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## **IAG Response to NATS (En Route) plc RP3 revised Business Plan (rBP)**

Dear Mr Smith,

We would like to thank you for giving us the opportunity to comment on the NERL RP3 revised Business Plan. IAG has participated in all the NERL RP3 Customer Consultation Working Group meetings held during the summer of 2018 as well as a number of related meetings and workshops to address specific issues arranged by the CAA and NATS. The IAG view on the process was that airspace users were able to share their views with NERL on the key areas of RP3 and also that the initial business plan issued on April 9<sup>th</sup> 2018 was subject to detailed discussion which enabled the airlines to gain insight into NERL's rationale and perspective. However, the progress and development of the business plan that we were able to influence was limited by a lack of 'real' options and NERL's approach to modifying the initial business plan as it stood.

### **Approach to the NERL RP3 Consultation Process**

IAG is supportive of the approach taken by the CAA (through CAP1625) in setting out the requirements expected of NERL for its RP3 Business Plan. The level of detail that the consultation process explores is unique and we would hold this up as the exemplar that should be adopted elsewhere in Europe. We recognise the amount of work undertaken by all parties involved in the process – not least by NERL in terms of preparation for each consultation meeting. Whilst we supported the new CAA approach to RP3 in seeking NERL to 'own' its business plan and to include options our view is that this has not worked as well as hoped. In hindsight, the RP2 process where NERL had to provide both a service-led and a price-led iBP for consultation was, we believe, more effective in getting NERL to provide options and allow airlines to more fully understand trade-off between cost and service.

During the CCWG process IAG noted the fundamental challenges for RP3 as determined by NERL: to continue to provide a safe and efficient service capable of handling the predicted rise in traffic during the reference period whilst at the same time changing the operation to create more capacity

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and capability for post-RP3 operations. IAG, along with fellow airspace user representatives, accept the targets proposed by NERL in terms of safety, service quality, environment and investment and notes the average price reduction over the regulatory period of 12% in comparison to RP2.

IAG, in common with the other airspace user representatives, chose not to submit individual comments to the CAA on the initial Business Plan following the final CCWG consultation meeting held on September 13<sup>th</sup>. It had been determined that the report of the co-Chairs would incorporate the collectively agreed views of the airline representatives through Neil Cottrell, Head of Infrastructure – British Airways, in his role as co-Chair. The report included eight observations – all of which were fully endorsed by IAG - and none more so than observation number eight which stated that it was important that, given the time and effort put in by NERL and its airline customers, their agreements and dis-agreements be fully taken into account by the CAA and included as a substantial part of the final arrangements.

IAG was very pleased that of 80 subject areas included within the initial Business Plan 45 were agreed to during the CCWG process. It is to be hoped that the 10 pending/provisional areas can be agreed following further discussion or decisions from the European Commission (including the setting of RP3 performance targets). The failure to reach agreement over 25 subject areas across five elements (Resourcing; Oceanic (Satellite ADS-B); DC Pension Costs, Capital Cost and Productivity) led to speculation as to how NERL could address these areas given its staunch defence of its iBP during the CCWG process and its reluctance to commit to optioneering other than for a limited number of specific technical programmes. The publication of the revised (but largely unchanged) Business Plan has confirmed our fears that the consultation was regarded more by NERL as a means to present their business case rather than take account of the views of their customers. The following pages set out the position of IAG with regard to those areas that could not be fully agreed during the CCWG process and which we believe remain of concern.

### **Customer Priorities**

IAG broadly supports the customer priorities (and the order of priority) which were taken into consideration by NERL when developing the initial Business Plan. Whilst changes have been made in the revised Business Plan a number of concerns raised in the co-Chair report remain including WACC, staff numbers and pensions. We understood that CAA requirements included the need for accountability with key issues being efficient price and service quality improvement and it is not clear that the Business Plan will maximise net benefits to its customers. We agree with the CAA view that the priority through NERL RP3 is the delivery of a customer-driven strategy but, given the external risks to the airspace modernisation plan, there is a concern that actions to minimise delay and improve overall service may founder. This concern emphasises the urgent requirement for strong leadership and governance processes to ensure efficient delivery of airspace change which we hope will soon be established through the emerging AMOG structures.

### **Traffic Forecasting**

In his foreword to the Business Plan Martin Rolfe (NERL CEO) states that '*Traffic, already at record levels, will exceed airspace capacity according to all existing forecasts*' and highlights the '*risk of significant air traffic delay*'. We are pleased to note that the concerns over RP3 forecasting (as raised within the CCWG) have been addressed by NERL and that a revised forecast has been used. The

indication in the August 2018 figures (compared to December 2017) that UK traffic would rise by 10% during RP3 (up from 6%) is, we believe, more closely aligned with our view on traffic growth.

We note that NERL is fully aware of limitations on existing airspace and that route network structures supporting ATM are increasingly outdated and that NERL therefore recognises the immediacy of the need for airspace modernisation. The analysis by NERL for the DfT on the impact of capacity constraint with potential delay of 80 seconds/flight by 2030 without airspace re-design highlights the urgency of the situation. Given that NERL warns that traffic has already reached saturation levels in some key south-east sectors at peak times and that there are indications that there will be an increase of commercial aircraft based at south-east airfields during the last year of RP2 more targeted forecasting may be a future consideration.

We would support interim meetings between NERL and its customers as and when STATFOR forecast data becomes available and once EU targets are set to ensure that the forecast data used is aligned to meet the objectives of the Business Plan. We would still support the use of NATS data for the Oceanic forecast given the account taken of data provided by the UKMO.

### **Safety**

We support the Business Plan in terms of safety and agree that, whatever safety regime is implemented post-Brexit, that the UK should remain compliant with EU safety targets. We do have a concern over delivery timescales (within RP3) for safety improvements not least given the issues surrounding electronic conspicuity. Whilst we accept the principle that prevention of risk in controlled airspace should be funded by users we believe the cost of initiatives should be reasonable and that they should not be open-ended. We would expect NERL and the CAA to also engage with and seek appropriate funding from other airspace users, for example, UAV operators and General Aviation to minimise any risk and ensure appropriate funding sources.

### **Service Quality – Capacity & Delay**

We support the retention of the service performance metrics and targets (which will depend on the final EU regulation). Whilst aware that the proposed targets remain as per RP2 we accept that the increased traffic forecast makes meeting these targets challenging. We would expect detailed consultation and collaboration for special event transition delay (perhaps through the use of 'Deep-Dive' workshops) given the large number of critical project implementations planned during RP3. Whilst we have no particular desire to see NERL's exposure to a regime of increased penalties or bonuses versus the current RP2 exposures we note the potential for the EC performance regulation to increase the size of both risk and reward - but do not believe this should be reflected in the cost of capital. We would ask for further consultation following publication of the EC performance regulation.

### **Service Quality – Environment & Flight Efficiency**

As discussed during the CCWG process, IAG agrees with the use of 3Di (over KEA) and with the points raised by the airline team on metric scope and target ranges. We note the change of focus from 7,000 feet to 9,000 feet for departing traffic in the Business Plan which will place more demands on the airports but also provide them with the potential for more terminal routing options. We note

that the DfT and CAA are currently setting additional requirements on noise management that will impact the work on environment and flight efficiency being undertaken by NERL for RP3. At the same time the CAA expectations of RP3 included an indication of NERL's willingness to be accountable (including people overflowed) and to demonstrate how best it considers the balance between flight efficiency and the noise experienced by overflowed communities.

## **Opex**

We note that, despite discussion during the CCWG process and a study for the CAA by Steer Davies Gleave, the revised Business Plan retains the headcount plans of the initial BP.

IAG has understood NERL's case to support (from current) ATCO numbers in order to be able to meet the performance targets in an increased volume scenario. We believe that ATCO numbers do need to increase in RP3 and do not want to see any level of challenge in this regard that will compromise NERL's ability to deliver punctuality performance. However, we feel that we have not yet had sufficient evidence of ATCO efficiency gains that we had expected to be delivered through our investment in escape from legacy technology in RP2, and ongoing.

We remain uncertain about the number of ATSA staff that is appropriate in RP3. Going into the CCWG there was a latent expectation that ATSA numbers would fall through RP3 as a result of innovations such as ExCDS. However, NERL have now asserted that the ATSA role can perform functions that reduce the demand for ATCOs and that therefore the number of ATSA staff should be increased as well. Our understanding of the breadth of the functions performed by ATSAs was improved through dialogue with NERL during the CCWG process but we remain concerned at the direction of travel in this area and the lack of demonstrable efficiency gains enabled through new technology.

We accept that there will be a change in respect of maintaining the original planned numbers given the increased traffic forecast. We note that NERL headcount for trainee ATCO's, Operations Support and Technical Services remains broadly similar between the iBP and rBP. The comments in the co-Chairs report regarding pay levels remain unanswered and we would expect the CAA to challenge NERL over those employee groups that SDG believed were paid above realistic levels.

One of the airline concerns was over ATCO training time and how this compared when set against other ANSP's. The rBP fails to address the questions raised other than to state that initial training is 'favourable' when compared to other European ANSP's. We appreciate the complexity of UK airspace but remain to be convinced that all avenues have been explored in seeking to reduce training times. We would like the CAA to examine the opportunities offered through the significant investments in new technology that have been made through RP2 and that will continue to be made through RP3 to reduce the time taken to train ATCOs with the aim of improving efficiency.

With regard to pension costs we reiterate the views contained in the co-Chairs report and, whilst accepting the work that NERL has put into reducing the impact of pension costs on its customers (within the bounds of the non-degradation constraints it finds itself in), we would like the CAA to look again to assess whether further measures could or should be implemented. Pension costs remain a very significant component of NERL's overall cost base and the CAA must challenge NERL to ensure that these costs do not remain at the current very generous levels over the longer term. We believe a new DC scheme benchmarked with current DC new starter pension rates in other industries could be implemented from the start of RP3 for new employees that could reduce the

cost of pension provision whilst still remaining attractive to potential new staff. We appreciate the cost reduction brought about by the use of Pension Cash Alternative but remain concerned that this could lead to unexpected increased early retirements amongst those ATCOs with the longest service (and experience).

#### **Investment Plan – RP3 Change Portfolio**

We agree with the continued need for change to continue into RP3 as we are fully understanding of the need to upgrade technology and modernise airspace but do not feel able to comment in detail on the costs or new technologies contained within the NERL plan. We are aware that NERL has a limited number of suppliers for the tools they require and that this will affect their ability to secure good procurement outcomes. We believe we are not in a position to agree either the actual monetary level of Contingency for the Capex programme or the point estimate value that will have to be determined by the CAA but for the avoidance of doubt, we do support the principle of portfolio contingency and the assumed percentage proportion of contingency versus overall portfolio cost.

#### **Investment Plan – Airspace Modernisation**

The airline view of airspace modernisation as discussed during the CCWG process was largely positive with agreement with the NERL plan in almost all areas. It is noted that the rBP includes costing for the proposed increased NERL role. As stated in the co-chair's report, the issue of funding a PMO will need to be determined by the CAA but this must not delay the delivery of essential airspace infrastructure upgrades – especially with LAMP2 in the south-east. However, if this is to be funded via NERL charges in RP3 it should be subject to an appropriate level of control and should not be treated as a simple cost pass-through without oversight. As we are at the outset of this process the actual costs for this are not fully known and the principles around this must be clearly set out in the CAA's determination. We are aware of the risks that are inherent in the airspace modernisation programme and not least the fact that most are outside the ability of NERL to control. We understand the reasoning behind the deployment schedule proposed for the implementation of LAMP and wider airspace change but are concerned that, as has happened in RP2, there will be additional delay into a later regulatory period with subsequent continued unplanned cost and operational disruption. We note that we face a second regulatory period of agreeing to pay for airspace modernisation without receiving the full benefits of that investment due to the LAMP Phase Two being forecast to deliver only at the very end of RP3.

#### **Investment Plan – Technology Programme**

IAG supports the comments contained in the Co-Chair's report regarding CAPEX and Benefits to customers. Without a level of understanding of technical requirements, suitable suppliers and NERL procurement far in excess of what could be delivered through the CCWG process we must expect the CAA to examine this area further. We would support further discussion on the benefits of DSESAR and proposals on business and technical resilience (most suitably via the SIP process) – especially where productivity benefits appear low and/or the airlines will be expected to equip their fleets further to achieve NERL goals. For this to be meaningful we would require individual business cases and greater opportunities to participate with NERL technical teams.

The Business Plan provides legacy escape and establishes a technology programme that will enable airspace change although many of the initiatives appear simply to automate or upgrade current systems. With regard to technical resilience and business resilience we agree with the comments contained in the Co-Chair report and remain unable to comment on the effectiveness or efficiency of the investments proposed. As per our comments on the Change Portfolio, whilst we endorse the approach of holding a capex contingency fund at portfolio level rather than include this within each project we are not in a position to support the current monetary value of contingency that NERL say they require.

### **Investment Plan – Oceanic**

IAG supports the Oceanic Plan as applied to the 'south-east corner' (Tango routes) airspace. There was a sound business case made for this investment. The airline community has been fully involved in seeking a solution for those aircraft unable to meet the ICAO mandate on NAT Datalink and we agree with the investments in technology, costs and charges as established under Project Telstar.

On the other hand, the proposal to implement spaced-based ADS-B on the north Atlantic in RP3 is the most contentious part of NERL's Revised Business Plan. There has been much discussion on this area between NERL and its customers over the past 3, or so, years (not least of which has been within the RP3 CCWG sessions), but, as of yet, we remain unable to endorse a business or safety case for the implementation of ADS-B on the north Atlantic. We are very mindful of the much-lauded potential benefits that NERL, NavCanada and Aireon have variously claimed over the years and continue to engage as best we are able in an effort to validate the benefits claimed, as it is recognised that this transformational technology would, if proven, have the potential to enable a changed CONOPS over the Atlantic and bring improvements that airlines would welcome. The main stumbling block that prevents airlines from yet being able to endorse ANSP enthusiasm for the technology remains the intractable Aireon data charge. Once IAG is in a position to be able to see a clear safety and/or business case for the implementation of space-based ADS-B on the north Atlantic we will be supportive of it; however, that time has not yet come.

Within the IAG group British Airways has been assessing (and continues to assess) those flight efficiency benefits which it is able to assess and that NERL has used as a means of mitigating the fixed charge set by Aireon. It has proven difficult to undertake this, not least because of several uncertainties (including operations using UPR's and access to fulsome historic data). The ongoing work by airlines to try and validate ANSP claims about efficiency benefits enabled by space-based ADS-B are important and need to be given time to proceed. IAG would welcome the CAA removing the threat of any regulatory induced time pressure that has the potential to saddle airlines with a significant increase in costs in Oceanic operations (50+% increase vs current due Aireon data costs) prior to airlines being supportive of either a business or safety case to implement the technology. There is no need for a CAA regulatory determination to be aligned with the timescales associated with the domestic rate, and the current RP2 solution (CAP 1254 para 3.11), whereby you allowed for the addition of space-based ADS-B to be implemented within the regulatory period at such time that airlines supported it, could also be applied in RP3.

IAG is also extremely concerned that a regulatory outcome that would allow Aireon and ANSPs to insulate themselves from the inherent risks of this technology, simply passing an obligation to pay (handsomely) for the surveillance data to airlines and their customers, transfers the consequence of under-delivery or failure away from where it should rightfully sit. At such time that airlines are able to endorse a safety and/or business case for the deployment of space-based ADS-B on the north Atlantic any obligation for airlines to pay the 'pass-through' Aireon data charges would have to come

with an obligation on the ANSP to ensure delivery of changes in CONOPS that actually enable airlines to access benefits.

IAG is aware that IATA are also submitting a letter to the CAA in relation to NERL's RP3 rBP and that their letter will go into greater detail on various specific concerns about NERL's plans for implementation of space-based ADS-B.

### **Regulatory Mechanism**

IAG notes the projected average price for RP3 CSU's are below the average price in RP2 but believes it is too early for airlines to comment fully on the proposal. The proposed price reduction includes RP2 n+2 true-ups and will require further discussion on Opex and Capex. The most significant factors may be the impacts of the finalised network-wide EC Performance Plan and the departure of the UK from the EU.

We note the NERL views on Cost Efficiency and Traffic Volume Risk Sharing but, whilst accepting that there are reductions in the proposed DUC, believe that there are opportunities to reduce this figure further. Given that revenues for UK NATS have been above costs over recent years and that profits have been above those established under the regulatory return that has been set we believe this is an opportunity for NERL to continue to differentiate itself from the EC proposal. This should be achievable given the potential traffic increases that will result from the implementation of a number of programmes slated for delivery by NERL during RP3.

The airlines were unable to agree with NERL on Cost of Capital during the CCWG process and took the view that NATS has consistently exceeded the expected regulatory return during RP1 & RP2. The release of the updated report on WACC for RP3 by NERA for NERL in September 2018 has widened the gulf with an increased Vanilla WACC of 4.51% in the rBP compared to the 4.31% proposed within the iBP. This increase led IAG to commission CEPA to produce a report (Cost of Capital for NATS (En-Route plc) published on November 16<sup>th</sup> 2018. The CEPA report (which has been shared with the CAA and NERL) states that the cost of capital as proposed is *'significantly higher than can be justified by the available evidence and higher than recent regulatory precedent'*. We believe the CEPA report provides sufficient evidence to suggest a WACC of 2.16-3.28% to be more appropriate and would ask that the findings of this report be taken into consideration.

### **Governance & Accountability**

IAG participated in the NERL 2019 Service & Investment Plan meeting on November 8<sup>th</sup> that included a 'Deep Dive' on the SIP process. We note the direction provided to NERL through CAP1625 – not least the plan for *'Shared governance and assurance of NERL's capital programme'*. We also fully endorse the regulatory framework that exists in the UK and the high level of customer engagement that has been developed over many years that enables the airline industry to be involved in key decisions on service and investment planning.

We would like to thank both the CAA and NERL for the opportunity to discuss the NERL Business Plan and the wider RP3 programme. Despite there being a number of areas of disagreement between NERL and the airlines during the consultation process we appreciate that NERL sought our priorities and requirements before publishing the initial business plan thereby ensuring our focus was

concentrated on those areas such as LAMP2 that we believe will deliver the service needed for the forthcoming Regulatory Periods.

We look forward to the CAA's initial proposals, view on WACC and the concluding report from Steer/Helios in 2019 and will engage fully in the consultation on these.

Yours sincerely,



David Leitch,

Category Lead – User Charges

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