

RP2 Customer Consultation Working Group - Report from Co-Chairs

1 Introduction

1.1 BACKGROUND

NERL and airline customers have completed the Customer Consultation process mandated by the CAA as part of the process for setting NERL's price controls for Reference Period 2 (RP2) - the five year price control period starting on 1st January 2015.

In April 2013, the CAA set out the terms of the mandate for Customer Consultation in its document "The CAA process update for the economic regulation of NERL and contribution to the UK-Ireland FAB Performance Plan for Reference Period 2 (2015-2019) of the Single European Sky Performance Scheme: A Mandate for Customer Consultation between NERL and airspace users."

The results of the Customer Consultation are intended to inform the further stages of the economic regulation process which will be progressed initially by the CAA during the remainder of 2013, and in 2014 within the framework set by the European Commission for RP2.

1.2 PURPOSE

The purpose of this report from the Co-chairs of the Customer Consultation Working Group (CCWG) to the CAA is to present a summary of:

- The Customer Consultation process (Section 2.1) and an assessment of its overall effectiveness (Section 2.2).
- The areas of agreement and disagreement that have been identified through the consultation process in respect of each of the major elements of the Revised Business Plan (RBP) that NERL will submit to the CAA by 18th October 2013. (Section 3 and Appendix). This comprises the main content of this report.

2 The Consultation

2.1 THE PROCESS

Customer representation in the process

In March 2013 NERL issued invitations to join the RP2 Customer Consultation process to their airline, trade body and business aviation customer organisations. Following this invitation, 30 customer representatives from 15 organisations (see Annex 1) signed up to the process. Together, they represented the majority of movements through UK airspace and a comprehensive cross section of airline interests and trade associations.

Working Arrangements for the Consultation Process

Following consultations with stakeholders in 2012 the CAA laid out in its April 2013 Mandate document the timetable for, and its expectations for the governance of, the process of Customer Consultation that NERL would undertake with its airspace users to review and refine its Business Plan for RP2. The Mandate included a list of the issues to be covered, on which the CAA expected outputs through the consultations.

A kick-off, plenary meeting was held on 29th May 2013 when the CAA presented the context of, and their Mandate for, the Customer Consultation process. Working arrangements for the Customer Consultation were discussed and drafted, and after some amendments, subsequently agreed in a document entitled "Final CCWG Working Arrangements". The Customer Consultation Working Group (CCWG) was established and it was agreed that it would be co-chaired by Mark Gardiner - Airport Development Manager, British Airways - who would also act as coordinator of the airspace users' views, and Hugh Westaway – acting as an independent co-chair. Both would have a duty of care to the CAA. The Working Arrangements also set out rules for, inter alia, the management of meetings, timely preparation and distribution of papers, presentations and minutes including the use of a dedicated NERL customer web site.

NERL proposed a programme of meetings and workshops, and outline agendas which were agreed. These were amended with the agreement of the CCWG, as the process progressed, by the addition of extra meetings of the CCWG or smaller meetings between NERL specialists and members of the airspace user community to explore specialist topics. In recognition of the complexity of the operating costs extra time was taken within the consultation process to explain further the various elements of the NERL cost base. Time was also allocated to the Oceanic service.

The dates of the CCWG meetings and/workshops held and their main subject matter are summarised below.

Date	Meeting	Main Subjects/Purpose
29 th May	Meeting One	<ul style="list-style-type: none"> Reminder of consultation process Initial plan presented
5 th June	Workshop One	<ul style="list-style-type: none"> Customer requirements Trade-offs
19 th June	Workshop Two	<ul style="list-style-type: none"> Operating Expenditure
3 rd July a.m.	Workshop 3	<ul style="list-style-type: none"> Traffic Forecast
3 rd July p.m.	Workshop 4	<ul style="list-style-type: none"> Oceanic consultation
10 th July	Workshop 5	<ul style="list-style-type: none"> Capital investment
7 th August	Contingency workshop	<ul style="list-style-type: none"> Capex Business Case Approach, Rostering and pay scales
4 th September	Meeting 3	<ul style="list-style-type: none"> Present areas of agreement/disagreement Present proposals for plan amendment

Airline group members also met separately in order to develop their questions and positions ahead of meetings with NERL.

NERL Business Plan for Customer Consultation

On May 10th NERL issued a document entitled "RP2 Business Plan (2015-2019) for Customer Consultation" (the Initial Business Plan or IBP), which it had issued as input to the process. At the kick-off meeting, NERL presented the IBP document and the two plans it contained – Plan 1 and Plan 2 - both of which offered reductions in prices but with different levels of service.

This report does not give a complete summary of the different elements of Plans 1 and 2, nor of the revisions NERL propose to reflect in response to the consultation in the RBP which it will submit to the CAA by 18th October 2013. However in order to provide some overall context to the statements of agreement and non-agreement on each major issue, a table which NERL presented at Meeting 3 of the CCWG is included below. It summarises measures of the main outputs and inputs, in terms of absolute levels or changes, that were included in the two plans in the IBP and that NERL proposes to include in the RBP. The inclusion of the table in this report does not imply the airline groups'

acceptance of any of the three plans. Whilst there is alignment on some aspects such as safety and the broad capital programme, the airline community stopped short of complete endorsement of the RBP because there are still some challenges airlines want to ask the CAA to look at which may result in improvements from the airlines' point of view, including a lower cost base.

Summary Table of Key inputs and outputs in the IBP and Proposed for the RBP

	Cost Efficiency (real DUC reduction per annum)	Price Reduction (real saving end RP2 v end RP1)	Operating Cost (real saving v 2011 actual)	Service (NERL attributable En Route ATFM delay*)	Service (resilience risk)	Safety (lower risk per flight)	Fuel Saving by 2019	Capital Expenditure (RP2 total 2012 prices)
PLAN 1 Service led plan at lower price	-5.3%	-17%	-12%	< 6s	Low Risk	13% (same as today)	£180m pa (276KT)	£610m
PLAN 2 Price led plan	-6.0%	-19%	-14%	6-12s	Moderate Risk	13% (same as today)	£100m pa (153KT)	£560m
REVISED BUSINESS PLAN	-5.6%	-18%	-13%	< 6s	Low Risk	13% (same as today)	£180m pa (276KT)	£575m

Source: NERL presentation to Meeting 3 on 4th September 2013.

2.2 CO-CHAIRS' ASSESSMENT OF EFFECTIVENESS OF THE CONSULTATION

From the co-chairs' perspective the initial working arrangements agreed for the Customer Consultation were appropriate to the task, were modified only by agreement, were complied with by both NERL and airspace users, and worked well.

NERL worked with the co-chairs to ensure the meetings were well-planned and effective and provided well-structured and clear information ahead of all meetings.

Customers were well organised through pre-meetings with their nominated co-chair, Mark Gardiner, building alignment around their approach to key issues but care was taken to ensure that the discussions were in compliance with IATA competition law guidelines at all times.

There was excellent customer attendance and involvement at the consultation meetings at which discussions were open and constructive throughout on the part of both NERL and airlines.

The co-chairs are of the view that the consultation process addressed the CAA's mandated questions to the extent possible within the constraints of the limited time available, given the range and complexity of the issues, and that results from the studies commissioned by the CAA were not available during the consultation process.

NERL are of the view that the Mandate has been fully met: NERL provided significant amounts of relevant and detailed operational and financial information to airlines, hosted a long series of workshops which were well attended by customers, allowed a generous amount of time at all workshops for question and answer sessions and answered all follow up questions from airlines

raised during that process. NERL believe this report reflects the key conclusions of those discussions and in a number of cases (for example, governance), a more detailed exposition of the airlines' view.

Airlines are of the view that the mandate was only partially fulfilled because of the lack of time and detailed information from NERL - especially on business cases, and the absence of results from the CAA consultancy studies during the consultation process.

The airline group indicated at Meeting 3 that they will submit a supplementary paper to the CAA giving views on some additional specific issues which they felt there was insufficient time for them to develop during the consultation process:

- Level of opex including contingency and pensions;
- Collaborative governance arrangements in general and on capital investments in particular;
- The need for greater ongoing transparency on business cases and project management.

(In addition, the airlines will submit to the CAA their views on the weighted average cost of capital (WACC) which was not within the scope of the Customer Consultation).

The co-chairs also believe that the summary in this report of areas on which customers were agreed or not agreed with NERL's proposals, when used in conjunction with by the minutes and other material from the CCWG meetings and workshops, should provide the CAA with useful inputs to the RP2 review.

3 Key outcomes from the consultation

The landscape tables in the Appendix at the end of the report are the heart of the report. They contain the main outcomes of the consultation process in terms of key points that either have, or have not been agreed in relation the NERL IBP and RBP. They are set out under headings of each of the main elements of the plans.

4 Conclusion

As the co-chairs of the Customer Consultation Working Group we have to reflect that there is a difference of view between NERL and the airlines on the extent to which the mandate from the CAA has been met.

NERL are of the view that the Mandate has been fully met and that the substantive issues raised during the consultation process were addressed.

Airlines are of the view that the mandate was only partially fulfilled because of the lack of time and detailed information from NERL - especially on business cases, and the absence of results from the CAA consultancy studies during the consultation process.

We believe that the process has nonetheless improved mutual understanding and alignment on issues of importance to their businesses. It has also identified some areas, notably on governance, in

which further collaboration, whether inside or outside the RP2 process, might benefit both NERL and its customers in RP2 and beyond.

We want to thank NERL and their customers for their positive engagement which has simplified our task.

APPENDIX OF POINTS AGREED/NOT AGREED

3.0 CUSTOMER PRIORITIES

Element	Airlines' View	NERL's View	Status
<p>3.0.1</p> <p>Customer priorities</p>	<p>3.0.1</p> <p>Maximise price reduction and fuel-efficient flight profiles whilst continuing to provide a safe, consistent and resilient service.</p> <p>Airlines are not persuaded that the RBP goes as far as it could in maximising price reductions whilst still meeting the other priorities. There are a number of areas, which will be addressed in a separate paper to the CAA, in which airlines believe costs might be reduced; mainly pensions and operational contingency levels. There was also insufficient information on some areas – notably detailed capital investments business cases for airlines to judge whether value for money would be delivered.</p>	<p>3.0.1</p> <p>In section 3.4 of the IBP, NERL summarised its understanding of customers' priorities for services. In essence:</p> <ul style="list-style-type: none"> • First and foremost they are safe; • They provide efficient flight profiles , imposing no delay and being as resilient as possible; • They have low total costs from both 'direct' charges and 'indirect' ATC-related flight inefficiency (fuel) and delay costs. <p>Accordingly, IBP Plans 1 & 2 both offered significant price reductions but to different extents, reflecting different service offerings on the spectrum between the two Plans. NERL has responded to customers' views from the consultation by proposing that the RBP be based on an intermediate mix of service delivery and charges. NERL's proposals for each of the main components are described in more detail below.</p>	<p>3.0.1</p> <p>Agreed</p> <p>Not agreed</p>

3.1 TRAFFIC FORECAST

Element	Airlines' View	NERL's View	Status
3.1.1 Use of STATFOR forecast for the Business Plan	3.1.1 The airlines accept that in the absence of a better alternative the STATFOR forecast should be used subject to the points below.	3.1.1 NERL has used the February 2013 STATFOR forecast in the IBP and will use the May STATFOR forecast in the RBP because: A) The forecasts are similar to NERL's own forecasts, and B) STATFOR will be the independent source for the EC forecast for the target setting and assessment.	3.1.1 Agreed
3.1.2 Transparency of Forecast	3.1.2 Airlines want full transparency of the forecast that is used in the CAA's determination.	3.1.2 NERL recognises the importance of transparency of the forecasts and has had a specific workshop on this topic for the relevant inputs in relation to the IBP and RBP.	3.1.2 Agreed
3.1.3 Airlines' engagement on forecasting	3.1.3 Airlines want to be more engaged with STATFOR directly to understand the STATFOR forecasting process and to influence the development of the model to improve the robustness of the model and reduce forecasting risk. This will be focused around understanding the model assumptions and the treatment of load factors and economic drivers. Airlines welcome the opportunity that NERL have	3.1.3 NERL fully supports the Airlines' desire to improve their understanding and engagement with STATFOR and has facilitated this.	3.1.3 Agreed

	<p>facilitated to engage with STATFOR to achieve a better understanding of their forecasting process.</p> <p>Airlines understand that once the RBP has been submitted by NERL it will be for the CAA to decide whether to make any changes to the forecast before it makes its final decision on the NERL price control.</p> <p>Airlines want any changes to the forecast at any stage in the RP2 process to be made transparent to airlines and the impact of the changes to be carried through to the other aspects of the settlement.</p>	<p>NERL do not intend to make any changes to the forecasts before the RBP is submitted to the CAA on 18th October 2013 – this plan will be based on the May STATFOR forecast.</p> <p>It is a matter for UK/EU regulators whether, prior to the start of RP2, they use a more up to date STATFOR traffic forecast as the basis of UK/Ireland FAB RP2 Performance Plan.</p>	
3.1.4 Oceanic Traffic Forecast	3.1.4 Airlines agree on the process that NERL have set up to derive a format for Oceanic for the STATFOR forecast.	3.1.4 NERL business plan for Oceanic is based on a traffic forecast based on the STATFOR forecast.	3.1.4 Agreed

3.2 SAFETY PLAN

Element	Airlines' View	NERL's View	Status
3.2.1 Safety is paramount	3.2.1 Complete agreement on the paramount need to consistently deliver a safe operation.	3.2.1 The business plan is to further improve on NERL's already high safety performance with risk per flight reducing year on year.	3.2.1 Agreed
3.2.2 Reduction in the safety risk	3.2.2 Agreement on the reduction of risk per flight in the safety plan of 13% proposed by NERL to maintain the current levels of safety as traffic increases in RP2 period	3.2.2 NERL's strategic aim is to deliver a 35% reduction in accident risk per flight during the period 2013-2025 which translates into a 13% reduction in RP2.	3.2.2. Agreed
3.2.3 Carriage of transponders by GA.	3.2.3 Airlines want to work with NERL and the regulator to legally require general aviation to carry transponders to improve safety.	3.2.3 NERL also wishes to reduce the risk to safety from general aviation by encouraging their carriage of transponders. However, NERL emphasised that the mechanism for delivering this was through FAS, in conjunction with the CAA, instead of customer consultation.	3.2.3 Agreed

3.3 SERVICE QUALITY – CAPACITY / DELAY

Element	Airlines' View	NERL's View	Status
3.3.1 Relevance of Service Measures	3.3.1.1 Airlines acknowledge that the T1 service measure mandated by the EC must be used in the NERL business plan.	3.3.1.1 The Business Plan service measures are those mandated by the EU for RP2 and/or those put in place by the CAA for RP1.	3.3.1.1. Agreed
	3.3.1.2 The EU service measure of performance T1 is a measure of limited value to airlines. The T2 and T3 measures are recognised by airlines to be of more relevance.	3.3.1.2. NERL acknowledges that T1, T2 and T3 may not measure all aspects of service performance that is currently relevant to Airlines but believe they reflect some relevant aspects of performance for airlines.	3.3.1.2 Agreed
3.3.2 Level of performance targets	3.3.2 The targets set for each of these are insufficiently challenging and are a poor basis for incentivisation of NERL because they are already being 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.	3.3.2 NERL notes that airlines believe that the target levels of performance for RP1 were insufficiently stretching, but understands that actual service delivery to Airlines during this period has been broadly acceptable. Maintaining performance at these lower levels, as proposed in the RBP, will be stretching in RP2 which is a period of expected traffic growth with significant changes in processes and systems.	3.3.2 Not Agreed

3.3.3 Incentives cap on Service	3.3.3 The 1% revenue cap is too low and Airlines would be prepared to pay more to incentivise NERL more strongly to improve performance against performance measures relevant to Airlines. They recognise that the current EU charging regulation sets a 1% cap.	3.3.3 NERL understands the Airlines' desire to increase the level of incentives available in RP2. However, such forms of incentivisation may not be permitted by the EU charging regulation.	3.3.3 Not Agreed
3.3.4 Wider collaboration on incentives	3.3.4 NERL should have some financial incentives to collaborate more widely with other service providers and the airlines in the industry in order to improve performance in areas for which NERL is not directly accountable e.g. weather delays.	3.3.4 NERL is happy to continue working collaboratively with customers on all aspects of service, including mitigating the impact of delay caused by weather. NERL believes it should only be financially incentivised against areas that are directly under its control.	3.3.4 Not agreed

3.4 SERVICE QUALITY – FLIGHT EFFICIENCY / ENVIRONMENT

Element	Airlines' View	NERL's View	Status
3.4.1 Flight Efficiency Metric	3.4.1 The 3Di metric is of more relevance to Airlines than the horizontal or 2D metric required by the EU and is acknowledged by them as being at the leading edge as a measure.	3.4.1 NERL is encouraged by the Airlines' support for both the use of the 3Di metric in the RBP and for its further development.	3.4.1 Agreed
3.4.2 Planned Flight Efficiencies	3.4.2 Airlines support the higher end of the range of fuel savings of £180m proposed by NERL in their RBP.	3.4.2 NERL will include the high end of the enabled fuel saving range (c. £180m by 2019) in the RBP in response to feedback from Airlines.	3.4.2 Agreed
3.4.3 Assurance on fuel savings delivery	3.4.3 Airlines currently lack confidence that the full extent of airline fuel-savings benefits identified by NERL through their modelling are being realised in practice. 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.	3.4.3 NERL acknowledges the Airlines concerns and has committed to work with Airlines to help ensure the delivery of actual benefits.	3.4.3 Agreed

<p>3.4.4 Flexible use of Airspace</p>	<p>3.4.4 Airlines support the development of the flexible and dynamic use of airspace to deliver more efficient routings.</p>	<p>3.4.4 NERL is committed to the UK’s “joint and integrated” approach to ATC service provision with its emphasis on sharing, rather than segregating, airspace (which is a show-case model within Europe for flexible use of airspace and design), and to contribute to its development in order to deliver further benefits for users.</p>	<p>3.4.4 Agreed</p>

3.5 NON-REGULATED INCOME

Element	Airlines' Views	NERL's Views	Status
3.5.1 Level of Non-Regulated Income in RP2 Plan	3.5.1 Airlines are content that the RBP responds to Airlines' request to maximise non-regulated income subject to the results of CAA studies.	3.5.1 The RBP will include a stretch target of £5m of revenue above the range in the IBP Plans 1 and 2, which NERL believes is the maximum credible within market constraints.	3.5.1 Agreed
3.5.2 Cost and revenue allocation	3.5.2 Airlines seek reassurance on the allocation of costs and revenue between regulated and non-regulated activities that will be provided by the CAA's consultant report. . Airlines welcome the CAA's confirmation that 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 that will ensure a like-for-like comparison between the plans.	3.5.2 NERL has confirmed the appropriateness of cost and revenue allocation between regulated and non-regulated businesses and noted that this is to be reviewed by consultants retained by the CAA.	3.5.2 Agreed

3.6 INVESTMENT PLAN

Element	Airlines' View	NERL's View	Status
<p>3.6.1</p> <p>Understanding of the investment plan</p>	<p>3.6.1</p> <p>Airlines general support for the capital investment programme is heavily qualified due to:</p> <p>A) The limited time available to review a complex capital investment programme.</p> <p>B) Insufficient information provided on the detailed business cases.</p> <p>C) Lack of clear outputs from the SES/SESAR project.</p>	<p>3.6.1</p> <p>The capital investment plan in the RBP will deliver the balance required by Airlines between service quality and cost containment.</p> <p>NERL recognises that the capital investment programme is a complex area to be addressed but has provided as much information as possible in the time available for consultation.</p>	<p>3.6.1</p> <p>Not Agreed</p>
<p>3.6.2</p> <p>Composition of the capital investment plan</p>	<p>3.6.2</p> <p>Airlines support general composition of the capital investment plan and adjustments in timing that NERL have included in their RBP in response to Airlines feedback.</p>	<p>3.6.2</p> <p>The RBP will take account of the Airlines comments and provides the right balance between service delivery and costs</p>	<p>3.6.2</p> <p>Agreed</p>
<p>3.6.3.1</p> <p>Major Capital Investment Projects</p>	<p>3.6.3.1</p> <p>LAMP</p> <p>Airlines support the LAMP capital programme being delivered as per NERL RBP but have concerns about the deliverability of the programme in RP2.</p>	<p>3.6.3.1</p> <p>The RBP will reflect the Airlines support for these major projects</p>	<p>3.6.3.1</p> <p>Agreed</p>

3.6.3.2	3.6.3.2 NTCA Airlines support the NTCA capital programme being delivered by NERL as per their RBP	3.6.3.2 The RBP will reflect the Airlines support for this major project	3.6.3.2 Agreed
3.6.3.3	3.6.3.3 iTEC General Airlines support for the ITEC Programme in RP2 subject to the qualifications in 3.6.1.1 above	3.6.3.3 The RBP includes the iTEC programme in RP2, but given customer priorities for price reduction in RP2, the iTEC plan in the RBP will be the slower deployment consistent with Plan 2 not Plan 1	3.6.3.3 Agreed
3.6.4 Efficiency of Investment	3.6.4.1 Airlines have not had the opportunity to review the efficiency of the capital investments proposed by NERL and look to the CAA consultancy studies to assess this and to improve the on-going governance arrangements to provide the assurance the Airlines require in this area.	3.6.4 The RBP will be based on NERL's assessment of efficient investment costs and this will be subject to review by CAA and its consultants.	3.6.4 Not Agreed
	3.6.4.2 Airlines recognise the need for asset replacement in RP2 but expect NERL to sweat the assets harder given the present financial constraints.	3.6.4.2 The IBP reflected NERL's assessment of the minimum efficient asset replacement/upgrade consistent with Licence obligations, but avoiding nugatory spend (investment and operating costs) on ageing systems. The RBP will acknowledge customer expectation and be aligned to the minimum asset replacement plan (i.e. Plan 2 of the IBP).	3.6.4.2 Agreed

<p>3.6.5</p> <p>Regulatory treatment of investment</p>	<p>3.6.5.1</p> <p>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, SES, SESAR, FAB and airspace change consultations</p> <p>Airlines propose the adoption of ‘Core & Development’ treatment of capital to address these uncertainties.</p> <p>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.</p> <p>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 RP. 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,</p>	<p>3.6.5.1</p> <p>NERL has a highly inter-related capital programme with complex linkages. NERL has created a capital investment plan for RP2 that balances the cost and service performance with the forecast traffic levels. The existing SIP process has provided flexibility to respond well to changes to the business environment while providing assurance of value for money to customers and the CAA. For example, in CP3 in response to lower than expected traffic NERL refocused its capital programme from providing capacity to reducing cost and customer fuel burn. In winter 13/14, NERL will consult with customers on improving the SIP process so that they are more engaged with the capital investment programme during RP2.</p>	<p>3.6.5.1</p> <p>Not agreed</p>
	<p>3.6.5.2</p> <p>Airlines require a structure of ‘Triggers’ to be included in the final settlement to incentivise NERL in the timely delivery of benefits from capital investments, and offer a mechanism that recompenses airlines for benefits that are</p>	<p>3.6.5.2</p> <p>NERL does not believe that the use of ‘triggers’ is appropriate for its project portfolio, given its complex and inter-related nature as well as the scarce and specialist resource required to deliver it efficiently.</p>	<p>3.6.5.2</p> <p>Not agreed</p>

	<p>not delivered as planned.</p>	<p>NERL believes that it is more appropriate to set incentives based on plan outcomes overall – i.e. the delivery of fuel savings and reductions in delays – rather than setting targets for specific individual capital projects. The delivery of some programmes is also partially outside of NERL’s direct control (e.g. public consultation or reliance on other industry stakeholders), which makes it unreasonable to set ‘triggers’ on NERL. Further, it is not clear how this form of incentivisation would be permitted by the EU charging regulation.</p>	

3.7 OPERATING EXPENDITURE

Element	Airlines' View	NERL's View	Status
3.7.1 Level of Operating Cost	3.7.1 Airlines acknowledge that the rate of cost reduction in the RBP places NERL towards the top end of the PRB revised target range (May 2013)	3.7.1 The operating costs to be included in the RBP are at a maximum consistent with delivery of the service levels and low risk profile requested by airlines. As a result of the consultations NERL, the RBP also includes a proposed further 1% of savings compared to the significant reductions already proposed in IBP Plan 1, with service levels and fuel savings remaining consistent with IBP Plan 1 levels.	3.7.1 Agreed
3.7.2 Opportunities for further cost reductions	3.7.2 Airlines believe nonetheless that there are further areas of saving that NERL can make in their in their cost base, in particular; (A) Pensions – has this been managed to industry best practice and is it operating at market levels? (B) Rostering – has rostering efficiency been maximised right across the NERL business? (C) Pay Scales – is best practice for progression through the NERL pay scales been adopted. Airlines note that the above areas need to be addressed in the CAA reports commissioned by CAA consultants.	3.7.2 It is NERL's judgement that the RBP shows reductions of these costs which are the maximum possible to avoid any IR disruption with its associated very high impact on airlines. As part of the 1% total additional savings (3.7.1 above) operational controller deployment (B) has been further optimised from IBP Plan 1 levels by approximately 20 FTEs (just over 1.5%) On pensions, NERL has recently gone through a further round of major reforms to its defined benefit pension scheme, building on the previous round at the end of CP2. From a practical point of view, further reforms to this scheme would come at the price of significant amounts of goodwill	3.7.2 Not agreed

		with the staff and Trade Unions, which would effectively prevent the planned restructuring and working practice changes and savings that are at the heart of the cost efficiency proposals in the RBP and that require their support. Outside of changes to be made voluntarily by the staff and Trade Unions (and which are, additionally, subject to CAAPS Trustee discretion), NERL does not believe any further reforms are legally viable.	
3.7.3 Opex Contingency Costs.	The airlines note that NATS are currently including contingency equating to 5-6% of variable costs, or £7mpa where a competitive and efficient company would normally be expected to work to 1-2% of variable costs.	NERL believes that the proposed level of contingency on total determined costs is reasonable given that determined costs are now being fixed for a reference period that concludes over 6 years from now. Its experience from previous reference periods is that it has more than used its contingency allowance.	Not agreed

3.8 OCEANIC

Element	Airlines' View	NERL's View	Status
3.8.1 Oceanic Strategy	3.8.1 Airlines agree with the Oceanic strategy presented by NERL in the RBP. Airlines are also keen to engage with NERL on the option and costs for satellite surveillance.	3.8.1 The RBP will be based on this strategy agreed with airlines and the acceleration into RP1 of COAST (collaboration of Oceanic airspace and system tools). During RP2 NERL, will bring forward to airlines business cases for satellite surveillance as options become available	3.8.1 Agreed

3.9 GOVERNANCE

Element	Airlines' View	NERL's View	Status
3.9	<p>3.9</p> <p>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.</p> <p>The purpose of these arrangements would be to improve the transparency and engagement on the following ;</p> <p>(A) Strategic development</p> <p>(B) Shaping major programmes and projects</p> <p>(C) A well-defined gateway process throughout the life of the project with a strong focus on expected benefits and delivery.</p> <p>(D) The development of capital investment plans and major project lines</p> <p>(E) The efficiency of capital investments.</p>	<p>3.9</p> <p>NERL is of the view that a good framework for collaborative governance is in place through inter alia OPA, SPA and SIP. However NERL is open to discussions with Airlines on how the governance might be improved and has already begun this process. During the winter 13/14, NERL will offer a proposal for strengthening the SIP process prior to the commencement of the RP2 period.</p> <p>Any proposed scope and strengthening of the governance arrangements through the RP2 settlement should be proportionate and efficient as well as also setting out the commitments that airlines would need to make to fulfil them.</p>	<p>3.9</p> <p>Agreed</p> <p>Not agreed</p>

	<p>These new governance arrangements should::</p> <ul style="list-style-type: none"> • 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 and more appropriate cross-section of the airline community representing airline operational, strategic and business areas. 		

3.10 COST OF CAPITAL

Element	Airlines' View	NERL's View	Status
	<p>3.10</p> <p>The NERL RBP has been based on a cost of capital set for CP3 and the cost of capital did not form part of the discussions for the RP2 consultation.</p> <p>Given the central importance of the WACC in the overall settlement the Airlines welcome the CAA's engagement of consultants to review the cost of capital for RP2. The Airlines will make their own submission on the cost of capital to the CAA. Transparency of this paper will be provided to NERL.</p>	<p>3.19</p> <p>Reflecting independent advice from Oxera, the RBP will assume a reduced real vanilla WACC from the IBP (from 5.7% to 5.1%), mainly reflecting the lower real cost of debt.</p> <p>The final RP2 WACC will be based on the allowed cost of capital set by the CAA within its determination.</p>	<p>Not agreed</p>

Annex 1

Organisations which signed up to the Customer Consultation		
Aerlingus	ELFAA	Monarch
American Airlines	Flybe	Ryanair
British Airways	IATA	TUI
CityJet	Jet2	United Airlines
easyJet	KLM/Air France	Virgin

End of report.