Date 4 August 2023 ,

Mr. Stewart Carter
Programme Director NR23
Consumer & Markets
UK CAA
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By email to economicregulation@caa.co.uk Stewart.Carter@caa.co.uk

Dear Mr Carter,

IATA Response: UKCAA CAP 2553 Provisional Decision for the next price control review ("NR23")

IATA welcomes the opportunity to submit a written response on the initial proposals set out by the UKCAA in CAP2553 and its associated annexes. IATA support the intention of the UKCAA`s Provisional Decision to reduce NERL's enroute Determined Costs in NR23 from £3,238 million in NERL's business plan to £3,055 million (£ -183M). We note that the figures have slightly disimproved from the initial decision (£-65M), due largely to the updated macroeconomic aspects in combination with an increase in CAPEX and the UKCAA's softened approach on elements of OPEX.

Within the UK airspace modernization in combination with maintaining the level of safety remain the top strategic priorities for our members. While we note a level of ambition with the NR23 plan to achieve this and the UKCAA's clear intent, we are presented with a challenge that already existed at the start of RP2 (2014-2019), namely, that the current technological infrastructure continues to be a barrier to achieving the required airspace change. The Airspace user community are concerned that legacy escape continues to be just that, a legacy!

Given the challenging timelines around delivery of our response we have chosen to formulate it around the price control building blocks as ordered by the UKCAA's consultation document. IATA has engaged and coordinated with a considerable number of geographically diverse airlines and through that process we have endeavoured to deliver as complete a response as possible, reflective of our airline members views.

Airlines are supportive of the position taken by the UKCAA on many of the associated decisions, however, we also take the opportunity to point out some areas that require reconsideration and, or further evidencing. Some specific areas where the UKCAA's judgements should be evidentially justified and currently display strong notions of regulatory discretion are around the area of the DC Pension Scheme and covid-19 TRS debtor recoveries and associated assessment of NERL's efficient costs during the 2020-2022 period. The Voluntary redundancy allowance levels and the voluntary salary reductions (topping up furlough pay to 100% salary - instead of capped at the government allowance or topped up to 80% of salary) are unjustifiable, do not adopt the recommendations of the UKCAA's advisors and significantly are at distinct odds to actions taken by airlines to reduce costs when facing comparable challenges.

We remain available for further discussion, either bilaterally or through an extended process.

Our key feedback is summarized in line with the key areas identified in CAP 2553:

Traffic forecasts

- IATA support application of the latest and updated STATFOR Base Case Forecast by the UKCAA and its continued application for the control period in all areas. We advocate that traffic forecasts, along with macroeconomic inputs, will require additional consideration before the final decision is made in Q4 2023 to ensure the latest available evidence and data is considered.

Service quality targets and incentives

- IATA support that the UKCAA have completed extensive analysis of both capacity and environmental service performance and have maintained the targets on Environment and Capacity in your provisional decision. The targets appear to provide a suitable incentive on NERL in consideration of 2023 performance to date especially in consideration of NERL's acceptance of 2023 targets, outturn traffic levels and the ATM environment.

- The decision on modulation of C2 due to the "uncertainty" of forecasts is not supported for the reasons the UKCAA identifies in its Initial Proposals and sets out in its Provisional Decision for the dismissal of NERL's proposed 3Di Environmental traffic modulation.

UK en route Determined Costs and Determined Unit Costs

- IATA support the intention of the UKCAA`s Provisional Decision to reduce NERL's enroute Determined Costs in NR23 from £3,238 million in NERL's business plan to £3,055 million (£ -183M) We note that the figures have slightly disimproved from the initial decision (£-65M), due largely to the updated macroeconomic aspects along with an increase in CAPEX and the UKCAA's softened approach on elements of OPEX.

- The 26% increase in costs is extreme and should be thought of in full awareness of the cost pressures prevalent for customers as the industry recovers from the covid-19 pandemic and consumers as they navigate the cost-of-living crisis. IATA fully supports the UKCAA in its efforts to deliver a price control that limits the significant increases in charges.

- It is imperative that the UKCAA only allows an efficient level of costs required for the delivery of the required outputs. The UKCAA must continue to have mindful consideration of its statutory duties and strike the appropriate balance in these considerations, ensuring it does not err on the side of excessive caution or in unjustified adoption of the positions of the regulated entity which have the potence of failing customers and ultimately consumers.

Reconciliation review 2020 to 2022

- The reconciliation review of 2020 to 2022 of efficient costs for NERL for leading to a calculated efficient cost baseline in respect of 2020 to 2022 of £707 million to be recovered through the TRS mechanism, is not opposed by IATA but requires further adjustment, namely in reducing the allowance for VR scheme in line with those assessed by the UKCAA's own consultants, Steer, and secondly the reduction in "voluntary salary reductions" to reflect, at minimum, a 20% pay reduction for furloughed staff that was introduced at numerous airlines in the UK.

- As pointed out in our earlier submission on the initial proposals we retain the position that customers and consumers should not fully mitigate the revenue gaps of NERL during 2020/21 due to the extent of traffic decline and cause of such decline being outside of airlines control, i.e., caused by Government restrictions. The traffic risk sharing concept was adopted to incentivise ANSPs to deliver performant services irrespective of normal variations of traffic resulting from airlines business decisions. It has not been conceived as an absolute protection of ANSPs including for events caused by the global pandemic. We once again draw the attention of the UKCAA to the cases in France, Germany, Italy and Norway where various State and NSA policy supports are clear through reduction of cost of capital, reduction or removal of return on equity (ROE), or full State coverage of the losses is evidenced [1] (we include the reference documents in annexes for ease of analysis)

Operating expenditure

- IATA supports the majority of the UKCAA allowances for OPEX, which will require close monitoring, and benchmarking particularly in the early years of the Price Control considering the current macroeconomic pressure the industry faces, we would encourage the UKCAA to undertake an annual review and consult the results with all stakeholders, highlighting the actual cost versus plan and any related matters to cost exempt or pass through, such as inflationary adjustments etc. This could be handled in a similar manner to European states where the NSA is obliged to produce an annual review and report on cost exempt items.

- The removal of challenge applied to Graduate headcount is firmly opposed due to a lack of justification provided by NERL that is recognised by the UKCAA along with the disregarding by the UKCAA of recommendations from the UKCAA's consultants, Steer, that NERL's proposed level warrants reduction. Unless additional, compelling evidence is presented by NERL the CAA should maintain its Initial Proposal and the advice given by its own independent advisors.

- The decision that pays benchmarking presents too many difficulties is, in the view of IATA, an incomplete step in process and inappropriate due to the significant impact that Staff cost has on the overall cost base. Due diligence and sufficient analysis should be carried out on all aspects of staff costs to reach a suitably evidence-based decision. Conflictions in evidence should be further investigated and assessed.

Pension costs

- IATA welcome and support the position taken towards NERL's DB pension scheme. We do however question if the adoption of the mid-point of the benchmark range, assessed by GAD, is the appropriate point and represents the most efficient costs. Given the scale and regulatory protections, we encourage the UKCAA to again review this in terms of efficiency for the DB Scheme

- For the DC new joiner Scheme, while IATA understand the CAA's decision reflects the limited Transport sector comparators and has set forward the level of employer contributions to be accounted for at 12%, when analysing the evidence presented in the GAD report of a reasonable sized comparator group, presented by in the form of FTSE100 companies, there is a clear representation that an employer contribution rate of 11% is reflective of market conditions and should not unduly hamper NERL in its recruitment of staff, especially in consideration of the overall reward packages and career opportunities offered by NERL.

[1] France- 1 st July French Airspace Users' consultation meeting Revised French RP3 cost-efficiency: cost of capital calculation.
Spian-ESPP3 Spain Performance Plan for RP3: 2020 – 2024 Air Navigation Services
Italy- RP3 Performance Plan- Stakeholder Consultation 06 Sep 2021
Germany-BAF Supplementary Information ENCOM - En-route Charging Zone Germany Reference Period 3 (2020-2024): 31 May 2022
Norway- Ministry of Transport- Supplementary Information ENCOM – Enroute Charging Zone Norway Reference Period 3(2020-2024):01 June 2023

Capex

- IATA welcome the additional independent scrutiny that will be provided by EGIS on the CAPEX review. As this review will not be available until early Autumn, we reiterate the changes to the DP Enroute and Common Platform programmes proposed by NERL are highly concerning, along with the level of consultation that accompanied these changes. The impact of any continued delay could have a pronounced impact on service quality and cost efficiency throughout this and future control periods.

- We are encouraged that the UKCAA will conduct an *ex-post* analysis of NERL's CAPEX for RP3 and NR23 in the round ahead of the NR28 price control.

- In considering measures to strengthen the CAPEX delivery incentives placed on NERL. We urge the UKCAA to also undertake further targeted consultations aimed at strengthening CAPEX delivery through associated incentives. We request that the UKCAA place clear requirements on NERL to establish and publish cost, delivery and benefit expectations for projects ahead of initiation, following independent reviewer assessment and customer support.

Regulatory asset base and regulatory depreciation

- IATA recognize that the UKCAA have taken considerable steps to minimize the impact by spreading the recovery of TRS over 10 years with an even split of cost recovery between NR23 and NR28. However, this could also lead to significant inflationary adjustments in the coming years which could drive up the cost further.

- We reiterate that IATA opposes applying the allowed WACC to the TRS revenues, noting that the impact of the covid-19 pandemic was outside the control of airlines, and the full WACC was not applied by several European states notably France and Germany, while no ROE was applied in Italy for 2020- 2022. We would encourage the UKCAA once again consider the regulatory precedent shown by European states.

- The UKCAA should also follow the regulatory precedent established by European states in disclosing the contents of the RAB. With the TRS recoveries established as a separate reporting line, the approach should be extended to the full RAB contents to enhance transparency.

WACC and corporation tax

- The airline community maintain the view that NERL is a relatively low risk business with significant regulatory protections and as such has greater access to financial independence than our members. We support the adoption of the latest evidence and information to update the parameters proposed in a range for the RPI-real vanilla post-tax WACC of 2.31% to 4.06%, with a point estimate of 3.19% in the UKCAA provisional proposal. These parameters should be continually assessed and updated up to the point of publication of the UKCAA's Final Determination.

- IATA support the iimproved transparency which will be derived from presenting the tax allowance as a separate line in Determined Costs, we also note and support the updated information lowering the tax liability by some £18M.

Non-regulatory revenues

- The revision to NERL's non regulatory revenues is supported; however, this must also be seen in the context of potential additional opportunities that could arise from the charging scheme for "new Entrants" and should be reviewed after the work on a new charging scheme is finalized.

Overall revenue and unit rate/Benchmarking

- The 26% increase proposed year on year must be seen in the overall context that when compared to other Eurocontrol states it is only outstripped in 2024 by states who are suffering the continued effects of virtually no traffic due to the war in Ukraine (e, g. Estonia, Finland). Airlines have and will continue to face significant increases across operating costs and the significant increases in the UK unit rate contribute to these challenges and the costs to consumers. To preserve the UK's competitiveness and to assist the airline industry, which is still emerging from the worst financial crisis in its history, we respectfully urge request the CAA to revisit and lower the proposed increase in the unit rate. In short, these cost increases in the UK and other jurisdictions ultimately are passed along to the traveling public.

- IATA again call for prudence and scrutiny of all cost elements throughout the control period.

Regulatory mechanisms to manage uncertainty and support innovation.

- Airspace Modernization Strategy (AMS) is and remains a key priority for IATA and our members, as such we support the mechanism allowed to continue development of the UK technological infrastructure under the AMS. The CAA maintenance of the AMS Support fund is acknowledged, we go one step further and urge the UK Government to further promote, support and fast track Airspace modernization, especially of the lower airspace. The AMS will reduce fuel burn and greenhouse gas emissions and make flying safer and more efficient by reducing flight times.

- The proposal to amend and spread the -10% traffic risk sharing mechanism is broadly supported, we would also encourage the UKCAA to consider implementing a similar regulatory step in that if a greater than -10% traffic situation was to occur then a similar reconciliation for efficient costs to that conducted for 2020-2022 be conducted. There is also a potential requirement to include a defined re-opener clearly establishing at what level of traffic depression in a singular, consecutive, or multiple year scenarios the CAA would instigate a review of the price control and subsequent recovery of efficient costs. Finally, spreading the recovery of revenues over multiple years where there are unexpected traffic reductions over 10% will help mitigate the impact of a significant decline in traffic on user charges.

- Considering inflation adjustments, IATA`s position is that the mechanism was originally intended to mitigate, for the involved entities, the risk to absorb through the cost risk sharing any deviations in costs that are due only to inflation. The adjustment is calculated on the total determined costs, under the assumption that the plan is binding and, therefore, executed in full. But, when a part of the plan has not been executed such as capex deferral, it makes no sense to adjust ex post the inflation, as well as regulatory return, on cost that never happened or was incurred in a later year than originally planned in the price control. That could mean NERL is receiving additional income for non-delivery of a part of the plan, and the users must pay extra costs without having received anything in exchange.

- IATA fully support the UKCAA position on not accepting NERL's proposal to include transfer costs from the DB pension scheme to the PCA. We support the recognition that the proposed costs have no value to consumers and as such as is correct to not incorporate NERL's request.

- IATA welcome the UKCAA position to not include a TRS mechanism for Oceanic traffic and remain fully supportive of the need for an independent cost/benefit review of the introduction of SB ADS-B data charges as well as the development of quantitative metrics to measure its benefits against plan, as outlined in the CMA review and CAP 2351

- IATA support the UKCAA proposed changes to the CAPEX engagement incentive and that it remains a penalty only scheme. Include including the simplification of the scoring process will drive stronger and much needed users' engagement.
- IATA also welcome the decision to implement a User Pay Principle approach to new users in UK Airspace. We would request that the UKCAA lead the development of this new charging scheme, not NERL as the UKCAA in our view, is better positioned to include developments and scrutiny the ongoing developments at ICAO and Eurocontrol level, rather than NERL.

We remain available for further discussion and look forward to further engagement with the UKCAA`s before finalisation of your proposal during 2023.

Yours sincerely,

Rory Sergison,
Head, ATM Infrastructure, Europe
Regional Safety and Flight Operations,
IATA

ANNEX 1. Supporting Information

ANNEX C - FR - 8 - French Airspace user (

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ESPP3 1.5_ Main Doc & Adoption.pdf

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Annex C - Stakeholder consultat