

Economic regulation of NATS (En Route) plc: Decision on licence modifications and guidance

CAP 2011

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About this document

This decision relates to the price controls for NATS (En Route) plc's (NERL) regulated activities under its air traffic services licence for the period 2020 to 2022. It follows on from our August 2019 Reference Period 3 (RP3) price control decisions, the subsequent reference to the Competition and Markets Authority (CMA), the CMA's final report on NERL's price control arrangements, and our consultation on licence modifications to implement the CMA's final report. The decision is pursuant to the statutory requirements, under the Transport Act 2000 (the Act), to make licence modifications to give effect to a CMA determination.

The document encompasses:

- the modifications to the licence conditions required to remedy or prevent the adverse effects specified in the CMA's final report;
- the introduction of a new condition to NERL's licence, establishing processes and procedures to coordinate airspace modernisation (Condition 10a – Airspace modernisation);
- some minor licence modifications to improve the clarity of certain obligations created by the licence; and
- guidance relating to NERL's capital expenditure incentives.

If you have any questions on this document, please contact Rod Gander at rod.gander@caa.co.uk.

Summary and introduction

This document sets out the CAA's decision to modify the NERL licence and implement price controls following consultation under section 14 of the Transport Act 2000 (the Act). The Competition and Markets Authority (CMA) has informed us that it is content that the modifications notified to it on 18 November 2020 and set out below are those needed to remedy or prevent the adverse effects specified in its final report to the CAA in July 2020.

In autumn 2019, NERL rejected the CAA's proposals for new RP3 price controls and these matters were referred to the CMA to determine.

The significant impact on aviation of Covid-19 became apparent in spring 2020, after the CMA had conducted its substantive analysis on the RP3 reference. In response to a CMA consultation, the CAA, NERL and some other stakeholders suggested that the CMA could not reasonably take account of the impact of Covid-19 in its final report, as there would still be material uncertainty in relation to these matters.

The licence modifications in this document reflect:

- the CMA's final report to the CAA (which was substantively based on its pre-Covid-19 analysis but to reflect the ongoing uncertainty, the CMA determination covered only the period 2020 to 2022 inclusive, rather than the full five years of RP3 – 2020 to 2024);
- throughout our RP3 work programme we have been clear that NERL should have a key role in supporting the development and implementation of airspace modernisation in the UK. While the context has changed as a result of Covid-19, there remain benefits from an appropriately scoped strategy and programme. We are introducing a new licence condition to oblige NERL to set-up and manage an Airspace Change Organising Group (ACOG) and develop an airspace change masterplan; and
- a number of minor changes to NERL's licence to improve the clarity of certain obligations on NERL, created by the licence.

Our consultation on these modifications ended on 21 October 2020. We received three responses to our consultation. The respondents raised some questions and points on the clarity of our proposed Conditions and guidance. We have taken these into account in producing the revised Conditions and guidance in this document. Overall, however, respondents raised no points that have caused us to make substantial changes to our suggested modifications or guidance.

Introduction

1. NERL is the monopoly provider of en route and certain approach air traffic services (ATS) in the UK. NERL is currently subject to economic regulation of its en route services both under the European Union Single European Sky (EU SES) performance scheme, and the Act and licence conditions. We are required by the performance scheme regulation to set targets and incentives for NERL with regard to four key performance areas – safety, capacity, environment and cost efficiency – over five-year reference periods. The targets and incentives are part of the UK Performance Plan for RP3 and also inform the price control on NERL's en route activities as set out in its licence. It is currently expected that when the implementation period for the UK's exit from the EU ends, the Air Traffic Management (Amendment etc.) (EU Exit) Regulations 2020 will disapply the EU SES performance scheme regulation and so our economic regulation of NERL will be based solely on the provisions in the Act and the CAA's licencing scheme. Where the UK and EU make an agreement encompassing ATM, we will need to consider what steps, if any, are appropriate to align the current regulatory framework with the agreed regulatory framework. NERL's licence also includes a separate five-year price control for its charges for ATS for flights through airspace over parts of the Atlantic Ocean (Oceanic service).
2. The current Reference Period (RP3) started on 1 January 2020 and will end on 31 December 2024. On 29 August 2019 we published our price control decisions for NERL in the UK Performance Plan and Oceanic charges for RP3.¹ These decisions (our "RP3 decision") were rejected by NERL² and on 19 November 2019 we referred the matter to the Competition and Markets Authority (CMA) under section 12 (s.12) of the Act for resolution.³
3. On 23 July 2020 the CMA sent us its final report on the reference.⁴ The CMA said that the price control licence modifications should:
 - allow an appropriate remuneration of NERL's investments, properly reflecting the risks to which investors are exposed;
 - provide NERL with financial resources to achieve airspace modernisation while maintaining reasonable pressure to continue to deliver operational efficiencies;

¹ [CAP 1830 – 'UK RP3 CAA Decision Document' \(August 2019\)](#)

² [NATS \(En route\) Plc/CAA Regulatory Appeal – Final Report \(August 2020\)](#) – paragraph 2.65, page 30

³ [NATS En route Limited \(NERL\) Price Determination case page on CMA website](#)

⁴ [NATS En-route PLC/CAA Regulatory Appeal – Final report \(August 2020\)](#)

- provide appropriate incentives to protect the quality of service to airspace users;
- strengthen NERL's accountability for carrying out its investment plans by putting in place appropriate incentive arrangements and encouraging NERL to develop new and improved governance arrangements; and
- provide for technological enhancements in the Oceanic service necessary to create safety benefits.

4. The CMA determined that NERL's licence should be modified to provide:

- new price controls for NERL's Eurocontrol, London Approach and Oceanic services for three years from 2020 to 2022. The Oceanic price control allows NERL to recover the costs of using newly-introduced satellite surveillance data;
- an enhanced role for the Independent Reviewer (IR) of NERL's capital expenditure (capex);
- quarterly updates on NERL's Service and Investment Plans (SIPs);
- a new capex efficiency incentive, with reference to a regulatory policy statement (RPS) on its operation; and
- a new capex engagement incentive, with reference to CAA guidance on its operation.⁵

Licence modifications

5. Having regard to the CMA's final report, on 24 September 2020 we consulted on the modifications to the licence conditions that we considered would remedy or prevent the adverse effects specified in the final report, including:

- Condition 10 – Business Plans, Service and Investment Plans and Periodic Reports. This Condition sets out capex governance requirements on NERL;
- Condition 21 – Control of Eurocontrol Service Charges;
- Condition 21a – Control of London Approach Charges; and
- Condition 22 – Oceanic Charges.

6. We also consulted on:

⁵ The CMA set out the licence modifications it expected us to make in appendix F of its final report

- a proposal to introduce a new condition to NERL's licence establishing processes and procedures to coordinate airspace modernisation (Condition 10a – Airspace modernisation); and
- some minor licence modifications to improve the clarity of certain obligations created by the licence.

Guidance

7. In its final report, the CMA said that it would be appropriate for the CAA to set out its approach to the capex efficiency incentive and capex engagement incentive in a RPS and guidance. Furthermore, the CMA noted that these should be available in draft at the same time as we consulted on Condition 10. While not subject to the statutory provisions of the Act with respect to consultation, in the September consultation we also sought stakeholder views on:
- the draft RPS for the capex efficiency incentive; and
 - the capex engagement incentive draft guidance.

Legal framework

8. The statutory requirements and processes for modifying NERL's licence are set out in the Act. The requirements and processes are different for those modifications that relate to the reference to the CMA.

Licence modifications following a reference to the CMA – implementation of CMA determination

9. Under s.14(2) of the Act, following receipt of the CMA's final report, we must suggest such modifications of the licence conditions as we consider are needed to remedy or prevent the adverse effects specified in the final report. Under s.14(3) and (4) of the Act, before making the suggested modifications, we must have regard to the modifications specified in the CMA's final report and publish a notice setting out our suggested modifications, stating their effect and the reasons for proposing them, and stating a period of not less than 28 days within which representations may be made regarding the suggested modifications. Our consultation commenced on 24 September 2020 constituted the notice "s.14(4) notice").
10. Following this consultation, under s.14(5) of the Act we are required to give notice to the CMA ("s.14(5) notice") setting out our suggested modifications to

implement its determination and the reasons for the suggestions. We must also send the CMA any representations made in response to the s.14(4) notice.

11. Under s.15(2) of the Act the CMA may direct us not to make any or some of the suggested modifications notified to the CMA in the s.14(5) notice, but it may do so only if it thinks the modifications set out in our notice are not modifications which are needed to remedy or prevent the adverse effects specified in the CMA's final report. If the CMA does not direct us, we must make the modifications as set out in the s.14(5) notice.
12. If the CMA directs us not to make some of the modifications suggested in the notice, we must comply with this direction but we must make any remaining modifications to which the CMA's direction does not apply and were included in the notice.
13. If the CMA directs us not to make any or some of the suggested modifications, the CMA shall, under s.16(4) of the Act, publish a notice inviting representations on such modifications it thinks are needed to remedy or prevent the adverse effects specified in its final report. The CMA must, taking account of any representations it receives, then make such modifications to the licence conditions as it thinks are needed to remedy or prevent such adverse effects as are specified in its final report.

Other licence modifications – airspace modernisation and modifications to improve clarity

14. Under s.11(1) of the Act we may modify the conditions of a licence if its holder consents to the modifications. NERL agreed to the modification proposed to introduce Condition 10a and to the minor changes summarised in chapter 3 of the September consultation.
15. Under s.11(2) and (3) of the Act, before making modifications to a licence the CAA must publish a notice setting out the proposed modifications, their effect and the reasons for the proposal. The CAA must also state the period (of no less than 28 days) within which representations may be made regarding the proposed modifications. The September consultation document constituted such a notice.

CMA decision on our suggested modifications and next steps

16. On 18 November 2020, as required under s.14(5) of the Act we gave notice to the CMA setting out our suggested modifications to implement its determination and the reasons for the suggestions. We also sent the CMA the representations made in response to the s.14(4) notice. The CMA had until 16 December 2020 to direct us not to make any of our suggested modifications. On 30 November 2020, the CMA informed us that it would not be sending us any direction and that it was content that our suggested modifications are those needed to remedy or prevent the adverse effects specified in its final report to the CAA in July 2020.
17. We are now modifying NERL's licence by making the modifications to implement the CMA's final report, introducing the new Condition 10a as set out in chapter 2 of this document and making the modifications to improve clarity as set out in chapter 3 of this document.
18. After taking account of representations to our September consultation, we have made changes to two of our proposed modifications that are unrelated to the CMA's final report. NERL has consented to these modifications, which are to the definition of the business plan renewal date in Condition 10(18) and to a paragraph concerning operating leases in Condition 5(29).

Structure of this document

19. The structure of this consultation document is as follows:
 - chapter 1 discusses the responses to the September consultation on how we should modify NERL's licence to take account of the findings in the CMA's final report and determination and sets out our proposals on the way forward;
 - chapter 2 discusses the responses to the September consultation on how we should modify NERL's licence to take account of airspace modernisation and sets out our proposals on the way forward;
 - chapter 3 discusses the responses to the September consultation on how we should modify NERL's licence for the minor changes to improve clarity and sets out our proposals on the way forward;
 - chapter 4 deals with stakeholder comments on our draft RPS in relation to capex efficiency;
 - chapter 5 deals with stakeholder comments on our draft guidance for the capex engagement incentive;
 - appendix A sets out the revised licence conditions relating to the CMA's final report and determination;

- appendix B sets out the new licence condition and accompanying guidance in respect of airspace modernisation;
- appendix C sets out the minor licence modifications to improve clarity;
- appendix D sets out our RPS on the application of the demonstrably inefficient and/or wasteful capex incentive; and
- appendix E sets out our guidance on the application of the capex engagement incentive.

Chapter 1

Licence modifications to implement the CMA's determination

- 1.1 The modifications we consulted on in September to remedy or prevent the adverse effects specified in the CMA's final report and the representations we received on them are summarised below. We also explain any changes that we have made to the proposed licence modifications, in light of representations received. These modifications are designed to implement the CMA's determination (and achieve the outcomes set out in paragraph 3 of this document). Full versions of the modified conditions are in appendix A.

Condition 10 – Business plans, service and investment plans and periodic reports

Proposed licence modifications

- 1.2 In our September consultation we proposed to modify Condition 10 to:
- Require NERL to send us and users quarterly updates on its service and investment plans (SIPs) by the end of April and October each year.
 - Introduce a financial incentive on the efficiency of NERL's capex. The incentive shall be based on whether any of NERL's capex has been demonstrably inefficient and/or wasteful. The assessment shall be carried out following criteria in an RPS we produce. Any penalty shall be applied in the following regulatory period.
 - Introduce a financial incentive based on the quality of NERL's engagement with users on its capex programme. The incentive shall be based on the following assessment criteria:
 - timeliness;
 - user-focus;
 - proportionality;
 - optioneering;
 - responsiveness; and
 - mitigating/corrective actions.

- Specify that the process we would use to assess NERL's performance against the incentive shall be set out in guidance we publish and specify that any financial penalty should be related to NERL's return on equity on its actual capex in the reference period.
- Expand the role of the Independent Reviewer's (IR's) to include:
 - assessing whether NERL has sufficiently explained and justified its capex in its SIPs;
 - assessing and proposing scores for NERL's engagement with users against the criteria in the engagement incentive and published guidance;
 - tracking and assessing NERL's progress in delivering its capex programme and achieving the associated benefits; and
 - reporting on the cost efficiency of NERL's capex and its implementation.

1.3 Additionally, we proposed to modify Condition 10 to:

- Put back by one month the dates by which NERL has to submit SIPs and interim SIPs each year to 31 January and 31 July.
- Delete outdated requirements for NERL to produce detailed and outline technology programmes, a detailed airspace programme and an outline of options for implementing lower level airspace changes in London terminal airspace. These dates were specific to Reference Period 2 (2015-19).

Representations

1.4 We received the following representations on Condition 10:

- a) BA welcomed the increased role of the IR and the introduction of quarterly SIP updates.
- b) BA noted that the definition of the Plan Renewal Date of 1 January 2015 and every fifth anniversary did not appear to dovetail with the need for a new price review commencing 1 January 2023.
- c) IATA thought that the Independent Reviewer's role could be expanded to include whether NERL was providing a full ADS-B based Oceanic service.
- d) In response to our draft guidance, NERL said that the engagement incentive should only apply to capex begun after 1 January 2021.

CAA views on representations

1.5 The representations did not include any substantive comments on our proposed modifications. Our responses to the individual points are:

- a) We welcome BA's support for the increased role of the IR and for quarterly SIP updates.
- b) We agree that the current definition of the Plan Renewal Date does not include provision for price control reviews that do not coincide with the 5-year regulatory periods. As there may be benefits in shorter regulatory periods and the CMA determination set a price review covering three years, we consider that the definition should give us discretion to require NERL to provide Business Plans at other dates we reasonably specify. We will consult NERL before specifying another date.
- c) As noted in para 1.18(d) below we do not consider that there is significant uncertainty as to whether NERL is providing a full ADS-B service and so do not regard this as something that is appropriate for the IR to consider.
- d) The engagement incentive should commence on 1 January 2020 in line with the price controls, but we agree that it should apply to capex begun after 1 January 2021. This is because the guidance has not been in place so the expectations on NERL have not been clear until now. It is particularly important in light of the need for NERL to significantly review its capex plan because of the effects of Covid-19. Nonetheless, it will also apply to capex projects that began before that date that are subject to material changes after that date.

Licence modifications

1.6 After taking account of representations, we are making the modifications suggested in the September consultation, plus the following further minor clarification:

- Condition 10 (8) will start "From 1 January 2021, the Licensee..."; and
- modifying the definition of Plan Renewal Date in Condition 10(14) to:
 - means 31 December 2020, or such other date as the CAA shall reasonably specify after consultation with the Licensee, and every fifth anniversary thereof".

1.7 The modified Condition 10 is in Appendix A.

Condition 21 – Control of Eurocontrol service charges

Proposed licence modifications

- 1.8 In our September consultation, we proposed modifying Condition 21 to implement the CMA's control on Eurocontrol charges for 2020-22, including the level of determined costs, target values for the C1, C2, C3 and C4 service quality incentives, the number of exemption days for the C4 incentive and target values for the 3Di environmental incentive. We also proposed adding terms to return Innovation and Networks Executive Agency (INEA) funding and any unspent portion of the Future Airspace Strategy (FAS) Facilitation Fund to users and updating the list of exemptions from the C3 and C4 capacity incentives.

Representations

- 1.9 We received the following representation on Condition 21:
- a) NERL noted that we stated that we intended to enable it to recover the revenue difference between the CMA's decision and our decision on revenues for 2020 through our interim RP3 review. It suggested that including these adjustments in the price control decisions in the Licence for 2021 (or even 2022) would be the clearest way of establishing this intention and a clear baseline on which future consultations could be based.

CAA views on representations

- 1.10 In our next price control review we will consider how best to allow for any revenue corrections for 2020, given the extraordinary impact of Covid-19 on aviation. As set out in our September consultation, in conducting this assessment our assumption on the charges that NERL would have been entitled to recover will be the assumptions set out in the CMA's final report. We regard this as a clear policy position and do not consider that a licence modification would bring further clarity to these matters and so do not intend to modify the licence modification drafting to take account of these matters.

Suggested modifications

- 1.11 Bearing the above in mind we are making the licence modifications to Condition 21 set out in the September consultation. The modified Condition 21 is in Appendix A.

Condition 21a – Control of London Approach charges

Proposed licence modifications

- 1.12 In the September consultation, we proposed modifying Condition 21a to implement the CMA's determination for London Approach charges in 2020-22,

including determined costs and adding an 'other revenues' term to adjust for revenues collected from Biggin Hill.

Representations

1.13 We received the following representations on Condition 21a:

- a) As mentioned in paragraph 1.9(a) NERL said that we should include the difference between the CMA and our decision for 2020 in the licence.

CAA views on representations

1.14 As set out in paragraph 1.10 above, we do not consider it appropriate to modify NERL's licence in respect of these matters.

Suggested modifications

1.15 We are making the licence modifications set out in the September consultation for Condition 21a. The modified Condition 21a is in Appendix A.

Condition 22 – Oceanic charges

Proposed licence modifications

1.16 In the September consultation, we proposed modifying Condition 22 to implement the CMA's determination for Oceanic charges for the period 2020 to 2022, including:

- moving from one Oceanic charge to separate charges for transatlantic flights ("Atlantic flights") and flights through the eastern Atlantic area bordering Ireland, the UK, France, and Spain ("Tango flights");
- adding a charge for the use of satellite-based ADS-B data, with separate charges for Atlantic and Tango flights;
- introducing a requirement that NERL can only levy ADS-B data charges if it has certified that it is operating a fully ADS-B based service to 99% of all flights in the oceanic area; and
- establishing a requirement for NERL to commission an independent review of whether the benefits of providing ADS-B outweighed the costs of provision. The review should take place no less than two years and six months after NERL has certified it is providing a full ADS-B service.

Representations

1.17 We received the following representations on Condition 22:

- a) As mentioned in paragraph 1.9(a) NERL said that we should include the difference in revenues between the CMA and our decision for 2020 in the licence.

- b) IATA questioned whether the charges formulae correctly implemented the CMA's determination on correcting charges for differences between forecast and actual traffic levels in 2020 and 2021.
- c) BA and IATA asked some questions about NERL's certification of whether it was providing a full ADS-B service:
 - Over what period is the 99% measured?
 - What does being provided with a full ADS-B service mean? BA said it should not include compromised or degraded service levels, which do not enable full application of the reduced separation standards ADS-B enables, and it should include the filing of user preferred routes.
 - If there is a lack of regulatory approval, for instance if ICAO withdraw the relevant approval, then can ADS-B be considered fully available?
- d) IATA also asked whether there should be an independent assessment of whether NERL was providing a fully ADS-B based service. It suggested that this might be a task for the Independent Reviewer.
- e) NERL said that as ADS-B measures were yet to be agreed between it, the CAA and users, it was unclear what benefits would form part of the independent review. It suggested that the that the review should be of its performance against measures agreed with users and the CAA, rather than whether the benefits of providing a full ADS-B based service outweighed the costs.
- f) BA said that the independent review did not appear to be a particularly strong incentive. It asked:
 - By when must the report of the review be delivered? It said that airlines should be consulted prior to any agreement by the CAA to delay the timeframe for the delivery of the report.
 - Whether the scope, form and level of detail (at least), if not the full terms of reference for the review, could be specified more tightly in the Condition?
- g) BA noted that the CMA:
 - Agreed with a need for the review to be concluded earlier than the end of RP3.

- Was satisfied that further detail on the scope and approach, including the potential outcomes, of the review would be provided in the near future.
- Recommended that the CAA, NERL and users should define more precisely the approach to be taken and that there should be a clear understanding of how the review would operate before it started. Furthermore, that it was important that airlines would be able to participate by providing reliable information on the flight efficiency changes that had occurred in practice.

CAA views on representations

1.18 In summary our responses to these representations are:

- a) NERL's point on revenues is dealt with in paragraph 1.10 above.
- b) We have checked the charges formulae and remain of the view that they correctly implement the CMA's determination.
- c) We consider that:
 - NERL should only certify that it is providing the service, if it expects that it will be providing the service to 99% of flights for the foreseeable future. If the service is not provided to a flight after it has provided a certificate, it should not charge that flight for the service. If NERL does not provide a service for 99% of flights for an extended time period (i.e. three months), it would need to provide a new certificate when it returns to providing a service to 99% of flights.
 - NERL would not be providing a full service, if its service included any significantly compromised or degraded service level, which would not allow the full application of the reduced separation standards that ADS-B is designed to enable. A full service should also include the filing of user preferred routes.
 - We note that while ICAO could make recommendations about the use of ADS-B it cannot itself mandate whether NERL could or could not provide the service.

- d) We consider that only NERL will know whether it can provide a fully based ADS-B service, so it should self-certify whether it is providing the service. Any independent assessment would have to rely on NERL to provide that information.
- e) The impact of Covid-19 has been to reduce transatlantic traffic to a very low level. As the reduced levels are continuing it is unlikely that measures of the effects of the introduction of ADS-B would produce meaningful data at present. Although this may delay work on the measures, it does not mean that we should alter the scope of the review or how this scope is specified in the licence modification. The review should involve consideration of both NERL's performance and whether the benefits of using ADS-B outweigh the costs of provision.
- f) When we made our RP3 decision in August 2019, our intent was that the independent review should report within two years and 6 months of NERL certifying it is providing a full ADS-B service. However, the usefulness of the review will depend on traffic levels in the period that the review covers and at present it is uncertain what the traffic levels will be in the coming years. If traffic remains at current levels over that period, we may need to reconsider the usefulness of any review at that milestone. However, it would be premature to revise the date of the review at present. In paragraph 9 of the draft Condition 22, consulted on in September, we gave ourselves and NERL the discretion to agree a different date for the review. We will consult users before deciding whether we should agree a different date. Given the current uncertainty, including the form, scope and level of detail of the review would also be premature, and we do not consider it would be sensible to constrain these details of the review by including them in the licence.
- g) We can confirm that we will discuss the form, scope and detail of the review with NERL and users and that there will be a clear understanding of how the review will operate before it is started. While we are not defining the arrangements for the review now, we are clear that reliable data and comments from airlines on their experience of using the ADS-B service will be an important part of the review.

Suggested modifications

- 1.19 We are making the licence modifications set out in our September consultation for Condition 22. The modified Condition 22 is in Appendix A.

Chapter 2

New Condition 10a: Airspace modernisation

- 2.1 A key strategic consideration in our RP3 decision was to enable NERL to support the implementation of the UK's Airspace Modernisation Strategy (AMS) to modernise critical national infrastructure and deliver a broad range of benefits to consumers, the aviation industry and local communities. We and the Department for Transport (DfT) co-sponsor airspace modernisation through setting the overall strategy and governance for the programme.
- 2.2 NERL's roles in supporting the AMS include:
- To develop a coordinated implementation plan for airspace changes (an airspace change masterplan) in the UK; and
 - To create a coordination group (the Airspace Change Organising Group (ACOG)).
- 2.3 While the context for airspace modernisation has changed as a result of Covid-19, there remain benefits from appropriately scoped strategy and programme. In our September consultation we included a draft new licence Condition 10a to underpin requirements on NERL. The draft condition set out our expectations of NERL to establish, maintain and manage ACOG, and create and maintain an airspace change masterplan.

Provisions in proposed Condition

- 2.4 In our consultation we proposed the following provisions in draft Condition 10a:
1. NERL to establish, maintain and manage ACOG;
 2. NERL to create and maintain UK airspace change masterplan;
 3. Masterplan must be consistent with the CAA's AMS, meet criteria set by the CAA and DfT, comply with any requirements or guidance from DfT or the CAA, and take into consideration stakeholder views;
 4. Masterplan to be assessed and accepted by the CAA in consultation with DfT;
 5. NERL to make changes to masterplan as reasonably proposed by the CAA;
 6. NERL to update masterplan as reasonably requested by the CAA;
 7. NERL to prepare and submit to the CAA airspace change proposals (ACPs) related to the airspace for which it provides en route air traffic control services. The requirement for these ACPs may be identified in the masterplan or other work undertaken by NERL in its activities under the licence;

8. NERL may provide support to ACPs proposed by other bodies with the agreement of the CAA;
9. NERL to report to the CAA progress against the masterplan by 1 November in each year and on request; and
10. NERL to be responsible for other activities identified in the masterplan which it is required to undertake under other legislation.

Representations

2.5 We received the following representations on Condition 10a:

- a) BA and IATA supported Condition 10a, which they regarded as a critical enabler to ensure steady progress is made on delivering the upgrades in the AMS. IATA disagreed that the impact of Covid-19 on traffic levels had reduced the urgency of the need for airspace modernisation.
- b) BA said we needed to ensure that ACOG maintains its independence, allowing the independence and impartiality of ACOG's Steering Committee to continue, and providing the best possible assurance that the masterplan is being delivered.
- c) IATA asked for clarity on:
 - the timelines for the creation of the masterplan and the approach to engagement with airline stakeholders during the development phase;
 - the management of conflicting priorities if airline customer requirements (expressed through the SIP process) did not align with specific upgrades required by the AMS; and
 - the management of funding, resources and opportunity costs should NERL be asked to revise its investment plan by the CAA to assist other stakeholders in their airspace changes at the expense of commitments made to airlines.
- d) IATA requested that the international airline community be offered representation within the governance arrangements that oversee ACOG's activities.

CAA views on representations

- 2.6 While the representations raised important points of context and policy, they did not include any substantive comments on our drafting of the licence modification. Our responses to the points raised is summarised below:
- a) We welcome BA and IATA's support for Condition 10a.
 - b) Condition 10a, and the accompanying guidance, explicitly require the establishment of ACOG as a separate and impartial unit within NERL, as well as establishing the Steering Committee to oversee ACOG's work.
 - c) In respect of IATA's comments:
 - Activities to progress the timelines for the creation of the masterplan and associated engagement are currently paused while the impact of Covid-19 is considered, in particular while airspace change sponsors consider their next steps. ACOG is engaged with co-sponsors on what will be required to resume the timely development of the masterplan.
 - In our further work on the RP3 price control we will seek to provide NERL with sufficient flexibility to meet the reasonable requirements of the AMS and the needs of users. If funding constraints were to create a conflict between airspace user priorities and AMS implementation requirements it would be for NERL to work with interested stakeholders – including AMS co-sponsors and airspace users – to work constructively to find a suitable way forward.
 - d) Condition 10a establishes the requirement for at least one airline representative on the Steering Committee, as well as other independent members with appropriate experience. In conjunction with the Chair of the Steering Committee, it will be for airspace users to determine the most appropriate representative and for that representative to engage with other airspace users as appropriate. The ACOG governance arrangements also require structured engagement with a broad range of stakeholders, which will provide an opportunity for IATA and airspace user representatives to engage on ACOG's work.

Decision on Condition 10a

- 2.7 We will add Condition 10a to the licence as set out in our September consultation. Condition 10a is in Appendix B.

Chapter 3

Minor licence modifications to improve clarity

- 3.1 The September consultation included some minor modifications to improve clarity of NERL's obligations under its licence. In particular, these concerned the target level of gearing in Condition 5(26)(b)(ii), deleting a paragraph on leasing in Condition 5(28) and adding a definition of finance leases in Condition 5(29).

Representations

- 3.2 NERL agreed with us that the paragraph on operating leases in Condition 5(28) starting "At the time of the inception" is out of date. However, it disagreed that the whole paragraph should be deleted. Instead it said that as part of the paragraph remained relevant it should be retained and rephrased. Otherwise there would be a risk that the treatment of financial indebtedness would be misinterpreted.

CAA views on representations

- 3.3 We agree with NERL that part of the paragraph remains relevant and provides clarity on the treatment of operating leases in the definition of financial indebtedness used in the licence. We have agreed with NERL to replace the current paragraph with the following: "For the duration of the charge controls set out in Conditions 21, 21a and 22, the definition of Financial Indebtedness under the licence has not changed. This definition excludes liabilities relating to leases which were previously classified as operating leases but which have generally been classified as debt since 1 April 2019 as a result of a change to the accounting treatment of operating leases."

Decision on modifications to improve clarity

- 3.4 We will make the modifications to improve clarity of NERL's obligations, as set out in the September consultation, apart from the paragraph on operating leases in Condition 5(28) which we will modify as set out in paragraph 3.3 above.

Chapter 4

Regulatory policy statement (RPS) on capex efficiency

- 4.1 In its determination the CMA said that NERL should be subject to a financial incentive based on its capex efficiency. The CMA also said that we should publish policy on how we would apply the incentive to provide NERL with sufficient safeguards with respect to its application. In our consultation we invited comments on a draft RPS on the capex efficiency incentive.
- 4.2 This chapter summarises the draft RPS, the views of respondents and our decision on the guidance.

Proposed RPS

- 4.3 We proposed that NERL's capex should be assessed according to whether it was Demonstrably Inefficient or Wasteful (DIWE). This test would be similar to the arrangements for assessing the capex efficiency for Northern Ireland Electricity and previously endorsed by the CMA. We set out the draft RPS for consultation which explained the principles and procedure we would expect to follow in determining whether any of NERL's future capex should not be included in its RAB.

Representations

- 4.4 We received the following representations on the draft RPS:
- a) NERL said that the RPS was unclear on how we would decide whether expenditure was DIWE if there was no user consensus on whether it was required.
 - b) BA welcomed the RPS and encouraged us to draw on experience from our regulation of Heathrow Airport, other aviation entities and other regulated sectors to ensure that best practice is implemented to create clear efficiency incentives for NERL.
 - c) BA said that the DIWE test was a useful model to use although noted that the definition of efficiency was open to interpretation in the context of capex.
 - d) BA noted that assessments of capex efficiency in other regulated sectors typically incorporate a used-and-useful test or some form of assessment of the value of the assets created by capital programmes.

- e) BA also noted that any DIWE assessment may not take place for many years after projects commenced. As a result, it would be critical to ensure that the *ex post* assessment could make informed assessments based on quality information, as there is potential for inefficiencies to be hard to identify many years after decisions and processes have been undertaken.
- f) BA welcomed the strengthened role of the IR, especially where this would enable airlines to gain greater visibility and oversight of capex projects.

CAA view on representations

4.5 In summary our responses to the above points are:

- a) As we noted in paragraph 7 of our draft RPS while user support is desirable it is neither a necessary or sufficient condition in deciding on DIWE. We will take account of user support in our assessment and it will be an important factor, but we will also consider the full range of circumstances that NERL faced in making decisions on its investment and any information it provides that supports the efficiency of its spending.
- b) We will draw on wider experience and evidence, to the extent it appears relevant in our assessment of DIWE.
- c) Paragraph 13 of the RPS sets out factors that we will consider in our assessment of DIWE and so provides further guidance on how we will define efficiency.
- d) We will use concepts such as the used-and-useful test if they appear at the time to reasonably support an assessment of DIWE.
- e) We agree with BA that the longer an assessment of whether capex is DIWE is from the commencement of a project the harder it may be to identify inefficiencies. To ensure that NERL produces ongoing quality information on its capex, the IR will review the timeliness and accuracy of NERL's reporting and its explanation and justification of its capex in its SIPs. Part of this review will be about NERL's explanation of variations in the ongoing costs of its projects.
- f) We agree that the strengthened role of the IR will be important in ensuring that users have greater visibility of progress on projects.