

Strategic outcomes for the economic regulation of NERL 2020-2024: Discussion document

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Civil Aviation Authority,
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Enquiries regarding the content of this publication should be addressed to: bronwyn.fraser@caa.co.uk

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Contents

Contents	1
About this document	3
Views invited	3
Executive summary.....	4
Our duties.....	4
Outcome 1 – Effective accountability mechanisms.....	5
Outcome 2 – Efficient prices	6
Outcome 3 – Continued improvement in service quality	7
Strategic outcomes for RP3 unrelated to NERL	8
Proposed timetable.....	8
Key discussion questions	8
Structure of this document.....	9
Chapter 1	10
Background and context	10
Background	10
Legal and policy framework	11
Single European Sky Performance and Charging Regulations.....	11
The Transport Act 2000	12
Regulatory best practice	12
Key context for the development of RP3.....	13
Brexit	13
Airspace and SESAR.....	13
System resilience.....	15
NERL's past performance against regulatory targets	15
Chapter 2	17
Initial views on the strategic outcomes for RP3	17
Outcome 1 – Effective accountability mechanisms	17
Outcome 2 – Efficient prices.....	20
Approach to considering efficient prices.....	20
Transparency between en route and London Approach	22
Financeability	23
Outcome 3 – Continued improvement in service quality	25
NERL delay/capacity performance	26
NERL's environmental responsibilities	26
Resilience	27
Incentives around service quality	28

Chapter 3	30
Proposed timetable for development of RP3 performance plan.....	30
EU regulatory timetable	30
Proposed CAA timetable	30
Appendix A.....	32
Our duties	32
Appendix B.....	33
NERL past performance.....	33
UK unit rate evolution against EU peers (nominal)	33
NERL unit cost efficiency (in 2009 prices)	33
NERL's service quality metrics	34
Capacity key performance area	34
Environment key performance area.....	35
Appendix C.....	36
Setting of the NERL price control	36

About this document

This discussion document seeks views from all interested parties on the process, strategic outcomes and the relevant issues that should shape the CAA's approach to the future economic regulation of NERL in the period from 2020 to 2024.

Following our consideration of feedback on this discussion document and engagement with stakeholders, we intend to publish a consultation paper in September that sets out our latest thinking on the best approach to the future economic regulation of NERL.

This document does not address safety issues, as NERL's pursuit of economic and service quality performance outcomes will always be in the context of maintaining safety.

Views invited

We welcome views on all the issues raised in this document, in addition to the discussion questions (listed in the Executive Summary). Responses are invited to our consultation no later than **31 May 2017**. While responses by online consultation are preferred, we will also accept responses sent to economicregulation@caa.co.uk no later than **5pm on 31 May 2017**. We cannot commit to take into account any representations received after this date.

We are keen to engage with anyone interested in the future regulation of NERL. If you would like to discuss the issues raised in this document outside the scope of the consultation, please contact Matt Claydon (matt.claydon@caa.co.uk) or Bronwyn Fraser (bronwyn.fraser@caa.co.uk).

Representations will be made available on our website. There is an opportunity to mark your responses as anonymous or confidential on the consultation. Where responses are sent by email, any material considered confidential should be clearly marked as such and included in a separate annex. Please note that we have powers and duties with respect to disclosure of information under Schedule 9 of the Transport Act 2000 and the Freedom of Information Act 2000 and it may be necessary to disclose information consistent with these requirements.

Executive summary

NATS (En Route) Plc (NERL) provides en route (both domestic and Oceanic) and certain approach air traffic services in the UK. As a monopoly, it is subject to economic regulation under the EU's Single European Sky (SES) Performance Scheme for Air Navigation Services and the Transport Act 2000. This legislation provides for the setting of performance targets and incentives for NERL.

Such targets and incentives have been set for the current regulatory period, Reference Period 2 (RP2), which runs from 2015-2019. The European Commission's preparations for RP3 (2020-2024) of the Performance Scheme are already underway and this discussion document sets out our views on the main strategic outcomes for the economic regulation of NERL for this period.

Our duties

In developing the proposed strategic outcomes set out in this document, we have taken into account of our duties under the Transport Act to:

- maintain a high standard of safety in the provision of air traffic services;
- further the interests of airspace users;
- to promote the efficiency and economy of NERL;
- ensure that NERL does not find it unduly difficult to finance its activities; and
- take account of any Government guidance on environmental objectives.

These Transport Act duties (set out in more detail in Appendix A) mean that we will make proposals for the regulation of NERL's activities for the period 2020 to 2024 whatever the evolving nature of the UK's relationship with the EU.

Our duties and responsibilities (as the UK's National Supervisory Authority (NSA) under SES) have informed our initial views on the strategic outcomes we intend that NERL should achieve over RP3.

To further the interests of airspace users, NERL will need to deliver on airspace reform, particularly over the south east of England, to support the Government's plans for airport capacity expansion. This is important to our first strategic outcome for NERL – developing effective accountability mechanisms. In delivering these reforms NERL will need to develop plans that are efficient and economical and consistent with the efficient financing of its activities. This will allow for reasonable charges for airspace users and will support our second strategic outcome for NERL – that its prices are efficient. Finally, airspace users are concerned not only with delivery of change to airspace and efficient prices, but also that NERL delivers consistently high service levels across its existing and developing activities. These matters are addressed in our final strategic outcome – continuing improvement in quality of service.

Outcome 1 – Effective accountability mechanisms

The CAA has consistently stressed that capacity improvement in the south east of England will benefit passengers. NERL had initially planned to address airspace redesign in RP2 through its London Airspace Management Programme phase 2 (LAMP2); however, in 2015 it was decided in light of several key challenges to delay the implementation of LAMP2 to RP3 and instead take the opportunity to accelerate the implementation of SESAR technologies and systems to replace ageing infrastructure. As airspace redesign has been delayed from RP2 to RP3 and plans for airport capacity expansion are moving ahead, it is critical that airspace change is delivered over the period 2020-2024. We expect that NERL will be responsible for the significant changes to airspace that are required across the south east of England, including LAMP2 and changes necessary to facilitate the expansion of runway capacity at Heathrow.

As a minimum it will be important:

- that NERL reflects user requirements and government priorities in the development of future capital investment programmes, including the UK's Future Airspace Strategy (FAS) and the EU's SES ATM Research (SESAR) programme;

- that those programmes are fully justified, well thought through, properly coordinated and transparent;
- that NERL keeps its customers properly informed and that these customers have suitable opportunities to make meaningful inputs into NERL's investment planning processes; and
- that NERL can be held accountable for the delivery of appropriate airspace change on time and to budget through regulatory interventions and incentives.

To the extent that broader measures need to be brought forward to ensure the appropriate leadership and coordination of airspace modernisation in the UK, we expect NERL to play a full role in developing and supporting the delivery of such measures.

Outcome 2 – Efficient prices

The prices that NERL charge are a key issue for airspace users. In setting regulatory limits on the maximum prices NERL can charge airspace users, the CAA would expect to take into account no more than the efficient level of costs. This will involve:

- an assessment of the efficient level of operating and capital costs, where practicable supported by benchmarking;
- NERL supporting its proposals for capital investment programmes with transparent, robust and persuasive cost benefit analysis and strategic optioneering;
- NERL setting out clearly the interdependencies and potential tradeoffs between price levels and service quality and resilience;
- NERL demonstrating its costs are transparent and appropriately attributed and allocated between monopoly and other activities;
- within its monopoly activities, appropriate cost drivers are identified and costs attributed and allocated in a way users find helpful, including consideration of whether the cost of London Approach services should be separately identified;
- NERL's business planning taking into account a number of scenarios with regard to key economic drivers such as traffic levels; and

- ensuring that those paying for the service are able to understand NERL's cost base and its forecasts of costs, and influence the plans and service levels that drive these costs.

In considering efficient prices, we need to take into account our duty to ensure that it is not unduly difficult for NERL to finance its activities. This will require consideration of:

- how best take account of the significant deficit on NERL's defined benefits pension scheme; and
- the level of appropriate return that NERL can earn (commensurate with the risks it faces) on its Regulatory Asset Base (RAB).

Outcome 3 – Continued improvement in service quality

The quality of the service provided by NERL across all its services is very important for airspace users, and we consider there is scope for more consistent delivery from NERL. The incentives to support this will be increasingly important in RP3, especially as there may be a risk that delivering airspace change means that NERL unnecessarily loses focus on service quality.

Performance incentives are limited under the current SES scheme and we would like to consider whether these can be strengthened. However, stronger incentives would only be effective if supported by good quality data on performance, and so we may also need to review the quality of NERL's performance data.

In addition to reviewing the current delay/capacity service quality targets, we have identified two further priorities in respect of continued improvement in service quality:

- resilience – ensuring NERL provides an effective and resilient service (not only in response to a specific events, but also in the face of demand/capacity imbalances) and is incentivised to act in the interests of the air traffic management network as a whole; and
- environment – how to broaden NERL's environmental focus beyond its current flight efficiency (3Di) metric to encourage it to consider the impact of noise on local communities resulting from changes to its operational procedures.

Strategic outcomes for RP3 unrelated to NERL

Competition can drive significant benefits for consumers. Under the Performance Scheme, a Member State may be exempted from the requirement to set cost efficiency targets on terminal ANS (TANS) where it can be demonstrated that the market is subject to sufficient competition.

The UK has such an exemption for RP2. As the UK TANS market is not a monopoly activity and concerns activities in relation to NATS Services Ltd (NSL) rather than NERL, it is not addressed in this document.

Proposed timetable

The Commission's key milestones and our proposed work plan for the development of the RP3 Performance Plan are set out below. These are indicative dates and will be refined as the programme develops.

Milestone	Proposed dates
CAA scene setting discussion document	April – 31 May 2017
CAA regulatory approach consultation document	September 2017
NERL customer consultation on its initial business plan	April – September 2018
European Commission adoption of revised regulations for RP3	June 2018
European Commission adoption of EU targets	December 2018
CAA consultation on draft RP3 performance plan	January – March 2019
DfT adoption of RP3 performance plan and submission to the European Commission	June 2019
European Commission assessment of performance plans	July – November 2019

Key discussion questions

We welcome views on any issue raised in this document. We would particularly welcome feedback on the following key discussion questions:

1. Are the proposed three strategic outcomes the right ones to guide our future regulation of NERL in the period 2020-2024?

2. Is there additional context or background information we should consider in developing our approach to the strategic outcomes?
3. Have we captured the right issues within each of these strategic outcomes?
4. Is our timetable appropriate?

The focus of this discussion document is the strategic outcomes and our approach to the regulation of NERL for RP3, rather than views on the EU regulatory framework. However, if stakeholders feel change to the existing EU framework is necessary to support delivery of these outcomes then we would welcome representations on these matters.

Structure of this document

The structure of this document is as follows:

- **Chapter one** sets out background and context for the preparations towards the future economic regulation of NERL;
- **Chapter two** presents our initial views on the strategic outcomes for the future economic regulation of NERL; and
- **Chapter three** explains our initial proposed timetable for the development of the RP3 Performance Plan.

Chapter 1

Background and context

Background

- 1.1 NERL is the provider of en route (both domestic and Oceanic) air traffic services in the UK. NERL is a subsidiary of NATS Limited, which in turn is a subsidiary of NATS Holdings Limited, established as a public-private partnership in 2001. NATS' shareholders are HMG (49%), Airline Group¹ (42%), Heathrow Airport Holdings Ltd (4%) and the NATS Employee Sharetrust Ltd (5%).
- 1.2 NERL provides en route, and some approach, air traffic services on a monopoly basis, under an economic regulation licence issued by the Secretary of State for Transport. It is also subject to the EU's Single European Sky Performance Scheme for Air Navigation Services.
- 1.3 The current regulatory period and settlement of the SES Performance Scheme, RP2, runs from 2015-2019. Preparations for RP3 (2020-2024) are already underway. The method used for setting the NERL price cap in RP2 is set out in Appendix C.
- 1.4 NERL's en route revenue for 2015 was approximately £585m – which was equivalent to approximately £2.30 of revenue per passenger in 2015.²

¹ The Airline Group comprises USS (50%), British Airways (17%), easyJet (13%), Monarch (13%), Virgin (2%), Lufthansa (2%), Thomson Airways (2%) and Thomas Cook (1%).

² This figure is based on NERL's 2015 Regulatory Accounts and represents revenue from UK en route and London approach services derived from UK flights (2,302,757) and average passengers per flight based on Eurocontrol standard CBA (111); this leads to £2.29 average revenue per passenger.