British Airways (BA) welcomes the opportunity to respond to the CAA consultation on the NERL price control review for Control Period 3 (CP3).

The airline’s main base is London Heathrow Airport, the UK’s primary international hub airport and one of the busiest airports in the world. BA also operates from 9 other airports in the UK, and worldwide, to 154 destinations in 75 countries. It employs more than 43,000 people, of whom 38,000 work in the United Kingdom.

BA offers almost 550 flights in total to and from Heathrow each weekday, with a further 190 services a day to and from London Gatwick daily and 44 per day to and from London City.

BA is the largest single user of NATS services in the UK.

Responses to Annex B Questions

Chapter 4 - Benchmarking the performance of NERL

Q.1 The CAA invites interested parties to comment on the potential usefulness of benchmark analysis to inform the CP3 price control review, and on the CAA’s proposed approach to developing analysis of the available European data on comparative ANSP charge performance.

We believe benchmarking is a very useful tool, as evidenced by the good work currently undertaken by the PRC. Any benchmarking within Europe should be based upon the PRC model and information, rather than starting from scratch. We understand that there maybe concerns from NATS that the UK has airspace of a size and complexity that makes accurate comparisons difficult. However, based on our experience as an international airspace user, there are a number of other European TMA’s that are equally complex, German airspace (Frankfurt), Madrid, Amsterdam, Zurich/Geneva are all complicated even if in some cases, with not as much demand. We believe that all of these areas would make excellent comparators.
We also feel that in order to benchmark against TMA’s which offer equal complexity and demand, it could potentially could also be useful to look at non-European hubs similar to UK: LGW/LHR, for example NYC: JFK/EWR?

In terms of the content of the benchmarking, there are obvious areas which are already targeted by the PRC around operational performance, safety and charges, however we feel this ought to be extended to include comparisons of other essential elements, for example manpower and productivity, Capital Programme, investments, and trajectory management.

We believe that this will demonstrate that whilst NATS are without doubt, productive, their cost base is too high.

When benchmarking within Europe there should be good commonality, as all ANSPs should be going through the same European SES/SESAR programmes. We are particularly keen to understand how other countries and ANSPs are interpreting SES and SESAR, for example their approach on Cost reflectiveness and approach charges.

Chapter 5 – Approach to CP3 Review

Q.2 The CAA invites views on which of the two approaches outlined above would enable the CAA better to fulfil its statutory duties.

As a user we do see some risks in following the new proposal for Customer Involvement, for example, the significantly greater resource available from NATS compared with the airline resource, or the potential for lack of a unified or majority agreement by users on key issues and also the basic risk in following a new NATS CP process for the first time.

However despite the risks in attempting to follow a new process, there were issues with the traditional CP2 process and the resultant outcome was seen at the time, and has since been proven as far from satisfactory from a users perspective - the final outcome was not reflective of the comments and requirements stated by the users in terms of performance targets, bonuses and penalties, and the price control itself. As a result we would not opt to follow the same process again.

We acknowledge that the new Customer led approach has risks but we believe that there is enough potential for improvement over the traditional approach, offering improved opportunities for airlines to actively participate in setting the agenda, making proposals and deciding the trade offs appropriate to meet their business needs, to make it the preferred option.

There has also been evidence of a general move by NATS towards being more open and engaged with its airline customers, as demonstrated by the regular Bilateral and multilateral meetings, and other customer feedback activities. Whilst there is still further progress to be made, we believe that this shift in emphasis, and the groundwork in terms of a meeting structure, is a good basis for developing the Customer Involvement CP3 process.
A key learning point from the CP2 process, as well as the latest constructive engagement process for the regulation of Heathrow and Gatwick, it is imperative that decision-making is not back-loaded to the final period of the CP, and that active CAA engagement with both NATS and the users, occurs throughout the process. This applies equally to the proposed Customer led process as the traditional approach.

A final learning point is that in order to deliver a truly effective process, with an outcome reflective of the content of the consultation, the final decision documents need to be absolutely clear and specific and not allow room for ambiguity and potential gaming of the system.

Q.3 Under the customer consultation approach, the CAA invites views on:

a) The suggested structure and governance of the customer consultation process;

We suggest that the consultation should be structured as a series of clearly defined work streams, each with allocated timescales and goals, and each with defined fora, where possible making use of existing meetings, and corresponding governance. The work stream should consist by topic, of relevant airline representatives, NATS representatives, and a CAA representative responsible for the stream, even if not in attendance at all sessions.

Examples of these work streams could be, Fuel and environmental efficiency, technical projects, Performance targets, Capital investment and strategic direction.

The governance of each work stream should work with a reporting line up into the overarching steering group (CCWG), with membership consisting of senior/signoff level airline representatives, specified NATs representatives, and CAA representative. We are open to the inclusion of a independent chairman in the membership of this group.

The work streams should regularly report up to the steering group with progress made, including key information defined and decisions and/or recommendations to be recorded as progress is made.

In the event of an issue, which cannot be resolved, the work stream should be able as a group, or on request by either airline or NATS representatives, to request the assigned CAA representative for the work stream, to participate in resolving the issue. Should this not be sufficient to achieve resolution, there must be the ability for any participating group to escalate an issue to the steering group for resolution.

The key is that there needs to be gateways or checkpoints throughout the process, where agreements and decisions are ratified by participants with signoff capabilities, and recorded, and that these checkpoints must have CAA involvement to ensure the final CAA consultation is reflective of the direction and decisions agreed by the airlines and NATS. It will also highlight at the earliest possible time, any likely areas of disagreement, to facilitate resolution, rather than discovering misunderstanding or
disagreement during the final stages, with insufficient time to gain a satisfactory resolution.

As previously mentioned, there are a wide variety of Fora already in place between NATS and its airlines stakeholders, for example, OPA, Airline OPS etc, and it would be more efficient to try and utilise these as much as is possible, supplementing these when necessary.

The full timetable and definition for each work stream and matching meeting schedule, should be available to all on the Customer Website, to ensure all interested parties are able to decide whether to attend or not, rather than relying on emails getting to the right person.

b) The proposed allocation of issues to NERL-airline consultation and to CAA scrutiny, respectively;

We propose that the issues should be allocated as follows:
NERL-Airline Consultation:
- Performance metrics including costs, fuel, delays, meeting project and growth milestones, staffing resilience, operational resilience, capacity and growth, key programmes, strategic roadmap, bonus/neutral/penalty targets.

CAA Scrutiny:
- How much money is needed, cost of capital, RAB, final levels of charges.

This broadly works out as Airline Consultation on issues which form the basis for the service and quality required and key requirements, whilst the CAA scrutiny establishes the mechanism and costs to deliver this.

c) The timing and balance of the review between customer consultation and the subsequent CAA consultation on regulatory proposals

The traditional approach with previous NATS CP’s and to an extent with BAA airport regulation has been for the bulk of the work to be done upfront, with a relatively short period towards the end with full CAA consultation and involvement.

As raised previously, we view leaving CAA consultation to the end of the process as one of the biggest risks to the success of the CP3 process. Whilst undoubtedly there needs to be a final phase to the process, following the Customer Consultation, where all decisions are collated and formulated into a cohesive package for consultation led by CAA, we believe that as discussed in Question 3 a, as part of the Customer Consultation, there need to be gateways or checkpoints throughout the process, where agreements and decisions are ratified and that these checkpoints must have CAA involvement.

The idea of a “Go-No-Go” decision point during the Customer Led period of the process is a sensible one, ensuring that should irreconcilable problems arise, that there is more than sufficient time for a thorough consultation to still occur.
However, by following our suggestions for greater CAA involvement during the customer led process, we believe the potential for such a situation, should be significantly lessened.

We would however like to understand in greater detail the criteria that will be used to assess the “Go-No-Go” point, and the level of input the airline users will have in making this decision.

d) The nature of the CAA mandate; and

The mandate must be to facilitate positive and engaged consultation, ensuring that users have appropriate access to any relevant requested information, that there are suitable and adequate opportunities to engage, that key decisions are captured and incorporated into the final outcome.
It is also imperative that any issues arising during the NATS- customer consultation which cannot be resolved between the two parties, are resolved with input by CAA during the process rather than leaving it to the final CAA led consultation.

All these points require that CAA be actively involved throughout the consultation process.

e) Suggestions as to the procedures and protocols for consultation, which might be incorporated in such a mandate.

The key elements or protocol and procedure that we envisage for effective consultation are:
- Transparency/accessibility of information in a timely manner
- Structured work streams with detailed timetables that are stuck to
- Meeting arrangements and timetables published on the NATS Customer Website with minimum 4 week notice of meetings
- Requests for input or responses given in timely manner allowing sufficient time to respond
- Structured clear governance
- Clear escalation process for resolution of issues during the process; work stream to CCWG, CCWG to CAA
- Regular formal progress and signoff checkpoints/gateways, including recording of areas where agreement has not been reached
- CAA involvement throughout- as an observer, but with the mandate, when required, to be actively involved in offering guidance or resolving issues

Q.4 Do respondents have any other suggestions on how the process for the CP3 review might best be structured to meet the CAA’s regulatory requirements, recognising the scope for and constraints on airline users participating in this process?

In order to ensure that the outcome facilitates an efficient and cost effective Air traffic System and that the interests of all categories of users are represented, the vast resources available to NATs in comparison to the airline users must be recognised. It
must also be recognised that Airlines are losing staff, and will not necessarily have the capacity for endless detailed responses.

In order to do this, the consultation needs to be arranged into a clearly timetabled programme with defined topics. The programme needs to be given to the users with significant lead times and specific dates of meetings in order to allow users to plan and allocate resource throughout the consultation, or to the elements that are most important to them if continuous cover is not achievable. It would be unacceptable for meeting dates to be scheduled without enough notice to present a representative, and for this to be construed as airlines having been given the opportunity to participate.

However, in order to move forward through the consultation, is must be recognised that it would be unworkable for topics to be reopened and agreements re-worked to accommodate new joiners to the process, once consultation has begun.

It must be made clear when the timetable is issued, that airlines are welcome join at any point, but that decisions made with majority agreement during the consultation, cannot be reworked simply for the reason of a late joiner wishing to have a say.

Chapter 6 – Scope of Price Controls

Q.5 Do respondents agree that Eurocontrol charges need to continue to be controlled by a revenue or price condition?

Yes, we agree with this statement. The interaction between NERL, Eurocontrol and the emerging SES II regulation is key, which indicates that all three areas must have a common basis for treatment.

Q.6 Do respondents agree with the CAA’s preliminary views on the scope of regulation of the London Approach?

We agree that the London Approach should continue to be regulated under the CP3 Process.

We would consider that it would make sense in terms of consistency for Luton and London City to be brought into the process, and therefore disagree with preliminary CAA analysis that this is not an appropriate action. However in order to make a definitive decision on whether this is an appropriate action, we would need to understand the actual costs and impacts of taking or rejecting this action before moving ahead.

In particular we would like to see the NERL analysis which believes that the costs of coordinating all 5 London airports will increase significantly if LTN and LCY remain outside- we would fundamentally oppose being subject to the pass through of a significant rise in cost if airlines had not been afforded to opportunity to decide on this.
We would also like to understand whether London City and Luton approach under recoveries are charged under en-route.

With regard to Enroute and Approach charges, there are a number of significant issues around the proposed changes to charges for Enroute and Approach Charging.

We understand that there is regulation emanating from SES II, which requires cost reflectivity and cost recovery, and in principle we agree with the theory of cost reflective recovery and are not discounting the potential to separate Enroute from Approach.

However, MTOW or any other calculation based on weight is NOT a cost reflective charging mechanism, and is therefore not a valid means by which to separate charges.

The cost to NATS of dealing with a large or heavy aircraft is not significantly different than dealing with a small or light aircraft either in approach nor enroute, whereas the handling of light aircraft on approach can create greater complexity and therefore cost due to their reduced ability to cope with Wake vortex and adverse weather conditions requiring greater separation and monitoring.

By introducing Scenario 2, introducing a separate charge for Enroute and approach and using a MTOW based calculation, instead of a subsidy of approach by enroute via under recovery of approach charges, with a marginal net impact to all carriers, a situation would be created whereby UK London based Long-haul airlines will effectively be subsidising UK and Overseas Short-haul Carriers with considerable financial impact to the long-haul carriers.

Furthermore, BA believes a considerable amount of benchmarking must be conducted to understand how approach charges are calculated across Europe, and the direction other Euro zone countries are taking in applying the SES cost recovery directive. To avoid the scenario where UK operators are penalized at base and when operating away from base, whereas other national home carriers have a commercial advantage, it is imperative that a consistent and equitable approach an option to the charging of approach needs to be applied across Europe.

There is currently considerable ambiguity around what is TMA- it is currently enroute till 20Km out, despite TMA reaching as far out as coast in some places. It is therefore important that comparison is done between the size and complexity of the London approach as compared with other approach areas in Europe. The size of the London TMA could be the same as the TMA plus large areas of enroute for other ANSPs. We would suggest that some work needs to occur defining a suitable threshold for UK enroute/TMA, which could affect the charging mechanism.

We therefore strongly disagree with the CAA analysis that Scenario’s 1 and 3 are unsuitable means for handling the rebalancing of costs.

In order to comply with the SES II cost reflectivity, we would suggest that CAA should use modulation if necessary to differentiate between enroute and TMA by recognising
that the complexity of the London TMA causes the cost variance, rather than the weight differentials of aircraft. By using the SES II ability to apply a modulation for areas of complex airspace, rather than an arbitrary weight based calculation, cost recovery for all aircraft using London TMA could be more equitably achieved.

We would also like to have visibility of the criteria on which the assumption was based that London TMA is a Terminal Zone.

It is also important to note that we expect unit costs to reduce year on year, based on continuous improvements in cost efficiency.

Q.7 Do respondents agree that there should be a separate price control for Oceanic services based on a relatively simple and low-cost price review process?

Yes we agree with this statement. It is also key especially for Oceanic services, that the usage of data link is increased. We suggest that some form of data-link incentive should be introduced which allows for a reduction in charges when an aircraft uses data-link.

Q.8 Do respondents agree that there should continue to be no price cap for North Sea Helicopter services but the costs and revenues (excluding the East Shetland Basin) should continue to be taken into account in the charging till for setting the enroute charge condition?

Yes, we are in agreement with this statement.

Q.9 Do respondents agree that it is appropriate for NERL work as part of the SESAR Joint Undertaking to be conducted by the regulated business and recovered through the Eurocontrol charge?

We support this statement in that there is work that the investment needs to happen, and there is money available via the Eurocontrol charges.

We need to understand via benchmarking what other ANSPs involved in the Joint Understanding are doing with regards to their SESAR investment projects. What we are clear must be avoided is that British Airways along with other UK carriers pays directly through NATS for development projects, and then pay again via en Eurocontrol enroute charges, particularly if other ANSPs have used JU funding where NATS have not, which acts as a defacto subsidy by the UK.

NATS must ensure that they maximise the potential use of JU funding.

As a baseline point of view, we do not expect to see unit charges to increase to cover SESAR when European funding is available.

We also need to understand if there are any other available options for external funding, for example governmental funding, that can be explored for general development, or projects within a specific arena, for example Environmental or fuel efficiency.
Discussion and clarification is also required as to the mechanisms at play if using airline user charges, NATS were to develop something, which subsequently becomes a source of one off or regular income to NATS.

We believe that there needs to be detailed and regular reporting of NATS SESAR work to allow users confidence and input that NATS are managing this work in a timely, effective and cost efficient manner.

Q.10 What are respondents’ views on how the risks of the SJU should be reflected in the price control?

We suggest that as the SJU is mainly Opex spend; it should be managed on that basis. To try and estimate what Capital expenditure could arise during the SJU work, would be difficult and could easily result in an overprovision in the RAB.

There are risks that agreed capital expenditure and milestones for NATS non-SJU projects could change as a result of SESAR changes, and this needs to be carefully managed by using a greater degree of transparency on progress of programmes, and continual feedback of rising issues to allow airline customers to participate in decision-making and setting priorities.

Q.11 Do respondents agree that the CAA’s approach described above represents a workable approach for the medium term, which is sufficiently flexible to accommodate currently foreseeable change?

Yes, we agree in principle at this level.

Q.12 What are respondents’ views on the balance of incentives facing NERL and the potential risks to users in the development by NERL of new products?

We suggest that the most critical point is that NERL should be incentivised to move forward with unplanned developments that arise subsequent to the start of Control Period 3.

A potential risk to users could be that NERL reprioritises its planned CP3 portfolio of developments, as agreed with the airlines based on their priorities as users, in order to pursue an alternative development.

The key mitigation to this, is NERL having a clear understanding of user priorities and in conjunction with its customers setting a clear strategic roadmap, which would allow new alternative proposals to be compared to existing plans in terms of strategic “fit”.

This would leave the two possibilities for NERL to continue with new developments. Firstly, that the users endorsing the new proposal as a beneficial alternative, and replacing something from the roadmap within the same cost base, or as an additional item that users agree is worth increasing the funding for.
There is a need to however ensure that this is not overly inflating RAB at later date.

Alternatively, if it is something the users fail to endorse, but which NERL wish to pursue, NERL could pursue this outside of the CP3 cost allowance, but retain any resulting revenue.

We would support the ability of NATS to offer pricing incentive to users in order to influence behaviours. There are a number of projects which could benefit NATS as well as users, but for which the full benefits will only be achievable by positively influencing behaviours towards adopting certain technology or equipment. We would support the ability of NATS to develop and implement these products and offer service or cost incentives to airlines that adopt these.

**Q.13 What are respondents’ views on the regulatory incentives and/or constraints which might be placed on NERL during CP3 in this respect?**

We agree with the CAA analysis that there is a risk that users may end up paying twice for the same service, and that this must be actively prevented.

We also agree that it would be unacceptable for a basic level of service offered by NERL to be compromised and that therefore this level of service must be clearly defined and suitable incentives and penalties put in place to prevent this occurring. However given the diverse nature of the airline users and their business needs, British Airways would support the ability of NERL to develop and offer enhanced services and/or incentives as options to users.

This would enable users to feed in specific priorities to NERL who could formulate a development response and a related cost. If the benefit to the users is sufficient to offset the cost of facilitating the development, NERL will have an incentive to pursue such development.

If at a later date, further users wish to make use of the development, then the initial users will have had the benefit for the initial period, and once the new users come on stream the ongoing costs should then decrease for those participating.

**Q.14 Do respondents have any other views on any scope issues raised in this chapter, or on questions of scope which have not been covered here?**

There are no further comments.

**Chapter 7 - Interaction between EU Single European Sky II and CP3 Review**

**Q.15 The CAA invites views on its provisional assessment of the potential interaction between UK economic regulation of NERL and the proposed SES II performance regime.**
It is important to recognise that the UK has the only provider with binding targets and full formal regulation. We would therefore fully support the proposed Option II, as described in 7.31.

We fully expect CAA and other UK representatives to be actively pushing forward and influencing SES II in the scope and direction of the standards and incentives.

Q.16 The CAA invites views on its proposed approach to the scope and conduct of the CP3 review, which seeks to align as far as possible the outcome of the CP3 review with the requirements on the UK which are likely to stem from SES II.

As mentioned in the previous question, as the only current ANS provider with binding targets, we firmly believe that CAA must ensure that user requirements developed in CP3 are not diluted via SES.

We anticipate that the customer requirements and resultant standards set as part of the CP3 process, will be significantly more stringent than those put forward under the SES regulation, and that there would be no penalty for NERL in delivering performance over and above that prescribed by SES, if that is the basis on which the CP is based and charged for.

We would therefore not expect that it would be necessary for the Control period to be reopened or amended in order to bring the NERL standards in line with SES, and would expect CAA to actively ring fence key elements and standards as being core to the NERL deliverables.

Chapter 8 – Regulating NERL’s financial arrangements and setting the cost of capital

Q.17 The CAA would therefore welcome views on the relative weight that should be attached to the two objectives set out above.

The use of efficient financing should be a primary objective of any company or organisation, whether regulated or not. The regulation of NERL should be no different in that the most efficient financing should be sought within the acceptable risk profile for the stakeholders.

Likewise, a robust financial structure is also a primary objective of any public company, particularly in light of recent economical events. The regulation of this should be limited to a set of boundary conditions rather than a prescriptive methodology.

Therefore there must be focus on ensuring efficient finance, but weight must also be given to ensuring a robust financial structure to ensure stability of the company and guaranteed continuation of service.

Q.18 Do respondents agree that the two alternative approaches are as set out above; or are there any other approaches to the regulation of finance?
The two alternatives proposed are variants on the structural and behavioural regulation normally applied to monopolies. The objectives of regulation are:

- Protection against exploitation of position.
- Encouragement of efficiency and innovation.
- Minimization of the burden of regulation,
- Promotion of competition.
- Maximization of the proceeds from privatisation and prospects for the firms.

It is incumbent on the regulator to identify the current behaviours and structure of NERL and determine if these need to be changed. If this is the case then the regulation should be applied to address the structural and behavioural issues.

Q.19 Do respondents agree that the CAA should pro-actively regulate NERL’s financial arrangements via licence conditions?

The arguments in the consultation document for continuing to pro-actively regulate were entirely based on the prevention of licensees to financial failure. This in itself should not be a reason for pro-active regulation given the nature of the business and the license renewal mechanism.

The fundamental idea of having licence conditions is to provide a mechanism for regulating a provider of a service. Pro-active enforcement of the licence conditions should therefore also be fundamental rather than a passive regulation.

Q.20 The CAA invites views on what, if any, changes should be made to the existing licence regime.

The licence regime should reflect more accurately the passengers’ priorities by:

- Setting challenging service standards that deliver what passengers would choose in a competitive market.
- Setting price limits to prevent unfair pricing mechanisms and encourage efficiency and innovation.
- Require effective engagement with representative bodies.
- Setting challenging service standards that deliver what passengers would choose in a competitive market.
- Setting price limits to prevent unfair pricing mechanisms and encourage efficiency and innovation.
- Require effective engagement with representative bodies.

We have responded in detail to both CAA consultations in 2006 and 2008 in relation to the NATS licence. If as a result of these consultations, there are specific proposals to change elements of the licence, or regulation of such, then we would be happy to comment on them.
Q.21 Do respondents agree that CAPM should form the principal means of estimating the cost of capital?

See Q.23

Q.22 Do respondents agree that the approach to the market equity risk premium, analysis of beta and the non-zero debt beta provide will be relevant considerations in the CP3 review?

See Q.23

Q.23 Do respondents agree with the CAA’s initial thoughts on the cost of capital as set out above? What other factors should the CAA take into consideration?

General Comment on Cost of Capital Issues:

Requiring NATS to achieve continuous improvement in Service quality levels, along with demonstrably improving cost efficiency should be the primary goals. Cost of capital is one small element of the review, and can be seen as an indicator of the efficiency of NATS as a business.

We will be submitting further detail around the questions raised on Cost of Capital in this consultation, which we will forward at the earliest possible time.

In terms of other comments on the Capital elements of the CP3 consultation, it has been evident from following the progress of the NATS project portfolio that there are still considerable issue with managing spend and programme. The majority of the larger programmes are running years behind schedule and overspending by multiples of 100% with little or no financial implications, with all costs passed on to users, who do not receive the benefits.

Whilst we understand the Capital portfolio is small in comparison to the NATS Opex, and for example, that of BAA; it is important that the appropriate Capex behaviours are developed to demonstrate more rigour in delivering benefits to deadline, making sure that the capital being spent is providing the promised benefits.

We would like to see the development of a better management mechanism to encourage these behaviours and suggest that a system akin to the BAA triggers process is needed-, which has proven to be a very effective tool in galvanising rigorous project control.

Taking into account the complexities faced when dealing with large technical projects such as IFACTs, rather than fixing the trigger on the specific project and completion date as a deliverable, we suggest that the benefit promised and the date becomes the trigger, enabling NATS to deliver an alternative project to the same deadline should difficulties be encountered with the original proposal. Failure to deliver the benefit to schedule then produces a penalty to rebalance the cost to the user and delayed benefit.