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6th June 2018

Dear Richard

NERL's RP3 (2020 – 2024) initial Business Plan

Thank you for your letter of 25 May regarding the CAA's pre-consultation views on NERL's initial Business Plan. It is helpful to have this opportunity to clarify the way we have approached the plan. I have therefore set out an initial response below that should provide immediate assurance but we will, as requested, more fully address many of the points you raise in our revised Business Plan to be issued in October.

Our core en route plan

On 9 April we published a detailed and comprehensive plan to our customers that we believe will deliver their priorities and those of the wider industry in RP3. Our plan was based on a survey of the needs of our airline customers alongside the CAA's guidance document. As well as delivering a high quality service every day, with significant real term price reductions and handling increasing traffic, our plan also completes the roll out of a major new technology and transformation programme in RP3.

This investment, which complies with the Europe-wide SESAR programme, is essential if NATS is to safely handle the traffic in RP3 and beyond. In turn this investment will provide the foundation for the long overdue modernisation of UK airspace. All of these initiatives deliver significant benefits to our customers in capacity, flexibility, efficiency and resilience across RP3 and into RP4 and beyond.

Our wider plan

As you requested in CAP1625, we have produced a wider plan that sets out a number of areas where requirements are less certain. To the extent these can be agreed between all parties by September, we will incorporate them in our core plan. Failing this, we have proposed a regulatory mechanism that will enable us to develop these areas in RP3 when the requirements become more certain. Where these are contingent on factors and future actions that are outside our control (including, for example, airspace modernisation and conspicuity), we will work with you and our stakeholders over the coming months to reach a common understanding on which

potential outcomes could be modelled in order to provide greater predictability as part of the revised wider plan.

Having set out this background, I turn now to the specific points in your letter.

Airspace modernisation

Our core plan, which is fully costed, describes how we will modernise flightpaths above 7,000ft.

In our wider plan, we have indicated our willingness and desire to take on a broader project management and coordination role for modernising flightpaths in airspace below 7,000 ft. This falls outside our Licence and remains the responsibility of others to design and deliver, predominantly airports.

Our ability to succeed in this programme management role relies on obtaining the engagement and full support of government, the CAA, airports and airlines. In particular, it depends upon a robust governance structure and enforcement powers for the DfT, CAA or NERL to drive the programme to a successful conclusion. There is already significant ongoing work led by NERL with the DfT and CAA as to how best to achieve this.

Subject to this tripartite work concluding sufficiently by September we will then be pleased to include costed plans for this activity in our revised Business Plan.

Shared governance arrangements

We strongly believe in, and actively support, a collaborative approach in the governance arrangements concerning our Service and Investment Plan (SIP). This commitment has been demonstrated with improvements made in RP2 and we have proposed in our iBP making further improvements in RP3. Feedback from airlines and their trade associations make it clear that the level of engagement they have in NATS governance is far greater than they have with any other European ANSP. I therefore hope you feel able to support our proposed enhancements.

We fully recognise the need for oversight, and being held to account for the delivery of this plan. However, I would caution that extending customer and CAA/reviewer input beyond the comprehensive levels proposed would lead to a confusing mix of input and output regulation by both regulator and our customers. This would seem to be inconsistent with the principles of arms-length regulation between commercial licence holder and regulator.

Conspicuity

I agree with you that for many years we have been an advocate for electronic conspicuity outside controlled airspace. However, the decision to move to a full conspicuity solution specifically through the use of ADS-B technology in uncontrolled airspace has been confirmed only very recently by the CAA as your desired approach.

We therefore took the opportunity in our wider plan to signal our support for the CAA's decision, to elaborate on our view of the significant potential benefits and to describe the key enablers. These include the development of international and UK regulatory requirements, the potential need for changes in airspace or classification, the nature of the costs to be taken into account and for these to be borne by all airspace users in a fair and equitable manner.

As stated in our plan, we will be happy to engage with you on extending NERL's remit to surveillance of uncontrolled airspace, and pleased to include this in our revised Business Plan in October.

Operational resilience

We both agree on the importance of robust plans to ensure appropriate numbers of skilled controllers are available to underpin operational resilience. Our core plan and appendix K describe how this will be achieved. Based on our published assumptions for training lead times, pass rates and retirement ages we projected the numbers of trainees entering operational service for each of the next seven years. As you would expect, we have strong governance and processes in place to manage such a key part of our business but RP3 provides us with the opportunity to address the constraints of RP2 and scale our operation accordingly.

The further growth in air traffic controllers is necessary to catch up with the unforecasted traffic growth in RP2 and to have the resilience to manage the additional traffic we expect in RP3 as well as to support our airspace and technology change programmes. By 2022, this will deliver a better balance of supply over demand and reduce our current reliance on voluntary overtime.

Our monthly reporting to the CAA confirms that we have completed all the recommendations from Project Oberon and these are now integrated into our daily operational processes. For clarity, we will include these completed actions in the revised Business Plan. If there are other steps or commitments that you consider are required in response to Project Oberon, we should be grateful to understand these as soon as possible.

Evidence in support of our proposals and assumptions

Regarding detailed evidence to justify our proposals and assumptions used I would draw your attention to the following elements of the plan:

- Traffic forecasts with accompanying methodology, key assumptions (GDP, airport capacities, load factors, rates of growth of cargo) and comparison to STATFOR forecasts
- Costings for all regulatory building blocks which make up proposed pricing levels
- Bench marking against other major European ANSPs of our financial cost effectiveness, economic cost effectiveness (including costs of delays), ATCOs cost efficiency and employment costs, ATCO productivity and support costs. This data, which is sourced

from Eurocontrol, shows us to be best in class in overall financial and economic cost effectiveness

- Bench marking by NERA of our operational, engineering and support staff subject to collective bargaining and bench marking using Hay data of non-operational and management pay
- Post privatisation performance of our operating costs compared to water, electricity and gas companies
- Analysis of the elasticity of our costs including the relationship with inflation
- Analysis of the relationship between our costs and the indirect costs of airlines through delay, airspace change, disruption and flight efficiency
- Description of the development of each major cost category and how our plan will deliver further cost efficiency
- Description of all the mitigations we have taken along with trustees to mitigate the costs and risk of pensions
- A comprehensive cost of capital study by NERA
- Key financial assumptions with sources: inflation, pensions, tax, financing, dividends and sources of non-regulatory income.

Regarding performance targets, our plan sets our clear targets for safety, capacity, and the environment. We propose to maintain these at the stretching levels set by the CAA in RP2 while handling 15% more flights in RP2 and a further 6% more flights in RP3. These levels will ensure that we meet our objective to deliver a performance that compares favorably to any European ANSP handling similar levels of traffic, as measured by Eurocontrol and other independent bodies.

I am proud that the plan we have submitted will be one of the most ambitious in Europe for RP3. We expect to discuss our proposed targets and their implications for our plan over the course of the consultation with customers.

Optioneering and satellite ADS-B surveillance

Our plan describes how key strategic optioneering decisions made and initiated in RP2, after consultation with customers and endorsed by the CAA, will be deployed in RP3. Our customers were actively involved in these plans and the subsequent SIP consultations which have taken place every year since. They have also been comprehensively scrutinised by the CAA's Independent Reviewer at every step since his appointment. At the outset of a programme of this scale, complexity and duration naturally there were areas that lacked detail at inception. These have been resolved over time and, together with the positive progress we have subsequently made in delivering the outcomes, provide us with confidence in the plan we have submitted.

Creating a comprehensive plan for NATS capital investment that is aligned with the European ATM master plan, with a duration of two reference periods, has naturally constrained the number of practical options that exist at the halfway point of implementation. We understand our customers would like options and therefore, where genuine tactical options and choices exist, these are set in chapter 6 of our plan along with the costs and benefits. We have invited customers' views on this during our consultation process. In the event that there are alternative options that the CAA or airlines raise in consultation we will of course consider them fully.

In response to your concerns regarding the cost benefit assessment for Oceanic satellite ADS-B surveillance, I would draw your attention to chapter 8 and appendix M. In summary:

- Safety benefits – 76% reduction in vertical collision risk
- Service quality benefits – 90% of traffic receiving requested flight trajectories, compared to 60% at present, and with 80% of traffic being able to fly without speed restriction, compared with 0% at present.
- Environment and fuel benefits net of costs – net savings of between US\$ 153 and US\$ 312 per flight across the North Atlantic, following multiple comprehensive independent cost benefit analyses.

This reflects the business case developed by ICAO and supported by the CAA, the DfT and IATA. During RP2 we expect oceanic flights to grow by 25% and to grow by a further 10% in RP3. The advent of ADS-B technology will, for the first time, enable ICAO target levels of safety to be achieved. As we have confirmed to our customers at our Oceanic consultation, there are currently no credible technical alternatives to this satellite based solution to deliver these benefits.

Interface with NATS non-regulated activities

The Licence sets out clearly our obligations to avoid cross subsidies between any part of the Licensed activities and non-regulated activity. We have policies, systems, procedures and reporting arrangements in place to fulfil these requirements and these remain open to review and audit by the CAA, its consultants and by external auditors.

We continue to maintain these controls and will be happy to elaborate on these further in the revised Business Plan and to CAA consultants in their studies.

Summary

I hope you find this response to your letter helpful. Whilst we do not agree with all the points you raise we recognise that it is crucial that we work together with you and our customers through the consultation process to achieve an RP3 settlement that delivers an ATM service and infrastructure that the airlines and traveling public require for the next decade and beyond.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Martin Rolfe', with a long horizontal flourish extending to the right.

Martin Rolfe
Chief Executive Officer