

Paul Smith
 Consumer & Markets Group Director
 Civil Aviation Authority
 CAA House, 45-59 Kingsway
 London WC2B 6TE
 Sent by email to: economicregulation@caa.co.uk

8th February 2019

Dear Paul,

Re. Independent Planning Cost Review on costs relating to the Heathrow Expansion Programme covering the period 2016 and 2017 (CAP1752)

I am writing in response to the CAA's summary of the PwC Independent Planning Cost Review (IPCR) reports on Heathrow Airport Limited (HAL) Category B planning costs for the Heathrow Expansion Programmes incurred in 2016 and 2017. As previously communicated, IAG's position regarding overall Category B planning costs policy is that we do not support:

- HAL being allowed to recover planning costs pre-DCO grant, which constitutes pre-funding;
- HAL being awarded an additional 5% on all Category B costs in the event it successfully secures DCO; and
- HAL being able to pass through £10m of Category B costs in each year, without any efficiency review.

The CAA confirmed its policy early in 2017¹, stating *"the CAA would make a final decision on the level of planning costs to be added to the RAB, taking into account all the available information, including the advice of the IPCR"*².

We are disappointed, but not surprised, by the issues raised by PwC in both their initial and supplementary reports, in relation to the lack of a HAL baseline plan, forecast costs and risk, and the lack of effective governance controls that were meant to be put in place to manage and track Category B planning costs. In the wider Expansion Programme engagement with HAL, we have consistently raised these issues and do not feel that the airport has adequately responded to our concerns, and certainly not over the 2016-2017 period.

HAL's apparent reluctance to fully and seriously engage with PwC in mid-2018, as the initial report was compiled, is consistent with its approach to Expansion costs planning to date. Providing evidence for only 60% of Category B costs in the initial report, and then requiring the CAA to extend the review period and then commission a supplementary report is not acceptable. The CAA clearly stated in CAP1513 that:

*"HAL must provide an annual statement of the planning costs that it has incurred within four months of the end of each Regulatory Year in sufficient detail to allow effective scrutiny by the IPCR and/or the CAA"*³

¹ CAP1513 "The recovery of costs associated with obtaining planning permission for a new northwest runway at Heathrow Airport: Policy statement" – CAA, 27th February 2017

² Ibid para 5.12

³ Ibid para 5.13, bullet 6

That the CAA's appointed reviewer of costs notes that HAL provided *"unallocated invoices in an unstructured folder"* and that they *"requested that HAL clarified the allocation of the invoices included in the unstructured folder but HAL declined to do so"*⁴ clearly indicates that HAL actively chose not to assist PwC's review for the CAA. The fact that subsequent to the initial report HAL eventually provided information on all the Category B costs it claims to have incurred, with evidence for 95%, should in no way allay the view that HAL's approach and management of these costs is patently inefficient.

The PwC initial report sets out the areas it considered as part of its review that claimed expenditure had been incurred efficiently including whether there is: a baseline plan of scope, cost, schedule and risk up to DCO; baseline governance; clear and consistent reporting of progress and performance and impact of consequential delay; and that information provision is relevant, complete and timely. We consider that on all these *"efficiency tests"*, HAL has failed.

We do not believe that these *"efficiency tests"* alone are sufficient to fully assess HAL Category B costs. Despite promising that HAL's Category B costs would be subject to a CAA review of efficiency, this seems to amount to HAL claiming its incurred expenditure to date, and that so long as the cost can be categorised as Category B (and supporting evidence is provided) then the CAA will deem that as *"efficient"*. There is no effective assessment of efficiency applied to any of the claimed Category B expenditure that allows a judgement to be made as to whether it was either necessary and, if so, did it deliver value?

On this basis it is difficult to see how the CAA's efficiency review for Category B costs in excess of £10m per year differs from the £10m it has allowed HAL to incur without review. The CAA's policy on efficiency of Category B costs must be reviewed.

In light of HAL's reluctant approach to the PwC review, the fact that the review had to be doubled in length due to HAL's lack of engagement, the failure of HAL to provide a baseline plan against which an assessment of efficiency could be made, and the absence of any effective review of whether or not HAL's expenditure was necessary, value for money and efficient, the CAA's *"minded to"* proposals to disallow only £5m of £82m costs claimed in 2016-2017 appear to reflect neither the issues found by PwC in its review, nor be appropriate or well-evidenced.

We believe that the CAA's position that it *"expects HAL to provide better information on costs and efficiency for future years (including 2018)"*⁵ is insufficient, and in no way holds HAL to account for its apparent lack of management of Expansion costs to date.

The CAA should develop and undertake effective efficiency assessments for 2016 and 2017. Any determination on Category B costs for 2016 and 2017 should be held pending the CAA's consultation reviewing the regulatory treatment of Category B planning costs now that the estimate for Category B costs has grown to £530m. The CAA must demonstrate and satisfy itself that expenditure incurred by HAL to date has been efficient.

Yours sincerely,



Neil Cottrell – Head of Expansion

⁴ CAP1750, page 6

⁵ Ibid, page 5, bullet 4.

cc. Anna Bowles – Head of Regulatory Accounting, CAA