

Stakeholders

26 August 2021

Dear Stakeholders

NERL: consultation on the programmes and projects to be assessed under the capital expenditure engagement incentive

On 10 June 2021, we requested feedback from stakeholders on the operation of the regulatory incentive on NERL in relation to the quality of its engagement on its capital expenditure programme. Under this “engagement incentive” the Independent Reviewer (“IR”) of NERL’s capital expenditure, currently Egis, will score NERL’s engagement with stakeholders on a selected list of programmes and/or projects in 2021 and 2022.

We are grateful to all stakeholders that responded to the consultation and joined the associated webinar held on 22 June 2021. We received six written responses to the consultation with one other stakeholder expressing its views at the webinar. The responses are on our [website](#) in the NERL capital investment section.

The consultation was designed to seek views on:

- the timing of the IR’s review of NERL’s engagement; and
- the programmes and/or projects in NERL’s overall programme to be assessed.

Having carefully considered the issues discussed in the webinar and the written responses, we have decided that the IR’s assessment of NERL’s engagement should:

- commence with assessment of its engagement in preparing the interim service and investment plan 2021 (“ISIP21”) and assess its overall engagement up to the publication of ISIP2022 (due July 2022), enabling the results of the assessment to feed into NR23; and
- cover the programmes and project included in Option 2 of our consultation –that is a subset of NERL’s capital expenditure covering 93% of its programme, including a specific assessment of the AD6 Essex radar airspace change.

Responses and reasons for our decision

Timing of the assessment

We consulted on when the IR should assess NERL’s engagement under the incentive so that the assessment scores could feed into the next price control (“NR23”) starting on 1 January 2023. We proposed that the IR should make its initial score based on the evidence for engagement in iSIP21 published on 31 July 2021, update its score when NERL publishes SIP22, and make its final score when NERL publishes iSIP22, due by 31 July 2022. Only the final score would be used for the calculation of any penalty payments. This approach would enable us to:

- see how NERL's engagement has progressed through the period;
- use the final score in setting the NR23 price control; and
- provide an opportunity to identify any improvements to the approach for the engagement incentive and/or associated guidance for the NR23 control.

All respondents who commented agreed with an initial score at ISIP21. British Airways, Prospect and Ryanair favoured a final score at ISIP22 while NERL favoured using SIP23 (due 31 January 2023) as it would give the IR and CAA more opportunities to see how the incentive works in practice. Ryanair requested clarification on the timeline for the rest of 2022 and NR23 so focus on NERL's engagement did not end on 31 July 2022.

Some respondents were uncertain whether the scores would be an assessment of a particular document (SIP or ISIP) or a broader assessment of NERL's engagement over 2023. This assessment will consider NERL's engagement on an ongoing basis, albeit that, in accordance with the published guidance for the incentive, the IR will score NERL's engagement at the time of the ISIP 2021 and ISIP 2022.

Although a later assessment would allow NERL more time to respond to the incentive and earlier IR scores, if the final score is only produced when SIP23 is produced, the effects of any penalty could not be taken into account in the price cap at the start of NR23, and would require an "in-period adjustment" to the price control. Because of this we have decided that the final assessment will be undertaken by the IR when ISIP22 is produced at the end of July 2022.

Because this approach will see the IR's assessment of NERL's engagement on capital expenditure come to an end in the summer of 2022 for the purposes of the NR23 price control, we intend to address NERL's capital expenditure engagement after the ISIP2022 as part of any subsequent continuation or evolution of the incentive for NR23.

Programmes and/or projects to be included in the assessment

As noted on our consultation letter and discussed in the webinar, there is no "obvious" or "perfect" subset of programmes and projects that should be used. The larger the number of programmes and projects included in the assessment, the larger the proportion of NERL's total programme that will be covered and, so, engagement incentivised. Conversely, the larger the number of programmes and projects included the lower the weighting given to each individual programme or project will be. This may underplay the importance to stakeholders of some specific projects.

We consulted on three potential options for the projects and programmes to be assessed, but were clear that other combinations could be used. The options were:

Option 1 – All eight programmes in NERL's baseline programme;

Option 2 – The five largest programmes by forecast spend plus the AD6 Essex Radar airspace change project; and

Option 3 – The DP (En Route) and airspace programmes only.

Respondents had different views on which options should be used, with each option receiving some support.

- British Airways favoured Option 1 as it thought the whole programme was important and stakeholders had different priorities so did not want to exclude anything. In particular it thought Oceanic was an important programme that was only included in Option 1.
- American Airlines agreed with British Airways.
- Emirates said Option 1 provided a more complete overview, but Option 2 would be an alternative.
- NERL favoured Option 2 as it covered most of its planned capital expenditure, but avoided the cost of scoring the 3 programmes that were too small to materially affect the overall outcome.

- Prospect also favoured Option 2 as it covered most of NERL's planned capital expenditure and had the potential to transform some of the most major issues: ageing infrastructure and airspace.
- Ryanair favoured Option 2 with the free route airspace project added which it considered, with AD6, were important.
- easyJet favoured Option 3 as it considered that engagement on capital expenditure scheduled for 2021-22 had been acceptable so the focus should be on the most significant capital expenditure in future years: DP (En route) and airspace.
- Emirates and NERL considered that Option 3 was too narrowly focussed and should not be used.

While Option 3 was supported by easyjet, other respondents preferred including a broader range of programmes. Some respondents specifically asked us to reject Option 3 as it was too narrowly focussed. In our guidance, we said we envisaged having a relatively small number of programmes and/or projects which collectively represented a large share of NERL's overall capital expenditure. Given these points we have decided not to choose Option 3.

Options 1 and 2 are similar, making it harder to choose between them. British Airways favoured Option 1 as it did not want to exclude any programme. In particular it mentioned Oceanic as being of particular importance to it. Ryanair and Prospect favoured Option 2 as it was more focussed on what they considered important. NERL favoured Option 2 as it was more proportionate and reduced the compliance burden on all parties. Ryanair wanted the AD6 project (in Option 2) and also suggested the free route airspace (not in Option 2) project included. On balance, NERL's point that it would be burdensome to include the smaller programmes as they would not materially affect the overall outcome has merit, in particular as the incentive only covers 2 years. Therefore, we, have decided that the IR will assess NERL's engagement on the five projects/programmes set out in Option 2. These are:

- DP En route and voice;
- Airspace and ops enhancements;
- Sustainment and surveillance;
- Facilities management; and
- Information systems.

With respect to NERL's point on proportionality there is a question of whether we should choose to include individual projects, or any of the 3 programmes not included in Option 2 in the assessment. Taking the projects and programmes mentioned in responses in turn:

- AD6 was included in Option 2 during consultation. Ryanair specifically wanted it included because of its importance in respect of the Palamon decision. None of the respondents which favoured Option 2 said they wanted it excluded. Given this and the importance we attached to the project as part of Palamon¹ we will include AD6 in the assessment.
- Free route airspace (FRA) was not included in Option 2, but Ryanair suggested it was included due to delays in its deployment. As with AD6, it is part of the airspace programme so NERL is incentivised to engage with users on it even if it is not included separately as a project. Also, its scale means it is unlikely to make a material difference to the overall score. Given this, and the lack of explicit support from other respondents we have decided not to include it separately in the IR's assessment.
- Oceanic was mentioned by British Airways as a programme it considered was important to airlines. Our understanding is that airlines' concerns are about the use of ADS-B data for the Oceanic service which is an operating costs issue and not about the capital expenditure required to make full use of ADS-B. The ADS-B data issue is being considered as part of a separate workstream, and therefore it is not necessary to specifically address it as part of the capital expenditure incentive.

¹ See [CAP2100: Investigation under s.34 of the Transport Act 2000: Project Palamon – Final Decision](#).

Other issues raised in responses to be considered when the guidance is reviewed for NR23

Respondents raised some other issues about how the incentive works that were not directly relevant to the questions we asked in the consultation. These include:

- should the weightings given to programmes and projects remain linked to the actual spend on each programme and project;
- whether the baseline expectation on NERL's engagement should be increased from 'average' to 'good'; and
- whether the incentive should remain penalty only.

As the incentive is new it needs time to "bed in", there will inevitably be issues that arise when it is in operation. For regulatory certainty, we will follow our guidance without modification during this period up to NR23.

That said, each new regulatory period gives us an opportunity to consider whether our guidance can be improved to address issues that have arisen in the current regulatory period. As part of the NR23 review we will consider whether the capital expenditure guidance in light of experience to date and whether there are any sensible opportunities to improve it.

If you have any questions about our decision or the operation of the capital expenditure engagement incentive for this period, please contact Rod Gander (rod.gander@caa.co.uk).

Yours sincerely

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