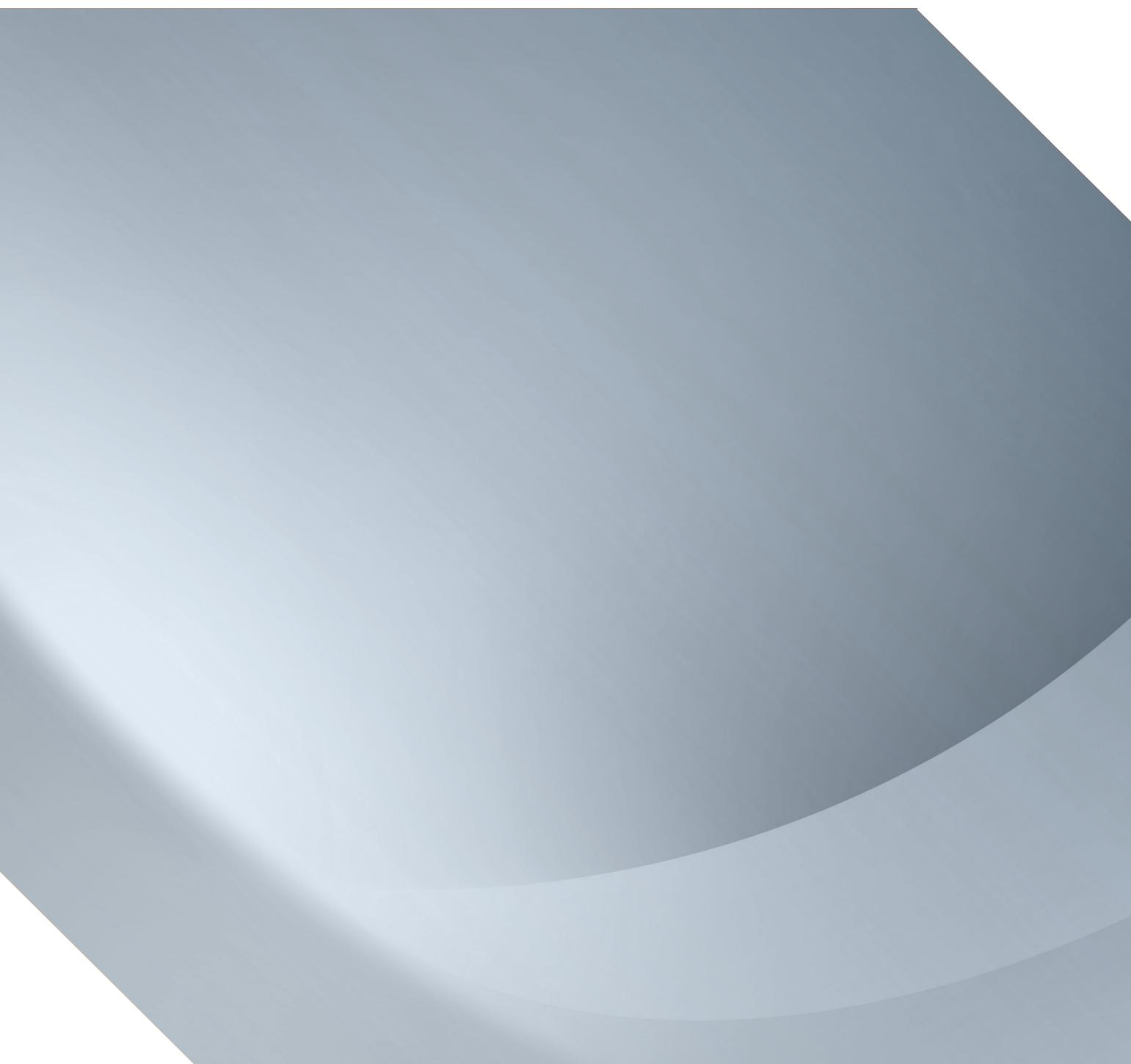


The CAA process update for the economic regulation of NERL and contribution to the UK-Ireland FAB Performance Plan for Reference Period 2 (2015-2019) of the Single European Sky Performance Scheme: A mandate for Customer Consultation between NERL and airspace users

**April 2013**

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# Executive Summary

## Purpose of this document

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1. This document sets out the CAA's plan for its review of the NATS (En Route) plc (NERL) component of the UK-Ireland Functional Airspace Block (FAB) Performance Plan for the second reference period (RP2) of the Single European Sky (SES) Performance Scheme. RP2 covers the calendar years 2015-2019.
2. In particular, this document sets out the CAA's expectations for the governance of the process of customer consultation that NERL will undertake with its airspace users to review and refine its business plan for RP2. These expectations are summarised in the CAA's Mandate for Customer Consultation included in this document.
3. The CAA would like to thank stakeholders for their input to date on this issue. This document has been prepared based on feedback the CAA received to its consultation that closed on 28 September 2012, subsequent stakeholder workshop held on 15 October 2012 and informal bilateral discussions.

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## Context for the CAA's review

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4. The CAA has delayed issuing this policy update pending the agreement of the revised SES Performance Regulation and Common Charging Regulation. These were adopted by the Single Sky Committee (SSC) on 8 March 2013<sup>1</sup> and provide the legal framework for the CAA's review together with its duties and obligations under the Transport Act 2000.
5. Following the European Commission's (the Commission) acceptance of the UK's Performance Plan for the first reference period (RP1 - 2012-2014), it signalled a clear expectation that it wanted a more significant contribution from the UK in RP2 in the key performance area of cost-efficiency. This is especially relevant to the CAA's review of the NERL price control as this component makes up about 85 per cent of the UK's

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1 The final text is now undergoing the Commission's internal processes and will be published in the Official Journal of the European Union in due course.

Determined Unit Cost (DUC). The other elements of the UK's DUC will be reviewed as part of the general consultation on the Performance Plan.

6. Another feature for RP2 is the requirement to adopt Performance Plans at the FAB level. Hence, the CAA will work closely with the National Supervisory Authority (NSA) of Ireland - the Irish Aviation Authority (IAA) - in the formulation of a UK-Ireland FAB Performance Plan for RP2.

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## Mandate for Customer Consultation

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7. The CAA considers that its review of NERL's business plan for RP2 will be much more in tune with airspace users' requirements if NERL is required to discuss its initial business plan (IBP) with airspace users before taking this feedback into account and then providing the CAA with a revised business plan (RBP). This will help ensure NERL's future direction is aligned to airspace users' interests.
8. This process is called Customer Consultation and it will begin with NERL issuing its IBP to airspace users on **10 May 2013**. The CAA has required NERL to submit a RBP to it by **18 October 2013**. Following this, the CAA will review those areas of the business plan where NERL and its airspace users have a significant divergence of views. The CAA expects to develop its own in-depth analysis of NERL's projections for operational efficiency and its weighted average cost of capital (WACC).
9. The CAA's experience from RP1 and its recent price control review of airports indicates that the process works more effectively where it sets out clear expectations up front. It has done this with its Mandate for Customer Consultation, as set out in chapter 4.
10. The CAA does not expect NERL and airspace users to agree the RBP. This is unrealistic given the very different commercial perspectives each side has. However, the CAA does expect NERL to use its best endeavours to understand airspace users' priorities and ensure these are taken into account in its RBP.
11. This requires meaningful engagement to take place, which in turn requires from NERL transparency, quality and timely information, and a responsive approach to airspace users' queries. On the other hand, it also requires airspace users to ensure they participate constructively and that both sides engage in good faith.

12. It is important to note that the process of Customer Consultation is principally one that is between NERL and airspace users. The CAA expects the parties to agree on an independent chair or co-chairs of the process, respect process rules, and complete the process with a joint report to the CAA on the areas of agreement and disagreement between the parties. However, the CAA does propose that it has a step-in/step-out role but this is restricted to secure procedural fairness rather than on outcomes where it cannot fetter its discretion at this stage of the process.
13. Due to the timetable for development and consultation of the UK-Ireland FAB Performance Plan for RP2, the NERL Customer Consultation process will necessarily take place alongside the development of the European Union (EU)-wide targets. Nevertheless, the draft Performance Plan put to stakeholders for consultation prior to Member State adoption will take account of the final EU-wide targets adopted by the Commission, as well as the outcome of NERL Customer Consultation and independent expert analyses.

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## Timetable for the development of the Performance Plan

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14. Member States are required to submit their Performance Plans to the Commission and Performance Review Body (PRB) in **June 2014**. The UK will submit a joint FAB Plan with Ireland.
15. In advance of this the CAA and IAA intend to consult on a draft of the UK-Ireland FAB Performance Plan around **February 2014**.
16. The Commission will notify Members States by **November 2014** on whether Plans are consistent with and make adequate contribution to the EU-wide targets for RP2.
17. The CAA will, under UK law, need to consult on a licence modification for NERL in late 2014 to implement the new price control arrangements. This will, however, be contingent on the Commission accepting the relevant components of the UK-Ireland FAB Performance Plan and a further licence modification after this date may be necessary where this is not the case.

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## CAA contact details

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18. If you would like to discuss this document please contact Mike Goodliffe on 020 7453 6226 or by email to [mike.goodliffe@caa.co.uk](mailto:mike.goodliffe@caa.co.uk) or Matt Claydon on 020 7453 6508 or by email to [matt.claydon@caa.co.uk](mailto:matt.claydon@caa.co.uk).
19. The CAA will from time to time review this process and alert stakeholders to any revisions. Details will be available from [www.caa.co.uk/npp](http://www.caa.co.uk/npp). If you would like to receive email alerts related to this work programme please contact Matt Claydon on the contact details above.

## CHAPTER 1

# Legal background to the CAA's review

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- 1.1 In setting targets and in effect putting limits on charges for RP2, the CAA is subject to both EU and domestic legislation.

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## Performance Regulation

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- 1.2 The Performance Regulation places obligations on Member States to set binding targets, performance indicators and reporting requirements for specified key performance areas (KPAs). Those KPAs are safety, environment, capacity and cost-efficiency.
- 1.3 "Binding targets" has a specific meaning under this Regulation as "a performance target adopted by Member States as part of a national or functional airspace block performance plan and subject to an incentive scheme providing for rewards, disincentives and/or corrective action plans".
- 1.4 The process currently mandated is as follows:
- the Commission (advised by the PRB) proposes targets for the EU as a whole for the reference period, which are adopted by the SSC;
  - NSAs draw up Performance Plans at national or FAB level;
  - NSAs hold effective consultations with stakeholders;
  - Member States, at national or FAB level, adopt and communicate to the Commission, at the latest six months before the beginning of the reference period, their Performance Plans containing binding performance targets; and
  - the Commission (advised by the PRB) assesses the Performance Plans, their targets and in particular their consistency with, and adequate contribution to, the EU-wide performance targets.

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## Charging Regulation

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1.5 The Common Charging Regulation was introduced in 2006 forming part of the initial SES requirements. This was amended in 2010 to translate the financial consequences of the Performance Scheme into the requirements for charges. In the context of the Performance Scheme for RP2 the Common Charging Regulation sets out:

- the scope of, calculation of and basis of allocation (between en route and terminal services) of costs;
- the calculation of charges for en route and terminal services;
- a prescribed mechanism to be applied to en route and terminal services whereby the risk that traffic is higher or lower than anticipated is shared between Air Navigation Service Providers (ANSPs) and users; and
- provisions to allow financial incentive schemes.

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## Recent changes to the Regulations

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1.6 In preparation for RP2 the Commission has developed revised Performance and Common Charging Regulations, which form the basis of the Performance Scheme. The revised Regulations were considered by the SSC between October 2012 and March 2013, and were adopted at SSC/49 on 7-8 March 2013.

1.7 The key changes include the following.

### Performance Regulation

- Performance Plans to be drawn up at the FAB level.
- A change to the timeline relating to gaining approval by EU.
- Targets to be set across all KPAs (capacity and cost-efficiency only at national level in RP1).
- FAB targets for en route horizontal flight efficiency, Air Traffic Flow Management (ATFM) delay and across the three safety key performance indicators.

- Targets to be set at en route and terminal level.
- Threshold for airport coverage revised to 70,000 IFR<sup>2</sup> air transport movements.
- Greater scrutiny of ANSP investment expenditure by the PRB.

### **Charging Regulation**

- Introduces the possibility of considering CNS, MET and AIS services<sup>3</sup> in assessment of market conditions.
- Changes to criteria for assessment of market conditions:
  - places emphasis on a public tendering process in the context of market conditions for terminal Air Navigation Services (ANS);
  - clarifies the explicit role for the Commission in 'agreeing' market conditions assessments.
- Introduces a provision to allow 'restructuring costs' to be recovered via the unit rate:
  - subject to a business case demonstrating net benefit to users over time;
  - allowing recovery over more than one RP.
- Sets a maximum level for bonuses and penalties for financial incentives.
- Specifies that pension costs resulting from changes in financial market conditions can be covered by the provisions for those costs deemed outside the control of the entity concerned.
- Specifies that recovery of traffic risk sharing and inflation adjustments should not take place earlier than year N+2.

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2 Instrument Flight Rules.

3 CNS, MET and AIS services means communication, navigation and surveillance services, meteorological services for air navigation and aeronautical information services.

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## The Transport Act 2000

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- 1.8 The CAA must exercise its economic regulatory functions under the Transport Act 2000 so as to maintain a high standard of safety in the provision of air traffic services; and that duty is to have priority over the following:
- the CAA must exercise its functions under Chapter I of the Transport Act, in the manner it thinks best calculated:
    - a) to further the interests of operators and owners of aircraft, owners and managers of aerodromes, persons travelling in aircraft and persons with rights in property carried in them;
    - b) to promote efficiency and economy on the part of licence holders;
    - c) to secure that licence holders will not find it unduly difficult to finance activities authorised by their licences;
    - d) to take account of any international obligations of the United Kingdom notified to the CAA by the Secretary of State (whatever the time or purpose of the notification); and
    - e) to take account of any guidance on environmental objectives given to the CAA by the Secretary of State after the coming into force of this section.
- 1.9 The only interests to be considered under a) above are interests regarding the range, availability, continuity, cost and quality of air traffic services. The reference in a) to furthering interests includes a reference to furthering them (where the CAA thinks it appropriate) by promoting competition in the provision of air traffic services.
- 1.10 If in a particular case there is a conflict in the application of the provisions of the CAA's secondary duties above the CAA must apply them in the manner it thinks is reasonable having regard to them as a whole.
- 1.11 The CAA must exercise its functions under Chapter I of the Transport Act so as to impose on licence holders the minimum restrictions which are consistent with the exercise of those functions.

## Interpretation

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- 1.12 In very general terms, there is a broad measure of agreement between the aims of EU and domestic legislation in terms of promoting safety, cost-efficiency, service quality and environmental performance. Regulation at both EU and UK level is committed to the sustainable development of the air transport system by improving overall efficiency of the air navigation services across the key performance areas of safety, environment, capacity and cost-efficiency.
- 1.13 As a general principle EU legislation will take precedence over domestic legislation. In more specific terms, the relationship is usually rather more subtle, with EU law having the effect of overriding any conflicting domestic legislation or effectively nullifying legislation/legal instruments on broadly the same subject matter. The issue here is that the UK has a domestic economic licensing regime for which there is no EU legal requirement, but which is increasingly touched by EU requirements on performance, charging and certification.
- 1.14 The CAA will endeavour to make sure that its processes are timed to contribute to and be fully informed by the emerging requirements of the EU and PRB processes.



## CHAPTER 2

# Context for the CAA's Review

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## Stakeholder expectations for RP2

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- 2.1 The UK government is fully committed to the SES. It expects the CAA, as the UK's NSA, to develop a set of regulatory arrangements that meet the UK's obligations under the Performance Regulation. The CAA fully supports this ambition and is committed to working constructively with the Commission and its PRB in its pursuit. The UK process for developing price controls should also align with the European process under the Regulations<sup>4</sup> and not pre-empt Commission approval.
- 2.2 The CAA notes that the Commission, in accepting the UK's Performance Plan for RP1, made it clear that it expected greater focus in RP2 on improvement in the key performance area of NERL cost-efficiency. More recently the Commission has requested that more effort is made by the UK-Ireland and other FABs to realise benefits for users.

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## Development of EU-wide targets

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- 2.3 The PRB formally began consultation activities in January 2013 to develop EU-wide targets for RP2, with an initial consultation on ranges between 20 January 2013 to 20 February 2013, supported by a stakeholder workshop held on 6 February 2013.
- 2.4 The PRB will undertake further consultation on proposed targets during May/June 2013 and will then present its recommendation to

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4 The relevant regulations are the following as amended by the Single Sky Committee on 7 March 2013 (official text pending):

Regulation (reference pending) laying down a performance scheme for air navigation services and network functions and amending

Regulation (reference pending) laying down a common charging scheme for air navigation services.

the Commission by the end of September 2013. After which the Commission will issue a draft Decision on the targets for SSC approval by the end of 2013.

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## Range of cost-efficiency scenarios for NERL's initial RP2 business plan

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- 2.5 In its July 2012 consultation document<sup>5</sup>, the CAA asked NERL to develop, as part of its draft RP2 Business Plan, scenarios for DUC reductions of -2 per cent, -3.5 per cent and -5 per cent per year in real terms. (It subsequently informed NERL that it expected this to be based on a starting point equal to the 2014 target in the National Performance Plan (NPP) for RP2 in real terms.) These targets were pending the confirmation of EU-wide targets ranges.
- 2.6 The CAA now considers it appropriate to modify these scenarios to reflect the range of scenarios being consulted on by the PRB.<sup>6</sup> The CAA has therefore written to NERL revising scenarios to the four proposed by the PRB of -3.2 per cent, -4.1 per cent, -4.6 per cent and -6.9 per cent per year.<sup>7</sup> This also includes a revised starting point equal to what NERL's target for 2014 would have been had the reduction in the DUC been consistent with the annual percentage reductions in the EU-wide targets adopted by the Commission for RP1, adjusted to take full account of the variation in traffic between the NPP forecasts and the traffic now expected for 2014.<sup>8</sup> The starting point used in the final FAB Performance Plan will reflect that set out in the EU-wide targets adopted.

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5 A consultation on the CAA's process for developing economic regulation for Reference Period Two under the Single European Sky at <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=585>.

6 EU-Wide Targets for RP2: Indicative Performance Ranges <http://www.eurocontrol.int/sites/default/files/content/documents/single-sky/pru/performance-targets/2013-02-25-rp2-eu-targets-report-1.pdf>

7 A copy of this letter is available from the CAA's website at [www.caa.co.uk/npp](http://www.caa.co.uk/npp).

8 On the basis of current traffic expectations for 2014, the PRB proposals imply a steeper downward trend to the DUC compared to the previous CAA scenarios but starting from a higher starting position.

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## Stakeholder expectations on the CAA's process

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- 2.7 The CAA's July 2012 consultation paper set out the expected requirements, under the SES Performance Regulation, for a Local Performance Plan for RP2 and the process and timetable that it proposed to adopt for doing so. It received written responses from the following seven organisations:
- BAA Airports Limited;
  - British Airways;
  - Gatwick Airport Limited (GAL);
  - IATA;
  - NATS;
  - NATS Trade Union side; and
  - Ryanair.
- 2.8 Full written responses are available on the CAA website.<sup>9</sup> The CAA notes the following general messages from the responses.
- 2.9 Airlines on the whole expressed considerable disappointment with the outcome of the RP1 (2012-2014) plan, particularly in terms of the level of ambition of NERL's cost-efficiency performance. They considered that the CAA should align with the Commission processes for RP2 and not get ahead of them. They did not consider developing a concept based on Total Economic Value (TEV) to weigh up trade-offs between KPAs was a priority and would prefer a much more rigorous focus on putting downward pressure on unit costs.
- 2.10 BAA expressed concern that airport performance measures were not yet sufficiently mature to agree targets. It would like to see further analysis undertaken to understand the root cause of performance and the behaviours to be incentivised. GAL had a particular concern that any proposals should adhere to the principles of Better Regulation and do not prevent the further development of airport or ANSP competition.
- 2.11 NATS said it was keen to engage constructively with airlines on the detail of the NERL business plan for RP2 and to better understand

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9 <http://www.caa.co.uk/default.aspx?catid=78&pagetype=90&pageid=13986>.

airline preferences. NATS considered that the CAA's approach should take into account:

- the principles of being objective, economic and evidence led;
- targets should represent an appropriate balance between challenging and achievable. In its view, real reductions in the DUC of -2 per cent/-3.5 per cent/-5 per cent per year would be challenging;
- some joint FAB targets may be appropriate but only where there were clear tangible benefits. They should not apply to cost-efficiency;
- safety, capacity and environmental targets for Terminal Air Navigation Services (TANS) are most appropriately applied on a "bottom-up" rather than "top-down" basis; and
- Oceanic airspace should continue to be subject to economic regulation with a strong emphasis on a simple and proportionate design.

2.12 The NATS Trade Unions supported a bottom-up, rather than a top-down, approach and were concerned at what they saw as a strident approach from Europe. They expressed concern that an over ambitious approach to RP2 would be damaging to Air Traffic Management (ATM) service delivery.

2.13 The CAA held a workshop with interested stakeholders on 15 October 2012 to allow further discussion and feedback from stakeholders on issues raised.<sup>10</sup> Airlines reiterated a number of significant issues from their submissions:

- they were looking for the high-level SES targets<sup>11</sup> to be achieved by 2020;

<sup>10</sup> The CAA also received a consolidated FAB Europe Central Position on the RP2 regulatory approach as contribution to the CAA's workshop.

<sup>11</sup> The high level SES targets envisage: unit costs of ANS being cut to less than half levels, capacity increased by a factor of 3, safety being increased by a factor of 10 and a 10% improvement in the effects flights have on the environment, compared to 2005 performance levels. The original target to achieve these goals was 2020 but this was against expectations of high traffic growth. The original timeframe set out in 2005 for achievement of the SES high-level goals was 2020. The revision introduced by the Single Sky Committee in November 2011 has linked the realisation of these goals to a doubling of traffic relative to 2005.

- although they wanted engagement with NERL on its business plan for RP2, they wanted the CAA to set out its expectations at the start with regards to its governing principles;
  - they expected more benefits realised from the UK-Ireland FAB than had been achieved hitherto.
- 2.14 NATS emphasised the importance of trade-offs between cost and service quality and envisaged a role for considering total costs taking account in particular the cost of delay and flight efficiency.

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## Other relevant issues

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### En route charging: N+2

- 2.15 At the time of the 2013 charges setting process in November 2012 there was some dispute as to whether under- or over-recoveries due to traffic risk sharing and outturn inflation could be adjusted on the basis of forecasts in the following year (N+1) rather than two years hence (N+2) when the actual values involved had been reported. The text of the Common Charging Regulation at the time allowed recovery “no later than N+2” and therefore did not seem to preclude a phased recovery.
- 2.16 The revised Common Charging Regulation which takes effect from 1 January 2015 has changed the text so that the recovery of under-recovery will not take place before N+2 and repayment of over-recoveries in N+2. To avoid further dispute, the CAA will propose to modify the charging condition in the NERL licence so that this revised approach to under- and over-recoveries would take effect from 1 January 2014. The CAA would expect to carry forward the sums implied for recovery in RP2 to the full extent permitted by the Common Charging Regulation and consistently with the requirements of the Transport Act 2000. NERL has agreed in principle to this change, subject to the opportunity to review the detailed proposals.
- 2.17 The CAA is separately publishing for consultation proposals for modifying NERL's licence in respect of calendar year 2014 – i.e. the last year of RP1 – rather than for RP2.

## Oceanic

- 2.18 The UK and Ireland both provide ANS in the northeast Atlantic Ocean, under an ICAO<sup>12</sup> mandate. The element of this Oceanic service provided by NERL is subject to price control under the NERL en route licence but is not subject to the SES Performance Scheme.
- 2.19 The CAA intends to consider the price controls for Oceanic services alongside (but not subject to) the process for the Performance Plan.

## Terminal Air Navigation Services

- 2.20 The Performance Regulation requires some local targets to be set for TANS for RP2. While it was always envisaged that the Performance Regulation would apply to both en route and terminal services, RP1 was a transitional step which focused primarily on en route services.
- 2.21 The Performance Regulation allows Member States to exempt some or all of their airports with fewer than 70,000 IFR air transport movements per year from the requirements of this Regulation. The CAA anticipates that the UK will seek this exemption.
- 2.22 Airports with more than 70,000 IFR air transport movements per year are subject to key performance indicators (KPIs) for safety and capacity. Those airports that do not pass the market conditions assessment as set out in the Common Charging Regulation are also subject to a cost-efficiency KPI. In addition Member States must set determined costs and calculate terminal charges, and set financial incentives, in accordance with the requirements of the Regulation.
- 2.23 The TANS at all the relevant UK airports<sup>13</sup> with more than 70,000 IFR air transport movements per year are operated under contracts between NATS (Services) Limited (NSL) and the individual airport operator. Subject to the Department for Transport's (DfT) views on contestability (see below) the CAA's provisional view is that it intends to base the Performance Plan to the maximum extent possible on the terms of the existing contracts. To that end, activity to develop national targets for TANS will be conducted separately to this process and the NERL Customer Consultation Mandate.

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12 The International Civil Aviation Organisation.

13 Based on 2011 Eurocontrol data, the following UK airports are within scope of the 70,000 IFR air transport movements threshold: Heathrow, Gatwick, Manchester, Stansted, Edinburgh, Luton and Birmingham. In developing the RP2 Performance Plan, the decision on which airports are within scope will be based on the average of 2011, 2012 and 2013 IFR air transport movements data.

## Market Conditions in TANS

- 2.24 On 28 February 2013 the CAA published its advice<sup>14</sup> to the DfT on whether TANS at larger airports in the UK are subject to market conditions as defined in the Common Charging Regulation. Where such market conditions can be demonstrated, Member States may opt not to set TANS cost-efficiency targets, determined costs, calculate terminal charges or set financial incentives under the Performance Scheme.
- 2.25 The CAA considered that the balance of available evidence, including stakeholder opinion, did not currently support the existence of market conditions for those UK airports with more than 70,000 IFR air transport movements. However, the CAA believes there is the potential for market conditions to exist in the future, and would like to work with aviation stakeholders to identify changes to strengthen these prospects. There may therefore be a need for further assessments where situations change significantly, to allow the regulatory regime to reflect the most up-to-date evidence.
- 2.26 It is now for the DfT to take its own view of whether or not the airports meet the assessment criteria and inform the Commission accordingly before the end of May 2013. If the DfT decides that market conditions have been established, the Commission would then have four months to consider whether or not it agrees. Thus while the process to establish whether or not market conditions are present in UK TANS is not yet complete, this update builds into its timeline an assumption that the Performance Plan is likely to require cost-efficiency targets for these airports.

## London Approach

- 2.27 London Approach is the radar approach service provided from the Area Control Centre at Swanwick to Heathrow, Gatwick, Stansted, Luton and London City airports and is provided under NERL's licence. A separate charge is levied on users for this service and the charge is subject to a separate price control under the NERL licence. This is a hybrid service in that it has some of the characteristics of both an en route and a terminal service.
- 2.28 The CAA intends as part of the Performance Plan to consider how the treatment of this service can be better designed to meet the

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<sup>14</sup> <http://www.caa.co.uk/application.aspx?catid=14&pagetype=65&appid=7&newstype=n&mode=detail&nid=2216>.

requirements of the Common Charging Regulation. To that end the CAA expects to consult on this issue with stakeholders later this year.

## CHAPTER 3

# Timetable

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### Interaction between the European and UK process

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- 3.1 Figure 3.1 updates the timetable in the July 2012 consultation document. The CAA will keep this timetable under review and post updates on its website.

**Figure 3.1: Timetable for developing RP2 Performance Plans**

Date	EU Milestone	UK Milestone
May 2013		NERL publishes its IBP  NERL/airspace user Customer Consultation starts
May/June 2013	PRB consults on initial proposals for EU-wide targets	
September 2013	Commission proposes EU-wide targets	NERL/airspace user Customer Consultation finishes and CCWG reports to CAA
October 2013		NERL submits RBP to CAA
December 2013	Commission adopts EU-wide targets	
February 2014		UK and Ireland NSAs publish draft Performance Plan for stakeholder consultation

May 2014		NSAs submit Performance Plans to UK and Irish governments
June 2014	Commission requires Member States to submit Performance Plans	UK and Irish governments submit the UK-Ireland RP2 FAB Performance Plan to the Commission
October 2014		CAA publishes proposed formal changes to NERL licence (contingent on Commission approval of the UK-Ireland FAB Performance Plan)
November 2014	Commission notifies its assessment to Member States	
December 2014		CAA publishes its formal decision for NERL price control for RP2 (contingent on Commission approval of the UK-Ireland FAB Performance Plan)
January 2015	RP2 starts	

Source: CAA

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## **UK requirement to modify the NERL licence**

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- 3.2 A NERL licence modification will need to be in place from 1 January 2015 to implement the RP2 regime. Under UK law, this modification must allow for a minimum 28 day prior consultation period. The CAA intends to make its proposals contingent on the Commission's decision on whether or not to accept the relevant elements of the Performance Plan. If this approval is not forthcoming the CAA will need to consider a further subsequent licence modification.



## CHAPTER 4

# Mandate for Customer Consultation

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## Introduction

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- 4.1 The CAA considers that there is considerable merit for promoting NERL/ airspace user consultation prior to drafting the UK en route charging component of the Performance Plan for RP2.
- 4.2 The CAA has developed the process outlined in this chapter based on feedback received to its consultation in 2012 and the stakeholder workshop.
- 4.3 The CAA will retain overall responsibility for drafting the UK en route component of the Performance Plan. In drafting this plan, the CAA will draw on evidence arising from Customer Consultation in addition to other sources such as its own analysis of NERL's business plans.
- 4.4 The CAA will also consider the appropriate regulatory arrangements for NERL's Oceanic service. This is outside the remit of the RP2 Performance Plan but the CAA considers that it is efficient in terms of resources for both NERL and airspace users for it to be considered as part of the Customer Consultation process. Notwithstanding, the CAA may review the timetable for the Oceanic service as the process develops.

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## Scope of NERL activities under review

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- 4.5 The following NERL activities are within the scope of the review, and as such, within the scope of the Customer Consultation discussion:
- the Eurocontrol price control, which currently takes account of the following NERL services, within a single till arrangement:
    - the UK en route business, charged through the Eurocontrol unit rate;
    - the London Approach service; and

- non-regulated activity, excluding inter-company receipts, but including the North Sea Helicopter service and activity under NERL's contract with the Ministry of Defence.
- 4.6 In addition, the CAA expects Customer Consultation to consider the Oceanic en route service, which is separately price controlled.
- 4.7 NSL activity is excluded from the scope of Customer Consultation discussion. There will be targets and performance indicators for TANS at some airports. As this will involve a different set of stakeholders, the CAA considers that it will be more efficient to consider airports through a different process forum to en route. It will engage with stakeholders in due course on the arrangements for this.

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## CAA expectations of the process

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- 4.8 The CAA expects NERL to establish a Customer Consultation Working Group (CCWG), which will be convened with a fair representation of its airline customer base for a series of focused one-day plenary meetings. This may be supplemented by further workshops on particular subjects.
- 4.9 The CAA expects NERL to publish its IBP in May 2013. This will form the basis of Customer Consultation between NERL and airspace users before NERL submits a RBP to the CAA by no later than 18 October 2013.
- 4.10 The CAA does not expect NERL and airspace users to agree the RBP, though this would be a welcome development. The CAA expects NERL to engage constructively to seek airspace users' priorities for RP2 and ensure these are taken into account in formulating its RBP and where it cannot meet these priorities and demands it provides a cogent and timely explanation.
- 4.11 Among other issues that NERL and airspace users should cover in their discussions, the CAA expects outputs on the following.
- i) The key airspace user priorities for the RP2 period and beyond for UK en route services.

- ii) NERL's proposed plans for meeting airspace users' needs in RP2, in terms of the KPAs under the Performance Regulation: safety, environment, capacity and cost-efficiency.
- iii) The key components of NERL's business plan including traffic projections, its capital plan, operating costs, and financing costs etc.
- iv) The steps that NERL is taking to improve its cost-efficiency in RP2 and beyond.
- v) NERL's programmes (including costs and benefits) required to deliver the Future Airspace Strategy (FAS).
- vi) NERL's ambitions and plans for delivering improved outcomes for users through its relationship with the IAA ANSP and the UK-Ireland FAB.
- vii) The use of incentive mechanisms to encourage NERL's performance.
- viii) The priorities of airspace users in relation to certain trade-offs relating to strategic choices NERL could make regarding cost and service quality.
- ix) Airspace users' requirements for Oceanic services for the five years beginning 1 April 2015. (nb: as this is not an issue related to the Performance Regulation it could be considered separately and potentially later. However the CAA sees merit in reviewing this issue in parallel to minimise stakeholders' resource requirements.)

4.12 The CAA expects the output from Customer Consultation to be recorded and submitted to it clearly describing the areas of agreement and areas of disagreement. The CAA will use this report, together with its own independent analysis of NERL's business plans to formulate specific proposals for the NERL price control, which will comprise the UK en route component of the draft UK-Ireland FAB Performance Plan expected to be published for consultation in February 2014.

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## Stages of the process

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- 4.13 The CAA expects the process to be conducted within the following framework following the publication of this mandate.

### Stage 1: The Customer Consultation Plenary Meeting – May 2013

- 4.14 The CAA expects NERL and airspace users to agree a process for fulfilling this mandate. NERL has proposed that it will establish the CCWG comprising senior representatives from airlines and airline trade body representatives.
- 4.15 In March 2013, NERL sent an invitation to airspace users and their trade body representatives to attend a launch event in May 2013. NERL is also in the process of establishing a series of one-day plenary meeting with airspace users to consider the key issues.
- 4.16 If possible, the CAA considers that the CCWG should be chaired either by an independent person agreed between NERL and airspace users or else there should be co-chairs with one co-chair from NERL and one co-chair from airspace users.
- 4.17 Although funded by NERL the CAA expects the chair or co-chairs to have a duty of care to the CAA for the proper and fair functioning of Customer Consultation. Their principal responsibility should be process assurance and not to act as a representative for one side or another.
- 4.18 The CCWG through the chair or co-chairs will produce a report at the end of the process detailing the points of agreement and disagreement between NERL and airspace users.
- 4.19 The CAA expects NERL and the airspace users to agree on the nomination for chair/co-chairs by no later than the first plenary session and to seek to agree the governance structure as early as possible.

### Stage 2: NERL/airspace user meetings – June to September 2013

- 4.20 NERL is proposing a process comprising of a number of plenary meetings on the IBP. As a minimum the CAA expects NERL to hold sufficient meetings to enable airspace users (a) to properly understand the IBP; (b) to enable airspace users to give feedback on the IBP; and (c) to respond to airspace users in terms of how it has or will take their views into account in its RBP.

- 4.21 These plenary meetings should allow a process where airspace users can discuss NERL's plans and put forward questions for answering by NERL on the day or recorded for a timely follow up.
- 4.22 Alongside the plenary meetings on the overall IBP, the CAA expects NERL to host a number of workshops on more detailed specific issues relevant to the IBP. As a minimum the CAA expects NERL to organise workshops to cover the following areas: traffic forecasting; the capital plan; operating costs; service quality; and the programmes to deliver FAS.
- 4.23 The plenary meetings and workshops will be more effective if NERL circulates material in advance, the discussion is minuted and NERL responds afterwards in a timely way to any queries it cannot deal with on the day. The CAA reserves the right to attend the meetings as an observer (not an active participant). It may also review the minutes of the meetings and NERL responses to follow-up questions.
- 4.24 The CAA considers that the chair/co-chairs will need to be flexible in their approach to the number of meetings. This is because it may not be possible, or indeed desirable, to cover an issue sufficiently in one session and hence there may be value in a follow-up session or a continuing process. The CAA expects NERL to respond constructively to this. However, given the relatively tight timetable it will not be possible for there to be unlimited opportunities to engage on the detail of particular issues.
- 4.25 The CAA recognises that the resources users can devote to these meetings are limited. However, it would encourage users to contribute sufficient resources to get value from the process. The CAA has defined the scope widely in order not to unreasonably restrict discussion. In doing so the CAA expects users to bring insights that they have gained from other fora with NERL/NATS (e.g. the OPA, SIP and FASIIG<sup>15</sup>).
- 4.26 The CAA reserves the right to submit to the chair/co-chairs some questions for meetings discussion in advance of the sessions.

### **Stage 3: CCWG Report to CAA – September 2013**

- 4.27 The CAA expects a report from the chair or co/chairs of CCWG by the end of September 2013 setting out:

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<sup>15</sup> OPA - Operational Partnership Agreement, SIP - Service and Investment Plan and FASIIG - FAS Industry Implementation Group.

- the issues on which NERL and airspace users have agreed; and
  - the issues where there has not been agreement setting out the views of each party (including any differences in view between various airspace users).
- 4.28 The CAA would welcome consensus on major issues, but recognises it is unlikely to occur in every instance, and that Customer Consultation has the potential to yield useful contributions to its review even in the absence of consensus between NERL and airspace users.

### **Stage 4: NERL's revision to its business plan – October 2013**

- 4.29 The CAA expects NERL to review the IBP, with a view to adjusting it, following its consultation with airspace users. Where possible, NERL should take into account the full range of feedback from consultation in producing its RBP.
- 4.30 In so doing, NERL should lend weight to planning for outcomes likely to deliver the greatest overall value to airspace users, taking account of the four KPAs under the Performance Regulation.
- 4.31 NERL's RBP should also make it clear how it will contribute to benefits as a result of the UK-Ireland FAB.

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### **CAA expectations of NERL and airspace users**

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- 4.32 The CAA expects NERL to provide airspace users at the outset of discussions with at least the following material.
- An overview of NERL's business and performance over the RP1 period to date, in order to allow customers to become familiar with the context of the price control review.
  - An IBP, which highlights NERL's proposed forecasts for the RP2 period, in the following areas:
    - UK and Oceanic en route traffic;

- operating costs (both ongoing and exceptional cost items), highlighting the trajectory of efficiencies possible proposed in each of the years of RP2, and the effects on performance (safety, price, quality and environmental). A breakdown of operating costs should be given. The effects on performance and risks associated with greater cost efficiencies should also be set out;
  - options for capital investment (the scope of activities proposed, business cases for major programmes, the effects in performance terms (safety, price, quality and environmental) of not making specific investments, alternative ways of meeting performance targets, and the proposed cost of the aggregate programmes breaking out the cost of major programmes including those necessary to deliver the FAS);
  - the level and composition of forecast of restructuring costs;
  - cost of capital and regulatory return;
  - forecast of regulatory depreciation on the regulatory asset base (RAB); and
  - indicative price profiles for UK and Oceanic en route services, highlighting the value of the average price reduction implied over the relevant period.
- A clear schedule for users for when key inputs in the business plan will be updated (such as traffic forecasts).
  - A simplified or 'ready reckoner' type model so airspace users can understand the impact on charges of making different assumptions for various inputs.
  - Further background information: by providing customers with information behind key regulatory assumptions and how these translate into an indicative price profile.
  - Meeting hosting: host the meetings and provide the CCWG with meeting venues, at its expense.
  - Website: communicate material relevant to CCWG meetings on a controlled website that can be accessed only by airlines (including airspace user representative bodies) engaged in the process and the CAA.

- Openness and transparency: act in a way that is in keeping with the aims of an open and transparent process, given necessary confidentiality, respecting views expressed in meetings.

4.33 The CAA expectations of airspace users include the following.

- Engage with NERL in the process in good faith. The CAA considers that the benefits of Customer Consultation are most likely to be realised if customers:
  - engage in the process in numbers sufficient to represent NERL's customer base; and
  - are represented by sufficiently senior staff members, who both have the knowledge (i.e. operational, financial, regulatory etc) and seniority to input practically to discussions and to move discussions forward.
- Provide the CCWG with a co-chair, who will work alongside the NERL co-chair or approve an acceptable single chair.
- Maintain the confidentiality of material shared within the process, to prevent communication of material beyond the airlines and named trade body representatives engaged in the process; and to control internal access to material to relevant staff members who are either engaged directly in CCWG meetings or are part of the governance system for approving decisions on relevant matters. The CAA reserves the right in certain circumstances to support NERL in seeking non disclosure agreements (as has been the case for certain data disclosure to airlines as part of the regulated airports' price reviews).
- Act in a way that is in keeping with the aims of an open and transparent process, given necessary confidentiality, respecting views expressed in meetings.

4.34 The CAA expects both NERL and its airspace users to:

- agree a plan and code of conduct for proceeding through the Customer Consultation process;
- provide the CAA with minutes from each CCWG meeting, detailing areas of agreement and disagreement, citing majority and minority views, agreed with attendees from the meeting; and

- conduct all Customer Consultation policy discussions within the CCWG framework and to report offline conversations to the CCWG, to ensure that each party in the process has an opportunity to contribute equally to the consultation.

## Role of the CAA

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- 4.35 The CAA has the responsibility under European legislation of drafting the Performance Plan as the NSA. (As this will be a plan for the UK-Ireland FAB, this responsibility will be conducted in concert with the Irish NSA (the IAA Safety Regulation Department.) The CAA has also the responsibility under UK legislation for implementing any changes to the NERL licence to implement charging requirements derived from the EU process or for Oceanic services.
- 4.36 To inform these responsibilities it will:
- initiate the proposed Customer Consultation process between NERL and its airline users;
  - issue this current mandate to NERL and airspace users;
  - request that NERL initiates discussions with airline representatives regarding the appointment of a chair/co-chairs of the CCWG. The CAA expects to see agreed arrangements put in place as soon as possible;
  - ensure that the CAA is adequately informed of the progress in and the substance of discussions between NERL and airspace users. The CAA requests that NERL supply to it all papers, submissions, and data provided to the CCWG, and minutes and actions arising from meetings of this group; and
  - enable any party (including those not involved directly in the CCWG exercise) to raise any concerns about the conduct of the Customer Consultation process at any time. The CAA will maintain an 'open door' policy with respect to the views of the parties on this issue. The CAA will decide how best to respond to any issues raised in light of the specific concerns and the context of the Customer Consultation process at the time.
- 4.37 The CAA will also undertake its own research in 2013 on NERL's business plans. The CAA is still formulating its plan for this analysis but as a minimum it expects it will cover in-depth assessments of NERL's operational cost-efficiency and the appropriate WACC.

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## CAA use of Customer Consultation material

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- 4.38 The CAA will treat minutes from the meetings as input to its drafting of the UK en route component of the FAB Performance Plan and in drafting its proposals for the Oceanic service.
- 4.39 Subject to the CAA's consideration of the extent to which the results from Customer Consultation reflect the interests of passengers, cargo shippers and airlines not directly represented in such consultation (informed in part by written submissions from such customers), the CAA would be minded to adopt agreed outcomes and to incorporate these into its own proposals for UK en route and Oceanic.
- 4.40 The CAA would also be minded to place weight on partial agreements, for example where NERL and airlines may have converged on proposals for investment, capacity and service quality, while remaining not in full agreement on the projected costs of delivering these over RP2.
- 4.41 In such cases, the CAA would form its own judgement and set out its own proposals, for consultation as part of the draft FAB Performance Plan or price condition proposals for Oceanic, on the overall combination of projected outputs, costs and regulated revenues which it considered best meets its obligations at EU or domestic level as appropriate.

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## Legal basis for Customer Consultation

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- 4.42 The CAA is mandating the Customer Consultation process for the RP2 process within the EU and domestic statutory framework. The CAA considers that, by providing high quality information at a formative stage of the review, this process would be likely to assist the CAA draft the UK en route component of the FAB Performance Plan in the manner best calculated to achieve its statutory duties.
- 4.43 The CAA's objectives for Customer Consultation are:
- to enable the CAA to draft a UK en route component of the FAB Performance Plan for RP2 which is as well informed as possible about users' future requirements for safety, environment, service, capacity and cost-efficiency;

- to enable airline users to understand as fully as possible the options open to NERL to meet the performance requirements for RP2 and to provide airlines with an opportunity to engage with NERL on further developing NERL's plans before their submission to the CAA;
- to enable NERL to conduct a comprehensive and structured consultation with its customers to inform the development of its RP2 business plan before submission to the CAA; and
- to provide a forum in which NERL and its airline users could seek to reach agreement on aspects of the UK en route component of the RP2 plans and, to the extent that this is not possible, to provide the CAA with a clear view of the positions of each party.

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## Competition law basis for discussion

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- 4.44 All parties to the Customer Consultation should be aware of their responsibilities to operate within the bounds of competition law. The CAA does not envisage that competition law requirements would hinder the flow of information between NERL and airline participants necessary for Customer Consultation. However, this is ultimately the responsibility of each of the parties.
- 4.45 In considering the results of Customer Consultation, the CAA will be mindful of the interests of all users of NERL's price-regulated services, and not just the interests of those airlines that participated in or were represented in Customer Consultation.

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## Consent to consult

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- 4.46 CAA endorses the establishment and operation of the CCWG, based on the terms of the agreement set out in this document, and with the objective of providing high quality information to the CAA at a formative stage of the RP2 process, to assist the CAA in the conduct of its statutory duties.