RP2 Airline Community – Special Interests Paper
Final- Dec 2013

Introduction

The Co-Chairs Customer Consultation Working Group report for RP2 provided CAA with a summary of the respective positions of NATS/NERL and the Airline Community. The Airline Community referenced within the report the fact that it wished to provide the CAA with supplementary material for their consideration in their final assessment for RP2.

This paper covers those areas of special interest and offers additional supporting material that it requests the CAA considers in its deliberations on RP2. A full un-redacted copy of this paper will be made available to NERL.

As made clear in the Co-Chairs report the airlines believe that NATS and CAA have many opportunities to achieve further efficiencies to the UK RP2 business plan with specific focus in the areas of:

- Operational Expenses
- WACC
- Capital Expenditure
- Traffic Forecasting

Incorporating the savings highlighted in the detail below would lead to the NATS business plan achieving price reductions over the RP2 period of approximately 30%, which compares to the offering of the current NATS revised plan of 18% over the period.

As a general comment, the Airline community have been very disappointed and frustrated at the lack of opportunity to examine the output of CAA consultancy work during the period of the consultation, when it would have added most value, nor in the period during which the co-chairs report and this paper were required to be written. Being unable to use the consultants' reports to direct further informed questioning of NATS to relevant issues during the process has severely curtailed the ability of the airlines to come to a fully informed position supported by detailed evidence. The airlines view this situation as most regrettable and both cause and impact needs to be addressed by the CAA.

If the CAA require any further clarification or discussion on the points raised in this paper we are available for further dialogue as an Airline Community.

Section 1 – Operational Costs

The Airline Community encourages the CAA to consider very carefully the operational cost data that is available to them through the consultancy work and the material presented in this paper on pension costs. We would remind the CAA that any lack of comment from airlines in this report, or the co-chair report, on opex issues raised within the CAA consultancy reports does not indicate any level of support for the NATS operational cost figures, rather the lack of actual evidence that has been available to the airlines to comment on.

NATS has emphasised (at the 04th Sep 2013 meeting) that the cost-efficiency and price reduction figures in their revised plan are very much susceptible to "potential future adjustments" including CAA decisions informed by their consultant studies and its own findings, updates for latest traffic and inflation forecasts, and updates for PRB methodology. In other words what we see is not necessarily what we get, and while this could of course work either way our interpretation was this is a strong caveat.

Our collective view is that whilst NATS have presented a polished case for the figures they have presented during this customer consultation, due to the lack of transparency of finer detail, the airlines have not been convinced that the cost base put forward by in all three plans presented to date is truly representative of where it is and where it should be as an efficiently run business. The airlines believe that this over statement of costs must be adjusted downwards by the CAA in the final settlement. The airlines recognise that in the revised business plan, NATS have made small moves to assuage the airlines feelings on operational costs, however the movements made so far do not reflect the requirements of the Airline Community. Our expectation is therefore, that CAA should adopt a lower operational cost base irrespective of the plan adopted by NATS. In short the Airline Community are looking for the delivery of the revised Business Plan at a lower and more efficient cost.

We would bring to the attention of the CAA the following areas:

1.1 RP2 Operational Cost Challenge and EU targets

The airline community is aware that whilst the EU itself is still remaining committed to the current reduction measures, this is despite a weakening of the recommended targets for cost efficiency advised by the PRB. The latest PRB advice to the EC on cost-effectiveness is to use a determined cost base of EUR 6,133m for the starting point for RP2 instead of the 2014 RP1 end point of EUR 6,179m that we had been hoping for.

For the absolute avoidance of doubt, regardless of the final targets determined by the EU, the airlines involved in this consultation fundamentally do not accept that there should be any reduction in the level of efficiency being asked of NATS for RP2 from the proposals previously tabled by the EU. In fact, we strongly support the recognition by the CAA that setting a settlement that exceeds the EU targets was a real and viable option that NATS must consider as a possibility, as stated in the letter from CAA to NATS, dated 09th Sep 2013, where CAA stated that;

"Subject to customer preferences and evolving traffic forecasts we expect you to plan to meet **or surpass** the rate of reduction likely to be adopted by the EU".

Given that at the 2014 en route unit rate meeting, DfT confirmed that the independent CAA/NSA regulator will be allowed to determine the appropriate targets for the UK, with the understanding that these can be tougher than the EU-wide targets if considered appropriate, we strongly encourage CAA and DfT to follow this path.

We would also draw the CAA's attention to the ongoing position NATS takes in the comparison of cost efficiency across Europe. Whilst NATS has indicated through their charts, that they have improved their position, when currency variations are taken into account, they remain one of the most expensive.

Finally, we remind CAA of the clear written statement made by the EU to CAA in July 2012, which set out the expectation around under achievement of efficiency during RP1.

"…***What was not provided in RP1 was considered owed for RP2".***

We have not yet seen any proposal from NATS or CAA during this consultation process that takes into account the considerable under achievement of cost efficiency during RP1. To be clear, we view any proposals by NATS in their business plans to be based entirely on meeting and exceeding their RP2 obligations only. We therefore expect CAA to work inline with the EU expectations, and to take further remedial action on the NATS costs, to take into account the under achievement in RP1.

1.2 Pensions

The Airline community are alarmed by the size of the annual pension costs within the NERL proposal. At £81m per annum this represents 18% of the total operating costs of the business. This figure is representative of a business that has failed so far to address a key component of its operating cost base and face up to its responsibility of running a commercial operation.

More over we are led to understand that the pension costs as a percentage of base salary is currently running at 46%. In the recent analysis undertaken for Q6 it was established that a benchmark pension cost was 20% for a defined benefit scheme and 7% for a defined contribution scheme. In a company such as NATS/NERL, and the fact that the defined benefit scheme was only closed to new entrants in 2009 the expectation would be a combined pension cost of circa 17%. The fact that it still remains at 46%, with no plans to tackle this issue, is of serious concern to those customers that continue to be expected to pay for this. The Airline Community reiterates the position held during the CP3 consultation, that whilst NATS continue to be allowed full pass through of cost of their overgenerous schemes, they have no incentive to deal with the level of change required. More over, given that those expected to implement such changes are themselves beneficiaries of these schemes, the incentives for change are even further destroyed in our considered opinion.

The airline industry has undergone significant structural changes regarding Pensions over the past decade, with many carriers that have previously offered defined benefit schemes to its employees both closing them to new entrants and materially changing the scheme to reduced accrual rates and increased retirement ages. These changes have been undertaken in the context of highly unionised environments where the potential of industrial unrest is equally unpalatable, never the less, the issues have been tackled by the airlines, and for the most part, successfully implemented through negotiation without significant IR impact. On the side, many other airlines that operate in the industry are low cost base carriers that have never operated a defined benefit scheme. To either group of airlines, continuing to fund a generous scheme such as NATS have, in any economic climate is unpalatable. From the airline perspective this also erodes value to our passengers.

The airline position is therefore simple, and consistent with the Airline Community arguments used during the Q6 settlement for the airports, and supported by the CAA. That we should only pay a pension rate that is in line with the commercial benchmarks. To that end we propose that CAA implement a reduced pass through contribution rate of closer to 18%, rather than an untenable 46%, and that this would be both fair and appropriate. Similarly, the community also considers that it is entirely inappropriate for the airline community to remain accountable for rectifying any current or future deficit in the NATS pension schemes.

Given the precedent now set for Gatwick and Heathrow, the airline community cannot identify any justifiable reason why the same approach should not be taken at NATS. We have high expectations that the CAA will address this market failure for RP2.

1.3 Operational Contingency Costs

The proposed operating cost of NERL is circa £325m, so the £7m contingency referenced in their plans represents circa 2% of overall operating cost. However as NATS have been at pains to point out, a large element of NERL's base cost is fixed (i.e. minimum number of ATCO's, property, known maintenance contracts etc.), which we would estimate at 80%, this would then mean that their contingency is actually about 10% of overall costs.

More than this, according to the NATS plans shared with us, particularly relating to the majority of their reduction measure being undertaken in late RP1, over the course of RP2 the operational costs remain static. This means that this cost is not a contingency for non-delivery of cost savings initiatives. On that basis we do not understand why NERL need to charge any contingency as this element could be argued as being covered within the WACC.

Therefore, we would estimate that the range of operational cost contingency should be between zero and 1% of £65m (£650k). This leads us to our conclusion that there is an overcharge of circa £30m over the RP2 period.

1.4 London Approach statement

As CAA is aware, the Airline Community had some concern at the end of the consultation period, that potential reallocation of charges between En-route and Approach might be hidden within changes of opex being put forward as savings by NATS. We thank CAA for the clarification offered by Matt Claydon, and we are encouraged by CAA's response detailed below.

"Further to our conversation this morning, I can confirm NATS was tasked to develop both its initial and revised business plans on the basis of the current (RP1/CP3) approach and allocation for charging for London Approach services. This will ensure a like for like comparison between the two plans.

CAA will shortly issue a consultation on how to address London Approach for RP2, mindful of the revised performance and charging regulations. Any potential changes to London Approach charging as a consequence of the consultation will not be deemed to 'contribute' further to cost reductions in Euro control charges identified as a part of the RBP

Nonetheless, any potential change in cost allocation as a result of the London Approach consultation will be reflected in the final en route costs in due course."

We understand that the CAA Approach Charge consultation has now ended, and individual airlines may have made submissions as to their views on how the charges should be handled going forward. Given there may be differing views between involved airlines, this response does not seek to express any preference on appropriate charging mechanism. We would however ask CAA to ensure that the decision taken minimizes regulatory complexity, and takes into account the timing of any similar related work being undertaken in Europe. Given the costs and complexity of implementing changes, which will in the end be borne by the airlines themselves, we would not see it in the best interests of the airlines or the passengers to have multiple changes to the mechanism within a short time frame.

Section 2 – Cost of Capital

We would draw attention to the fact that CAA or NATS has not discussed issue of WACC with the airlines during this process. We therefore cannot endorse any proposal made by either NATS or CAA. As a key driver of price, the airlines do however consider that they have a significant interest in the WACC. We do consider however that until we have seen CAA's deliberations on WACC any detailed paper on this subject at this stage could be purely speculative and premature. As a result, the Airline Community does intend to submit a further paper on this subject at the appropriate time in the process. This paper will be made available to NATS as well.

As an interim, we would ask the CAA to take into account the following high level points:

- The recent Competition Commission's provisional determination of the WACC for Northern Ireland Electricity Limited has set out a cost of capital for NIE of 4.1%. This is significantly lower than the cost of capital the CAA set out for both Heathrow and Gatwick airports. The CAA needs to reflect on the CC's estimate of NIE's WACC, the selection of credible range points, and the implications this may have on its view of the WACC contained in the NATS business plan. It is clear that the CAA has been inconsistent with the CC's current judgment in this area.

- It is also important to note that the level of WACC used during the consultation period and in NATS price modeling has been 7%. This is well above the CAA decisions regarding both Heathrow and Gatwick airports and therefore is another reason for considerable change. It is considered that NATS are a business of much less risk than the airports and therefore at a minimum, without having to take into account the above arguments, the WACC level should come down to what has been agreed at Heathrow airport.

- It is also worth noting that there is precedent for this level of WACC, as demonstrated by ORR which has set the WACC for CP5 is 4.93 % in pre tax terms.

- Taking all this into account we believe that the CAA has no choice but to significantly lower the current estimate of a 7% WACC which is contained in the NATS business plan to a level below 5.65% (this is the figure used in the airlines modeling).

Section 3 – Forecasts

The airlines recognise the difficulties that have been encountered with accurate forecasting following the 2007 financial crisis. From the evidence and information provided by NATS during the consultation, at this time, we do not see any reason to indicate the NATS model should be used in preference, whereas for the sake of comparability, we do see that there is a clear potential benefit to all states using the same forecasting model. We therefore endorse the use of the STATFOR model at this time. Given that the forecast will be an iterative process right through to the end of the RP2 regulatory process, we would however request that NATS continue to run their model in parallel, and share the results with the airlines, in order that any significant divergence between the two can be discussed and investigated.

It is important to recognise that the forecast is a key driver of the outcome of the regulatory settlement, and that as a result, any change to the forecast, will have an impact on the other drivers within the calculation. For example, an increased forecast could have an impact on service quality and opex, whereas a reduced forecast would have the opposite effect, and either may require adjustments to capex priorities. We therefore expect that there is full transparency around submission of new forecasts to the process so that airlines have the opportunity to identify any material issues arising from the change, and be consulted on any changes that NATS or CAA seek to make as a result. We would also expect CAA to ensure that any material changes to the forecast, are followed through all elements of the settlement. We would however ask that CAA draws and adheres to a final point where new forecasts will not be accepted, and where this new information will not be used to drive changes to the settlement. The airlines would view it as unacceptable if a repeat of the RP1 situation were to occur, when a new and additional forecast was accepted after the end of all customer consultation, and was used to drive a change to the settlement without sight of or consultation with the airlines.

The airlines also draw attention that they have not changed the traffic figures used in when carrying out their own modeling but would like to note that it is expecting there to not be a last minute change in traffic by NATS that will have an impact on the RP2 price.

Section 4 – Capital Expenditure and Governance

4.1 Capital Expenditure

Capital Expenditure is a very important aspect of the NATS RP2 business plan considering it is the basis for the delivery of technology upgrades that will allow NATS to continue to produce a better and safer service to its customers. Unfortunately the amount of detail reviewed and discussed during the consultation period did not allow the airlines to sufficiently analyse the value for money each project would deliver. This point is dealt with in more detail in the next section of this report.

Considering the lack of detail provided and the inability of the airlines to review the value for money of each project, or in simple terms not knowing if the costs associated with each project are appropriate, the airlines believe there should be a 10% efficiency placed on the capital costs of projects.

4.2 Governance

The difficulty the Airlines experienced in reviewing and reaching conclusions on the NERL business plan and the capital investment plan in particular has highlighted the need for improved, on-going, collaborative governance arrangements, which currently are dominated by an annual SIP process.

The airlines recognise and welcome the fact that the SIP process and document has noticeably improved over time to become more focused and useful. Despite this, the airlines remain concerned that most of the influence that NATS ascribe to the airlines in relation to decision making around capital expenditure, is related to the SIP. It is difficult for the airlines to truly gain understanding of issues, and have meaningful and timely influence on key project decisions when the SIP process runs once a year. We support NATS therefore in their considerations of making the SIP process a more interactive process year round, with the understanding that this is enhanced by additional governance structures. To prevent extended debate and lack of clarity of expectations, these new arrangements need to be established by the start of RP2.

In addition, there is an issue around the need to address the right issues and decisions to the airline community population who have the correct knowledge, and in appropriate fora. Whilst the community does not necessarily wish to significantly increase the overall volume of governance, we do consider that the current NERL consultation structure in general is more focused on 'operational' groups instead of 'strategic or business groups' in the airlines. To be clear, the airlines do believe that it is absolutely critical that NERL continue with their operational engagement meetings, however we also feel that these meetings are not the right places/people to include strategic governance and capital decision. By attempting to cover such issues into a single meeting, the necessary focus on the business and governance issues is made more difficult and loses efficacy.
Hence, whilst we support NERL in attempting to utilise current fora more fully, it would be inappropriate to try and fit all capital governance through existing operational meetings. Recognizing the resource constraints of airlines to populate multiple remote meetings on different days, we suggest that where possible meetings are help on the same day, or consecutive days, in the same location, and with the option to remotely join the meeting, to enable airline resources to be used most efficiently. The airlines would also propose that consideration be given to appointing a part time representative/co-coordinator for the airlines, this would both offer assistance to smaller carriers unable to resource additional governance, but also offer an ongoing point of contact/scrutiny for NERL.

Whilst the purpose of these arrangements would be to improve the transparency and engagement on the following;

A. Strategic development
B. Shaping major programmes and projects including risk reduction where airline processes are impacted

C. A well-defined gateway process throughout the life of the project with a strong focus on expected benefits and delivery.
D. The development of capital investment plans and major project lines
E. The efficiency of capital investments

These new governance arrangements should:

- Take account of and reflect customer engagement best practice in other regulated sectors,
- Build on where appropriate, the existing processes including the OPA, SPA and SIP.
- Form part of the RP2 settlement,
- Involve a wider cross section of the airline community, representing airline operational, strategic and business areas.

Section 5 - Core & Development Capital

Airlines believe it is unrealistic and unhelpful for the plan to be based on a fixed investment programme given the uncertainties in the ATM environment e.g. traffic levels, and externalities which may affect some projects, SES, SESAR, FAB and airspace change consultations. Airlines propose the adoption of 'Core & Development treatment of a proportion of the NATS capital to address uncertainties on those projects which are insufficiently developed at this time, or where an external way-point must be passed before the project can proceed fully, for example LAMP.

Whilst it is helpful that the current price control is based on actual rather than planned spend, the additional governance that would be associated with a 'Core and Development' approach – in particular the close scrutiny at each stage gate of benefits and costs – would be beneficial.

In addition a Core and Development system would allow NATS to progress projects and finalise benefits and costs at a more mature point in thinking, rather than the outset of RP2. The airlines believe NATS will benefit from this by not needing to include such large capex risk into their projects, and be pressed into committing to cost, timing or benefits levels that are not achievable.
Adoption of a capital gateway process similar to that deployed at Heathrow should be seriously considered where capital would pass from development capital (P80) to core capital (P50) at a gateway 3-entry point.

Section 6 - Triggers

The airlines have clarified to NERL at several CCWG sessions that the issue of ensuring benefit delivery remains key to providing assurance over value for money and capital investment management.

In line with this position the group believes that there is a need for a mechanism by which customers are assured that their investment delivers the benefits paid for and at the time they are due.
Currently, whilst all have agreed that NERL programme management has continued to make improvements, there are no measurable consequences to NERL if projects fail to deliver in full the benefits as agreed, and on time, whilst generally the airlines are left without the desired benefit, whilst still paying for the project and any overspend. This is an unacceptable situation, which CAA has recognised and addressed in the airport regulatory arena for LGW and LHR.
Consequently, the airlines suggest that an adaptation of the tried and tested CAA trigger mechanism used with Heathrow Airport Ltd is both feasible and appropriate.

We are aware that CAA has historically had concerns that NATS projects may be too complex and subject to too many outside influences for a comparison to be made to the airport capital projects that have been triggered. Whilst we would agree that the method of delivery of some of these projects is different, and those within the

NATS portfolio can be more technically driven, we do not accept that there is a significant fundamental difference in risk, logistical difficulty or externalities that would prevent a trigger system being introduced.
Heathrow construction programmes can be extremely complex, drawing on external resource and specialists, must rely heavily on significant outside drivers which can be entirely out of their control- i.e. changes in availability and price of construction workers, weather conditions which impede progress on site, changes to governmental or Local authority planning policy or approvals processes to name a few.
We would view it, as a fundamental of project management to identify, plan for and mitigate risks, and that inability to do so, is in itself indicative of the need for a trigger type system that increases accountability for improving the internal project management capabilities needed.

We should also recognize the critical dependencies between Q6 airspace programme at Heathrow Airport, the UK's only hub, to enhance resilience and the enablers in LAMP to deliver the expected benefits. Coordination of these programmes across NATS and HAL is necessary. A trigger mechanism that can be applied across separately at both organisations, but covering the entire programme, will ensure the necessary focus on alignment across organisations and investment regimes and ensure benefit in the context of the CAA's Future Airspace Strategy. Note that this approach is without prejudice to addressing congestion issues at other airports in a non-discriminatory network approach overseen by the CAA.

We recognise that the complex technical projects where airlines are most keen to ensure benefit delivery and on time completion, for example LAMP, are likely to be those with most uncertainty as to the path followed for effective delivery. Rather than artificially constrain the expert project team to a specified delivery path, and to remain inline with the EU remit of 1% at risk for performance related targets, we suggest that any trigger should not be measured on delivery of specific scope, but instead, the deliverable should be the benefit promised in the business case, I.e. reduction in delay, additional x% capacity, £mpa environmental savings. In this way NATS are allowed the flexibility to change projects to react to unplanned difficulties, and are still incentivised to deliver to plan.
Recognising the constraints of the EU cap, we believe the scheme could be still be operated as either a HAL type rebate to users for full or part failure to deliver, as a bonus to NERL for on time delivery with fully accrued benefit, or a combination of the two. Given the airline position that bonus is generally unacceptable in rewarding a service that is already paid for, the first option would be the preference.

Section 7 – FAB performance plan consideration.

The Airline Community recognises that it would be premature to pursue some of the more radical potential FAB benefits at this time, before some of the enabling technological capabilities have been introduced. However, we believe that there are opportunities, which NATS could be pursuing and we remain highly disappointed at the lack of progress to move the FAB forward, and capitalise on the cost and performance efficiencies that could be realised if there was a real commitment to the Single European Sky.

We believe the following are areas that should be considered:

1. We support the continued investigation of exploring subcontract sector management between NATS and third parties. This would seem to be a sensible path to maximise capacity and efficiency. We believe that this could work in both directions, to reduce potential peaks and troughs in workload.
2. We would like to see more progress on the Rathlin and Lands End sector proposals as part of the FAB performance plan going forward where it would allow for potential efficiencies with the UK network where more cross sector qualified ATCO`s could be concentrated on delivery of the NTCA programme for example. We would stress that the UK/IRL FAB should also introduce market mechanisms, where possible, during RP2 to drive competition and ultimately cost savings into the areas of service provision such as meteorology, aeronautical information, communication, navigation and surveillance and should look to introduce centralised services where possible across the FAB.
3. Prestwick Night Shift –the Airline Community want to see work flowed to Swanick or Shannon. The IAA has stated that they could run Scottish Airspace from Shannon/Dublin and have demonstrated this capability in the recent High Level Sector Trials. We again we would encourage all options on efficiency to be considered as part of the FAB integration and performance plans going forward.

Section 8 – Targets & Measures

8.1 Targets and Bonus Incentive

The airlines have stated clearly during the RP2 CCWG consultation, that they believe the CP3/RP1 targets were set at a level which renders them redundant in terms of providing an incentive for continuous improvement, stretch, or value for money. Reading forward for RP2 the airlines consider that if the targets remained at similar levels, they would again be insufficiently challenging and would again be substantially exceeded. The airlines view is that earning a bonus for achieving a service level already paid for and which is being delivered with no stretch is not appropriate incentivisation or value for money for the customer.

The airlines would like to highlight that during the CP3 consultation, whilst the airlines produced substantial evidence that the proposed targets would be easily met, NATS strongly argued that they would be stretching and the targets would be unlikely to be met in most years. The airlines note that this same argument and justification have been used again by NATS for RP2, and again, the airlines do not agree that this is the case. Should NATS be given “the benefit of the doubt” again, the failure of CAA to set meaningful performance targets for a second consecutive reference period would be distinctly unacceptable to the airline community.

The airline community has also strongly expressed a view during the consultation, that some of the targets may not be working as fully as anticipated in focusing attention on ATM performance. The community acknowledge this is a complex area to target appropriately, and whilst NATS/NERL have made some good progress in identifying and tackling specific causes of delay, the community have a strong view that there must now be a more holistic view. This must now incentivise NATS to look at total delay as experienced by our passengers, rather than focussing on limited causes of delay under the T1, T2 T3 metrics.

Currently there are a number of areas which the RP1 targets do not cover, but where delays can be influenced by NATS/NERL behaviour. An example of this is weather related events that potentially impact on network performance. Whilst we of course acknowledge that NATS are unable to control weather, their choices on the day in response to weather conditions, and planning and implementation for new procedures and technology to mitigate weather delay fall entirely with them and can result in very significant variance in delay performance on a day to day basis. For this reason, we strongly urge CAA to pursue a Total Delay metric, in replacement for one or more of the current measures.

In addition, we would draw attention to the gap in measurement/responsibility around Terminal Delay. This is an area where the airlines perceive increasing challenge going forward (start up delays, GATE holds). Whilst this falls outside the NERL portfolio, for most of the UK, it remains the responsibility of NATS where they are contracted to provide ATS services by an Airport. By allowing all these source of delay to be outside a regulatory regime, NERL are given both incentive and ability to manipulate their ability to meet their en-route targets by utilising ground delay mechanisms. Whilst we acknowledge this is a complex issue to take from a regulatory incentive perspective, we believe that in order to fully optimise available airspace and airport capacity, and minimise the environmental impacts of air and ground holding, this is an area that CAA must require NATS to apply some focus on.

We would be fully supportive of working alongside CAA and NATS in further specialised workshops to develop these concepts further.

8.2 Modulation of targets

We have expressed the position that, aside from any debate as to the suitability of any of the targets, in order to be meaningful, the levels of any targets set for RP2, must also take into account a range of factors: current performance, the capacity headroom, which as predicted by airlines in the consultation for CP3, has been created by existing CP2/CP3 investment, future investment in LAMP etc in RP2 and also the change in forecasting accuracy experienced since the 2008/9 financial crises.

The airlines believe that targets must remain robust, stretching and meaningful throughout RP2. Given the acknowledged high degree of uncertainty in the accuracy of any traffic forecasts for the RP2 period, and the substantial current capacity headroom, we propose that any performance targets set by CAA must have the capability for modulation adjustments to be made to their par levels. We currently believe that with expected traffic levels that the traffic to delay relationship sits close to a linear level. We would suggest that a relationship of 4% for a reduction and 4% for an increase in traffic would be appropriate.

8.3 3Di Fuel Metric

The airlines would like to express their support for the focus that NATS have placed on improving airline fuel efficiency, as demonstrated by their commitment to the 3Di Metric. We view this metric as being the measure currently most in keeping with airline priorities and also, the measure where the target is most closely aligned with actual performance. We would therefore strongly support this measure continuing through RP2.

We would like however to highlight that Airlines currently lack confidence that the full extent of airline fuel-savings benefits identified by NERL through their modelling are or can be being realised in practice. In order for airlines to actively be able to access these savings, the processes and techniques that facilitate them, must be made a systemic part of every flight movement. Without this, airlines are unable to load less fuel on the potential of the possibility of a saving as a one off on a flight.

Airlines want to work collaboratively with NERL in this area to align theoretical and actual fuel savings. Clear statements on fuel savings as part of more-detailed business cases will also be essential to building this confidence. We do acknowledge the current efforts of NERL in ongoing meetings to work with the community on this issue.

Section 9- General Aviation Costs

The arguments regarding this issue have been rehearsed and run many times, which reflects the commercial and safety-related importance to the commercial aviation industry, which is burdened with excessive, and often uncontrollable, costs. During the RP2 process the airlines have reiterated to NERL the importance that the group places on seeking to end the cross subsidy of GA by Commercial aviation, and that they would like the continued support of NERL in lobbying CAA/DfT. We recognise from feedback during the CCWG process that NERL have already sought to reduce these costs by reducing a programme of asset replacement**.**

It remains clear to the airlines that GA should pay its fair share of the opex/capex costs incurred by NERL incurred through the services they use and the need to ensure the separation of GA and Commercial aviation.

This is, we believe, supported by European Union regulations 550/2004 and 1794/2006. Many ANSP's, and their regulators, around the world are struggling with the inequity in their respective charging systems that force commercial aviation to support the activities of GA, with some developments being made in achieving more equitable charging structures. An example is Airways New Zealand, who having recognised that GA activity was increasing its airport-related ANS costs at certain airports, which were being paid by commercial aviation, undertook a programme of consultation, which led, in 2009, to an amendment of their tariff for aircraft under 5 tonnes, which brought their charges appreciably closer to those of aircraft above 5 tonnes.

The cross subsidisation of GA can no longer be funded by commercial airlines. Some states, for instance, have accepted the relative importance of GA (and the iniquity of the cross-subsidy of GA by commercial aviation) by covering the costs caused by GA from central government taxation, thus rightly removing the burden from commercial aviation. The rise of partial ownership programs and evolution of micro jets means that many small commercial aircraft are competing on the same markets as the bigger commercial carriers, carrying the high yield business passengers on direct point-to-point flights but they are treated as GA. Despite the fact that these flights take approximately the same resource from NERL, presently the bigger carriers fund the air navigation services they receive. This is a situation that has to end.

We do not accept the previous argument from CAA that safe separation of the two traffic types is solely for the benefit of commercial aviation and that therefore commercial aviation should be forced, through NERL's charges, to pay for the poor practice of GA pilots, i.e. encroaching on controlled airspace, paying for improving the safety of controlled airspace due to GA pilots not installing, or not switching on, transponders. There is an equal obligation on GA pilots to maintain a high level of safety, the achievement of which is, to a large extent, within their gift.

Whilst CAA has identified that they see policy and practical difficulties in moving to charge GA for the services they receive, the airline group is of opinion that this problem is potentially easy to solve with the introduction of an annual payment for all registered aircraft, that covers the costs of the services and prevents flying without radio, without MET data and other information as the option is pay or don't fly.

Commercial aviation continues to be burdened with the unwanted role of being the provider of subsidies to GA, primarily; it would appear, as it is an easily identifiable and pursuable target.
We continue to urge the CAA to engage in a creative and constructive discussion with the Department for Transport with an objective of ensuring that the user pays principle is achieved.

Section 11 - Airline price modelling

Taking into account many of the points made above, the airlines have modelled an updated price path that we believe will deliver a price that is in passenger interests and that the CAA should expect NATS to deliver over the RP2 period.

The model has been created by the airlines using a base for their modelling of the NATS business plan. This has then been updated with updates to the following areas:

- WACC = 5.65%, which is considered a very conservative assumption
- OPEX updates as discussed above regarding pensions and contingency costs
- CAPEX = 10% efficiency on cost of projects

The final NATS business plan showed a price reduction of 18% over the RP2 period. Using the airline modelling detailed above showed a price path of 30% over the RP2 period is achievable.
We would be happy to talk the model through with appropriate CAA staff if you wish to discuss this work with us.

Summary

Firstly can we thank the CAA for the opportunity afforded to the Airline Group to provide this additional supporting paper to the Co-Chairs Report. A copy of this will also be made available to NATS as per our agreement with them at the time of the Co-Chairs Report.

We have focused this RP2 Airline Community Special Interests Paper on the critical areas as far as the Airline Group is concerned and we hope that it will provide useful information for the CAA to use in its deliberation on RP2. Given the relatively short period of consultation on RP2 the Airline Group is available at anytime to discuss the content of this paper and attend any workshops or reviews of consultancy studies that CAA run as they carry the RP2 process forward.

We have marked a couple of small areas of the report for redaction from general publication, as we are aware of the sensitivity of these as far as NATS is concerned.

Mark Gardiner
Co-chair of the Airline Group for RP2

December 4rd 2013