Date 12 January 2021

Civil Aviation Authority
Aviation House
Beehive Ring Road
Crawley
West Sussex
RH6 0YR

By email only economicregulation@caa.co.uk

Dear Sir, Madam,

Economic regulation of NATS (En Route) plc: Consultation on approach to the next price controls review CAP 1994

IATA welcomes the opportunity to engage with the CAA on the proposed licence modifications and guidance set out in document CAP 1994.

Aviation as a whole and Airspace Users, in particular, are among the hardest hit industries by the COVID-19 pandemic. Consequently, decisive measures by the industry and by lawmakers are required to get aviation back on a robust and financially sustainable track. This is the best way to support industry and wider economic recovery.

We have been very clear in our communication to DG MOVE, the EC as well as state representatives that Airspace Users are not able to and should not mitigate the revenue gaps of ANSPs. This situation is solely caused by the measures taken by states to fight the COVID-19 pandemic and therefore, the States must take a level of responsibility for covering this gap. From the beginning of our involvement we have advocated for a flexible approach towards EC or state support in mitigating the liquidity crisis in the European Aviation system.

The further development of the COVID-19 pandemic is still unpredictable. Forecasts now show that the return to 2019 level of traffic may be stretched out as far as 2024.The state measures allowing travelling to restart are not harmonised and with a third wave underway, the outlook is very challenging. As a result, Airspace Users will not have the necessary revenues to be able to offset any cost increases.

The existing draft implementing regulation developed by the European Commission will offer some alleviation to Airspace Users in the short term, it will not mitigate ANSP revenue gaps, which will be sought over the longer term. Airspace Users are asked to pay for a service they were not allowed to use as Member States suspended and restricted travel.

Possible financing alternatives, as discussed in this proposal by the UK CAA in Chapter 2 must be assessed quickly to address the NERL revenue gap. Furthermore, RP2 was closed with a healthy profit surplus for NERL. Those funds could now be additionally used to off-set the accumulated losses.

IATA’s comments on the CAA’s consultation to proposed modifications are detailed below:

Traffic Risk Sharing

The traffic risk sharing concept was adopted to incentivise ANSPs to deliver performant services irrespective of normal variations of traffic resulting from airlines business decisions or circumstances. **It has not been conceived as an absolute protection of ANSPs including for events caused by the global pandemic.**

Airlines are charged for a service delivered to them. They are not financially responsible for maintaining a full service that they do not use. This is the responsibility of the States/ Shareholders. The previously applied European regulation establishes a charging mechanism and not a taxation system. It is critical that the UKCAA identify the efficient level of NERLs costs for delivery of services that reflect a significantly reduced traffic level.

The gap in revenue should be the responsibility of ANSPs and states. It has been demonstrated by the PRB (in their recently published review of RP2) that ANSPs, including NATS, have increased their profits over the last years while not delivering the capacity nor investments paid for by airlines. So, in effect, the regulation was not implemented in full by States, despite normal business circumstances. Those states should not pursue airlines for full recovery in the same manner. If the state or NERL`s shareholders are unwilling to fund either the full amount or a portion of the of the shortfall, then IATA suggests that the UKCAA should mirror the current EC emergency proposals (EU2020/167)

The current EC proposals for treating 2020/2021 as a single period and allowing recovery of the revenue losses for ANSP`s from 2023, with a spread out of the recovery of 5 years with options to extend this to 7 years, is the minimum that airlines could sustain. Paragraph 1.7 of CAP 1994 references the current TRS process for states under the EU regulatory framework. Whereas the allocation of the loss of revenue based on the -10% threshold, of which airspace users would bear 70% of revenue losses and ANSPs only 30% is not acceptable to airspace users.

We suggest that due to the inability of airlines to operate their schedules due States decisions on border closures and restricting movements, consideration should be given to switching the traffic sharing keys so that NERL bear 70% and airspace users 30%, or to split the cost so that both parties take 50% for the period of 2020-2021 and recover this over a 7 year period. New arrangements maybe discussed and consulted in the context of a revised pricing agreement which includes a new baseline target for costs and efficiency incentives as and from 2023. This would allow the much-needed equitable split of the loss of revenue while supporting the recovery in the sector and affordability of user charges in the short term. It would also allow NERL to refinance its requirements with equity houses based on longer term return of the revenue gap.

Subsequently IATA supports the provisions discussed in Para 2.14, this approach is comparable to all other operators in the aviation value chain, where the shareholders of the respective entities have taken their part of the responsibility to help the aviation industry. We are willing to further discuss the mechanisms with both NERL and the CAA. And look forward to to receiving the UKCAA principles that will underpin the approach to TRS in the next weeks.

Financeability

It is critical that the UKCAA identify the efficient level of NERLs costs for delivery of a significantly reduced traffic level. The UKCAA must ensure that NERL`s costs are contained, adapted to the actual situation and users are only being charged the fair share of actual costs arising from the service provision to airspace users

We carefully note that all ANSP`s/NSA were to supply a report to the EC /PRB on what measures were taken to manage and control costs to adapt to the pandemic situation. We seek clarification that the UKCAA have requested and received same from NERL? if so, can it be shared with Airspace users to assist in our analysis and further inform our position? We have received information directly from NATS as to some of the measures taken, particularly on the CAPEX side but what exactly has been done on the Operational (OPEX) side is yet to be fully shared. We note that a VR scheme has also been offered by NATS to non-operational staff. Collation and dissemination of this information will be key to develop and define a base line for the coming short-term period, out to 2023. IATA along with many independent agencies do not forecast a return of traffic levels seen in 2019 until at least 2024, so concentration on the short term should remain the focus of any actions and or developments on price control. Cost for 2020 may at no way be higher than cost incurred in 2019, a -60% reduction cannot trigger costs higher than when NERL was handling +15% above forecast. The UKCAA should also consider that for 2020 & 2021 all returns on equity should be reset to zero. The logic being that how could ANSPs' shareholders receive a return where shareholders of airlines and airports have no dividends to be expected until far in the future.

Pension Costs- Regulatory Policy Statement

We generally welcome the draft regulatory policy statement relating to the NERL defined benefit pension scheme costs.

We do have some questions/observations however: -

In paragraph 9 of the "Background" section on page 38; where the draft refers to "all stakeholders should be prepared to play a part in helping deal with these difficulties"; does the CAA consider that NERL employees eligible for a DB pension are included in "all stakeholders"?

In paragraph 4 of Section 1 on page 39; where you outline your expectations that NERL and the Trustee should provide evidence to demonstrate that they have done all they reasonably can to mitigate the burden on airspace users arising from its pension obligations and that they have taken steps to ensure that the level of NERL's pension costs "remain affordable", the use of the term "remain affordable" lacks any real meaning, as affordable is difficult to define. Maybe it would be better to refer to "efficiently incurred relative to suitable benchmarks".

In paragraph 15 in principle 5 on page 41; you say that you "would expect the Trustee and NERL to take account of the relevant costs and consumer benefits both now and in the future, taking advice from experts as appropriate". Can you provide better definition of what "take account" of means in this regard? Is there an objective against which you would judge whether the Trustee and NERL had sufficiently taken into account costs vs benefits? Merely showing that they have considered the cost/benefit equation seems to lack enough recourse.

In paragraph 17 in principle 5 on page 41; you say, "in relation to the surplus, we expect NERL and/or the Trustee to manage the surplus effectively and efficiently in the best interests of current and future airspace users". Can you confirm if there is any conflict in this expectation with the duties of the Trustees? And if so how do you intend to remedy it?

In paragraph 18 in principle 5 on page 42; you say "We expect NERL to provide us with information on its preferred course of action, in particular to demonstrate how the interests of airspace users have been properly taken into account in selecting the way forward." Is this the furthest extent of the obligation that you are seeking to place on NERL? How would you foresee the UKCAA dealing with a situation where you disagreed with NERL's preferred course of action?

We also note that, increasingly, members of the DB scheme have been leaving the scheme and are being offered generous Pension Cash Alternative (PCA) sums instead. Obviously, these costs do not relate to the DB pension scheme, rather they are an alternative to it. There is no questions that the costs of the PCA seem to be lower for NERL than those of the very generous DB scheme, but that fact alone does not mean that PCA costs are efficient or compare favourably with benchmarks of similar schemes from commercially minded companies. In fact it could easily be argued that the NERL PCA is also extremely generous.

Is there any scope for the CAA providing guidance as to what they might deem to be reasonable costs in relation to PCA and the employer contributions in relation to the DC scheme?

Price control review and Timing

We acknowledge the intention of the UKCAA to develop a framework for economic regulation from 2022, as required by the CMA. As also pointed out, this would take considerable effort by all parties throughout 2021 to complete the required work to allow for implementation of a new period to start from Jan 2022. Resources on all sides will be extremely stretched and there is still some considerable uncertainty around if traffic will return to a sustainable level and what international operations will be viable in 2021,

For these reasons we support development of an interim price control for 2022 and a full review for implementation in 2023. This would also provide the opportunity to update the traffic and cost forecast to reflect the immediate impact of COVID 19. This can be accompanied by variance analysis for the years 2020/2021 with NERL then preparing and consulting a detailed business plan from 2023.

We also note the UKCAA favours a 5 year control period, however we also believe consideration should be given to a shorter 3 year period which will allow for a hopeful isolation of the current situation, a normalisation of traffic and sufficient time to adequately develop a robust price control to return to a 5 year control period from 2023. We understand that this has advantages and disadvantages in terms of the longer-term economic regime, but maybe a practical way to deal with the crisis situation in the short term, while laying the foundation for the future control period/s. This would also allow NERL sufficient time and space to implement cost control, achieve its 2-year rolling CAPEX programme and then develop and consult on a detailed Business Plan, for implementation from 2023.

It could also enable the UK to observe how the EC manages the situation with member states under the European regulatory framework for RP3 from 2022 while applying any lessons learnt from that process.

Space Based ADS-B

Regarding the ongoing situation on the North Atlantic we thank the CAA for providing the update, but are somewhat dismayed at the lack of an immediate date for this review. Also, we must ensure that there is no confusion; SB ADS-B has never been mandated by ICAO. For the reasons explained in earlier submissions, there was no regulatory need for SB ADS-B (and the associated charges and cashflow implications for airlines) to have been implemented. However, IATA maintains a keen interest in being part of the informal consultation process and we reiterate that the CAA's consultation on the independent review must take place as soon as practicable and address the following elements:

- Airlines must be able to participate in the review by working with the stakeholders to provide reliable information on flight efficiency benefits that have occurred over the period under review.
- Determine whether these matters were affected by the impact of the Covid-19 crisis. This will be particularly relevant when considering whether the claimed efficiencies are properly attributable to the addition of SB ASD-B services.
- Assess whether the loss of revenue due to the Covid-19 crisis, negatively impacted other areas of the operation, or offered an opportunity to remove inefficient and costly technology to reduce the overall charges.
- Determine, retrospectively, whether the charges levied so far were based on recovery of costs for services provided, and whether the charges outweighed the benefits actually received by the operators (and whether there ought to be reimbursement of charges to reflect this)

- Determine, prospectively, whether the benefits outweigh the costs, having regard to the provision of services and the availability of alternative technologies, and of SB ASD-B services offered by other providers.

  Effective consultation needs to allow all parties to share their views and these views must be properly assessed and considered before proposals / decisions are made, especially if such proposals / decisions are likely to result in higher charges in the short-, medium- or long term.
- Any decision (especially those involving an increase of costs) must be based on accurate data and a fair assessment.

We remain available and are keen to continue the discussion on the possible direction the UKCAA takes on the future direction of the next price review and hope that our feedback will be taken into account during the review.

Yours sincerely,

Rory Sergison
Assistant Director, ATM Infrastructure
Safety and Flight Operations, Europe