INTRODUCTION

1. Virgin Atlantic welcomes the opportunity to comment on the CAA’s proposed approach for the regulatory review leading to the setting of new price controls for the en route and oceanic businesses of NATS En Route Plc (NERL) for the third control period (CP3) 2011-2015.
2. Overall Virgin Atlantic is supportive of the proposed scope of the CAA’s review. However, we maintain reservations regarding the way in which the CAA proposes to undertake this review.
3. Virgin Atlantic is conscious of the highly uncertain environment in which the review will take place both in terms of the commercial backdrop and the evolving regulatory regime.

BENCHMARKING THE PERFORMANCE OF NERL

4. Virgin Atlantic agrees with the CAA’s proposed approach that ‘to derive the most informative and useful results from European benchmarking is likely to require some leadership from the regulator in terms of commissioning and publishing evidence and analysis. The CAA is therefore not minded to remit this topic to NERL and its
customers\(^1\). High quality benchmarking and performance data is a highly valuable source of evidence, through which the regulator can more effectively scrutinise information presented by the regulated company. Virgin Atlantic supports the use of benchmarking analysis wherever possible as we believe this will better inform the CAA’s understanding of achievable efficiency parameters and will increase the robustness and validity of the regulator’s decision.

5. Virgin Atlantic supports the CAA conducting the benchmarking assessment in order to obtain an impartial understanding of the achievable efficiency gains. We press the CAA to ensure that all aspects of benchmarking are considered and that where possible benchmarking is not constrained to comparisons with the practices of other (monopoly) air traffic control providers. In many areas, e.g. IT, benchmarking against other industries will provide a highly valuable source of information to assist the regulator’s decision.

6. Virgin Atlantic recognises the inherent logic in the CAA conducting the benchmarking analysis due to the resources and expertise required. However, the CAA should be mindful of airlines’ knowledge and experience in the purchasing of air traffic control services both from NERL and other providers. Airlines’ contribution is therefore highly relevant with regards to the potential achievable efficiencies of NERL.

7. In addition, whilst the CAA proposes to conduct the bulk of the efficiency scrutiny of NERL business plans and projections for CP3, it should remember that airlines’ priorities are highly dependant on the balance of resources and their efficient use. We welcome the CAA’s recognition that in order to deliver the most value, benchmarking and efficiency analysis should be undertaken in the early stages of consultation to avoid dramatic shifts in expectations.

**APPROACH TO CP3 REVIEW**

\(^1\) CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 39, para. 4.20.
8. Virgin Atlantic recognises the sense in evaluating the approach to the structure and conduct of the CP3 review before it commences. We welcome the opportunity to comment on the relative merits of the proposed ‘customer consultation approach’ compared to the more traditional regulator-led review.

LESSONS FROM CP2

9. The apparent need to reconsider the way in which the CP3 review will take place appears to be borne out of some suggested discontent with the CP2 process. The CAA consultation paper highlights that the CP2 review may have imposed ‘a considerable degree of fatigue on airlines through a protracted process’; questions if airlines were able to engage effectively in the process and ‘influence the strategic issues being considered by the CAA’; suggests that there was some ‘cost entailed for the CAA in developing a sufficient understanding of the evidence’ and that the CAA-led review ‘may have mitigated against a more dynamic exchange of views between NERL and its users’.

10. However, it is not Virgin Atlantic’s view (nor do we believe this is the majority airline view) that the features identified by the CAA posed any substantial obstacles or practical difficulties in the CP2 review process. Indeed, Virgin Atlantic is concerned that the customer consultation approach may result in such outcomes. Consultation fatigue is much more likely given the protracted period which the CAA envisages the customer consultation and formal regulatory approach

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2 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 41, para. 5.3.
3 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 41, para. 5.3.
4 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 41, para. 5.3.
5 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 41, para. 5.3.
spanning. Meanwhile, we remain concerned that the approach may erode our ability to influence the strategic issues being considered by the CAA, if the CAA perceives the outcomes of the consultation to constitute ‘agreement’ (in terms of both output and cost) between the airlines and the monopoly provider as was the case in Constructive Engagement in the airports regulatory review. In addition, the proposed approach will also place a significant burden on airline resources over a protracted period.

**Price Control Reviews for Heathrow and Gatwick Airports and Constructive Engagement**

11. An underlying driver of the customer consultation approach appears to relate to the perceived success of the recent quinquennial review of Heathrow and Gatwick airports. In the consultation document, the CAA states that it considers that ‘Constructive Engagement at both Heathrow and Gatwick was a worthwhile innovation in the structure of the price control review’. However, the CAA goes on to note that it has yet to conduct a formal ex-post evaluation of the conduct of the price control reviews. If the CAA had in fact already undertaken the ex-post review of the airports price control review, we would most certainly hope that the CAA’s opinion of Constructive Engagement would be significantly downgraded.

12. It is well documented that, in Virgin Atlantic’s opinion, the process was inherently flawed in nature which, in turn, heavily influenced the end outcome in favour of the airports. The process was significantly weighted in favour of the monopoly provider, whose entire future is dependant on the outcome of the regulatory review. Logically therefore, and unlike airlines, the airports placed few limits on the resources they were prepared to devote to ensure a satisfactory

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6 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 43, para. 5.9.
result. This outcome is not dissimilar to what might be expected from the NERL review.

13. The CAA’s assessment of the factors that are likely to support a positive outcome of the customer consultation process and the CAA’s suggested approach demonstrate the CAA’s fundamental misunderstanding of the flaws of the airports review and of Constructive Engagement, e.g. the requirement for a ‘commitment on the part of NERL to openness and transparency’\(^7\). Openness and transparency were requirements of BAA in the airports review, however this did not prevent BAA submitting last minute OPEX costs to the regulator, which the airport operator had not discussed with airlines nor given airlines opportunity to comment. Despite this, the regulator permitted such allowances, in part, into the final price control.

**CP3 REVIEW APPROACH**

14. Virgin Atlantic recognises that there may be benefit in developing a greater role for NERL/airline consultation to inform the outcome of CP3. However, we do not believe that this should be at the cost of a diminution in the CAA’s involvement. We remain concerned that the customer consultation approach as currently formulated may lead to this diminution. We believe that the CAA should maintain a strong presence throughout the whole process in order to guard against the material imbalance in the ability of airlines to engage in effective consultation with NERL.

15. Virgin Atlantic appreciates that the core approach would be for NERL to consult on key strategic drivers including: traffic demand, customer requirements, NERL investment programmes and customer priorities - with the intention to produce a business plan to the CAA incorporating airlines’ views. Meanwhile, the CAA would undertake work

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\(^7\) CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 44, para. 5.10.
on business risk, efficiency and the cost of capital. Whilst Virgin
Atlantic does not fundamentally disagree with this division, it should be
recognised that it is virtually impossible to disentangle some of the
work being undertaken by airlines/NERL from that of the CAA. Thus,
whilst the CAA recognises that customers may ‘reflect on and, if
necessary, revise their initial views and preferences’ following
publication of the CAA’s input, there is a real risk that the separation
of these issues may derail consultation.

16. We welcome the CAA’s intention to establish guidelines on standards
of behaviour and expectations of NERL and of airline participants, in
particular requirements for the provision of information from NERL
and the efficient organisation and accurate recording of meetings.

Whilst guidance is of course helpful, there is no mention of how the
guidelines would be monitored or enforced by the CAA. Virgin Atlantic
believes that monitoring and enforcement should be specified in the
guidance in an attempt to avoid the sort of behaviour and activity
identified in paragraph 13 above.

17. Virgin Atlantic does not believe it is sufficient that the CAA is engaged
in the customer consultation process only via a mid-2009 review and
NERL reports from the Customer Consultation Working Group (CCWG)
with complete and agreed minutes. Due to the inherent imbalance in
both the ability for consumers to engage in the process and the
underlying motives of the various parties involved, we believe it is
paramount that the CAA is present at all meetings of the CCWG and
other sub groups where it is deemed necessary by NERL and/or the
airlines. Without CAA presence at the CCWG we do not believe that
the CAA can obtain a clear understanding of the spectrum of views
and the priorities of all parties. The CAA’s direct involvement in the
process would ensure that guidelines on standards of behaviour, set
out by the CAA itself, are adhered to. In addition, CAA presence at the
meetings would ensure the timetable for the customer consultation

8 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-
2015, October 2008, p. 47, para. 5.23.
process is met [another key risk for Virgin Atlantic] and would allow a better understanding of the issues by the CAA. This would enable a smooth transition by the CAA into the development of initial proposals as part of the more formal regulatory review process. This is a clear lesson to be learned from the airport Constructive Engagement process.

18. The CAA defends its intention not to attend these meetings in part due to its experience from the airports price review where the CAA considers that ‘notwithstanding the formal agenda and purpose of the meeting, the presence of the CAA in such discussions tends inevitably to focus users on negotiating with the CAA rather than seeking to resolve issues directly with the regulated company’\(^9\). However, Virgin Atlantic and other airlines requested that the CAA was involved in Constructive Engagement from the outset of the process. Despite this, the CAA declined to become actively involved. Any ‘grandstanding’, as the CAA’s statement implies, is likely to have been a consequence of the frustration experienced by airlines in the Constructive Engagement process, and the pressing need for the CAA to recognise the divergent views due to the attendance of the CAA only in the closing stages of the review. This can be circumvented in the NERL review only by the CAA’s attendance from the outset of the process.

19. In Virgin Atlantic’s opinion, failure by the CAA to participate in the customer consultation process, even if only in an observation capacity, would constitute a dereliction of its regulatory duty.

20. Following a mandate from the CAA to consult directly on elements of the price control review, the CAA acknowledges the need to establish a customer consultation working group (CCWG) and sub working groups to address the issues identified. Whilst Virgin Atlantic recognises the CAA’s intent, we are concerned that the CAA has failed to acknowledge a further failing of the Constructive Engagement process. In Constructive Engagement a complex network of steering

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\(^9\) CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 50, para. 5.35.
groups, working groups and sub-groups served only to weaken the consultation process further, to the benefit of the monopoly provider. Whilst it may be sensible to divide workstreams according to content, the regulated company (able to sit across all workstreams) has a greater ability to ensure the right outcome by ‘divide and conquer’ between different working groups and within an airline which may require input from a number of relevant departments on a single matter. In addition, whilst several fora may be necessary to address all relevant issues, it is difficult (particularly in the current economic environment) for an airline to resource all meetings. Finally, a well specified governance structure and reporting mechanisms between the sub-groups and the CCWG would need to be established. CAA representation at the CCWG and the appointment of two NERL-funded airlines representatives to attend each CCWG and all sub-groups could, in part, ameliorate this problem.

21. We agree that progress should be assessed against key milestones and that the CCWG should report to the CAA on the progress achieved. However, we remain concerned that progress in accordance with the milestones could be undermined by last minute information submissions by NERL to the CAA. We believe that appropriate safeguards should be put in place by the CAA to prevent any regulatory gaming.

22. We note that each airline should have a right to withdraw from the process and that in doing so the customer ‘should accept that it would diminish its ability to influence discussions, and thus any resulting change in the business plan may not be aligned with its interests’. However, we believe that even in the event that a customer decides to withdraw from the customer consultation process, it should preserve the right to take part in the formal CAA process. The CAA should continue to have due regard to the opinions and evidence the customer submits.

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10 CAA Consultation NATS (En Route) PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 52, para. 5.44.
23. Virgin Atlantic is concerned that the timetable would mean that the regulator would be extremely constrained in its ability to return to the full traditional price control review process should the customer consultation process fail to deliver outcomes that would enable the regulator to fulfil its statutory duty.

24. Subject to the caveats outlined above being incorporated into the proposed customer consultation process, in particular the CAA’s direct involvement from the outset, Virgin Atlantic is prepared to support for this process.

**SCOPE OF PRICE CONTROLS**

25. Virgin Atlantic welcomes the opportunity to comment on the possible scope of the CP3 review. Broadly, Virgin Atlantic is supportive of the CAA’s proposed approach, particularly the management of the interrelationship between NERL, SESAR and the requirements of ANSPs under the Single European Skies (SES) II regulation.

26. Virgin Atlantic agrees that activities under the NERL licence should continue to be governed by a revenue or price condition and that the benefits of regulation are likely to outweigh the costs. However, we do not believe in respect of the Eurocontrol cap and NERL revenue that the 50/50 volume risk sharing arrangement should continue. The 50/50 risk sharing arrangement was implemented at a time when, in its infancy, NERL suffered significant financial distress due to an unprecedented downturn in traffic following the events of September 2001. Since then, NERL has established itself as financially robust and profitable organisation. Given this financial stability and based on usual practice in the regulation of monopoly companies, Virgin Atlantic believes the arrangement should revert to NERL bearing 100% traffic volume risk, to ensure ongoing incentives are placed on NERL.

27. Broadly, Virgin Atlantic agrees with the CAA’s preliminary views on the scope of regulation within the price control till relevant to NERL.
28. Virgin Atlantic is a keen supporter of SESAR and the work being coordinated through the SEASR Joint Undertaking (SJU). Virgin Atlantic has supported NERL’s participation in SESAR. However, we recognise that this adds complexity to the CP3 process and raises the question regarding the appropriate mechanism for remunerating NERLs participation. We concur with the CAA’s preliminary view that the SJU work conducted by NERL should be remunerated through the Eurocontrol charge. However, appropriate safeguards should be implemented including: placing sufficient incentives on NERL to manage project risks and costs; and protections to avoid users paying twice for work undertaken by the SJU that are subsequently subject to licence payments. In addition, the CAA should ensure that all financial benefits, in any form, that NERL generates as a result of participation in the SJU should be passed back to users through the Eurocontrol charge. We believe that the risks associated with participation in the SJU should be placed on NERL to ensure that it is sufficiently incentivised to manage its participation, which NERL itself lobbied for, in the SJU efficiently.

29. Virgin Atlantic supports the development and implementation of Functional Airspace Blocks (FABs) and we recognise that this may necessitate some regulatory flexibility. We agree that the CAA should aim to provide a flexible regulatory framework to enable the development of FABs. However, in the absence of firm proposals at present it is not necessary for the CAA to consider the structural changes to regulation that may be required at some future stage.

Interaction between SES II and CP3

30. The emerging SES II performance regime will inevitably require the consideration of the compliance of the CP3 regime and may necessitate some integration requirements. Whilst we accept the CAA’s proposed approach ‘anticipating as far as possible the SES II
requirements in the CP3 review\textsuperscript{11} is appropriate, we believe that certain protections should be implemented. We agree that the CAA should ensure that it is able to modify licence conditions to align NERL performance requirements with those required of the SES II performance regime. However, this should only extend to the circumstance where CP3 standards mean that NERL is not compliant with the SES II performance standards, not where this would lead to a dilution of the standards deemed necessary by the regulator as part of the CP3 review.

**Conclusions**

31. Virgin Atlantic supports the CAA’s proposed approach to CP3 consultation process in regards to the use of benchmarking analysis. Additionally, we support the CAA’s proposed approach to the customer consultation process, provided that the safeguards suggested are put in place and the CAA’s direct involvement is confirmed.

32. Virgin Atlantic agrees with the CAA’s proposals for the scope of consideration of the review.

\textsuperscript{11} CAA Consultation NATS [En Route] PLC Price Control Review for Control Period 3 2011-2015, October 2008, p. 97, para. 7.32.