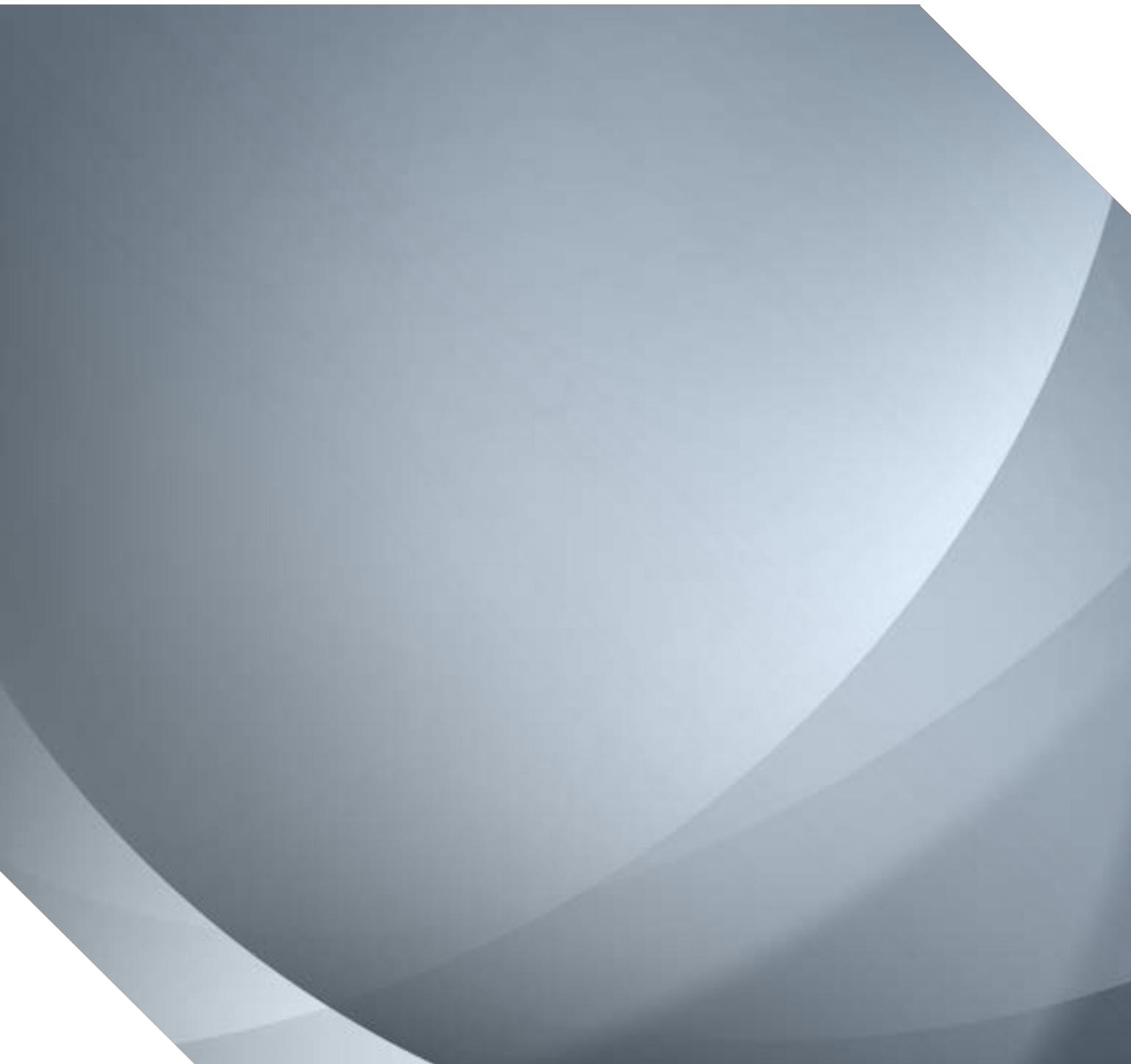


# Regulatory treatment of London Approach charges in Reference Period 2 (2015-2019) of the Single European Sky Performance Scheme

A consultation document

**CAP 1098**





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## Executive Summary

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1. This consultation document seeks stakeholders' views on the most appropriate regulatory treatment of charges for the London Approach service (LA) consistent with the EU charging and performance regulations ('the regulations')<sup>1</sup> and the CAA's statutory duties under the Transport Act 2000. This follows revision of the regulations in 2013 and the UK's finding that the terminal services at airports do not currently pass the market conditions test specified in the charging regulation which had previously exempted them from part of the regulations. In particular, this document considers three questions:
  - Whether there should continue to be a separate charge for LA?
  - If so, whether it should be considered as an en-route or terminal service under the SES requirements?
  - How costs should be allocated to any separate LA charge?
2. The current position is that LA is treated as if it is neither a terminal nor an en-route service and its costs are borne via a separate charge on air traffic users terminating at the five main London airports and UK en-route users generally.
3. This paper considers three options alongside the status quo.
  - Option 1: A separate Terminal Charge with the current allocation of costs;
  - Option 2: A separate Terminal Charge with full allocation of costs; and
  - Option 3: A consolidation of current LA charges in the Eurocontrol en-route charges.
4. The CAA's initial view is that the UK should move to Option 2 over time in line with an assessment of the treatment of approach services across the EU and the development of a common approach for the EU. In the meantime, however, for RP2 the CAA is minded to pursue Option 1, but would welcome views from stakeholders before coming to a decision on the matter.

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1 COMMISSION IMPLEMENTING REGULATION (EU) No 391/2013 of 3 May 2013 laying down a common charging scheme for air navigation services and COMMISSION IMPLEMENTING REGULATION (EU) No 390/2013 of 3 May 2013 laying down a performance scheme for air navigation services and network functions.

## CHAPTER 1

# Introduction

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## Purpose of this document

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- 1.1 This document considers the most appropriate regulatory treatment of charges for LA consistent with EU regulations and the CAA's statutory duties.
- 1.2 Nothing in this paper is intended to affect the current operational arrangements for providing the LA service, their inclusion within the scope of NERL's Licence, or to have any implications for safety.

## Views invited

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- 1.3 Any comments should be sent, if possible by e-mail, to Mike Goodliffe at [mike.goodliffe@caa.co.uk](mailto:mike.goodliffe@caa.co.uk) by 17 November 2013. Alternatively, comments may be sent by post to:

**Mike Goodliffe**

Regulatory Policy Group

CAA, 4th Floor, CAA House, 45-59 Kingsway, London WC2B 6TE

- 1.4 The CAA expects to make responses available on its website for other interested parties to read as soon as practicable after the period for written comments expires. Any material that is regarded as confidential should be clearly marked as such. Please note that the CAA has powers and duties with respect to information under section 102 of the Transport Act 2000 and the Freedom of Information Act 2000.
- 1.5 If you have any questions on this document please contact Mike Goodliffe on 020 7453 6226 (or, by e-mail, to [mike.goodliffe@caa.co.uk](mailto:mike.goodliffe@caa.co.uk)).

## Next steps

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- 1.6 The results from this consultation will help inform the CAA's decision on the matter and its preparation of the UK's contribution to the draft FAB Performance Plan for the UK and Ireland. The CAA expects to consult on this in February 2014.

## CHAPTER 2

# Background

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## Introduction

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- 2.1 The regulations set out separate specific requirements for charging and performance of en-route air navigation services on the one hand and for terminal air navigation services on the other hand. NERL provides a service for traffic using the five main airports in the London area<sup>2</sup>, London Approach (LA), that has characteristics of both types of service. It is provided from an en-route centre rather than from the airports themselves, but it is essentially providing a radar approach service to airports. This document considers options for amending the charging arrangements to ensure consistency with the revised regulations.

## What is the LA operational service?

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- 2.2 LA consists of the control and sequencing of flights between NERL's en-route service (which operationally includes holding stacks) and the tower service at London airports (which is provided at each by an ANSP under contract with the airport operator<sup>3</sup>). LA usually hands control to the relevant airport tower when aircraft are established on their final approach. For departures the handover points depend on various factors including the particular airport, routing, weather and the potential for conflict with arrival traffic sequencing. The relevant airport tower may hand over to LA or directly to an en-route sector. LA is provided from the Terminal Control (TC) room at NERL Swanwick centre and it is integrated with the rest of NERL's TC Operations which are charged to users via the en-route business.
- 2.3 A separate but common charge is levied on users by NERL in respect of services for Gatwick, Heathrow, London City, Luton and Stansted airports. Services are also provided from the Terminal Control room at Swanwick (TC) to traffic at other small airports in the London area.

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2 Gatwick, Heathrow, London City, Luton and Stansted.

3 All five contracts are currently operated by NATS Services Ltd (NSL).

## Why has LA been operated in this way?

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- 2.4 Traditionally, an approach service is provided from radar positions located in airport towers.<sup>4</sup> From the early 1990s, NATS<sup>5</sup> decided that there were safety and capacity benefits for airspace users from operating the radar service of Heathrow and Gatwick approach alongside its en-route service as part of a programme to create a central control function (CCF) at the West Drayton centre. Over time, the equivalent services for Stansted, Luton, London City and Biggin Hill were each added with the aim of enhancing safety and capacity benefits to airspace users in the London area. In 2008 NATS moved the London terminal control room (including en-route sectors and LA) from West Drayton to Swanwick.

## How are LA costs currently charged to users?

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- 2.5 For Gatwick, Heathrow, London City, Luton and Stansted airports, the London Approach service is delivered by NERL as a core requirement of its Licence. NERL levies a separate charge on airspace users on the basis of aircraft weight. For RP1, this charge is subject to price regulation by the CAA under the NERL licence by means of a separate annual revenue cap.<sup>6</sup> The charge is also published by the CAA in accordance with section 73 of the Transport Act 2000.
- 2.6 NERL's Terminal Control (TC) also provides services to aircraft in the London area. For Biggin Hill, TC provides an approach service, for which it pays an annual fee and this forms part of NERL's LA revenue<sup>7</sup>. TC provides control services to aircraft flying in/out of other London area airports (eg Northholt, Elstree, Fair Oaks and Redhill) but these services are not considered by NERL to be approach services and therefore they do not attract an LA charge. Aircraft using these airports would pick up en-route charges where appropriate (mainly where they are operated under Instrument Flight Rules (IFR) in controlled airspace). Battersea Heliport services are designated as under Special Visual Flight Rules and therefore these services are not charged. The services are provided by the LA team (Thames Radar) but they are not charged as NERL consider

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4 This remains the case at most UK airports other than the 5 main London Airports. Where this approach service is outsourced, is provided by the airport ATC provider under commercial contract to the airport operator.

5 NATS was part of the CAA at that time.

6 AirTraffic Services licence for NATS (En-route) plc - Condition 21.a.

7 This arrangement is contracted through NATS (Services) Limited.

this as essentially a safety service to keep helicopters away from traffic going to/from Heathrow and London City airports.

- 2.7 The CAA understands that when NATS transferred the LA functions from the respective airport towers to the West Drayton Centre, it said that the move would not adversely affect charges to relevant users of the service as a large part of the benefits of the re-organisation benefited users of airspace in the South East generally. As a result the costs transferred to West Drayton and therefore to users of LA (mainly staff costs, but also some non-staff and overhead costs) did not reflect the full costs of operating the service from the West Drayton Centre with the remainder of those costs allocated to en-route charges generally. It could be argued that this did not represent an economic cross subsidy as the users of the LA service were still paying the full amount of what it would cost to provide the service if provided separately from the en route service.
- 2.8 The CAA recognises that there may be different reasonable ways to allocate costs that cannot be causally linked to a given activity. However, on the basis of NERL's current allocation of costs according to the number of workstations, this would result in LA charges recovering only c. 40% of the fully allocated costs of the relevant workstations on an accounting costs basis<sup>8</sup>, or c. 30% on a determined costs basis<sup>9</sup>.

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8 NERL considers that between 2008/09 and 2012/13, the average percentage of accounting costs of the LA service covered by revenue amounted to 37.5%.

9 The difference between accounting and determined costs methodology is explained in paragraph 3.5 and Annex A, Table 2.

**Figure 1: LA costs and revenues (NERL estimate)**

	<b>2012/13 (fully allocated accounting costs)</b>	<b>2012/13 (fully allocated determined cost basis)</b>
LA: forecast costs	£27.7 million	£37.3 million
LA: revenue	£11.2 million	£11.2 million
Difference	£16.5m million	£26.1million
Percentage of planned costs of relevant workstations covered by planned revenue	40.4%	30.0%

Source: NERL<sup>10 11</sup>

## Looking forward

2.9 The LA service reflects the way that airspace around London has been configured over the last twenty years. Looking forward there may be significant changes that affect the demarcation between en-route and terminal services. For example, the CAA expects the redesign of airspace following FAS<sup>12</sup> and LAMP<sup>13</sup> to reduce the significance of aircraft holding in physical stacks with greater emphasis on speed control to regulate sequencing and more continuous descents and climbs. Any changes made to the treatment of LA should have a view to the possible future evolution of the service and how this will be accommodated within requirements of Single European Sky.

## Common practice

2.10 The charging regulation requires that where costs are incurred across different charging zones, they shall be allocated in a proportional way on the basis of a transparent methodology. In particular, the cost of terminal services shall be related to the following services:

- aerodrome control services, aerodrome flight information services including air traffic advisory services, and alerting services;

<sup>10</sup> This is based on NERL's 2012/13 Business Plan. NERL's Business Plan does not explicitly identify LA costs and revenues on a determined cost basis, but the estimate presented above is consistent with that plan. Actual revenue in 2012/13 was £10.2m. Note the revenue figures quoted in chapter 3 and the Annex are based on NERL's sampling methodology and therefore there may be small differences to the Business Plan information presented in the table above.

<sup>11</sup> This estimate provided by NERL has not been validated by the CAA.

<sup>12</sup> The Future Airspace Strategy Programme.

<sup>13</sup> London Airspace Management Programme.

- air traffic services related to the approach and departure of aircraft within a certain distance of an airport on the basis of operational requirements; and
  - an appropriate allocation of all other air navigation services components, reflecting a proportionate attribution between en-route and terminal services.
- 2.11 Despite these common general principles, it is widely acknowledged that there are different operational arrangements between ANSPs and the demarcation between what can reasonably be considered en-route or terminal varies significantly. For example, the Eurocontrol Performance Review Unit concentrates on considering ANSPs gate-to-gate cost efficiency rather than en-route or terminal cost efficiency in its benchmarking work because of this issue.
- 2.12 The term “certain distance of an airport”<sup>14</sup> is not defined and as stated above allows scope for significant differences in the way that the cost-allocation is applied between en-route and terminal ANS across European ANSPs.
- 2.13 The interpretation of what should be considered as terminal charges has also been applied differently for different functions. For example, in the methodology for constructing en-route service units applied by Eurocontrol an allowance of 20 kilometres is made around airports to allow for non en-route services whereas the performance regulation uses a distance of 40 nautical miles around airports when considering key performance indicators for terminal services.

## European legal requirements

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- 2.14 Under the SES legislative framework, ANS services are subject to a service provision regulation.<sup>15</sup> Article 15 sets out the principles behind charges. In particular, article 15.2.e stipulates:

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14 REGULATION (EU) No 391/2013 Article 8.2.(b).

15 REGULATION (EC) No 550/2004 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 10 March 2004 as amended by Regulation (EC) No 1070/2009 of the European Parliament and of the Council of 21 October 2009.

- cross-subsidy shall not be allowed between en-route services and terminal services. Costs that pertain to both terminal services and en-route services shall be allocated in a proportional way between en-route services and terminal services on the basis of a transparent methodology.
- 2.15 Charges and cost efficiency for ANS services are also subject to two specific EU regulations: a charges regulation, laying down a common charging scheme for air navigation services; and a performance regulation, laying down a performance scheme for air navigation services and network function. In particular, the regulations require “determined costs” to be fixed for a period of up to five years. Both regulations were revised in 2013.
- 2.16 In respect of the next reference period RP2 (2015-2019), the following requirements are significant:
- the regulations are clearly intended to address air navigation services in all phases of flight through a gate-to-gate approach;
  - Member States are required to establish charging zones consistent with air traffic control operations and services, after consultation of airspace users’ representatives. An en-route charging zone shall extend from the ground up to, and including, upper airspace. In complex terminal areas, Member States may establish a specific zone within a charging zone; and
  - the performance regulation requires cost efficiency targets for each reference period to be set for en-route services at a charging zone level.
- 2.17 In addition, the charging regulation sets out requirements regarding:
- how the cost base for services should be established and calculated;
  - requirements for how costs are allocated between charging zones and in general between terminal and en-route services;
  - prescriptive structures for charges for each of en-route and terminal services; and
  - specific traffic and cost risk sharing allocations between service providers and users.
- 2.18 In addition, the regulations allow for terminal services to be excluded from the requirements for charge setting and cost efficiency:

- for airports with less than 70000 IFR movements per year; or
- where airports meet a test of being subject to market conditions.<sup>16</sup>

2.19 If either of these conditions are met, the Member State may decide:

- not to calculate determined costs;
- not to set financial incentives for these services in the key performance areas of capacity and environment in accordance with Article 15 of the Regulation;
- not to calculate terminal charges in accordance with the Charging regulation; and
- not to set terminal unit rates in accordance with Article 17 of the Regulation.

## What has changed?

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2.20 A number of factors have changed between RP1 and RP2:

- the requirements of the regulations are now more clearly gate-to-gate;
- the requirements for RP1 had greater discretion; e.g. the old charging regulation included a recital: "The charging formula for terminal air navigation services should reflect the different nature of those services as compared to en-route air navigation services." This recital no longer appears in the revised regulation; and
- for RP1, the UK established that Terminal Services were either less than the minimum threshold or subject to market conditions. In February 2013 the CAA has advised the UK Department for Transport that it does not consider the balance of available evidence currently supports the existence of market conditions for UK airports with more than 70,000 IFR movements.

2.21 While there has been no one single factor that clearly distinguishes how LA should be treated, a combination of these factors make it appropriate for the CAA to review how the LA costs should be allocated and charged for RP2, consistent with the revised regulations.

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<sup>16</sup> The relevant criteria for this test are set out in Annex I of the Charging Regulation.

## Issues to be addressed

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- 2.22 The CAA considers that the following issues should be reviewed:
1. The nature of the service - whether it is primarily a terminal service, an en-route service, or whether it combines elements of both.
  2. Whether there should continue to be a separate LA charge? If so, whether it should be considered under the SES requirements as an en-route charge or a terminal service charge?
  3. How should costs be allocated to any separate LA charge?

## CHAPTER 3

# Options

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## Summary of options

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- 3.1 In addition to the counter-factual of maintaining the status quo, this consultation considers the following options:
1. implement a separate Terminal Charge with the current allocation of costs (Option 1);
  2. implement a separate Terminal Charge with a revised allocation of costs (Option 2); and
  3. consolidate LA costs in the Eurocontrol en-route Charges (Option 3)
- 3.2 The sections below set out the CAA's current view on the arguments for and against each option. For the purposes of this consultation, the CAA has accepted NERL's estimated cost allocation presented in figure 1 (see Chapter 2). In addition, to inform this consultation, the CAA asked NERL to provide an analysis of the effect of each option above on future charges for:
- users of LA services;
  - other UK arrivals /departures; and
  - overflights.
- 3.3 NERL has conducted an initial analysis based on historic winter and summer samples of flights in 2012 weighted up to a year to provide a broad illustration of the relative differences between the options under consideration. The results are set out at Annex A. NERL's analysis is historic and it has advised the CAA that in the future, the differences between the options could vary with future cost drivers, e.g. the proportion of investment in en-route rather than LA assets.
- 3.4 For each option above (other than the status quo) there is a question of which methodology to adopt for estimating the costs of LA based on either:
- a) NERL's statutory accounts; or

- b) the CAA's regulatory accounting or determined cost basis<sup>17</sup>.  
This is referred to as the regulatory basis in this document.

- 3.5 The principal differences between these two methodologies are explained in Annex A, table 2. These differences relate to different treatment of pensions, depreciation and cost of capital.
- 3.6 The two methodologies would lead to NERL recovering the same revenue from Eurocontrol and LA in total. However, the regulatory accounting basis would increase the scale of costs allocated to LA and therefore recovered from LA users.

## The status quo

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- 3.7 Under this option LA would continue to:
- be treated as neither fully terminal nor fully en-route under the charging regulation; and fixes both the allocation of costs and charging formula.

### Pros

- This approach has previously enjoyed support from users who expressed a view.

### Cons

- Does not enable review of the current cost allocation and charging structure.

### Which users may pay more or less?

- No change from today.

## Option 1 - Separate Terminal Charge with current allocation of costs

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- 3.8 This option would:
- continue separate charges to users for LA;
  - recognise that the London Approach Service combines elements of both terminal and en-route services;

<sup>17</sup> This would be consistent with the approach the UK has adopted for estimating the Determined Costs for the purposes of setting Eurocontrol charges. The RAB refers to the Regulatory Asset Base.

- require a separate charging zone and charging formula to be defined for the separate terminal London Approach charge;<sup>18</sup>
- continue with the current allocation of costs (i.e. c.40% of the fully allocated accounting costs recovered through the terminal London Approach charge with the remainder of costs recovered from en-route services); and
- enable the structure of charges to conform with the structure prescribed in the regulations.<sup>19</sup>

### Pros

- It requires the minimum change to align the current charges with the regulations.

### Cons

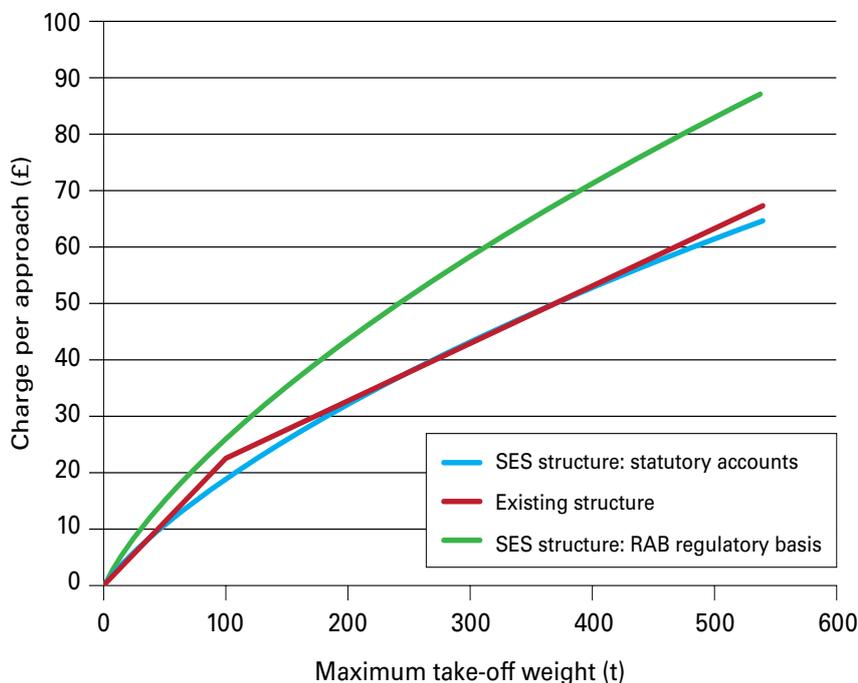
- It will not address NERL's assessment of the current cost allocation.

### Which users may pay more or less?

3.9 There are differential impacts on users operating aircraft of different weights. However, figure 2 shows that, for charges based on a statutory accounts basis, the structure required under the SES charging regulation tracks quite closely the existing structure particularly for larger aircraft with maximum take-off weight greater than 200 tonnes.

<sup>18</sup> It should be noted that the establishment of charging zones is a matter for the DfT rather than the CAA.

<sup>19</sup> The charge would be based on "terminal service units" (weight factor) expressed as a figure taken to two decimal places, shall be the quotient, obtained by dividing by fifty the number of metric tons in the highest maximum certified take-off weight of the aircraft, referred to in Annex IV point 1.5, to the power of 0.7 (i.e.  $\sqrt[0.7]{\frac{MTOW}{50}}$ ). While the current charging year for LA services is April to March the requirements of setting charges in line with the charging regulation would make it more practicable to adopt a January-December charging year.

**Figure 2: Comparison of charging structures**

Source: CAA analysis based on NERL data

3.10 Basing the costs on the RAB regulatory basis would increase both structures of charges with an equal reduction in Eurocontrol en-route charges. The RAB regulatory basis would also lead to a modest change in the net impact on different classes of user.

- Users of the London airports for which LA charges are levied would pay higher overall charges. NERL's analysis suggests that the annual total en-route plus LA charges paid by these users would increase by some £3 million (1.3%) in 2012 under the RAB regulatory basis.
- Users of regional airports would gain. The NERL analysis suggests that the annual total en-route plus LA charges paid by these users would decrease by some £1 million (0.6%) under the RAB regulatory basis..
- Overfliers would gain. The NERL analysis suggests that the annual total en-route plus LA charges paid by these users would have decreased by some £2 million (1.0%) under the RAB regulatory basis.

## Option 2 - Separate Terminal Charge with a revised allocation of costs

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- 3.11 This option would be the same as option 1 but would require NERL to:
- base the charges for LA on a full allocation of costs i.e. where costs are incurred across different charging zones they shall be allocated in a proportional way on the basis of a transparent methodology. One such proportional way could be in proportion to the number of relevant workstations.

### Pros

- This approach would align the form of charges with the revised regulations.
- It would allocate costs between terminal and en-route in a transparent way consistent with the regulations removing any contribution to the costs of the relevant workstations from users that do not use the LA service.

### Cons

- The basis of charging would no longer recognise the benefits of the consolidated approach function to , and contribution from, the en-route capacity in SE England.
- If it is considered that the London Approach Service has elements which are en-route in nature, a full allocation of costs to a terminal London Approach charge may not be consistent with the Charging Regulations.
- It would rely on NERL's current approach to cost allocation rather than being subject to independent review.
- It may be opposed by London-based airlines if they believed such costs are not fully borne by their major competitors elsewhere in Europe.

### Which users may pay more or less?

- Users of the London airports for which LA charges are levied would lose. NERL's analysis suggests that the annual total en-route plus LA charges paid by these users would increase by some £12million (5.4%) in 2012 under a statutory accounting approach or £18 million (8.0%) under the RAB regulatory basis.

- Users of regional airports would gain. The NERL analysis suggests that the annual total en-route plus LA charges paid by these users would decrease by some £5million (3.0%) under a statutory accounting approach or £8 million (4.8%) under a RAB regulatory basis.
- Overfliers would gain. The NERL analysis suggests that the annual total en-route plus LA charges paid by these users would have decreased by some £7million (3.4%) under a Statutory accounting approach or £10 million (4.8%) under the RAB regulatory basis.

### Option 3 - Consolidate LA in the Eurocontrol En-route Charge

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3.12 This option would:

- discontinue separate charges to users for LA; and
- allocate all the costs of the relevant positions providing an LA service to the Eurocontrol en-route charge.

#### Pros

- It would reduce the range of charges and hence could be very simple to administer.

#### Cons

- It may increase the contribution to LA from users of regional airports and overfliers.
- If it is considered that there are elements of terminal activity in the London Approach Service, then allocation of all costs to the en-route charge may not be consistent with the Charging Regulation.

#### Which users may pay more or less?

- Users of the London airports for which LA charges are levied would gain. NERL's analysis suggests that the annual total en-route plus LA charges paid by these users would decrease by some £6million (2.7%).
- Users of regional airports would lose. The NERL analysis suggests that the annual total en-route plus LA charges paid by these users would increase by some £3million (1.8%).

- Overfliers would lose. The NERL analysis suggests that the annual total en-route plus LA charges paid by these users would increase by some £3 million (1.4%).

**CHAPTER 4****CAA Initial View**

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- 4.1 The CAA's initial view should be based on the following objectives. First, any proposals need to comply with relevant EU and UK law. Subject to this, second, the CAA is inclined to improve the understanding of costs and their allocation to timescales that are practicable and reasonable.
- 4.2 The status quo does not seem feasible as it would put the UK outside the regulations given the current hybrid status of LA charges. The CAA is not inclined to pursue this option further.
- 4.3 Option 3 - consolidating LA into the Eurocontrol charge - may appear to be a simple solution, but it would move in the wrong direction in as much as there would be no allocation of costs between en route and terminal for the London Approach service. The CAA is not inclined to pursue this option further. This would only be appropriate if the LA service were wholly en-route in nature, and the CAA doubts this is the case.
- 4.4 This leaves Options 1 and 2 for further consideration.
- 4.5 While Option 2, gaining a better understanding of the nature of the service and its costs - to allow for a revised allocation of costs on to a more transparent basis, is a reasonable long-term goal, the CAA is mindful that:
- simply accepting now NERL's current fully allocated cost estimate may not reflect the benefits to users overflying South-East England of providing the terminal service from an en-route centre. Those benefits are likely to be positive but difficult to quantify. The CAA has not independently tested the cost allocation presented by NERL in figure 1 (although it does not have reason to dismiss this estimate);
  - the arrangements for allocating equivalent approach costs in the rest of Europe vary and that in some circumstances the costs of such services may be borne by users not using those approach services; and
  - the current EU Charging Regulation does not appear to foresee or provide for a separate Charging Zone and service which comprises both terminal and en-route elements.

- 4.6 The CAA is therefore inclined to move to Option 2 over time in line with a common approach that could be adopted for the EU and further work on understanding the appropriate allocation of costs. In doing so, the CAA will work closely with the Performance Review Body (PRB) and European Commission with a view to ensuring a consistent basis across the EU.
- 4.7 Similarly the CAA considers that it would be logically consistent when it pursues moves to a revised cost allocation for the costs for LA to be considered on the same accounting basis as the Eurocontrol charge, i.e. a regulatory asset based approach.
- 4.8 Until the CAA is in a position to pursue Option 2, it intends to pursue Option 1 for the UK component of the draft performance plan. Option 1 will:
- continue separate charges to users for LA and for the purposes of the charging and performance regulation, treat the directly charged LA element as a proxy for the terminal aspects of the LA service;
  - require a separate charging zone to be defined. (The establishment of charging zones is a matter for the DfT rather than the CAA); and
  - continue with NERL's current approach to allocating of costs. These costs will continue to be on a Statutory Accounts basis.
- 4.9 The CAA welcomes views on its initial view to pursue Option 1 for the UK component of the UK-Ireland FAB RP2 performance plan and Option 2 over time as part of an EU-wide solution. The CAA would welcome views by 17 November 2013.

## ANNEX A

# NERL's indicative analysis of the impact of possible London approach charging options for RP2<sup>20</sup>

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## Purpose of Annex

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- A1 The purpose of this paper is to set out NERL's initial analysis of the impact of different charging options being considered by the CAA for the London Approach service in RP2.
- A2 The analysis presented below has been built up on the basis of an historic sample data set and a number of simplifying assumptions. As such, this analysis offers a broad indication of the potential scale of the relative differences between the different charging options being considered by the CAA, but the actual impact may vary from this analysis depending on the final design of the charging arrangements, actual flight patterns and the nature and allocation of future operating and investments costs between London Approach and En-route services.

## Methodology

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- A3 The following scenarios were created using two samples of flight data taken from the first 7 days in both July and November 2012 (i.e. a peak and off-peak week, consisting of over 87,000 records). These traffic figures were aggregated together and multiplied by the charges that applied during these weeks and then by 26 to create the estimated annual impact. On the basis of this sampling technique, the total annual figures estimated using this approach may vary from the actual annual totals, e.g. because the two week sample grossed up may not fully reflect actual weekly traffic patterns throughout the year, and there may be small differences arising because different LA charges applied in the first quarter of 2012.

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<sup>20</sup> This has been provided by NERL at the request of the CAA for the purpose of discussion. The CAA has not carried out a validation of this analysis, but it has no reason to believe that it is not accurate to a level of confidence appropriate to considering this issue.

A4 Given the illustrative nature of this analysis, all revenue figures have been quoted to the nearest £m and percentages calculated on these rounded £m numbers. The resulting estimated charges (i.e. estimated revenue of the different scenario divided by terminal SUs) are shown to the nearest penny.

**Table 1 – Scenario Description**

Scenario	Description
Status Quo	Current London Approach arrangements with costs set on a statutory accounting basis to maintain existing levels of cost reflectivity and charges calculated on a <100 tonnes and >100 tonnes basis
1	London Approach terminal charging zone with costs calculated on a statutory cost basis with current levels of cost reflectivity and charges calculated in line with the EC Charging Regulation (i.e. where terminal service units = $(MTOW/50)^{0.7}$ )
1(DC)	As for 1 but with London Approach costs calculated on a RAB regulatory basis rather than statutory accounting basis
2	Fully cost reflective London Approach terminal charging zone bears all the fully allocated costs of the relevant workstations with costs calculated on a statutory accounting basis (again with the charging basis as per the EC Charging Regulation)
2(DC)	As for 2 but with London Approach costs calculated on a RAB regulatory basis rather than statutory accounting basis
3	No London Approach charge with all London Approach costs absorbed and charged as part of the UK en-route cost base

A5 The main differences between statutory accounting and the RAB regulatory basis are summarised in the table below:

**Table 2 – Statutory Accounting v RAB Regulatory Basis**

	Statutory Accounting	RAB Regulatory Basis
Pension rates	Based on IFRS accounting standards. These accounting pension costs (lower than cash costs) use best estimate assumptions.	Based on cash pension costs. These costs are based on contribution rates agreed with Trustees including a margin for prudence.
Depreciation	IFRS basis, using historic cost depreciation.	Determined cost or regulatory basis
Cost of capital	Not included.	Includes cost of capital at CP3 WACC.

A6 It should be noted that NERL has estimated the RAB for London Approach on a high level basis only. If the CAA proceeded to set charges on the basis of determined costs, NERL would wish to discuss with the CAA the detailed methodology for creating a separate RAB for the London Approach service. The level of future investment in London

Approach services relative to En-route services could materially affect impact analysis set out below.

- A7 Currently the London Approach charge operates from April to March. Under the SES Charging Regulation any proposal to change to one of the options under either Scenario 1 or 2 would require switching to a January - December billing period.

## Impact of different scenarios on NERL revenues and Unit Rate

- A8 The outcome from each scenario in terms of revenue (on an annualised basis for 2012) and charging rates is summarised in the table below:

**Table 3 – Scenario Comparison for 2012 (calendar year)**

Scenario	En-route Revenue (£m)	London Approach Revenue (£m)	Total En-route plus London Approach Revenue (£m)	London Approach Charge per Terminal SU (£)	NERL En-route Unit Rate per SU (£)	Difference in Unit Rate compared with Status Quo (£)
Status Quo	587	10	597	n/a	60.58	-
1	587	10	597	12.45	60.58	0
1(DC)	583	14	597	16.79	60.21	-0.37
2	569	28	597	34.02	58.72	-1.86
2(DC)	559	38	597	45.86	57.69	-2.89
3	597	0	597	0.00	61.66	+1.08

- A9 Scenario 1 would not have affected the En-route unit rate if only the current statutory accounting cost of London Approach was recovered. However, if the charge had been designed to recover the equivalent determined costs (Scenario 1(DC)) then there would have been a £0.37 (0.6%) reduction in the En-route unit rate.
- A10 It can be seen that under scenario 2, London Approach charge (Scenario 2) would have produced a £1.86 (3.1%) reduction in the En-route unit rate on a statutory accounting basis. On a determined cost basis (Scenario 2(DC)) the reduction in the NERL unit rate would have amounted to £2.89 (-4.8%).
- A11 However, the abolition of the London Approach charge (Scenario 3) would have resulted in a £1.08 (1.8%) increase in the NERL unit rate.

## Impact on Airspace Users

A12 The impact of each scenario on different categories of UK airspace user can be seen from the table below, which summarises the annual total (En-route plus London Approach) amounts paid by each type of user:

**Table 4 – Total (En-route plus London Approach) Charges for Different Airspace User Categories (2012, £m)**

Scenario:	Status Quo	1	1(DC)	2	2(DC)	3
Users of London Approach service	224	224	227	236	242	218
Other UK Arrivals/ Departures	166	166	165	161	158	169
Overflights	207	207	205	200	197	210
Total	597	597	597	597	597	597

A13 Under scenario 1, on a statutory accounting basis, the amounts paid by each category of airspace user would have been the same as for the status quo. On a determined cost basis, LA users would have paid £3m (1.3%) more.

A14 Under scenario 2 (statutory accounting basis) London Approach service users would have paid £12m (5.4%) more in total; on a determined cost basis they would have paid £18m (8.0%) more.

A15 Under scenario 3 London Approach service users would have paid £6m (2.7%) less. For non-London Approach flights the increase would have been £6m, or 1.6%.

### NERL