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Luton, March 10, 2022

easyJet comments on the proposed NERL business plan for NR23

Dear Sir/Madam,

We are writing to set out easyJet's views on the business plan submitted by NERL to the CAA for the next price control period NR23.

We welcome NERL and the CAA's decision to disapply the automatic application of the traffic risk sharing (TRS) mechanism for 2022 and an extension of the payment terms to NR28.

However, the proposed provisions are insufficient to promote a sustainable aviation sector recovery as they fail to achieve affordability of charges in NR23. We do not believe that an increase of +38% of the en-route rate in 2023 against pre-pandemic levels for an essential facility is proportional or justifiable.

Higher costs for users could be justified only by higher service performance. Users should not be responsible for financing NERL's losses. These losses should not be treated in the context of the TRS mechanism, which protects NERL against commercial decisions of airlines (and not a global pandemic). The unprecedented fall in demand was due to national and international restrictions and travel bans, rather than airspace users' commercial decisions.

For this reason, we reiterate our position on the recovery of the shortfalls 2020-22:

- NERL should not seek to recover the entire shortfall in revenue from 2020-22. The application of the TRS mechanism should at least be partial, meaning that NERL also absorbs at least 50% of its own losses;
- State-funding should be the primary source for sustaining the revenue shortfalls;
- Access to the debt market (as outlined in paragraph 2.16 of CAP 1994) should be investigated and consulted transparently with airspace users;
- Any use of shareholder's funding, as referred to in paragraph 1.15 of CAP 2245, should not result in airlines absorbing the COVID-related losses of NERL;
- NERL should dynamically modulate the losses, so that higher amounts are distributed in later years, when traffic is able to absorb them; and
- The TRS debtor amounts should not be included in the RAB and in the Cost of Capital.

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We have set out below our specific comments on NERL's business plan:

1. Determined Costs

We appreciate NERL's initiatives on cost-containments in response to the pandemic. However, we do not believe that the proposed cost savings in NR23 against pre-pandemic levels go far enough. NERL's total determined costs are flat on average in NR23 against 2019, while the traffic is forecasted to be -2% lower than 2019 levels on average in NR23. In 2024, NERL's total determined costs will be +2% above 2019 levels, when traffic will be at -3%.

1.1 It is critical that NERL looks to lower its cost base through efficiencies and lower annual expenditures – as much as airspace users. We would expect to see continuous cost monitoring, as well as continuous efforts on reduction of staff requirements and rationalising infrastructure.

1.2 As agreed, we await the CAA to establish an appropriate baseline for efficient costs in 2022, that would offer useful guidance to adjust NERL's costs in NR23 at an efficient level.

1.3 In relation to NERLs' proposals on Regulatory Depreciation, we support a depreciation deferral of £108m as initially suggested by NERL. This would help lowering prices for users in critical recovery years.

1.4 In relation to the Regulatory Return, we do not support NERL's proposal that the full cost of capital be applied to the TRS debtor in addition to the underlying RAB. This would effectively enable NERL to make a profit from a loss. We believe that NERL should follow other ANSPs (such as DSNA or DFS) and waive the regulatory return related to the TRS debtor.

1.5 We have concerns with NERL's focus on ENAV and four European airports (AdP, AENA, Fraport and Zurich Airport) as the main comparators for its WACC estimation. This is because airports tend to have less revenue protection than ANSPs, and thus a different risk profile. NERL provides a public interest service with the power to increase unit rates above prices that would exist in a competitive market. NERL also has the right to be compensated for any revenue losses by applying for an increase in unit rates as per TRS mechanism. For this reason, we believe that it is more appropriate for NERL to use a larger sample of peers to estimate the WACC. We advise to include other peers, mentioned in the report from Oxera, such as Copenhagen and Wien Airports, and other non-aviation comparators, such as the National Grid ESO or SONI in the set of comparators for NERL's WACC.

1.6 Finally, in relation to OpEx, we believe that further opportunities should be sought in NR23, to reflect any changes to working practices that might result from the pandemic. Regarding staff costs, NERL does not provide any justification for a stable average wage profile in real terms across NR23 despite an expected high turnover (29% of ATCOs expected to retire over NR23). We are equally concerned by an unjustified increase in headcount and wages of support staff. We also expected to see further reductions in non-staff costs, which will be 3.6% higher than 2019 on average in NR23. We request permanent, and not just temporary measures for NERL, in order to adapt and lower operational costs to the new normal.

2. Pricing

2.1 We do not support the proposed flat pricing profile throughout NR23. Instead, we propose a price profiling that includes 0% increase in en-route prices in 2023, while linearly growing in later years of NR23.

2.2 We support the proposed 10-year recovery of the 2020/21/22 carry-overs, but equally spread in NR23 and NR28 (instead of the proposed respective 75% and 25%).

3. Traffic Risk Sharing Mechanism in NR23

3.1 We support the initiative to update the TRS mechanism in NR23 in order to prevent the serious consequences for airlines caused by the existing provisions. However, we would reiterate that airlines share a general objection to users funding TRS.

3.2 We support the extension of the payment terms where variations are between -10% and -30% below forecast and the postponement of the recovery of these revenues over 2 years in N+3 and N+4. However, we suggest increasing the level of the lower bound (from -30% to -50%) to increase the scope of this provision and provide more regulatory certainty.

3.3 Finally, we support maintaining the existing mechanism when traffic is above forecast, so that airlines can benefit from a reduction in charges in year N+2.

4. Traffic

The adopted forecast will have consequences both on the pricing and the performance targets. NERL needs to ensure appropriate levels of service in light of a higher expected traffic than the one proposed.

4.1 We support the use of the independent sources of forecasts, such as the one offered by STATFOR. In the context of great uncertainty as demand recovers after COVID-19, STATFOR has an established track record for accuracy. However, we also believe that intelligence from airlines could further help in assessing local variations. For example, the adopted base case scenario of October 2021 from STATFOR does not accurately reflect the historically higher traffic growth rates in the UK, compared to the rest of Europe. We believe that the UK could eventually return to outperform EU growth rates after 2023. For this reason, we would suggest that the adopted forecast is set using the midpoint between the high case and the base case forecast published by STATFOR in October 2021.

4.2 Stability for targets and pricing throughout the plan is also needed. We are concerned that possible unjustified yet frequent reassessment of NERL's plan in light of new updated traffic forecast during NR23 could mean compromising NERL's (and airlines') planning capabilities.

5. Operational Resourcing

We understand NERL is currently training to maximum capacity after having stopped training activities from 2020 until March 2022. There is a risk that current and expected ATCOs' supply might not be able to meet traffic demand in 2023 and 2024 during summer months. This is particularly true in the case of a traffic forecast higher than the base case scenario proposed.

5.1 We are concerned that too high ATCOs' requirements and costs has been assessed by NERL for NR23. NERL has been conservative regarding ATCOs' productivity assumptions for NR23, despite considerable past and future investments in flexible and modern airspace operations. Equally, overtime has not been used as part of the resource planning.

5.2 NERL's experienced ATCOs are licensed to control multiple airspace sectors with associated capacity/resilience benefits. Their inexperienced replacements will not hold the same number of sector licences. NERL needs to address this gap and the potential impact in the short-medium term.

5.3 NERL must ensure it has the appropriate number of staff to deal with both traffic forecasts uncertainty and expected retirement levels in NR23 and NR38, ensuring the delivery of its proposed service targets.

5.4 NERL should also train at maximum available capacity while finding solutions to reduce training lead times and improve agility in resource planning. We support the proposed investment in ATC synthetic training to avoid capacity shortfalls going forward.

6. Capacity

6.1 We understand the proposed targets for NR23 are slightly better than the targets set for RP3. However, we believe that capacity targets should be set at more ambitious level, in light of the possibility of higher traffic than expected in NR23. We believe better targets can also be reached thanks to a less conservative resource planning.

6.2 The investments and actions deployed pre-2019 to increase capacity according to a pre-covid traffic forecast should allow NERL to set more ambitious targets. At an aggregate level, previously expected UK flights for RP3's 2022, 2023 and 2024 would outperform current forecasts by ca. +6% against the high case and +15% against the proposed base case.

7. Environment

We understand NERL plans a 4.4% CO2 reduction by 2035, achieved by optimising flight paths to reduce airlines' fuel burn and CO2 and delivering airspace modernisation.

7.1 We believe that these targets could be further improved, in line with the expectations of other actors of the industry. easyJet, UK Sustainable Aviation and Single European Sky (SES) targets all point to a 10% reduction in CO2 emissions by 2035 as achievable

7.2 During NR23, we also believe it will be important to update, together with airlines, the 3Di measure, as in the current framework conflicts with flight planning and tactical flight operations priorities might arise.

8. Safety

NERL needs to ensure safety levels are maintained against the background of rising traffic, including the safety implications of new airspace users.

We welcome investments in technology and airspace modernisation to improve safety and help mitigate the effect of increasing traffic over NR23. However, we believe that safety costs for dealing with drones should not be included in en-route charges. Users should only pay for the service they receive themselves.

9. Performance Targets Modulations

We support the proposed target modulations for capacity and environment given the uncertainties surrounding traffic forecasts. This ensures that NERL is appropriately incentivised to deliver capacity and environmental requirements against the traffic. It also avoids windfall gains/losses when traffic deviates from the base forecast used to determine targets.

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10. <u>Capital Investments</u>

We appreciate the efforts made so far by NERL to pause non-critical investments during the crisis and to rescale its NR23 plan against RP3's by -20%. However, users are missing defined monetary benefits for NR23 in the business plan. This makes it very difficult for airlines to assess the plan in light of expected cost-efficiency gains, which should be a priority for NERL in NR23.

It is also difficult to compare past-investments and or to reconcile e RP2 and RP3 investments with the ones proposed for NR23. This information would have helped users to comment more specifically on proposed performance targets and costs evolution over NR23. We would like to see this information set out in more detail during the next Service and Investment Plan (SIP) sessions in NR23.

10.1 We support the proposed 2+5 approach as we believe that engagement with customers on a rolling plan will enable all stakeholders to react to fast-changing market conditions.

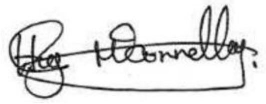
10.2 We believe that the proposed projects on airspace integration and modernisation are key to deliver essential capacity and growth. We endorse all the critical investments that will allow NERL to meet its service targets.

10.3 However, we are concerned that NERL is exposed to a significant number of retiring ATCOs over the next few years and that the level of investment proposed is not enough to mitigate the impact on NERL's service targets.

10.4 We would like to highlight that in addition to drones, space traffic would appear to be posing an increased challenge to the other airspace users in terms of shared airspace usage. Proposals for multiple ground/air launching facilities/airspace are in the pipeline with a number coming into operation within the short term. We are concerned this would conflict with planned airspace efficiency and modernisation initiatives.

We urge the CAA to support the industry's recovery by ensuring affordability of charges and, consequently, to help achieving the UK national ambitions in the aviation sector in terms of sustainability, airspace modernisation and growth. In light of the above, we believe that the CAA should request a revised plan which includes more challenging performance targets, cost-efficiency measures and a more sustainable pricing profile for en-route charges.

Sincerely,



Hugh McConnellogue

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