

International Air Transport Association (IATA) response to the CAA consultation of July 2012 on the process for developing economic regulation for Reference Period 2 (RP2) under the Single European Sky

1. In our view the CAA Decisions of December 2010 that were subsequently the basis of the cost-effectiveness target applied to the UK National Performance Plan (NPP) for 2012-14 or RP1 were over-generous and insufficiently challenging.

2. The 6 July 2012 letter from Matthew Baldwin EC Air Transport Director to the CAA and NATS was therefore of no surprise to us, and we certainly agree that the shortfall identified from RP1 should be recovered during the early stages of RP2 with full transparency, and that the return on equity should better reflect the real risk faced by ANSPs.

3. We recognise that as a part-privatised company, and as allowed within their Licence, NATS should be financially sound and successful. We are also aware that financial performance impacts credit ratings that affect the cost of borrowing. NATS profits and dividend payments over the last three years however can be viewed as excessive against the original NPP intentions of not for commercial profit, of NATS monopoly status and with the 2nd highest charges and the highest ROE in the EUROCONTROL area. This further indicates that economic regulation has been too benign.

4. We fully support the EC requirement and Performance Review Board (PRB) expectation for strengthening the role of Functional Airspace Blocks (FABS) for RP2. In our comments to the EC/PRB on the States' NPPs for RP1 we noted our disappointment that with very few exceptions there was generally no evidence of FAB coordinated efforts to reduce costs. In our view such efforts are an obvious vehicle to assist achievement of the necessary cost reductions and cost-effectiveness improvements required by the EC ANS Performance Scheme.

5. We are therefore pleased the CAA anticipates (3.3) that UK & I will submit a joint FAB plan for RP2 demonstrating that investment projects are assessed on the basis of FAB benefits including the assessment of investment projects together with clear accountabilities for delivery of the targets.

6. We have some concerns however regarding the CAA expectations that the FAB plan will pursue greater economic value for the users. While we of course very much welcome the claimed EUR 24.5 m savings from the UK & I FAB in 2011, particularly given the rising cost of fuel which is now some 32% of our operating costs, these savings are almost entirely operational (delay and fuel) related and could have been delivered regardless of whether or not a FAB existed. Our strong preference is for delivery and demonstration of real financial savings and cost-efficiency. The claimed EUR 24.5 savings for 2011 should also

be considered in relation to the combined UK&I cost base of EUR 875.6m for the year for en route charges, and this is without considering the TNC costs bases.

7. Real financial savings and efficiencies through genuine ANSP FAB consolidation should provide the vehicle for more meaningful cost-effectiveness targets and better assist the EC political and SESAR objectives to reduce European ANS costs by 50% and the estimated annual EUR 1.4b cost of fragmentation in Europe. We therefore welcome the CAA and IAA SRD call (3.3) for the FAB plan to identify cost-efficiencies as well as operational benefits that are expected to accrue to users in RP2.

8. We note (4.1 & 4.2) that the CAA details areas of difference between UK and EC legislation. We are surprised at this as our understanding was that EC regulations have primacy with regards ANS Performance Scheme requirements

9. While we recognize the reasons and License requirements (4.2) for the CAA to ensure NERL will not find it unduly difficult to finance activities, we trust this will not allow NERL to claim or be rewarded for excessive or unjustified risks, costs or ROE.

10. We welcome CAA acceptance for an approach (5.2) that complements bottom-up analysis with top-down challenge for greater unit cost-efficiency. We are acutely aware following the non-achievement of EC-wide cost-effectiveness targets by four of the big five States representing more than 40% of our total costs for the area, that among the best performers by comparison are those five States that implemented a top-down approach for RP1.

11. We note the CAA request (5.3 & 5.4) for NERL to produce at least three scenarios for Determined Unit Rate (DUR) reductions of -2%, -3.5% and -5% p.a. Apart from the fact these scenarios are centered on an average 3.5% which was the EC cost-effectiveness target for RPI, we do not see any explanation on why or how these numbers were chosen. Against the EC request for the RP1 shortfall to be recovered during RP2, our estimation is that the requirement is close to 5%.

12. In this situation and in order to optimise their revenue streams we could expect NATS strategy will be to warn airlines and the regulator of significant service reductions and trade-offs if they press for more challenging targets than 2%. We could also expect this to be linked to requests for total economic value achieved, whereas our major requirement is for real cost-effectiveness improvement and unit cost reduction.

13. The CAA (5.9) sees merit in re-establishing constructive engagement (CE) between NATS and its customers as part of the PR2 process. As the CAA notes this requires significant resource, time and commitment from the users to participate fully, which is increasingly difficult given the cost reductions as a result

of the intense competitiveness within the business. While CE is theoretically desirable the asymmetry of information in addition to resource restraints makes us skeptical of the outcome and its opportunity for sufficiently exposing NERLS costs to robust scrutiny and challenge.

14. Our major disappointment with the UK NPP for RP1 was the insistence of maintaining the CAA CP3 Decisions of December 2010 as the basis for not achieving the EU-wide cost-effectiveness target. The EU-wide targets for RP2 are not due to be finalized until September 2013. We are therefore concerned that the proposed process within this consultation including CE, will enable the same excuse to be made.

15. Against the background and points outlined above we believe further consideration should therefore be given to the option (5.6) for the appointment of independent consultants to develop the NERL business plan, and for the CAA to lead the analysis for the scope for potential efficiencies to achieve the required more significant contribution to cost-efficiency in RP2.

Geneva 28 September 2012