure, £77.3m. We agree with the CAA that these costs meet the tests for Category B costs, have been incurred in an efficient manner and are therefore recoverable.
3. On the remaining 3% of costs (£2.0m) where the IPCR has not yet been able to confirm that they are supported by evidence
  - a. £0.3m which "appear to relate to the period before 25 October 2016" – this should be reviewed as part of the IPCR review of pre-25 October 2016 Category B costs
  - b. £0.5m of costs that "appeared to have been incurred in 2018" – this should be reviewed as part of the IPCR review of 2018 Category B costs
  - c. £1.2m staff costs not clearly "related solely to seeking planning consent" – these costs are part of the remuneration of colleagues employed on Heathrow Expansion
4. Heathrow notes that £2.8m of its £82.2m submission was not reviewed by the IPCR. The £2.8m is comprised of low value accruals and invoices:
  - a. £1.445m of accruals - each accrual was less than £100,000
  - b. £1.424m of low value invoices – each invoice was below £100,000
5. CAA policy requires that statement cost data "includes any accruals at year-end included with supporting calculations for any accruals greater than £100,000" only.<sup>1</sup>
6. CAA policy requires Heathrow to "record the expenditure on planning costs on a monthly basis (with any items over £100k itemised individually)."<sup>2</sup> Items below £100k are not required.
7. The CAA's proposal that it is "minded to" disallow the £2.8m relating to invoices and accruals below £100,000 is unacceptable. It is inconsistent with its own policy and creates a damaging precedent for the stability of the regulatory framework for the delivery of Heathrow Expansion.
8. If the CAA was to proceed with its minded to decision - it would do so against the principles and rules that it defined on its own policy. If a regulator, when giving effect to its own policy arrives to conclusions that are inconsistent with it, the only thing it achieves is to undermine its own credibility, hinder the ability of the *regulatee* to rely on the regulators judgement, destroying confidence in the regulator and direct the *regulatee* in the direction of assessing its options on how to proceed.

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<sup>1</sup> CAA CAP 1651

Guidance on preparation of the annual budget and statement for those costs associated with obtaining planning permission for a new northwest runway, 5.7 page 16

<sup>2</sup> CAA CAP 1513 The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement, 5.13 page 29

9. In line with its own policy and established regulatory principles the CAA needs to make its efficiency assessment on the costs that were reviewed during the IPCR review and confirm that the £2.8m of low value invoices and accruals are not at risk of disallowance.
10. The CAA states that Heathrow has asked for certain pre-25 October 2016 costs to “be reclassified as Category B costs”. This does not represent Heathrow’s position. Heathrow is not requesting that Category A costs are reclassified as Category B costs.
11. In general, Heathrow has incurred Category B costs after the 25th October 2016 Government decision. However, to ensure that Heathrow Expansion is delivered in a timely and efficient manner, Heathrow legitimately incurred some Category B expenditure ahead of the 25th October 2016 Government decision.
12. This is consistent with CAA policy that Category B costs are: *“in general, incurred by HAL after the Government policy announcement on its preferred location for new capacity (25 October 2016); and associated solely with seeking planning permission for the delivery of new runway capacity at Heathrow.”*<sup>3</sup>
13. It is important that learnings are fully captured from the 2016 and 2017 review before future IPCR reviews of Category B costs to ensure greater efficiency for all parties. The level of detail demanded by the IPCR during the review was unprecedented and disproportionate. Heathrow dedicated significant resource to the review and over 1,000 individual invoices provided to the IPCR. It was akin to a full forensic audit that went well beyond any normal regulatory practice.

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<sup>3</sup> CAA CAP 1513 The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement, 3.10 page 18

### ***Minded to decision relating to where the IPCR has not yet been able to confirm they are supported by evidence***

14. The CAA has indicated that it is minded not to allow the recovery of £2.0m of Category B costs reviewed by the IPCR:
- a. £0.3m which “appear to relate to the period before 25 October 2016”
  - b. £0.5m of costs that “appeared to have been incurred in 2018”
  - c. £1.2m staff costs not clearly “related solely to seeking planning consent”

#### **2016 - £0.3m pre-25 October 2016**

15. It is inappropriate to describe these costs as at “risk of disallowance” as they may relate to the period before 25 October 2016. These costs should be reviewed as part of the CAA review of pre-25 October 2016 Category B costs.
16. While in general, Heathrow has incurred Category B costs after the 25th October 2016 Government decision, to ensure that Heathrow Expansion is delivered in a timely and efficient manner, Heathrow legitimately incurred some Category B expenditure ahead of the 25th October 2016 Government decision.
17. This is consistent with CAA policy that Category B costs are: *“in general, incurred by HAL after the Government policy announcement on its preferred location for new capacity (25 October 2016); and associated solely with seeking planning permission for the delivery of new runway capacity at Heathrow.”*<sup>4</sup>
18. For the avoidance of doubt, Heathrow is not requesting that Category A costs are reclassified as Category B costs.

#### **2017 - £0.5m appears to be 2018 related**

19. The CAA has indicated it is minded not to allow the recovery of £0.5m of 2017 Category B costs since it appears that these costs have been incurred in 2018 rather than in 2017. In this case it is inappropriate to describe these costs as at “risk of disallowance” as these costs should be reviewed as part of the IPCR review of 2018 Category B costs.
20. Heathrow notes that the IPCR has correctly stated that these costs are Category B costs. In addition, it is not unusual for an invoice to be dated after the work is final, though the actual work would have been complete well in advance of the invoice date.

#### **2017 - £1.2m staff costs**

21. The CAA has indicated that it is minded not to allow the recovery of £1.2m of 2017 staff costs given that it is not clear that these costs solely relate only to seeking planning consent
22. These costs are part of the remuneration of colleagues employed on Heathrow Expansion.

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<sup>4</sup> CAA CAP 1513 The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement, 3.10 page 18

### **Minded to decision relating to unevidenced costs**

23. The CAA is minded not to allow the recovery of circa £2.8m of Category B costs since it considers that Heathrow has not provided information to support its recovery. This is unacceptable:

- a. Heathrow has followed the CAA's policy to the letter. The £2.8m related to a) accruals below £100k that as per the CAA's policy guidance Heathrow was not required to provide and b) low value invoices where the CAA's policy is not to itemise any items below £100k. Furthermore, the CAA, IPCR and Heathrow agreed that it would have been inefficient to dedicate the necessary resource to provide the invoices given the relatively small values and percentage of the overall costs claimed.
- b. It is wholly inappropriate for the CAA to suggest cost disallowance, which is inconsistent with its policy guidance and with the agreed positions of the CAA, IPCR and Heathrow through the process. The CAA's policy is clear:

HAL must record the expenditure on planning costs on a monthly basis (with any items over £100k itemised individually) together with a reconciliation against the budget.<sup>5</sup>

(Heathrow to submit) Any accruals at year-end included with supporting calculations for any accruals greater than £100,000.<sup>6</sup>

- c. Costs not reviewed cannot be assumed to be inefficient. Heathrow has provided appropriate evidence for 97% of Category B costs incurred. The CAA should take comfort from this.
- d. In addition, the volume and granularity demanded and provided by Heathrow throughout the IPCR review more than satisfies the CAA's policy guidance. The CAA's policy guidance refers to a "random sample" of purchase orders, not the provision of 100% - a clear mismatch:

"A random sample of Expansion Programme Purchase Orders selected by the IPCR/CAA will be provided to the IPCR for review to confirm:

- That suppliers have been solely engaged to provide services for the Expansion Programme;
- that Purchase Orders have been coded to include one of the cost categories identified Appendix C, or where not possible that Heathrow has maintained clear reconciliations to show where costs are transferred<sup>7</sup>"

<sup>5</sup> CAA CAP 1513 The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement, 5.13 page 29

<sup>6</sup> CAA CAP 1651

Guidance on preparation of the annual budget and statement for those costs associated with obtaining planning permission for a new northwest runway, 5.7 page 16

<sup>7</sup> CAA CAP 1651

Guidance on preparation of the annual budget and statement for those costs associated with obtaining planning permission for a new northwest runway, 5.9 page 17

24. The CAA in its minded to decision states that:

*“in respect of the accruals, while we note the CAA’s policy note to only provide calculations for accruals greater than £100,000, we have concerns at the overall level of these accruals. Given the timing of the supplementary review (circa 8 months after the end of 2017) we would have expected only a de minimis level of accruals”.*

25. There appears to be some misunderstanding by the CAA. The IPCR review is based on Heathrow’s performance as at the end of 2016 and as at the end of 2017. Therefore, it reflects the accruals at these times only, not any accruals relating to 2016 or 2017 that may or may not still exist 8 months later.

26. The CAA states that *“had HAL put the systems in place to properly record these costs it would have been relatively straightforward for HAL to provide better supporting information on these costs”*. This statement is not relevant. CAA policy does not require Heathrow to provide supporting information on invoices and accruals below £100,000.