

“Guidance for NERL in preparing its business plan for Reference Period 3: Consultation document (CAP 1593)”

Introduction

Virgin Atlantic welcomes this opportunity to respond to the above CAA consultation. Please see set out below our responses to the specific questions raised in the consultation document.

1. Do stakeholders consider that a two track approach to NERL’s business plan is reasonable?

We believe it is reasonable to ask NERL to provide an initial business plan that includes their thoughts on what they consider “core” requirements and then a range of separate “wider” initiatives. This approach should enable meaningful consultation on real choices that can be made when considering what the performance plan for RP3 should eventually include. In RP2 the initial choices were presented in terms of a service-led plan or a price-led plan and it is hoped that given guidance to prepare a two track initial business plan, NERL will take into account airspace user (and other stakeholder) requirements and consider cost and benefits from a user perspective.

We feel it is essential that NERL provide, as part of their business plan, detailed cost-benefit analysis to justify all major investments.

2. Do stakeholders have views on the allocation of activities and outputs between the core and wider categories for NERL’s business plan?

Firstly, Virgin Atlantic fully supports the identification of LAMP2 as a core requirement. We believe that the core and wider activities will be developed through stakeholder engagement, which will provide guidance and/or direction to NERL to establish the most appropriate allocation of activities and outputs. Early interaction with stakeholders will enable these aspects to be developed to provide the necessary input to NERL’s business plan.

3. Are there any further views from stakeholders on extending the scope of the incentives on NERL to put greater emphasis on resilience and noise?

Incentives based on aircraft noise emissions may not produce the desired overall improvements and therefore need to be considered very carefully before being considered as part of the overall performance targets. It could be concluded that this is not the appropriate area to incentivise noise performance as any noise nuisance primarily relates to low-level airspace and

incentivising NERL to minimise noise emissions may put them in direct conflict or at odds with the airports.

The level of resilience, both technical and operational, provided or available in the system, will be a factor of current or existing levels and that provided by investment or changes in operational arrangements and/or processes. Any incentive scheme would first need to consider value for money and how improved resilience is benefiting all parties.

4. Is the broad approach to the draft business plan guidance on costs reasonable and is there additional third party assurance that NERL could reasonably provide to help demonstrate its forecasts of costs are efficient?

It is likely that until airspace users see what third party assurance NERL provide and the quality (in terms of applicability and level of detail) of that assurance, it is difficult to say if there is any additional assurance that NERL could reasonably provide.

The CAA state various requirements for NERL in this respect that provide reassurance to airspace users that what NERL present should be credible; such as:

- benchmarking
- clear and compelling cost benefit analyses and strategic options
- transparency of costs
- improved visibility and granularity of benefits
- an appropriate level of evidence that its cost forecasts are efficient

It will be important to have available the CAA appointed external consultancy report, judging both non-staff and staff Opex efficiency and Capex when discussing this aspect of the initial business plan with NERL. In theory, the requirements as set out seem like a good basis for consultation; with NERL being required to demonstrate efficiency on the core (minimum) requirements and then establish a range of extra “wider” options, on which they will be required to demonstrate the appropriate cost/benefit.

We have similar concerns about the CAA expectation that NERL will suggest, in relation to the capital expenditure, “whether better financial incentives, reporting requirements or licence conditions are required to help encourage capital efficiency.” Whilst we would expect NERL’s response here to be borne from self-interest, as opposed to a true customer-centric perspective, the ensuing consultation debate will at least be interesting and hopefully eventually establish

clear positions in this regard for the CAA to eventually determine on, as part of the performance plan and licence conditions.

5. Should the business plan set out information to facilitate the ex-post efficiency reviews of RP2 capex (which could include the disallowance of inefficient expenditure from NERL's RAB) or would these reviews be best carried out by a separate process?

We believe NERL should, as part of the business plan, set out a template of measures on which it proposes to report its performance to customers over the course of RP3. This template should be granular enough to make clear NERL's intent in relation to reporting RP3 KPI's and also the supporting aspects of operational, technical and people planning.

6. Is the above draft business plan guidance on transparency of NERL's capital programmes and projects fit for purpose or could it be further improved?

The draft business plan guidance on capital programmes encourages NERL to consider governance arrangements. We take the view that the existing governance arrangements do not properly permit the airspace users to proactively guide the setting of investment priorities for NERL. Additional guidance should therefore be provided to NERL, requiring that revised governance arrangements with a more prominent role for airspace users, be utilised.

7. Is there stakeholder support for the continuation of the FFF? If so, do the current governance arrangements remain appropriate for RP3? Should we give further business plan guidance to NERL on the FFF arrangements?

The FFF arrangements should be addressed by NERL's broader revision of governance related to capital investment, but on balance we support the FFF continuing under and within the appropriate processes and structure. The subject of NERL contingency funds within the RP3 settlement should constitute part of the RP3 consultation review and discussions and subsequent settlement agreement.

8. Should we provide further business plan guidance on expenditure governance arrangements and/or incentives?

The draft business plan guidance on capital programmes does appear to encourage NERL to consider governance arrangements. We take the view that the existing governance arrangements do not properly permit the airspace users to proactively guide the setting of investment priorities for NERL. Additional guidance should therefore be provided to NERL,

requiring that revised governance arrangements with a more prominent role for airspace users is proposed.

9. Is the draft guidance set out above on pensions reasonable and can it be improved?

With regards to the pension costs, the CAA has laid out a good level of detail regarding what is expected, that is; to provide sufficient certainty to Trustees so that they support a reasonable profile of pension deficit repair costs; NERL demonstrating that it has done all it can to mitigate the burden on airspace users arising from the company's pension obligations; that NERL has behaved and is continuing to behave in a manner consistent with a commercially minded company, by taking all steps available to it within its legal discretion which are in the interests of users to manage and mitigate the pension cost burden on airspace users.

The guidance may benefit from a clearer explanation of the CAA's expectations and logic in regards to how and why there would be a differentiation between some of the costs of pension deficit repair for future service between core and wider costs.

We look forward to being presented with details of how NERL has balanced the costs of increased pay remuneration in exchange for their employees foregoing rights to future pension service, and how this impacts on the cost of deficit repair and overall pensions costs.

10. Is the draft business plan guidance on the cost of capital, regulatory depreciation and financeability appropriate?

Cost of Capital – The CAA appears to have taken a light touch approach on cost of capital, allowing NERL to propose and justify a level. In asking NERL to do this work it should not mean that the CAA are not also concurrently doing their own internal work to inform their own view of the appropriate cost of capital.

Whilst the RP3 process may start from a position of NERL taking the lead on defining its own business plan proposals, the CAA cannot let the regulated monopoly lead throughout the process. We would expect the CAA to develop their own views on cost of capital independent of NERL.

RAB and regulatory depreciation – We would support the CAA on development of a new policy on regulatory depreciation, if required. In the first instance NERL will need to demonstrate the impact of lower levels of depreciation on efficient financing.

Financeability – In addition to the evidence the CAA has specified, it would be helpful for NERL to demonstrate how it manages its investor portfolio and what opportunities it has identified for more efficient financing.

11. How should we best include airports in the scope of the Customer Consultation mandate?

Virgin Atlantic supports airports being a consultee as part of the RP3 consultation process, but we would disagree that they should be given equal weight to airlines in the consultation. Airlines pay user charges to NERL based on their use of airspace. Airports do not pay any airspace user charges therefore they do not have the same level of exposure to all of NERL's activities.

We see RP3 as being a tripartite process between NERL, the airline community and the CAA. A clear airline community voice is needed within the RP3 consultation process and including airports in the definition of customer, when they have their own objectives and requirements, would potentially compromise this.

We would however support a specific form of consultation including relevant airports, NERL and the airline community to address matters such as capacity targets, perhaps at certain larger airports. It is envisaged that such a specific consultation would be supplementary to the NERL consultation and may assist the CAA in addressing certain broader aspects of the UK's RP3 Performance Plan.

12. What steps should NERL take to reflect the views of wider stakeholders, such as passengers and overflow communities, in the development of its business plan?

Virgin Atlantic believes that within the NERL regulatory process, the airline community can best represent the passenger. The incentives airlines face in optimising capacity, reducing delays and controlling and potentially reducing prices, strongly connect with the passenger's interests. Perhaps, specifically, we would suggest that timely delivery of LAMP2 and other airspace modernisation would meet the expectations of passengers more than any other initiative in RP3. The Government's new airspace policy and the new CAA airspace change process are focused on the impacts of noise on communities and will cover ongoing noise management and the impacts of airspace changes. Ultimately any RP3 project that leads to an airspace change will be subject to community consultation and that is the most appropriate place for that consultation to take place.

13. Should the customer consultation process follow the same broad approach as RP2, with a requirement for a structured engagement programme, customer consultation working group and an independent/joint chair?

Virgin Atlantic very much support taking the same approach as used in RP2 with a structured engagement programme based around both the key components of the regulatory settlement and using the CAA's consultancy studies to inform and lead the process. The customer consultation working group and the joint chair process seemed to work well during the RP2 consultation and we would be supportive of following that model again.

In addition, we would be supportive of the CAA Independent Reviewer (IR) function that has been deployed within the RP2 SIP arrangements, also being used in the RP3 consultation process. The IR appears to have built up a good working knowledge of the NERL RP2 business process and an understanding of the business plan assumptions that relate to ongoing programmes extending into RP3. The RP3 consultation process would clearly benefit from making use of both the IR's knowledge and expertise and it would probably be helpful to further develop and have access to that resource during the process.

14. What topics should the customer consultation programme address and what improvements can be made compared to the process for RP2?

The topics covered in the RP2 consultation largely hold for the RP3 consultation process, such as key priorities of airspace users, NERL's proposed business plan, key components of the business plan etc. The RP2 consultation proposed a spectrum of business plan outcomes with a service quality-led and price-led plan at either end. Our expectation of the broad approach set out by the CAA for RP3 is that rather than follow a similar approach this time, the onus will be on NERL to propose their initial plan and then the process to achieve a revised plan will incorporate user's views on service quality and price, among other factors. Having specific topics on potential service quality and price trade-offs should not be necessary as it should be embedded in the business plan options NERL present to users throughout the process.

We consider the primary objective in RP3 is to successfully deliver LAMP2 following its displacement from the RP2 plan. Airspace modernisation should deliver more benefits for capacity, performance, delay, resilience, noise, and flight efficiency than any other measures that maybe delivered in RP3.

Virgin Atlantic agrees with the CAA's position that LAMP2 should form a core requirement for NERL in RP3. Notwithstanding this position, it is also clear that although NATS should lead on driving LAMP2 forward to delivery, it is not wholly within their gift to deliver it. Recognising that change may happen in RP3, there needs to be a debate about how such change, if it happens, is dealt with and what mechanisms should be put in place to manage it and ensure airspace users have real choices. Managing the business plan within the RP3 period needs to be discussed as part of the consultation process.

Areas of the business plan that may be impacted by Brexit should be clearly identified within the RP3 consultation process and information shared as and when arrangements for the UK's exit and transition out of the EU become known.

15. Are there alternative model(s) of customer consultation that might be followed for RP3 – bearing in mind the constraints created by needing to align the timetable for customer consultation with the SES Performance Scheme and associated milestones.

We do not believe that there are alternative models of consultation that would likely improve this consultation process. The proposed process, as used for RP2, should drive effective engagement providing key inputs such as consultancy studies and enabling the initial business plan to be delivered as envisaged. The CAA should be able to hold parties to account and take an active role where necessary, beyond simply being an arbiter between NERL and the airlines. The co-chair process allows for areas of difference to be identified, jointly worked upon and for alternative proposals to be made. It also facilitates clarity in detailing the respective positions of NERL and the airlines which should make the CAA's job easier in understanding key issues to be addressed. During 2019, when the CAA consults upon the draft RP3 performance plan and up to the start of RP3, it would seem appropriate for there to be an opportunity to update the plan in light of any potential UK-EU Brexit arrangements that have a material impact on the proposed business plan.

16. What views do stakeholders have on the proposed CAA consultancy activities as discussed above and set out in Appendix D – in particular the nature of the proposed studies, their objectives, scope and deliverables?

Consultancy studies should be made available to stakeholders prior to the start of the RP3 consultation process, or in the early stages of the process. They must have been made available in good time prior to any specific customer consultation that takes place on those topics. In RP2 some of the consultancy studies were released very late and in some cases, after the process had finished. This may have negatively impacted the intention to ensure meaningful consultation and therefore should be avoided in the RP3 process.