

CAA SEMINAR ON THE NATS PRICE CAP REVIEW ON 22 APRIL 2004

On 22 April 2004 the CAA held a seminar on the initial consultation document that it published on 30 March 2004 to launch the review of the price controls on NATS (En route) plc. This note provides a summary of the points raised at the seminar.

Session 1: The context of the review

Prospect/PCS

The inflexible price control before 2002 added to NATS' financial difficulties. The CAA should add "sustainability" to its list of objectives for the review.

CAA response

This is already captured in the CAA's statutory objectives. The CAA will be looking for incentives that take into account NATS' high gearing.

Prospect/PCS

CAA will have to take into account NATS' £1 billion investment programme and its impact on gearing and service delivery.

CAA response

CAA will want to ensure that capacity is delivered cost-effectively.

ERAA

How did the CAA arrive at the figure of 5% as the proportion of airline costs made up by en route charges? For ERAA members the proportion is 7-9%. Also profits of ERAA members average about 1-2% of costs.

CAA response

The CAA took the figure from AEA's 2002 handbook but accepts that there will be variances between airlines and is aware of the position on airline profitability. A University of Westminster study has shown that airlines value low delays over low en-route charges. The CAA will need to strike the right balance between price and service.

easyJet

Customers want both low prices and good service. There is pressure on costs as well as on quality.

CAA response

The CAA recognises this but trade-offs have to be made at the margin. It will be for airlines to consider where they want the emphasis.

ELFAA

All costs are important to airlines. Non-Airline Group (AG) airlines regard en-route costs as costs over which they have no control. Ryanair and Buzz considered a legal challenge to the revised price control as part of the Composite Solution, but there was little support from other non-AG airlines. Their perception is that AG is unable to influence NATS. NATS' consultation processes should be looked at.

CAA response

The Composite Solution was developed in a particular set of circumstances. CAA would be interested to know what non-AG members would do differently from the AG. Consultation is addressed in the consultation paper.

Prospect/PCS

The AG is only a partial owner of NATS, so decisions are not made wholly by the AG.

Airline Group

Surprised that the CAA appeared to mistrust AG's motives after three years. Its investment was not for commercial return and was made to prevent NATS being acquired by those who would sweat its assets. There will be no return on the investment before 2013/14. The AG directors on NATS' boards carry out their duties in accordance with best practice on corporate governance (following Higgs/Greenbury) with NATS' interests paramount rather than those of individual AG members. There is also an IATA member on NATS' board.

AG's objective is that airspace capacity is created to the benefit of AG and non-AG airlines generally. To this end the new capex plan is to provide additional capacity before it is required. The price rises in France, Spain, Germany and Portugal after September 11th were far larger than the increase in NATS charges in the Composite Solution. As an airline Monarch is much more exposed to French en-route charges (about 50% of the amount Monarch pays for en-route ATC) compared to about 12% which NATS represents. Non-AG airlines have said that consultation has improved since the PPP. The CAA can trust the motives of AG.

CAA response

It is not a question of trusting or not trusting AG. There are legitimate issues which have to be aired with AG and non-AG airlines alike.

Prospect/PCS

In looking at the balance between price and service CAA has to look at CP3 and beyond as the capex programme for CP2 is probably the largest capex challenge NATS has ever undertaken.

CAA response

This will be covered in the capex review.

European Commission

The CAA will need to give proper emphasis to the impact on its work of the development of Single European Sky.

CAA response

Agreed

Session 2: The issues

Grant Thornton

There are pros and cons to using single till or dual till. Has CAA thought of looking at both approaches, using one as a cross-check on the other?

CAA response

There is no reason in principle to rely completely on one or the other approach but any approach adopted would need to be rigorous and transparent.

The Airline Group

Is the CAA aware of the timetable for Single European Sky? A report from Eurocontrol is due by October 2004 and this could influence the future of the CSU charging system. This could affect the CAA's review.

CAA response

It is important to distinguish between the determination of NATS' allowed revenue structure over the five years and the pricing structure which is set by Eurocontrol. The CAA will of course take the latter into account but it may not have significant impact on the setting of the price cap.

NATS

NATS would want to avoid looking at notions of revenue and price wholly separately. The CAA should take account of work being done on the price structure. NATS wants simplicity and would look at a blend of approaches.

CAA response

Simplicity is desirable but what determines the revenue requirement can be separated from the price structure. NATS has to make volume projections when it fixes prices and any mismatch is corrected subsequently. The important number is the revenue number.

European Commission

Within the SES framework Eurocontrol is looking at the charging scheme and is expected to complete its work by mid October 2004. The European Commission will then reach its own conclusions by the end of 2004. The mandate from the EC sets out general objectives and principles, the implications of which are that the current single rate per state could change and new incentives could be placed on airspace users and ANSPs.

BATA

There is some concern about the scope of the CAA's review. NATS has a large market share of the terminal approach and aerodrome business and this could point to greater regulatory controls in these areas.

CAA response

The CAA has floated the idea of extending price control to the London terminal approach which is a licensed activity. Aerodrome control on the other hand is not licensed (there is a 10 year exemption from the Government) and the CAA has no powers to set a price cap.

Eurocontrol

Eurocontrol is looking at the possibility of setting unit rates for five year periods. One question is who should be responsible for providing the CSU forecasts. NATS does so now and this affected the level of the rate in 2004. Independent forecasts, possibly by Eurocontrol, could be the way forward.

CAA response

The proposed five year period would be similar to the UK system, but is still cost recovery. The CAA will need to be satisfied with the traffic forecasts that are used to set the price cap. They will be NATS' forecasts, subject to CAA scrutiny, and there is a recovery mechanism.

Prospect/PCS

Prospect/PCS will be submitting a written statement on pensions. The cost of redundancies was not taken from the pension scheme but NATS put money into the scheme.

NATS

Opex and capex lie at the heart of the review. NATS supports benchmarking but this might be used to focus on measurable factors such as HR. It will also need to examine cost drivers, in particular the costs of providing safe capacity.

Grant Thornton

Why are there no performance indicators for safety such as the number of near misses?

CAA response

Safety is paramount. The CAA does not want to do anything which could, potentially, threaten the accurate reporting of safety incidents.

The Airline Group

Welcomed the inclusion of the variance of delay as a possible performance measure. There should be higher incremental penalties for longer delays. NATS has put a lot of effort into reducing delays. The recognition that the previous year's performance was unacceptable rather than the existence of financial penalties was the key driver for improvement.

CAA response

The CAA might also want to look at the impact of delays in different periods of the day.

easyJet

The debate is moving quickly towards a regime of penalties and bonuses. Key Performance Indicators have a role to play in ensuring continuous improvement for users.

CAA response

The CAA would welcome thoughts on this.

Prospect/PCS

The CAA has raised the question of the AG's stake in NATS not being for commercial return. It mentioned that this was not included in the Strategic Partnership Agreement. This raises questions as to the meaning of "not for commercial return" as the Strategic Partnership Agreement was never made public.

The Airline Group

AG's involvement is not for commercial return which is not the same as not for profit. The idea of not for commercial return came from AG; the Government had not suggested it.