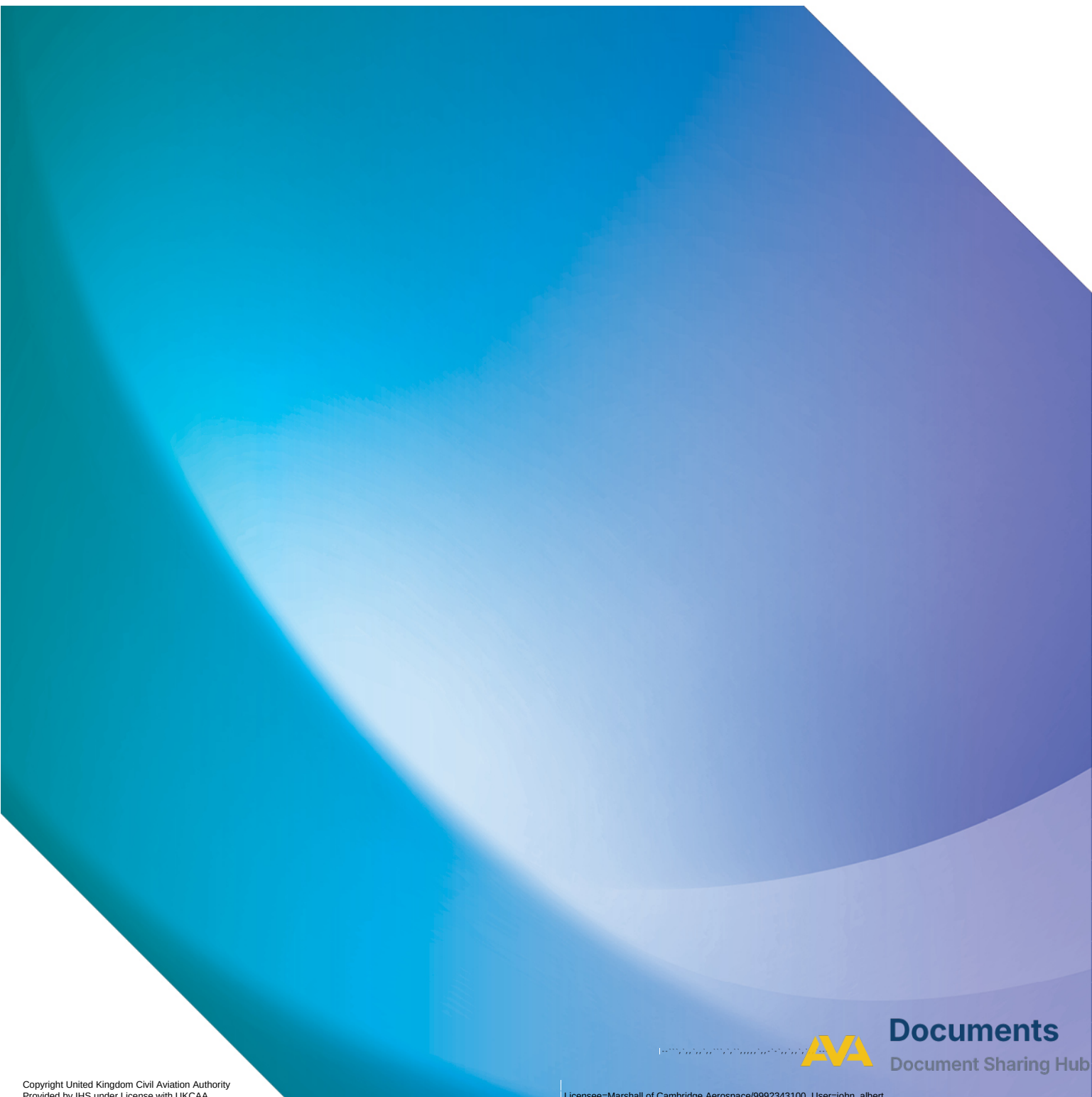


Decision on modifications to NATS (En Route) plc licence in respect of the Oceanic price condition for 2015-2019

CAP 1254



Documents

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Chapter 1

Introduction

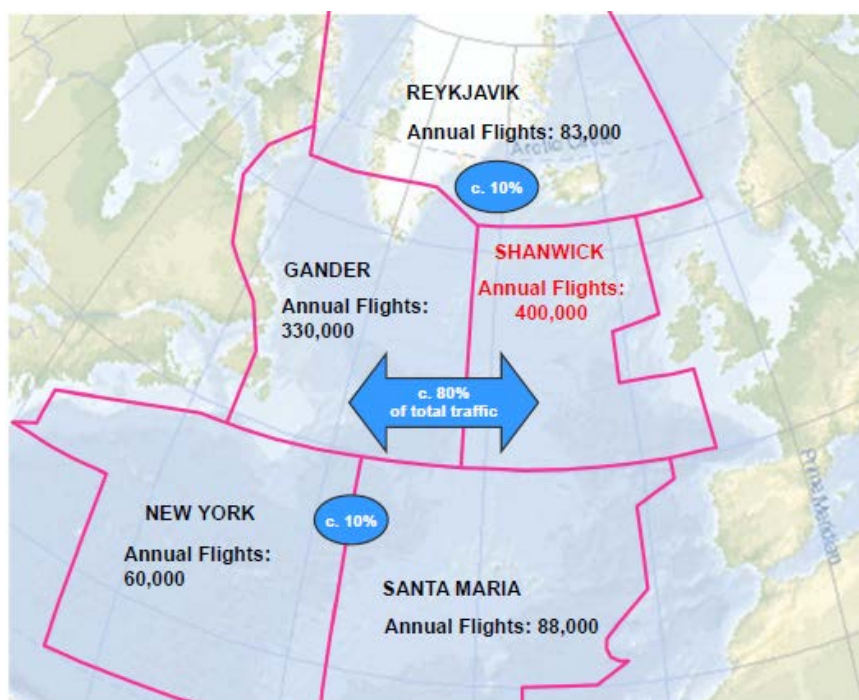
Purpose of this document

- 1.1 This document sets out the CAA's decision on modifications to the air traffic services licence held by NATS (En Route) plc ("NERL") in respect of a control on Oceanic charges for the period 2015-2019.

Background

- 1.2 The management of the Shanwick area of oceanic airspace over the North Atlantic is delegated to the UK and Ireland by ICAO¹. The UK is responsible for air traffic service and datalink communications while Ireland is responsible for high frequency communications.

Figure 2.1: Service Providers in the North Atlantic



Source: NERL

1 International Civil Aviation Organisation - an agency of the United Nations Organisation.

- 1.3 As shown in Figure 2.1, the Shanwick area is one of five service providers across the North Atlantic. The management and development of airspace governed by ICAO is through the North Atlantic System Planning Group (NATSPG) and sub-groups. The vast majority of flights (c.80%) are handled by a combination of the Shanwick service and the service provided by Nav Canada from Gander.
- 1.4 Oceanic is a non-surveillance operation (i.e. there is no radar coverage). Separation of aircraft is assured through clearance and management of planned flight trajectories. For transatlantic flights there is an organised track system (OTS), planned on a daily basis, depending on the position of the prevailing Jetstream, to minimise the adverse effect on westbound flights and maximise the benefit to eastbound flights.
- 1.5 There is considerable collaboration between NATS and Nav Canada at both a strategic and a tactical level. NATS has a long-term strategic relationship with Nav Canada for the provision of the Oceanic flight data processing system and supporting datalink systems. This technology is currently being upgraded and replaced under the COAST programme (collaboration of Oceanic airspace and system tools) based on a high level of commonality with the equivalent systems being implemented by Nav Canada. At a tactical level NATS and Nav Canada share planning of the OTS for Shanwick and Gander with NATS focusing on westbound and Nav Canada on eastbound flights.
- 1.6 The Oceanic business is a relatively small part of the NERL business with costs and revenues representing about 4%, and the regulatory asset base about 3%, of the NERL business.
- 1.7 The CAA currently regulates the maximum that NERL can charge users for Oceanic services by means of a condition in the NERL licence issued under the Transport Act 2000. The current charge control was set in December 2010. The maximum charge per Oceanic Flight was £64.92 in the year April 2011- March 2012. This maximum was then constrained to fall (in real terms) by the increase in the Retail Price Index (RPI) minus 4 percent (RPI-4%) in each of the three succeeding years until the year ending March 2015.

- 1.8 Although the Oceanic service does not fall under the SES performance scheme, the CAA asked NERL to consider the Oceanic service as part of its mandate for the Customer Consultation process in summer 2013, alongside its proposals for domestic services under SES. The CAA considered that this would be an efficient approach for both NERL and users. The initial business plan issued by NERL in May 2013, prior to Customer Consultation, therefore identified its plans for Oceanic services and one of the workshops during the consultation period was devoted to Oceanic.
- 1.9 At the conclusion of Customer Consultation the joint Chairs of the Working Group² reported that Airlines agreed with the Oceanic strategy presented by NERL in the Revised Business Plan (RBP). Airlines were also keen to engage with NERL on the options and costs for satellite surveillance.
- 1.10 In July 2014 the CAA conducted a first consultation on proposals for a new charge control condition that would apply for the five years from 1 January 2015 to 31 December 2019. These proposals would end the current charge control condition three months earlier than originally specified in order for it to be aligned on a calendar year basis with NERL's other regulated charges. (It was anticipated that in these circumstances NERL would also change the charging year for Oceanic charges to a calendar year.) The CAA held a workshop on the proposals on 1 September 2014 and the consultation period closed on 25th September 2014. The CAA received submissions from
- British Air Transport Association (BATA)
 - British Airways (BA)
 - International Air Transport Association (IATA)
 - NATS
 - NATS Trades Unions Side (NTUS)
 - Virgin
- 1.11 Appendix A summarises these responses in terms of overview comments and answers to specific questions posed in the consultation document. The full text of responses is published on the CAA website³.

2 The two joint Chairs were nominated respectively by NATS and the airlines.

3 <http://www.caa.co.uk/default.aspx??catid=5&pagetype=90&pageid=585>

- 1.12 Following the end of this first consultation the CAA proposed that it should modify NERL's licence based on the analysis in Chapter 4 below.
- 1.13 Under section 11(2) of the Transport Act 2000, before making modifications to the licence, the CAA must publish a notice setting out the proposed modifications and state the period (of not less than 28 days) within which representations may be made regarding the proposed modifications. The CAA issued such a notice on 17 November 2014. It received representations from NATS and Heathrow Airport limited which are considered in Chapter 5 below.

Chapter 2

Outline of proposal in the first consultation document

- 2.1 The first consultation document proposed the continuation of a simple price control with the features summarised below.
- 2.2 The control period going forward would be for calendar years rather than the current 31 March year:
- This would mean that the final year of the current price control would be for 9 months ending 31 December 2014 rather than a full year.
 - This would have some impact on profitability, all other things being equal, given that it would bring forward the use of lower traffic forecasts and lower costs for the new control period. It would also imply a gain to NERL due to the benefits of relatively more peak months in the nine months April to December compared to a full year.
 - The CAA proposed not to make any adjustment for the above effects on profitability. The effects of bringing forward traffic and forecasts appeared to cancel each other out while the unanticipated benefit to NERL in 2014/5 was not expected to be as great as the revenue shortfall due to lower traffic in that year compared to what was anticipated for CP3.
- 2.3 The correction term would be changed so that it would operate two years in arrears, when all the relevant information would be known in line with the approach for Eurocontrol Charges. (It was currently specified to operate one year in arrears based on forecasts.)⁴
- 2.4 The price control would take the form CPI-Z* rather than the current RPI-Z⁵:

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- 4 In practice this correction mechanism has not been active because NERL has charged at exactly the allowed maximum rate. It remains a technical possibility that NERL could charge at more or less than the allowed maximum rate.
- 5 The terms Z and Z* are used here to distinguish that the value of Z differs depending on whether RPI or CPI is used in the formula.

- This would make the indexation consistent with the requirements for the vast majority of NERL's services regulated under SES and thus avoid administrative complexity.
- The value of CPI-Z* would be set at an expected level equivalent to what it would have been if specified as RPI-Z.
- Consistent with Eurocontrol and London Approach charges, the CAA intended to continue to apply RPI as the appropriate index for revaluing the RAB given that this is the basis on which the weighted average cost of capital had been derived.

2.5 In CP3 the CAA applied a rolling incentive mechanism (RIM) designed to provide a constant incentive on the service provider to bear down on costs throughout the reference period by effectively allowing it to retain the benefits for five years. The CAA proposed to honour previous sums accumulated through the RIM but not to apply it further in 2015-2019. This is the approach adopted in the UK-Ireland FAB Performance Plan for services provided in UK airspace under Eurocontrol and given the small scale of the Oceanic business, the CAA proposed a consistent approach for Oceanic.

2.6 The CAA proposed that it would be prepared to re-open the Oceanic price control in the event of significant technological change where the Licensee is able to demonstrate to the reasonable satisfaction of the CAA that, after proper consultation with users and other interested parties, there is an acceptable level of support for the Licensee's proposals and that they would be in the general interests of Users.

2.7 In terms of the projections of the building blocks for calculating the maximum charges the CAA proposed:

- A set of traffic forecasts consistent with the UK-Ireland FAB Performance Plan based on STATFOR February 2014 forecasts.
- Equivalent cost interventions to those which had been applied in the UK-Ireland FAB plan:
- To reduce the assumption for increases in average staff costs to the rate of CPI.
- With respect to the Employee Share Ownership Scheme, to continue to make a cost allowance for the distribution of shares to employees at less than cost but not to make an allowance for the anticipated increase in the liability to eventually redeem shares generally.

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