

Guidance for NERL in preparing its business plan for Reference Period 3

CAP 1625



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About this document

This document sets out guidance to NERL for the development of its business plan for the period from 2020 to 2024 (Reference Period 3 – RP3) and, where appropriate, beyond. We have prepared this document following consideration of feedback from stakeholders on our draft guidance, which we published in September 2017.

NERL's business plan will inform the CAA's preparation of the RP3 UK performance plan and targets for the period 2020 to 2024, including price controls covering NERL's domestic En Route and related services, and the separate price control for NERL's Oceanic services for the same period.

Chapter 1

Introduction and key messages for NERL

- 1.1 NATS (En Route) Plc (NERL) provides En Route (both domestic and Oceanic) and certain approach air traffic services in the UK. As a monopoly, it is subject to economic regulation under the European Union's (EU) Single European Sky (SES) Performance Scheme for Air Navigation Services (ANS), which provides for the setting of targets and incentives to drive performance, and the UK's Transport Act 2000 which sets a broader regulatory framework.

The purpose of this document

- 1.2 Our economic regulation takes the form of price controls where we specify the maximum amounts that NERL can charge its customers for its regulated services. These amounts depend on how it performs against performance targets. We are engaged in reviewing NERL's price controls for the next reference period, Reference Period 3 (RP3), which we expect to run from January 2020 to December 2024. An important input to our review is a business plan that will be prepared by NERL.
- 1.3 This document contains our guidance to NERL for its preparation of that business plan. We envisage NERL preparing an initial business plan (IBP) for publication and customer consultation by 9 April 2018. NERL will use the IBP to consult with interested parties, notably its customers, before submitting a revised business plan (RBP) to us by 29 October 2018.
- 1.4 We published draft guidance for consultation in September 2017 (CAP 1593)¹ and this, our final guidance, takes into account the responses we had from a number of interested parties and the evolution of our own thinking. A summary of these responses is set out at Appendix A.

¹ www.caa.co.uk/cap1593

Our intended strategic outcomes

- 1.5 UK airspace is a critical piece of national infrastructure, and therefore a wide range of stakeholders have an interest in how it is planned, designed and operated both today and in the future. There are a number of parties who have important roles and responsibilities – including the Government, the CAA as the aviation regulator, airlines, airport operators and NERL. While a number of aspects of this overall airspace architecture are being reviewed at present, NERL currently has some core responsibilities for the planning and operation of the monopoly En Route, London Approach and Oceanic services. As such, NERL has a privileged position as a franchise monopoly provider of services that are of national importance, and it benefits from the revenue streams attached to them. It therefore needs to continue to earn the legitimacy of all relevant stakeholders to support this position.
- 1.6 To this end, we are looking to NERL to set out:
- how it can lead long term reform of the management of UK airspace in the future; and
 - its willingness to be accountable for how well it performs not just against the narrow terms of its business plan, but also in a broader sense against the reasonable expectations of its wider set of stakeholders.
- 1.7 Fundamental to achieving this will be for NERL to demonstrate its accountability, not just in terms of its licence and price control settlement to the airlines and the CAA, but also the wider group of stakeholders who are affected by its activities and airspace role (including overflown communities and general aviation). This recognition then needs to be reflected by NERL in the actions it takes and ,in particular, in reacting purposely and efficiently to the evolving needs of this wide group of stakeholders. Achieving this step change will support the legitimacy of NERL's ongoing role as the incumbent operator of the UK's national franchise monopoly of air traffic management (ATM) services.

- 1.8 Consistent with this ambition, we set out our intended strategic outcomes for our RP3 review in our March 2017 discussion document (CAP 1511²). In CAP 1593, we noted that stakeholders generally supported our proposals.
- 1.9 Our strategic outcomes can be summarised as:
- effective accountability – in particular in the context of better business planning and delivery, and providing for a leading role for NERL in respect of modernising the UK airspace architecture;
 - efficient prices; and
 - service quality improvement – in particular in respect of resilience and a broader view on the environment.
- 1.10 We have framed this guidance to further these strategic outcomes while taking account of respondents' views. In doing so, we have had full regard to our duties under the Transport Act 2000 and our functions as a National Supervisory Authority (NSA) under the SES Performance Scheme. We summarise these in Appendix B.

Our main theme for this guidance

- 1.11 Our main theme emerges from the first of our strategic outcomes, effective accountability.
- 1.12 We can best achieve our objectives for the regulation of NERL by ensuring that its managers, its board and its owners are effectively accountable for its business. Accountability for financial and service performance, which we can seek to harness through a regime of financial incentives, would be a way of securing our second and third strategic outcomes. They are important. But we see accountability as more than just a means to that end – it is integral to our longer-term vision for the industry.

² www.caa.co.uk/cap1511

- 1.13 We identified in CAP 1511 a need for “appropriate leadership and coordination of airspace modernisation in the UK”, but also identified that “at present, there is no ... one industry party [with] the obligation to develop [a] masterplan and the accountability for delivering it”.
- 1.14 It is not yet clear what role NERL will play in that vision, but we are looking to it to develop a business plan that sets out its preferred strategy for delivering on the needs of its wider stakeholders. For NERL to be fully accountable for that delivery, it needs to have ownership of the plan and to adopt (and even advance) best practice standards of regulatory corporate governance, including transparency, for UK businesses responsible for vital UK infrastructure.
- 1.15 Accordingly, NERL has an opportunity to frame both how it can best deliver, but also how it can best respond to unknown or changing circumstances and changing needs. It should be best placed to engage with its stakeholders and develop an offering that it believes optimises their interests, while managing in an evidence-based way any potential trade offs between those interests. This means that NERL should own and justify the key assumptions it makes in developing its business plan.

How we will evaluate NERL’s business plan

- 1.16 To help frame the guidance in the following chapters, we have set out in Appendix C how we expect to evaluate NERL’s business plan. NERL may find this helpful in organising and prioritising its business plan development.

Proposed timetable and next steps

- 1.17 Our programme is, to a significant extent, driven by the need to align with the EU process to develop the regulatory framework and targets for the RP3 period. The current high level milestones are summarised below. We will keep our timetable under review and update it as required with notifications on our website.

| Milestone | Indicative dates |
|---|------------------------|
| NERL customer consultation on its initial business plan | April – September 2018 |
| Commission adoption of revised regulations for RP3 | June 2018 |

| Milestone | Indicative dates |
|--|----------------------|
| NERL submission of revised business plan | October 2018 |
| Commission adoption of EU targets ³ | December 2018 |
| CAA consultation on draft RP3 performance plan | January – March 2019 |
| Department for Transport (DfT) adoption of RP3 performance plan and submission to the Commission | June 2019 |
| Commission assessment of performance plans | July – November 2019 |

1.18 CAA consultancy studies will be scheduled throughout 2018 in response to key deliverables, such as NERL's IBP. While recognising that there will be an expected intense period of work by NERL to develop its IBP for presentation to stakeholders in April, we note that the effectiveness of NERL's own stakeholder engagement on the IBP will be enhanced if there is effective assurance on the work of the our consultants. As such, we expect NERL to ensure that it gives a proportionate level of support to our consultants.

Structure of this document

1.19 The structure of the remainder of this document is as follows:

- **Chapter 2** outlines our high level approach to RP3 business plan guidance for NERL.
- **Chapter 3** sets out guidance on outcomes and outputs.
- **Chapter 4** provides guidance on the efficient costs necessary to deliver the outcomes and outputs.
- **Chapter 5** provides guidance on demonstrating financeability.
- **Chapter 6** sets out guidance on customer consultation.
- **Appendix A** summarises the responses to CAP 1593.

³ The current SES Performance regulation requires EU targets to be adopted no later than 12 months before the start of the Reference Period – i.e. December 2018.

- **Appendix B** sets out our duties under the Transport Act 2000 and role as NSA under the EU SES Performance Scheme.
- **Appendix C** sets out our evaluation considerations.
- **Appendix D** sets out our expectations for customer consultation.

Chapter 2

CAA expectations for NERL's RP3 business plan

- 2.1 This chapter sets out our high level expectations for the approach that NERL will take in developing its RP3 business plan. It confirms the framework set out in CAP 1593 for how we expect NERL to address requirements that will not be well defined before NERL submits its revised business plan – a two track approach – and provides an update on EU context and milestones.

Feedback from consultation and evolution in CAA thinking

- 2.2 We consider there is broad support from many of the respondents for the general approach we have adopted. We have therefore decided to retain the main themes in our proposals, which were to give NERL meaningful ownership of its plan and the stakeholder engagement process that informs it.
- 2.3 This is consistent with the continuing evolution of the CAA's thinking, and UK economic regulation more widely, with a greater emphasis on company-stakeholder engagement and the congruence of consumer-led and socially responsible strategies in shareholder-led regulated businesses.
- 2.4 While we see broad support for the general approach we have adopted, respondents have raised a number of important issues and suggestions. We pick up on these in this and the following chapters.

Stakeholder engagement and NERL's ownership of its plan

- 2.5 We emphasise that it will be NERL's business plan and we are looking to NERL to determine how it can best meet the needs of its stakeholders, in particular its customers, the airlines, but also more broadly airports, passengers, cargo owners and overflowed communities. NERL has an opportunity to frame how it can best deliver, but also how it can best respond to unknown or changing circumstances and changing needs. It should be best placed to engage with its stakeholders and develop an offering that it believes optimises their interests while, and in large part through, maintaining the active involvement of its investors and managers.

-
- 2.6 All stakeholders, including NERL's shareholders, should therefore be reassured to see a business plan that explains NERL's vision for how it can best contribute to the needs of its users.
- 2.7 In emphasising NERL's responsibility and opportunity, to develop its business plan in the context of a meaningful engagement with stakeholders, we are encouraging NERL to move with evolving best practice in corporate governance for regulated businesses in the UK, especially those monopolies that have a critical role in delivering and operating vital UK national infrastructure. Economically regulated businesses are different from the generality of businesses in that their users (and ultimately consumers) have no choice but to use their services. The regulator exists to protect those users' interests, but it does this in part by encouraging more consumer-driven behaviours within the regulated companies. Experience in other sectors indicates that a consumer-driven strategy in a regulated business can serve everyone's interest and strengthen its longer term, value-enhancing business model.
- 2.8 This theme speaks in particular to our strategic outcome of effective accountability. NERL should be accountable for how it impacts its stakeholders, including its customers. Some factors will be outside its direct control, but it may be able to mitigate the risk of possible negative impacts on stakeholders from those factors. Importantly, through this business plan process, it has the opportunity to propose arrangements for shared governance (sharing of decisions) and financial incentives (sharing of risks) to engage a wider community of stakeholders in managing and sharing those risks. We therefore encourage NERL to see the business planning process to be not just an input into a price control process but a formative expression of how it intends to go about its business for RP3 and beyond.

The broader regulatory framework

- 2.9 In considering the form and scope of its business plan we expect NERL to be directed by the needs of its stakeholders and to take account of requirements under the SES regulatory framework, including possible modifications that emerge in respect of RP3. In doing so, NERL should set out its justifications and rationale for the assumptions and parameters it proposes, given its overall vision for RP3.

- 2.10 We expect NERL's business plan to cover the regulated activities under its Air Traffic Services Licence (the Licence). These include its UK En Route and London Approach services, under the scope of the EU and domestic regime, and its Oceanic service, which is subject only to the domestic regime. Under EU requirements, there will need to be an evidence-based rationale for the levels of charges set for each of the UK En Route and London Approach services; the same evidence-based rationale should apply for its Oceanic charges. We therefore expect NERL to provide sufficient separation and granularity in its business plan between its separate regulated services and between its regulated and unregulated services. NERL should aim to provide assurance that the pricing of intra-group services, intra-group cost-allocations and its proposals for charges for each of its regulated services are justified as fair, evidence-based and in compliance with paragraph 8 of Condition 2 of its licence.
- 2.11 Given the future impact of Brexit and that the SES regulatory framework for RP3 is subject to review and change, it is not yet known what the requirements might be in respect of development of a UK-Ireland Functional Airspace Block (FAB) performance plan for RP3. Therefore, as appropriate, references to the UK performance plan should be construed as the UK-Ireland performance plan and that the CAA will work with the Irish Aviation Authority's Safety Regulation Department where appropriate.
- 2.12 In terms of the broader implications of Brexit on the development of the RP3 performance plan, and therefore guidance to NERL in developing their business plan, our view remains that there will be similar substantive regulatory requirements. Irrespective of whether the institutional arrangements change, and whether the UK is under the European or domestic legislative framework, we expect to produce a price cap and service quality targets that go towards achieving the strategic outcomes established in CAP 1511.

Two track approach

Feedback from consultation and evolution in CAA thinking

- 2.13 Stakeholders were generally supportive of the concept of two track approach, with most agreeing certain deliverables should be considered as core – for example delivery of the London Airspace Management Programme phase 2 (LAMP2). Some airspace user respondents also identified additional specific

programmes for inclusion as core and expressed a desire for early engagement from NERL on establishing which requirements were core and wider.

2.14 NERL proposed alternative definitions for core and wider and also set out prospective measures for dealing with wider requirements in the final performance plan.

2.15 Given the differing stakeholder interpretations of the core and wider approach and how and when it might be applied, we have provided additional clarification in the guidance below.

Guidance

2.16 We are conscious that there are certain issues that may require funding from NERL's RP3 price control revenue that could be important for NERL, its customers and consumers more generally, but that are at an early stage of development. These include airspace modernisation and certain new technologies.

2.17 Faced with these challenges, NERL should adopt a **two track approach** to developing its business plan:

- a baseline business plan incorporating known and expected requirements – “core” (e.g. delay targets); and
- supplemental information setting out the incremental effects on costs and performance of less certain requirements and possible future developments – “wider” (e.g. airspace architecture modernisation).

2.18 NERL could usefully assist stakeholders understand the nature of the uncertainties involved and the possible implications for the RP3 control of the following different circumstances:

- where some less certain requirements and possible future developments might be clarified, either before the RBP or before the RP3 performance plan is finally submitted; and
- where other requirements may remain uncertain into the RP3 period.

2.19 We would expect NERL to outline the implications of any wider requirements that may not be resolved in time for the finalised RP3 performance plan. It would be for NERL to propose, and test with its customers in particular, scenarios in its business plan for how it can accommodate such uncertainty. Its proposals might

involve accommodating uncertainty in its forecasts (there may be offsetting upside and downside uncertainties) or regulatory mechanisms to help appropriately price uncertain outputs or share the risks involved. The approach adopted should be clearly documented and justified.

2.20 Dealing with uncertain requirements in this way should allow NERL to make progress with the development of a business plan that is safety-focused, fully costed, well justified and high quality. It allows NERL to set out how it will deliver the activities characterised as “core”, while providing an opportunity to account for, inform and manage possible future developments of the “wider” considerations. These wider considerations may include:

- the potential future role of NERL in modernisation of the UK's airspace architecture; considering what role NERL might have in the development of any airspace master plan or coordination function and how this might impact on their operations in RP3 and beyond;
- potential cyber security obligations in accordance with developing Government policy – taking account of obligations that might arise from the EU Network and Information (NIS) Directive;
- electronic surveillance policy developments;
- responding to the introduction of new and potentially disruptive technologies (for example, drones) in a way that leads to positive outcomes for consumers - considering the possibility that the introduction of new technologies allow for the development of and significant changes to ways of operating; and
- responding to developments in relation to Brexit.

2.21 The key driver for the two track approach is to ensure the development of and engagement on the NERL business plan are not constrained or delayed by specific issues or requirements that are not yet fully developed, versus those that are more certain. Where there is sufficient information available, but still options for delivery, these should still be included as core, for example to allow discussion on decisions between particular known technologies, levels of service or degrees of cost efficiency.

2.22 The key criteria for determining between core and wider is confidence in the level of specification around an issue or requirement (i.e. not around the costs of delivering it). Presently, it is not envisaged that a distinction between core and wider requirements will be carried forward into CAA final performance plan proposed for DfT adoption in mid-2019. Any residual uncertain requirements

should by then be accommodated, for example through a regulatory mechanism. The core/wider approach is therefore a device to help structure NERL's business plan consultation process, not the RP3 regime itself.

2.23 We expect NERL to:

- clearly identify in its business plan both the “core” and “wider” considerations required to meet the established strategic outcomes.
- set out where there are a range of options to deliver capacity, resilience, environmental and safety performance. In doing so, NERL should clearly articulate its particular requirements and associated costs as being either “core” or “wider”, along with its rationale for why they consider them to be so.
- identify its preferred option. NERL should clearly explain how it has selected its preferred option, by reference to customer engagement, quantifying the customer benefits, assessing the business cases and contribution to ensuring a continuing resilient service, and assessing whether the preferred option is deliverable.

2.24 Chapters 3 to 5 of this document provide guidance to NERL in respect of outcomes, costs, and financeability, with indicative views of “core” and “wider” considerations.

Other matters and assumptions

2.25 We expect NERL to take care to clearly justify the assumptions it uses in its business plan and make forecasts of the efficient costs necessary to deliver outputs and outcomes. NERL should take account of requirements under both the current regulatory framework, and any developments as they emerge in respect of the SES RP3 framework. It should use a building block approach to establish levels of required revenue, and present costs information as clearly, transparently, and on an as consistent basis as possible to support effective stakeholder engagement. In particular, in relation to:

- military and other activities included in the single till;
- treatments of total and chargeable service units;
- use of calendar years and choice of inflation indexation; and
- use of a consistent price base.

2.26 NERL should use the traffic (including service units) and economic forecasts it thinks most appropriate, justifying them accordingly, mindful of existing

regulatory requirements. Traffic forecasts in particular should be transparent and based on evidence, where relevant, and explicit assumptions to permit effective stakeholder scrutiny.

- 2.27 It should propose and justify the start point it uses for its cost forecasts, ensuring information is presented in a way that enables ready comparison and analysis of performance with previous reference periods. NERL should be clear on its treatment of true-ups between reference periods in relation to costs, and should also provide information on the impact that such true-ups will have on charges.

EU context and timetable update

- 2.28 In March 2017 the European Commission (the Commission) set out high level options for the revision of the two SES implementing regulations – the performance regulation and the charging regulation⁴. Following a period of written consultation with Member States and industry stakeholders, the options and consultation responses formed the basis for an impact assessment study by the Commission's consultants. The consultants are expected to present their final report to the Commission in late January/early February 2018.
- 2.29 In late November 2017, the Commission provided Member States with high level, potential changes to the performance and charging regulations, based on the following six themes:
- streamlining overly complex operation of the schemes while considering the need for a more effective measurement of performance;
 - reinforcing the gate-to-gate approach and the link with the SESAR project;
 - strengthening the role of the NSA and strengthened consultation mechanisms and constructive customer engagement;

⁴ COMMISSION IMPLEMENTING REGULATION (EU) No 390/2013 of 3 May 2013 laying down a performance scheme for air navigation services and network functions and COMMISSION IMPLEMENTING REGULATION (EU) No 391/2013 of 3 May 2013 laying down a common charging scheme for air navigation services.

- consideration of the contribution of the Network Manager in the performance and charging schemes;
 - consideration of modifications to traffic/cost risk sharing mechanisms in relation to appropriate risk exposure for ANS providers; and
 - improving the incentive mechanisms.
- 2.30 Draft legal texts containing amendments to the performance and charging regulations are expected to be shared with Member States before the Single Sky Committee meeting in March 2018, with a vote to establish the Single Sky Committee's opinion still planned for no later than June 2018.
- 2.31 Given the modification of the EU regulatory framework will be happening at the same time as the development of the IBP and then RBP, CAA will provide updates to stakeholders through 2018, where appropriate, to inform business plan development and engagement activities. The Commission timeline also includes a period of open consultation on the proposals before their adoption. The text should be available on the Commission's Better Regulation⁵ portal in the first half of 2018.
- 2.32 The Commission also initiated a specific study on incentive schemes. The results of this were published in October 2017⁶.
- 2.33 It is understood that once the process for adopting the new performance and charging regulations is sufficiently mature, parallel work will be carried out on proposals for EU-wide performance targets. The latest Commission timeline indicates the proposal of EU targets by October 2018, with a view to adoption by the end of 2018.
- 2.34 In its preparation for RP3, the Commission is supported by the Performance Review Body (PRB) which is an advisory body of experts. The PRB is expected to drive the proposals for EU-wide targets and eventually carry out the

⁵ https://ec.europa.eu/info/law/better-regulation/have-your-say_en

⁶ Discussed further at 3.52

assessment of RP3 performance plans once they are adopted by Member States.

2.35 Currently, it is expected that the modification of the performance and charging regulations will provide for local adoption of performance plans at either the national or FAB level for RP3. As this requirement clarifies, the CAA will engage with the DfT and Irish Aviation Authority to determine the UK-Ireland position. We continue to provide input to the development of the revised regulations to ensure, as far as practicable, that they are consistent with the UK's strategic outcomes for the future economic regulation of NERL.

Chapter 3

Outcomes and outputs for RP3

- 3.1 This chapter sets out guidance to NERL on its RP3 business plan in respect of outcomes and outputs. These are largely driven by safety and the strategic outcomes of effective accountability and service quality improvement.
- 3.2 We set out a number of key areas for consultation by NERL, setting out the stakeholder feedback to CAP 1593, along with any evolution of CAA thinking and then guidance in respect of the allocation of activities and outputs between core and wider requirements. These key areas include safety, capacity, resilience, the environment, airspace and new technology.
- 3.3 This guidance is based on the information available to the CAA at the time of publication. In a number of areas, for example airspace architecture and noise policy, the Government and the CAA amongst others are considering changes to current policies and processes. Where this occurs, the CAA reserves the right to update this guidance.

Overall approach and key areas

- 3.4 The quality of services provided by NERL across all its activities is important for airspace users. As noted in CAP 1593, for RP3 we have taken a broader, more strategic approach to service quality compared to RP2, extending beyond capacity and delay to consider resilience and environmental issues. Our broader approach also extends to NERL's ownership of its planned outcomes and outputs, and its accountability for their delivery.

Safety

Feedback from consultation and evolution in CAA thinking

- 3.5 In responding to CAP 1593, NERL highlighted its view that safety should be an explicit outcome for RP3, seeking to agree what level of safety is "safe enough" and proposing to align with the UK State Safety Plan and the Acceptable Level of Safety Performance (ALoSP) contained therein. NERL also highlighted the

importance of electronic conspicuity within UK airspace and urged the CAA to require all classes of airspace user to be equipped accordingly.

- 3.6 Our guidance is consistent with this feedback in terms of what is “safe enough”. In respect of electronic conspicuity, we recognise the positive safety impacts in terms of situational awareness and reductions in mid-air collision and infringement risks it could bring. The development and implementation of a comprehensive electronic surveillance policy in RP3 will provide those benefits and associated performance improvements for all airspace users.

Guidance

- 3.7 NERL’s focus in delivering outcomes and outputs should always be in the context of maintaining and improving safety. It is our expectation that, as a core requirement, NERL will develop its business plan taking full account of its safety obligations, demonstrating how it is maintaining safety and where it plans to improve its safety performance.
- 3.8 At least as a wider requirement, where NERL identifies opportunities to enhance the safety of the overall delivery of its services and UK ATM more generally – such as through electronic conspicuity and surveillance requirements – it should set this out in its business plan as core or wider requirements depending on the circumstances, with appropriate cost and performance information and justification.
- 3.9 NERL should monitor and take account of developments in the evolution of requirements under the RP3 SES performance regulation regarding the key performance area of safety.

Capacity

Feedback from consultation and evolution in CAA thinking

- 3.10 Feedback from stakeholders addressed the level at which NERL’s capacity performance ought to be measured, with NERL stating that its licence requires it to manage the network as a whole, whilst some airspace users supported greater granularity between En Route and London Approach performance. NERL also said that it felt that performance metrics should only reflect what is fully within its control, whereas airspace users suggested that NERL should be encouraged to manage delay beyond what is wholly attributable to NERL.

3.11 In line with the principles set out in chapter 2, the CAA sees NERL's development of its RP3 business plan as an opportunity to adopt a consumer-driven strategy, in this case taking proactive actions to minimise delays experienced by airlines and providing sufficient granularity on the constituent activities of its overall service.

Guidance

3.12 Delays are traditionally measured by Air Traffic Flow Management (ATFM) delay metrics. There are established and understood measures of delay performance set out under the existing economic regulatory frameworks.

3.13 As a core requirement we expect NERL to:

- establish challenging and affordable targets for RP3, in the context of the provision of a safe service, using high quality data and analysis to understand historical trends, traffic evolution, and customer requirements.
- provide appropriate traffic forecasts as the basis for calibrating these targets, explaining and justifying the basis for these forecasts.
- conduct sensitivity analyses of the impact of higher and lower traffic levels at magnitudes it believes credible, justifying their rationale.
- review the scope of the London Approach service and establish metrics, forecasts and conduct sensitivity analyses consistent with the requirements for En Route, appropriately modified to align with the nature of the London Approach service to enable effective monitoring of performance.

3.14 When considering targets and metrics, NERL should set out any concerns it has with the current measures, identifying and justifying any proposed changes.

3.15 Core requirements around the London Approach service stem from the CAA's 2017 Project Oberon⁷, where it was identified that a more granular view of NERL's performance across its activities would enable the earlier identification of potential performance issues (for example, information on NERL attributable delay in the London Approach area).

⁷ www.caa.co.uk/cap1578

- 3.16 We also note that London Biggin Hill Airport (LBHA) has sought to be included in scope of the London Approach service. We expect NERL to provide sufficient information to enable assessment of the performance impacts of including LBHA in the London Approach service, and set out its preferred option, providing appropriate justifications.
- 3.17 We are not directing NERL to provide operating or accounting separation between its En Route and London Approach services. However, we expect NERL to consider and set out how it will provide greater detail and granularity around these different services in order to increase transparency for customers and to enable a more granular view of NERL's performance across En Route and London Approach services. It should also explain how it maximises performance and the value of the network as a whole. This should also support the establishment of challenging and affordable targets for RP3 using high quality data and analysis to better understand historical trends, traffic evolution and customer requirements. Increased detail will also support NERL in justifying the basis for its traffic forecasts.

Resilience

Feedback from consultation and evolution in CAA thinking

- 3.18 Stakeholders have made clear that delivering a robust level of technical and operational resilience is a key priority for RP3 and is fundamental to ensuring capacity performance.
- 3.19 NERL noted that ensuring a robust level of technical and operational resilience will be a core requirement of its plan. NERL also noted it will continue to take account of relevant recommendations of the Voluntary Industry Resilience Group (VIRG) in developing its IBP. NERL noted that there are limitations on its ability to perform a capacity oversight, assessment and advice function in light of not being able to enforce recommendations or manage combined airport scheduling decisions.
- 3.20 British Airways proposed that core requirements under operational resilience should be supplemented by additional requirements relating to mitigation of delay created by weather. British Airways also considers that RP3 should focus on resilience and addressing overall delay levels, but not noise as it is a consideration for wider UK policy.

Guidance

3.21 In CAP 1593 we set out our expectations of several core requirements for NERL around technical and operational resilience.

3.22 **Technical resilience** – as a core requirement we expect NERL to:

- ensure it understands and provides the appropriate level of systems resilience to achieve a high level of network performance, including as it safely deploys new ATM technologies; and
- consider the appropriateness of current performance and incentives and suggest improvements where appropriate.

3.23 **Operational resilience** – the CAA conducted a review⁸ of the operating resilience of the UK's aviation structure and the consumer interest, which identified planning and scheduling risks that could be addressed through NERL action in relation to capacity oversight, assessment and advice to airports and airlines.

3.24 As a core requirement, we expect NERL to:

- ensure it has in place robust procedures and processes to identify and plan for future operating requirements;
- take into account the Project Oberon recommendations (including for NERL to enhance its systems and processes so that it is better able to forecast potential shortfalls in air traffic control officer (ATCO) supply; to conduct more rigorous analysis of risks and issues that can impact a service; to enhance its systems and processes for contingency planning); and
- develop the means to perform a capacity oversight, assessment and advice function to advise airports and airlines of the opportunity for them to make early decisions between accepting delay or re-routes where there are particular hotspots. We note that in providing an advice function, NERL would have no enforcement or decision making powers relating to this issue.

⁸ CAP 1515 -

[Operating Resilience of the UK's aviation infrastructure and the consumer interest](#)

- 3.25 As a wider requirement we expect NERL to take account of relevant recommendations by the Voluntary Industry Resilience Group (VIRG) in developing its RP3 business plan. For example, in relation to NERL's potential network-wide role in improving situational awareness, operational coordination and decision making. We would also expect NERL to engage with its customers in respect of any specific expectations or requests they may have, for example in respect of NERL's role in mitigating the impact of thunderstorms.

Environment

Feedback from consultation and evolution in CAA thinking

- 3.26 In CAP 1593 we set out our thinking on outcomes and outputs around NERL's environmental performance in RP3. We noted that environmental performance in ATM has traditionally focussed on measures of fuel efficiency (through flight efficiency) as a proxy for carbon emissions, however, (in response to stakeholder feedback) we proposed to take a more strategic approach asking NERL to consider flight efficiency *and* noise experienced by overflowed communities as part of its deliverables in RP3.
- 3.27 Currently, NERL is incentivised to provide optimal flight paths that minimise emissions, and thus fuel burn, using a measure of horizontal and vertical flight efficiency known as 3Di. In its response to CAP 1593 NERL noted that it intends to develop a refined 3Di metric to measure the aspects fully within NERL's influence as the basis for future incentive arrangements.

Guidance

- 3.28 As a core requirement for environmental performance, we expect NERL to:
- reflect the principles of using past performance trends to establish challenging targets going forward in the context of understanding traffic evolution, supported by high quality data and knowledge of customer expectations;
 - take into account improvements in data, anticipated operational improvements and factors that can affect performance; and
 - propose any modifications to the 3Di model and draw out factors that could have a significant operational and performance impact. Where it does so, NERL should be mindful of any actions it could take to mitigate the impact of inefficient flight, even where the causes are not in their direct control.

Noise

Feedback from consultation and evolution in CAA thinking

- 3.29 Responses to CAP 1511 indicated some stakeholder appetite for broadening NERL's environmental performance to include noise. However, most responses to CAP 1593 indicated that stakeholders consider that the economic regulation process may not be the most appropriate place to address noise. Instead, stakeholders consider that the UK Government's new airspace policy and the new CAA Airspace Change Process (ACP)⁹ are focused on the impacts of noise on communities and will cover ongoing noise management and the impacts of airspace changes; also, that any RP3 project that leads to a change in airspace usage or an airspace change will be subject to community consultation and that is the most appropriate place for that consultation to take place, rather than through economic regulation. Nonetheless, the Aviation Communities Forum considers that the focus should move away from increasing capacity and airspace change over RP3 to reducing noise.
- 3.30 NERL stated that its IBP will focus on managing noise in line with DfT guidance and the CAA's ACP. NERL has also stated that it is working to develop a formal process by which it can show that it is managing noise impacts effectively. NERL has also stated that any new policy and regulatory requirements for RP3, that are as yet unknown, will be costed separately to its core plan.
- 3.31 The CAA has been reviewing and reforming its airspace change decision making process. CAP 1616: Airspace Design: Guidance on the regulatory process for changing airspace design including community engagement requirements was published on 13 December 2017 and came into effect on 2 January 2018. The revised process was developed following extensive consultation and incorporates a number of changes, including making the process more transparent, improving the stakeholder engagement required, and improving the evidence base used. The guidance also includes a section on information that

⁹ www.caa.co.uk/cap1616

aviation industry bodies should publish regarding noise impacts, which we have included in light of new directions from the Government. The implementation of the new process places greater emphasis and requirements on airspace design change sponsors in respect of noise that will impact NERL's approach to community engagement where it makes relevant changes to airspace design and operations.

3.32 The Government also intends to introduce a new policy for regulation of Planned and Permanent Changes to airspace that are not part of the published design of airspace, but come about in light of some air traffic control procedures. Once this policy is developed and implemented, NERL will be required to adhere to it.

3.33 Mindful of the additional requirements in the new ACP and forthcoming Government policy we have updated our guidance below, whilst ensuring consistency with our objective for NERL to demonstrate accountability with the wider group of stakeholders who are affected by its activities.

Guidance

3.34 As a core requirement we expect NERL to:

- develop measures to assess the impact its actions have in relation to noise and overflow communities; and where practicable, to identify appropriate incentives, in light of the SES charging regulation and principles.
- set out a proposed approach for managing the impact of aircraft noise in line with strategic or consumer outcomes and to clearly articulate the rationale behind this approach.
- identify how to balance incentives for flight efficiency performance with minimising the impact of, and where possible reducing, noise experienced by overflow communities.

3.35 The Government's forthcoming consultations on the Aviation Strategy will also consider the way in which noise impacts are understood and mitigated, and how noise should be considered as part of a strategic modernisation of airspace across the UK. In light of this, as a wider requirement we expect NERL to:

- reflect in its business plan how it will meet the Government's forthcoming policy on how decisions about the Planned and Permanent Redistribution of air traffic takes effect, provide information on transparency about airspace use

and aircraft movements, and any other relevant changes to Government policy related to aviation noise;

- explore and consider opportunities to directly measure its noise performance; and
- where appropriate, deliver tangible noise reductions.

Airspace

Feedback from consultation and evolution in CAA thinking

- 3.36 In CAP1593 we highlighted the importance of the implementation of the second phase of LAMP2 and airspace change for the successful development of a third runway at London Heathrow, and noted the challenges and complexities associated with it. We noted that while the implementation of the technology and supporting operational systems are clearly core activities for NERL, airspace change raises a broader set of issues including that the roles for its design and delivery are not yet clearly defined.
- 3.37 In the responses to CAP1593, there was broad support from airspace users and NERL for the delivery of LAMP2 as core requirement, not only as an enabler for capacity expansion in the south east, but also as a means of optimising existing capacity.
- 3.38 NERL recognised that major airspace modernisation is essential in RP3, and stated it will play an active role in areas where NERL is accountable and has effective control. Furthermore, that it could take on a greater coordination and delivery role if supported by customers, but that this should neither be a core requirement, nor an obligation under its licence.
- 3.39 Given NERL's role as a the UK's monopoly En Route service provider, that airspace modernisation is fundamental requirement of its current licensed activities and that it is the largest single source of relevant airspace design expertise, our view remains that NERL has a central role in the development of a coordinated and sequenced UK airspace modernisation plan and delivery of a range of specific airspace change proposals. This is consistent with the principles set out in chapter 1, in respect of NERL's ownership and leadership of a business plan that explains its vision for how it can best contribute to the needs of consumers as defined in that chapter (i.e. not just commercial aviation implied by NERL's response to the earlier consultation).

Guidance

- 3.40 As a core requirement, we expect NERL to consider the design and delivery of the LAMP2 programme and the individual airspace changes necessary to enable new runway capacity.
- 3.41 As a wider requirement, we expect NERL to set out how it will develop a coordinated and sequenced masterplan of UK airspace changes between 2020 and 2040 through:
- engaging relevant stakeholders in its preparations;
 - identifying the changes that are required and potential trade-offs between them; and
 - nominating which stakeholders are responsible for taking forward which changes.
- 3.42 All individual airspace changes will be subject to the CAA's process for changing airspace design set out in CAP 1616.

Cyber security**Feedback from consultation and evolution in CAA thinking**

- 3.43 In its response to CAP 1593, NERL stated that its core plan will contain resources to ensure a level of cyber security appropriate to safety critical operation, including meeting national and international standards.

Guidance

- 3.44 We expect NERL to already have arrangements in place to ensure protection, safety and service continuity in respect of cyber security threats as part of its business as usual activities. We expect these to be reflected as core requirements in its RP3 business plan, along with suitable information, justifying the level of service and associated costs. Where NERL expects any additional (but uncertain) requirements to arise from the recent EU Network and Information Systems (NIS) Directive and associated implementing legislation, NERL may consider these as wider requirements, providing suitable justification and information as to why they might not be considered core requirements – noting that the NIS Directive should be implemented by May 2018.

New technologies

Feedback from consultation and evolution in CAA thinking

- 3.45 NERL supported the categorisation of drones as a core requirement for RP3, and noted that its IBP will assume compliance with European Aviation Safety Agency (EASA) requirements. NERL also requested guidance from the CAA on the charging principles of providing ATM services relating to drones.
- 3.46 British Airways supported the categorisation of drones as core and all other new technologies as wider. British Airways noted that there is an element of choice in moving to new technologies, consideration of which will be through the Service and Investment Plan (SIP) process. British Airways considers that drone users should bear some or all of the cost of regulation and activity related to drones.

Guidance

- 3.47 The adoption of new technologies is expected to be necessary for NERL to effectively provide services in RP3 and beyond. To the extent that there are choices available to NERL as to what technology it will deploy in RP3, these choices should be reflected in its business plan and NERL should explain how these various options will enhance safety and meet strategic outcomes, and how they fit into the core and wider framework. We note that under Condition 10(6) of its Air Traffic Services Licence, NERL is required to produce an outline technology plan covering the RP3 period by 20 June 2018.
- 3.48 As a core requirement we expect NERL to:
- continue to safely and efficiently manage existing airspace users, as new classes of airspace users look to operate near and in the same airspace;
 - be proactive in implementing new technologies to mitigate such safety risks¹⁰ and improve cost efficiency where possible;

¹⁰ See paragraph 3.8

- set out options around potential improvements to be delivered through new technologies;
- set out the impact of drones on its business and costs for En Route and London Approach services that should legitimately be funded by airspace user charges;
- ensure consistency between the Condition 10(6) technology plan outline and its RP3 business plan. Where there are legitimate reasons for differences – for example, the emergence of new information over time – then we expect NERL to find a proportionate way to address these, such as in the engagement on its IBP.

3.49 It is possible that the introduction of new technologies allow for the development of and significant changes to ways of operating. This might include greater automation, or systemisation, or raise questions as to the scope of NERL's future business activities that should be considered as part of the airspace user funded monopoly activities under the price control. There may be opportunities to benefit from the creation of new markets in the provision of air traffic and airspace management that lead to positive outcomes for consumers. As a wider requirement, we expect NERL to:

- develop and assess the choice of technology and operating model and incremental costs and benefits, where there is uncertainty as to whether a technology should be adopted as part of its licensed monopoly business;
- identify those activities it is assuming are part of the monopoly business and those activities that are not, and set out its rationale;
- set out the potential charging models for safety related services that are outside the scope of the existing licence and should not be charged to existing users; and
- address innovative ways of operating that do not constrain the ability of the development of new technologies to deliver positive consumer outcomes.

Interactions between core and wider requirements

3.50 The implementation of the wider requirements described above may impact on core requirements and their associated performance measures. Wider requirements may also require the development of new measures and targets to support the delivery of the outcomes. In developing its RP3 business plan, NERL

should articulate which performance measures need to be modified or if new ones need to be developed, providing appropriate explanation and justification along with high quality metrics.

Incentives

Feedback from consultation and evolution in CAA thinking

- 3.51 Stakeholder feedback in respect of incentives focussed on four themes: the magnitude of incentives, resilience, noise, and accountability/quality of data. Whilst NERL was content with the magnitude of incentives currently provided for in the RP2 framework – i.e. 1% per Capacity and Environment KPAs, symmetrical and applied consistently – the Aviation Communities Forum (ACF) said that 1% was insufficient to drive behaviour; whereas IATA said that incentives should be penalty only. Neither NERL nor Trades Unions supported the application of incentives to resilience. Neither NERL nor airspace users favoured the application of incentives to noise – instead preferring the Airspace Change Process as the appropriate place to address noise; whereas the ACF said that noise incentives should be applied immediately. NERL said that incentives should only apply to performance that it is directly accountable for – citing issues with current delay allocation by the Network Manager in RP2.
- 3.52 In its high level thinking on changes to the RP3 performance and charging regulation, the Commission has suggested to Member States it might propose greater flexibility for NSAs in the application of incentives – provided that they were consistent with yet to be specified principles. In support of the Commission activity on RP3, Steer Davies Gleave conducted a study on incentives, which was published in October 2017¹¹, and the conclusions of which fed into the Commission's high level thinking for proposed changes to the performance and charging regulations for RP3.

¹¹ <https://ec.europa.eu/transport/sites/transport/files/2017-ses-final-report-incentives.pdf>

Guidance

- 3.53 The current incentive scheme is determined by the SES Performance framework and, as it relates to delay/capacity and environmental performance, is incorporated into the NERL Licence. The Commission is considering options to modify the incentive provisions within the performance and charging regulations for RP3 and NERL should keep abreast of development of the Commission's thinking in this area.
- 3.54 In preparing its business plan, NERL should propose the incentive arrangements appropriate to support efficient and timely delivery for its customers and wider stakeholders. NERL should consider opportunities to strengthen and broaden the incentive framework to better align its incentives with benefits for customers and wider stakeholders, taking into account cost elasticities, including where performance is partially as well as fully within NERL's control. It should clearly set out how these incentives could operate and any changes that would be necessary to align with the existing SES Performance framework. NERL may also suggest adjustments to the measurement of existing metrics, within the overall framework of the existing incentives, where duly explained and justified.

Chapter 4

Costs

- 4.1 Efficient prices are an important strategic outcome. Under the SES Performance Scheme and under the NERL Licence, the cost of providing air navigation services is met through charges to airspace users. These users, and ultimately consumers, want efficient and reasonable prices for aviation services. NERL's business plan should therefore demonstrate how it will ensure its activities are efficiently delivered and how cost efficiency will translate to efficient prices.
- 4.2 This chapter develops what we said in our CAP 1593 consultation about costs, reports respondents' views and sets out business plan guidance to NERL on efficient costs.

High level guidance

Feedback from consultation and evolution in CAA thinking

- 4.3 NERL noted that cost efficiency should be assessed in the context of priorities relating to safety and service. Feedback from bilateral discussions with its customers highlighted the importance of ensuring good levels of day to day operational performance, adequate levels of resilience and meaningful progress in modernising airspace to provide capacity in RP3 and beyond.
- 4.4 Airline respondents saw value in NERL providing assurance on the efficiency of its cost programmes, but expressed some scepticism around NERL's ability to overcome its self-interest to be objective, for example in its approach to benchmarking.
- 4.5 We recognise the inherent tensions between the interests of a monopoly service provider and those of its customers when setting cost forecasts in the RP3 performance plan. We intend to resolve those tensions to the benefit of consumers, whilst recognising that NERL must maintain safety and be able to finance its licensed activities. This will mean getting the shared governance arrangements between NERL and its customers right, getting the incentives right and having high levels of assurance for those who have to pay. NERL should approach how it develops its business plan with these objectives in mind. We will

be placing weight on our own analysis and cost assessment studies in due course, but NERL has the opportunity to set out its proposals with a quality of analysis and evidence that helps build confidence.

4.6 Since CAP 1593, and in light of the consultation responses, our thinking has evolved to emphasise more heavily the need for NERL's business plan to set out its proposals for the governance and incentivisation of NERL's cost programmes as well as its forecasts for efficient costs.

4.7 In developing its cost forecasts, its proposals for the governance of its cost programmes and its proposals for its regulatory regime, NERL should demonstrate:

- consistency with its outlook for outputs and outcomes, reflecting our guidance in chapter 3;
- a balance between value for airspace users and affected communities, including high quality information on costs and benefits of alternatives considered in developing the plan;
- planned activities that reflect strategic optioneering informed by clear and compelling cost benefit analysis;
- where the conclusions of its optioneering are less clear, meaningful options for service delivery for consideration by stakeholders;
- resilience and adaptability to uncertain requirements and uncertain economic drivers;
- value-enhancing approaches to programme governance, including thought-through proposals for shared governance, and financial incentives; and
- assurance that its forecasts reflect challenging efficiency assumptions, where appropriate using benchmarking.

Capital expenditure

Feedback from consultation and evolution in CAA thinking

- 4.8 NERL noted it had taken account of Helios/Arup's recommendations in its capex review for the RP2 review¹², with greater cost transparency, improved visibility and granularity of benefits and outputs, and evidence of cost efficiency in its recent SIPs and RP2 airspace and technology programmes. We are encouraged by the improvements we have seen in recent years, notably in NERL's 2018 SIP, but NERL maintaining and improving the quality of information remain important objectives for RP3.
- 4.9 Airlines supported a more prominent role for them in determining NERL's investment programme with capex subject to a specific approval and recovery mechanism, in which only investments consulted with the airspace user community and approved should be made. IATA proposed a conditional price cap arrangement for RP3, in which only the costs (depreciation and a return on investment) of approved investments would be reflected in the price control, with differences between planned and actual capex returned to or borne by airspace users on an n+2 basis (i.e. two years in arrears).
- 4.10 While we support the incentive aim of such conditional price cap ideas, we believe it is likely to be achieved more effectively with a structured approach to shared governance and assurance. The scope of any ex post efficiency reviews could be directed to where there has been a failure in programme governance that can be attributed to NERL.
- 4.11 NERL noted that the role of the Independent Reviewer (IR) is to assure the CAA and customers that NERL's reporting of progress is accurate, and it did not support extending the role to involvement in investment planning and programme execution, which it considered to be NERL's role. By contrast, airlines supported extending the IR's role to the RP3 consultation, to draw upon its good working

¹² NERL RP2 Capex Review – Arup and Helios Phase 1 Report

knowledge of NERL's RP2 business and understanding of the business plan assumptions relating to ongoing programmes extending into RP3.

- 4.12 The regime for capital expenditure in RP2 involves the value-neutral treatment of expenditure variances and some shared governance of NERL's capital programmes. Following the challenges of making significant changes to the capital programme at the start of RP2, we consider the IR's role is central to making shared governance an effective alternative to a high level of pre-specification for capital programme outputs and associated strong performance incentives.

Guidance

- 4.13 Subject to the SES regulatory framework, NERL will have the opportunity to build on the shared governance approach we adopted for RP2 or to propose departures from it. If the former, we would be looking for a strong commitment to shared governance between NERL and its customers, together with a well-designed future role for the IR function (or an alternative arrangement) during the course of RP3 that allows airlines to hold NERL effectively to account for its management of the programme.
- 4.14 To this end, we expect NERL to:
- propose well designed plans for shared governance and assurance for NERL's capital programme;
 - indicate how its shared governance proposals would allow NERL to give due regard to non-participating stakeholders and wider environmental outcomes
 - confirm its continued commitment during RP3 to high levels of transparency of cost and benefit information for participants in shared governance in line with the Helios/Arup recommendations;
 - propose assurance mechanisms, including independent review against best practice standards, around its broader programme management as well as around the specification and procurement of capital projects;
 - in light of differences between the incentives for capital and operating expenditure, show how it will secure that programme governance will remain aligned with the interests of customers when capital programme options have operating expenditure implications; and

- demonstrate how its proposals will provide meaningful accountability and protection to the economic interests of those paying for the programme (in the absence of strong financial incentives for efficiency).
- 4.15 If NERL proposes an alternative to shared governance, it should explain how its proposals would work in practice to give its customers and other stakeholders improved confidence in effective governance and protection in the event that the programme evolves during RP3.

Operating expenditure

Feedback from consultation and evolution in CAA thinking

- 4.16 NERL said our economic regulation should not focus solely on minimising NERL's direct costs, but seek to maximise net benefits to its customers and the travelling public. In view of the large and asymmetric costs of delays, NERL said that the regulatory outcome should include a margin to ensure resilience. It also said that during RP2 changes in its investment programme had led (or will lead) to significant additional training costs and dual running costs which were not included in the RP2 revenue requirements. It also said it should receive an operating cost contingency allowance to enable it to respond quickly to changes in the external environment and meet customer requirements.
- 4.17 Airlines welcomed the need for NERL to prove its own efficiency in its business plan. However, British Airways recognised that it could be difficult for NERL to benchmark itself effectively and objectively as salary information is likely to be confidential. Airlines stressed the importance of having CAA appointed consultancy reports available when airlines were discussing opex efficiency during customer consultation.
- 4.18 Trades Unions thought that NERL's business plan, needed to include enough operational and non-operational staff to provide a safe and resilient service, and to deliver projects. Prospect did not consider there to be value in staff

benchmarking. It said the quality of the staff benchmarking study for RP2 had been poor.

- 4.19 Most respondents supported retaining the FAS¹³ deployment facilitation fund (FFF), although Prospect thought it should be replaced by allowing NERL opex contingency, and were open to reviewing its governance. The FAS Deployment Steering Group (which includes NERL) proposed that the collection of the 'Small Gaps' element of the FFF could be investigated for RP3.
- 4.20 We welcome the attention that respondents gave to operating costs and consider that NERL needs to justify how the operating cost forecasts in its business plan will efficiently support the provision of a safe and resilient service in RP3. We aim to have the initial output from our independent study on RP2 operating cost efficiency available for early in the customer consultation process to allow NERL and airlines to have an evidence based discussion of NERL's costs. We recognise the difficulties in benchmarking ATCO remuneration, given the difficulty in finding suitable comparators in other industries. However, we note that comments such as the ATCO market is 'currently very tight' (in the Prospect response) show that there is at least some anecdotal market evidence available.

Guidance

- 4.21 Operating expenditure (excluding pass-through items, principally relating to defined benefit pensions) is a key driver of NERL's service charges. Staff costs, which in the 2016-17 accounts represented approximately 70% of operating expenditure (excluding defined benefit pension deficit funding), are particularly important.
- 4.22 We expect NERL to set out well justified forecasts for its operating expenditure demonstrating the evidence basis for them being efficient. Objective benchmarking could be a valuable source of evidence. We would expect NERL to set out a decomposition of its forecasts showing:

¹³ Future Airspace Strategy (FAS) – www.futureairspace.aero

- its understanding of and forecasts of the economic drivers, notably traffic levels, for activity levels (e.g. FTEs);
- its analysis of the effects of management and technology improvements and airspace change on activity levels, highlighting proposed or anticipated initiatives for improvements in operating efficiency;
- its forecasts for relative salary inflation or deflation in the UK and regional labour market, relative to the CPI base for NERL's financial model; and
- its forecasts for specific market effects, especially relating to ATCOs.

4.23 Given the ongoing implementation of the FAS and associated development, we would expect NERL to consider and explain in its business plan whether the FFF or something analogous to it should continue for RP3 and, if so, at what level and with what scope. In this context, NERL may wish to consider the broader question of uncertainty in its operating costs. We would expect NERL to propose alternatives to the current governance arrangements around the FFF if it concludes they would be more appropriate for RP3.

4.24 Forecasts are inherently uncertain. We would expect NERL to present an evidence-based analysis of the uncertainties involved in its operating costs, including the extent to which its forecasts are exposed to upside and downside risks. We would expect NERL to manage any asymmetric cost impacts of delays for its customers in this context – it should forecast on the basis that it should manage those impacts efficiently on behalf of its customers. We would expect NERL to account for any asymmetries in its own cost risks through balanced assessments of its expected costs.

Pensions

Feedback from consultation and evolution in CAA thinking

4.25 Respondents generally supported our proposed guidance. NERL requested the CAA further develop and clarify its regulatory approach.

4.26 While some respondents raised a concern around the allocation of deficit repair costs between core and wider costs, we are clear that the deficit at any one time relates to past pensionable service and cannot meaningfully be allocated to the uncertain future activities to which wider costs relate.

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- 4.27 We have framed the following guidance to meet NERL's request for further development and clarity. This is in line with wider developments in the regulation of consumer-funded pension schemes in other sectors, and notably the April 2017 'Decision on Ofgem's policy for funding Pension Scheme Established Deficits' and the subsequent August 2017 modifications to the respective Price Control Financial Handbooks.

Guidance

- 4.28 NERL is required to make financial contributions to its pension schemes on behalf of its current and former employees. Those contributions form a significant component of NERL's cost base and are expected to be substantial in RP3 and so the regulatory and business plan treatment of these costs is important.
- 4.29 Some of these contributions are for the current pensionable service of NATS' employees. Some of NATS's employees have defined contribution (DC) pension arrangements. Under these arrangements, once the employer has paid its and the employees' contribution, the company is not at risk to the ongoing performance of the respective fund. Other employees remain members of NATS's Defined Benefit (DB) scheme¹⁴. In contrast with the DC arrangements, the DB scheme provides for levels of post-retirement benefits agreed with the members when they are employees, benefits that are not affected by the performance of the scheme's investment portfolio. Accordingly, any deficit must be funded by the employer.
- 4.30 In common with many defined benefit schemes operated in the private sector, the DB scheme is now closed to new members, but the company still needs to make contributions to the DB scheme for the current pensionable service for employees who are still members.
- 4.31 In addition to this, a significant driver of NERL's pension costs over RP3 will relate to the need to fund an expected deficit in the DB scheme. This will be in respect of past pensionable service of all members, not just current employees,

¹⁴ The NATS Section of the Civil Aviation Authority Pension Scheme

including members' pensionable service prior to NERL's privatisation in 2001. At the last valuation the deficit for NATS's section of the scheme was measured at £458.7 million as at December 2015 (about 9% of scheme liabilities). NERL's share (about 76%) was equivalent to around 33% of its RAB. Its share of scheme liabilities represented about 3.6 times the value of its RAB. We understand that the scheme's Trustees intend to commission an actuarial valuation as at 31 December 2017 to help inform NERL's RP3 business plan, so this deficit figure is liable to change.

- 4.32 In CAP 1511, we identified a link between Trustees' confidence in the regulatory framework and the level of pension costs. Were the Trustees to lose confidence in the regulatory framework for the funding of pensions costs, their perception of risk could rise and they might adopt a more cautious approach to pension deficit recovery, leading to higher costs in RP3. Both the CAAPS Trustees and NERL highlighted this relationship, with NERL identifying the pass-through provisions of the current SES framework as being especially important to the Trustees' perception of risk. Under the pass-through provisions, variations between actual and determined costs due to unforeseen changes in national pension law, pension accounting law, or unforeseen market conditions are passed through to customers.
- 4.33 Since 2008, NERL's DB Scheme has been in deficit, with airspace users bearing certain additional costs of deficit repair. Airspace users should benefit if circumstances change and the pension scheme moves into surplus. In its response NERL agreed that its customers should benefit from reduced prices if financial market conditions change and this reduces the pension deficit or creates a surplus.
- 4.34 For a customer-funded scheme, as NERL's DB scheme essentially is, a surplus would represent money that has been paid by customers, potentially unnecessarily. It would be equitable to return that money, for example by way of pension contribution holidays that would translate into reduced charges for customers.
- 4.35 In practice, the scope to recover funds from the pension scheme in the event of a surplus is limited, although it could be possible to reduce by de-risking or even a pensions buy out at a cost that would not necessarily represent value for the customers' money.

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- 4.36 NERL will, however, want to ensure a balance between managing the recoverability of possible future surpluses, given market uncertainty and the prospect of a funded deficit in due course, and managing the current reality of a deficit.
- 4.37 The above suggests that NERL's business plan should explain and, where appropriate, provide evidence for how it can help manage the risks associated with a DB scheme in a way that acknowledges and respects that it is underwritten by customers, i.e. in the interest of those customers. This would include:
- constructive suggestions for the regulatory regime itself that might help improve the strength of the covenant and thereby facilitate the negotiation of more customer-led strategies for the scheme;
 - the company's approach to mitigating the deficit;
 - the company's approach to managing the risk of trapped surpluses and any associated high-cost de-risking;
 - how NERL proposes to include in customer charges for RP3 those pass-through adjustments arising from RP1 and RP2, and the process and evidence it has used to verify these adjustments.
- 4.38 The overall level of pension costs that are finally allowed in setting the RP3 price control, as well as the application of pass-through provisions, depend on NERL demonstrating that it has done all it can to mitigate the burden on airspace users arising from the company's pension obligations. One example we are aware of is that the company has recently offered remuneration uplifts to employees in exchange for their foregoing rights to future pensionable service – an outcome which might be advantageous to both parties.
- 4.39 In regards to the efficient level of costs, we expect NERL to provide the following evidence in its business plan:
- that it has behaved and is continuing to behave in a manner consistent with a commercially minded company by taking all steps available to it within its legal discretion, which are in the interests of users, to manage and mitigate the pension cost burden on airspace users;
 - it has considered and where appropriate taken actions consistent with those actions taken by other employers in the UK that do not benefit from the cost pass-through arrangements that have been available to NERL;

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- that it has worked with the Trustees to take actions to help minimise future costs and how these compare with actions taken by other employers and Trustees of other schemes, including those in sectors of the economy subject to normal commercial and competitive pressure. NERL should also set out and explain the assumptions it has made about the Trustees' future actions, including evidence of benchmarking these assumptions against the actions of Trustees operating schemes in sectors of the economy open to normal commercial and competitive pressures;
 - identifying cash costs of the DB Scheme separately from those of the DC Scheme, that the cash costs of the DB Scheme are separated between ongoing service and deficit repair and that its forecasts of these costs take into account information from the December 2017 actuarial valuation; and
 - that the assumptions supporting the December 2017 actuarial valuation are reasonable and are supported by independent benchmarking against other pension schemes.

4.40 In addition, to the extent business activities are included in the wider requirements of the plan then evidence should be provided showing:

- pension deficit costs, as they relate to past service, will all be identified as core costs, whereas ongoing pension costs, because they relate to future service, may be shown as both core and wider costs; and
- the allocation of ongoing costs pension costs has been made on a reasonable basis.

Chapter 5

Financeability

- 5.1 Efficient prices require the efficient financing of capex. This chapter: summarises what we said in our CAP 1593 consultation about financeability, reports respondents' views, and sets out business plan guidance to NERL on key aspects of financeability, including the cost of capital and the profiling of regulatory depreciation.

Cost of capital

Feedback from consultation and evolution in CAA thinking

- 5.2 NERL broadly accepted our proposed approach. While noting that determination of the cost of capital is a regulatory decision, it recognised the need for it to own all its assumptions. It acknowledged it would take account of our December 2017 policy update and consultation on our economic regulation of capacity expansion at Heathrow (CAP 1610).
- 5.3 Other respondents emphasised that the decision of the cost of capital should be the CAA's, independent of NERL's views.

Guidance

- 5.4 The cost of capital should remunerate providers of capital for their investment and be calibrated according to the risk that the business faces. NERL should assume a cost of capital no more than the efficient level necessary to compensate NERL for the business and regulatory risks it faces. Its business plan should identify a balanced set of proposals for incentives that both promote efficiency but also do not unduly increase risks and financing costs. The objective should be a set of arrangements that lead to the lowest overall costs for consumers. In formulating its business plan and proposals for an efficient cost of capital NERL will need to consider and transparently set out its assumptions and supporting evidence in respect of:
- regulatory precedent published since the RP2 decision;
 - market evidence on cost of capital parameters;

- its business risks (that should include its proposals for the treatment of pension deficit costs and the incentive framework); and
 - risks arising from external factors (e.g. uncertainty arising from Brexit).
- 5.5 NERL should in particular have regard to the interaction between traffic volume risk and its operating expenditure levels. If, following its revision, the SES regulatory framework is flexible enough, alignment of the traffic risk sharing mechanism with NERL's operating expenditure elasticity would effectively neutralise the risk for investors.
- 5.6 In relation to regulatory precedent we set out our early and preliminary views on the cost of capital for the next Heathrow Airport (HAL) price control review in CAP 1610. The technical appendix includes information on the market wide components of the cost of capital (e.g. the risk free rate). NERL should also refer to relevant papers from other regulators, notably Ofwat's final methodology for PR19 published on 13 December 2017.

Regulatory asset base and regulatory depreciation

Feedback from consultation and evolution in CAA thinking

- 5.7 NERL welcomed our invitation for it to consider how the one-off fall in depreciation projected in 2021 should be dealt with.
- 5.8 Other respondents noted that NERL will need to consider the effects of depreciation on efficient financing.
- 5.9 Our own thinking maintains our emphasis on financeability, but we consider it is helpful to provide some further clarity around the interaction between financeability and affordability. Assuming that the regulator correctly estimates the cost of capital and that the cost of capital for NERL also reflects the time value of money of its customers, then reprofiling regulatory depreciation has a neutral effect on investors and customers in present value terms,¹⁵ so decisions

¹⁵ Taking the Weighted Average Cost of Capital (WACC) as the discount factor

about the profile of depreciation affect the profile of revenues, not their overall value over time. The twin economic objectives are (i) the financeability of the regulated business over time and (ii) equity between different generations of customers, ensuring that the costs paid by different generations of customers relate to the underlying value of the services they receive.

- 5.10 We consider that the framework for determining depreciation specified in the SES regulatory framework, currently in Article 7 of the charging regulation, described in terms of the assets' operating lives, is consistent with a depreciation profile for the RAB that meets the economic objectives and economic purpose of regulatory depreciation.

Guidance

- 5.11 The level of regulatory depreciation under NERL's RP2 methodology is projected to fall during RP3 as the opening regulatory asset value at privatisation is fully depreciated. The projected impact is a one-off fall in depreciation in 2021 that would, if the methodology is unchanged for RP3, impact on revenues and cash. NERL should set out how it considers these matters should be best addressed in its business plan.
- 5.12 Lower cash flows may mean that NERL has a reduced ability to fund capex out of its operating cash flows and/or a reduced ability to fund dividend payments. These are normal features of a RAB based approach to determining price controls. Nonetheless, the lower level of regulatory depreciation may create challenges for efficient financing and in these circumstances NERL should make proposals that will allow it to retain access to financing on efficient terms.
- 5.13 Consistent with the approach we have adopted to the regulation of HAL, we will be open minded about more flexible approaches to the profiling of regulatory depreciation in the future, provided that they deliver an appropriate balance between affordability, specifically inter-generational equity, and financeability.
- 5.14 Consistent with the longer term effects of depreciation policy, we would expect NERL's analysis of the issues will be based on longer term business projections extending well beyond the RP3 period.
- 5.15 If NERL considers that a different approach to regulatory depreciation is necessary to provide for efficient financing it should clearly set out its reasoning and any changes to assumptions on asset lives and/or depreciation profiles. The

business plan should demonstrate the impact of the different options on user charges and on NERL's financeability both during RP3 and in subsequent periods. Any changes to approach to address short-term financeability concerns should also be consistent with efficient financing in the medium or longer term.

Assessing financeability

Feedback from consultation and evolution in CAA thinking

- 5.16 NERL accepted that there are complex interdependencies that need to be taken into account in assessing financeability. These include regulatory mechanisms, the methodologies used by credit rating agencies and the specifics of NERL's debt covenants.
- 5.17 Other respondents requested that NERL explore opportunities that may exist for more efficient financing.
- 5.18 Our own thinking continues to recognise the importance of metrics. However, it is important to highlight the interaction between risk, financeability and the profile of cash flows arising from depreciation decisions. We are particularly aware that the methodologies adopted by the rating agencies draw from a wider appreciation of the risk environment a company operates (and finances) in, not just the raw metrics. The stability and predictability of the regulatory regime itself is inevitably a consideration, but other risk factors are too.

Guidance

- 5.19 The metrics used by credit rating agencies to assess credit quality are an important reference point for assessing financeability. For companies subject to RAB based regulation these metrics typically focus on interest coverage and debt to RAB ratios. NERL should, however, adopt a broader interpretation of financeability that acknowledges the wider context of agencies' rating assessments.
- 5.20 Possible financeability challenges for NERL include its profile of regulatory depreciation discussed above, its pension deficit discussed in chapter 4, the proposed scale of its capital programme and uncertainties that will exist in the markets for debt and, if appropriate, equity.

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- 5.21 NERL will need to consider not only how its proposals have implications for financeability but also how it can shape its proposals to support its financeability.
- 5.22 In demonstrating that its business plan is financeable NERL should consider and present evidence on the:
- target credit rating that has informed its business plan;
 - metrics and indicators and the broader qualitative factors associated with this credit rating; and
 - scenarios that have been tested and the results of this testing.
- 5.23 When conducting financeability analysis, NERL should present evidence on: what corresponds to a successful financeability test. For example, does a temporary failure to meet a particular metric or threshold require action or must there be evidence of more persistent problems. If there is a need for action, then NERL should explain what are the appropriate actions that are also consistent with affordability, including:
- the provision of new equity;
 - changes to NERL's proposals for its business, financing or regulatory regime; and
 - re-profiling revenues in an NPV-neutral way (e.g. changing depreciation policy).
- 5.24 NERL will need to demonstrate that its business plan is financeable on the basis of its core activities and separately on the basis of core and wider activities.

Chapter 6

Customer consultation

- 6.1 This chapter summarises what we said in CAP 1593 about our expectations of NERL's approach to customer consultation for the RP3 regulatory review, reports respondent's views, and sets out our final guidance on customer consultation.
- 6.2 Our updated expectations for customer consultation are set out in full at Appendix D.
- 6.3 In CAP 1593, we set out the broad approach to consultation we expected NERL to follow:
- to take into account customers' views in producing a high quality IBP; and
 - to engage with customers to refine and calibrate the plan and take their views into account in formulating its RBP.
- 6.4 We said we would publish a customer consultation mandate to encourage NERL, airspace users and airports to participate in a structured and meaningful programme of engagement and discussion, following publication of NERL's IBP in March 2018.
- 6.5 We expected that:
- successful customer consultation would require meaningful engagement to take place, which would require NERL to provide transparent, quality and timely information, and to respond to customers' queries.
 - NERL to engage constructively to identify and understand its customers' priorities for RP3 and ensure that these were taken into account in formulating its RBP. Where it could not meet these priorities and demands, we expected NERL to provide a persuasive and timely explanation.
 - the customer consultation process for RP3 would improve on the process used for RP2, for example by ensuring that airports had the opportunity to participate in the consultation process for RP3.
 - NERL to consider carefully how best to ensure that the views of passengers and overflowed communities were taken into account in its IBP and RBP.

Respondents' views and CAA comments

- 6.6 Respondents to CAP 1593, in general, thought that customer consultation for RP3 should follow the same process as that for RP2. NERL said it had sought feedback on its RP2 process and customers had supported retaining a customer co-chair and similarly structured engagement and working arrangements for RP3. NERL and airlines also had similar views on how to take into account the interest of airports, passengers and overflown communities.
- 6.7 NERL proposed that airports should have a different role in RP3 to airlines, with airport views being sought on relevant topics including areas where there were dependencies on activities at airports, such as airspace modernisation and traffic forecast assumptions. Airlines consider that airports should not be given equal weight with airlines. British Airways suggested that there could be bilaterals between NERL and airports on airspace modernisation. IATA and Virgin said they would support consultation involving relevant airports, NERL and airlines on capacity targets at certain airports. They thought this could be a specific consultation supplementary to NERL's customer consultation.
- 6.8 NERL and airlines thought that the best way to engage with overflown communities would be within the airspace change process rather than during customer consultation. NERL and airlines also considered that airline interests (in optimising capacity, reducing delay and controlling and potentially reducing prices) correlated with passenger interests, so that the airline community would best be able to meet passenger interests.
- 6.9 We are encouraged by the agreement between NERL and airlines on the process for customer consultation, and that NERL had taken the lead in seeking airline views on the process.
- 6.10 We note the agreement between NERL and airlines about the role of airports, passengers and overflown communities during customer consultation. We agree that airlines and airports should not have equal roles for all aspects of NERL's business plan, as it is airlines that have to pay the charges rather than airports. We agree that airport views will be important in discussing airspace modernisation given airports' roles in the airspace change process. We also consider that NERL should seek airports' views during discussions on London Approach and traffic forecasts.

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- 6.11 We note that NERL and airlines do not consider that passengers and overflow communities should have a formal role in customer consultation. We agree that with respect to air traffic services that passenger and airline interests should be broadly aligned, and encourage all parties to share the results of any research into how passengers are affected by air traffic services.
- 6.12 We agree that overflow communities have an important role to play during the airspace change process, and welcome NERL's comment that it can build on this by engaging with communities at an early stage of any proposal. While we note that responses to CAP 1593 expressed the view that customer consultation may not be the most appropriate place to consider the concerns of overflow communities, we still expect NERL should consider how it can best meet the communities' legitimate concerns about noise through their business planning process, recognising that doing so will be important for them to achieve airspace change.
- 6.13 Our broad approach to NERL's business plan guidance is a departure from our practice at previous reviews where set out in detail the assumptions that NERL should take into account in its business plan. This approach is consistent with that we have taken in the current HAL review and that used more widely in other regulated sectors. The approach encourages NERL not to see the business planning process just as an input to the price control process, but as an opportunity to express how it intends to run its business during RP3 and beyond.
- 6.14 Consistent with this approach, we do not intend to issue a mandatory approach for NERL's own consultation process. Instead, we set out in Appendix D our expectations for NERL's customer consultation process. NERL's opportunity is to deliver the best business plan it can. It should therefore be for NERL to shape its own consultation process and it is free to depart from what we currently expect.
- 6.15 Finally, and importantly, NERL's business plan will need to navigate a wide range of objectives and stakeholders. Its current customers are an important interest group, not least because they are paying the bills. But there are wider interests to be addressed, including future consumers and non-customer interests such as overflow communities. NERL will therefore need to take care in interpreting the outcomes from its necessarily more narrowly-focused customer consultation.

Appendix A

Summary of responses to CAP 1593

In September 2017, the CAA published CAP1593. The CAA received nine responses from stakeholders to this consultation. This section summarises the responses given to this consultation, which are structured based on the topics as set out in CAP1593, as well as general comments on the Business Plan development.

Approach and strategic objectives of RP3

The table below summarises responses regarding the strategic approach and objectives that should be adopted for RP3.

| Respondent | Response |
|---------------------------|--|
| Two-track approach | |
| NERL | <p>NERL welcomes the opportunity to own and justify key assumptions within the business plan and supports the use of a two-track approach. There is uncertainty around how to interpret the two-track process and NERL proposes refined definitions for core and wider services:</p> <ul style="list-style-type: none"> - the 'Core' plan is seen as incorporating known and expected requirements, with alternative options provided where available. This plan will deliver a day-to-day service to meet both customer expectations and licence obligations, but also resources required to make essential preparations for future reference periods. - the 'Wider' plan includes supplemental information setting out effects on both costs and performance for less certain requirements. If developments are not quantifiable, directional statements will be provided. <p>NERL proposes two mechanisms for dealing with uncertain costs, namely:</p> <ul style="list-style-type: none"> - A FAS Facilitation Fund-type allowance, built into prices - A pre-defined trigger mechanism, not built into prices <p>NERL notes that under its core plan, delivery of LAMP2 would lead to</p> |

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| | efficiency benefits. |
| Airlines | <p>Airline stakeholders (British Airways, Virgin Atlantic and IATA) agree that the two-track process is reasonable and should enable meaningful consultation. Early consultation with stakeholders is proposed to define what is to be captured under a 'core' plan.</p> <p>British Airways note their scepticism that 'real choice' will be presented for the wider options given previous NERL statements around the interrelatedness of projects.</p> <p>All airline respondents request clear cost-benefit analysis to justify major investments, with Virgin Atlantic suggesting the two-track process meant that the focus on core activities should be on cost-efficiency, while under the wider plan, a broader cost-benefit analysis should be required.</p> <p>British Airways and Virgin Atlantic support LAMP2 being part of the core plan and see this as being key for meeting passenger needs. British Airways also provide their views on what would be captured under the core plan and the wider plan - British Airways consider that meeting new UK airspace policy/ regulatory strategy is a core requirement, as is the eTBS Phase 2 programme, while measuring noise on overflown communities should be a wider requirement.</p> |
| Prospect | Prospect consider that the two-track process brings flexibility to what they consider is a rigid and length regulatory process. However, they caution that this could become a 'pick and mix' exercise. |
| PCS | <p>PCS welcomes the flexibility of the two-track approach.</p> <p>PCS questions whether the stringent commitment to LAMP2 is necessary for RP3.</p> |
| London Approach | |
| NERL | <p>NERL requests further regulatory guidance from the CAA in relation to the London Approach charge (the scope and principles to determine the charge). In the absence of this guidance, NERL will assume the decision on Biggin Hill and other smaller airports remain as per 2010 and 2014 CAA decisions. NERL also will assume the basis for charges remains the same as at present.</p> <p>NERL rejects the development of separate metrics, targets or forecasts for the London Approach relative to En Route, noting the potential for</p> |

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| | perverse incentives in driving optimisation in one part of the business at the expense of another. |
| Airlines | IATA proposes a specific consultation around increased granularity in relation to the London Approach service. |

Outcomes and outputs for RP3

A number of responses were received with regards to outcomes and outputs for RP3, with specific responses provided for resilience and quality of services as well as noise and environmental issues that should be considered. We also address the economic regulation of drones within this section. These are summarised in the table below.

| Respondent | Response |
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| Resilience and quality of service | |
| NERL | NERL notes that it is limited in its ability to perform a capacity oversight, assessment and advice function in light of not being able to enforce recommendations or manage combined airport scheduling decisions. |
| Airlines | Both British Airways and Virgin Atlantic note the importance of resilience and taking account of the benefits case to all parties. British Airways propose two core requirements under operational resilience: <ul style="list-style-type: none"> - Thunderstorm resilience, where more proactive management could lead to benefits (and where they consider progress has been limited to date) - eBTS Phase 2 to deliver enhanced resilience under the most prevalent weather event i.e. strong winds. IATA proposes that incentives on performance targets should be penalty-only, transparent and fair. |
| Prospect PCS | Both Prospect and PCS note the importance of appropriate staffing to ensure resilience. Prospect does not consider that incentives should be extended on resilience. |
| Noise and environment | |
| NERL | NERL states that noise is out of its control and so it is not right to |

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| <p>Prospect PCS</p> | <p>incentivise noise within an environmental incentive (this position is supported by Prospect and PCS). However, NERL states that it will work with airports to design En Route services to better distribute noise impacts, with a formal process set up to show how this is being managed.</p> <p>NERL notes the importance of data underpinning any environmental incentive being reliable. NERL intends to develop a refined 3Di metric to measure the aspects fully within its control for the purpose of incentivising. This will remove the impacts of:</p> <ul style="list-style-type: none"> - runway direction - radar tracks outside of its control - extreme weather days - customer choices <p>NERL references the European legislation it operates under and considers a 1% symmetrical incentive is suitable.</p> |
| <p>Airlines</p> | <p>British Airways and Virgin Atlantic consider that incentives on noise may not produce the desired results, with the Government's new airspace policy and CAA's airspace change processes addressing noise impacts. IATA does not think an incentive should be introduced for noise.</p> |
| <p>Aviation Communities Forum (ACF)</p> | <p>ACF considers that a noise and emissions incentive should be introduced as soon as possible (ideally prior to RP3) given the impact on overflown communities.</p> <p>ACF states that an incentive capped at 1% of annual revenues is unlikely to achieve the desired behavioural change.</p> <p>ACF states that the focus of all parties should move away from increasing capacity and airspace change over RP3, and the CAA should be more active with respect to reducing, controlling and mitigating noise impacts. ACF notes legal obligations to undertake such activities.</p> |
| <p>Drones</p> | |
| <p>NERL</p> | <p>NERL supports the categorisation of drones as a core issue for RP3 - NERL expects this to be dealt with through a trigger mechanism.</p> <p>As a general principle, NERL proposes that drone users should bear the costs of managing airspace. NERL requests that the CAA provides</p> |

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| | charging principles around the provision of air traffic services to drones and unmanned air traffic. |
| Airlines | British Airways support the position that drone users should bear the cost of economic regulation for drones. |
| Safety | |
| NERL | NERL proposes that further discussion is held around setting appropriate safety targets, and ensuring safety is referenced throughout customer consultation. |
| PCS | PCS calls for NERL to be brought into the public sphere due to the potential for pursuing greater social benefits, including safety. If this is not adopted, PCS questions whether a RAB approach is suitable for a service business rather than an infrastructure operator. |

Cost assessment

The table below summarises the responses around pensions, capex and efficiency.

| Respondent | Response |
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| Efficiency | |
| NERL Prospect | <p>NERL recommends that the focus of any consultation be on maximising customer benefits, rather than focusing solely on costs. Prospect supports this position.</p> <p>Where additional costs are required within a price control, there should be a mechanism to reflect this. Contingency funding is one option for this.</p> <p>NERL proposes the introduction of a mechanism that provides greater flexibility between opex and capex, subject to customer consultation - exploring options in this area is proposed as a suitable next step.</p> |
| Airlines | <p>Airline stakeholders (British Airways, Virgin Atlantic and IATA) note a number of different ways for NERL to provide assurance around their business plan. This includes:</p> <ul style="list-style-type: none"> - Benchmarking - Cost-benefit analyses - Cost transparency |

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| | <ul style="list-style-type: none"> - Increased visibility and granularity of benefits - Evidence supporting accuracy of cost forecasts <p>British Airways and IATA state their concerns that NERL will be able to benchmark itself effectively and so see a role for external parties here.</p> |
| PCS | PCS is sceptical of the benefits of salary benchmarking, as it is difficult to reflect salaries appropriately for a highly specialised business. |
| Capex | |
| NERL | <p>NERL references improvements to the governance process around capex, including the SIP framework. NERL note that it has taken account of recommendations from Helios and Arup on capex governance.</p> <p>Core benefits are difficult to demonstrate with system critical systems, so will focus on presenting evidence of cost efficiency. Examples include use of competitive tendering and effective contract management.</p> <p>NERL suggests that information it will present may be limited to the programme rather than project level, due to certain aspects not being sufficiently mature.</p> <p>NERL requests assurance from the CAA that capex will continue to operate under a pass-through arrangement.</p> |
| Airlines | <p>Airline stakeholders (British Airways, Virgin Atlantic and IATA) suggest that existing governance arrangements do not properly permit airspace users to proactively guide the setting of investment priorities for NERL.</p> <p>These stakeholders suggest that NERL should be required to put forward revised governance arrangements and set out measures to report its performance over RP3 (including KPIs, operational, technical and people planning). British Airways and Virgin Atlantic note concerns around whether NERL will propose suitable financial incentives, reporting requirements or licence conditions that support capital efficiency.</p> <p>Both British Airways and IATA note different approaches for governing capex programmes to get over the perceived issues. British Airways suggest that NERL should be able to propose alternative methods of airspace users funding capex programmes over time periods that do not align with Reference Periods. This could be introduced as a conditional price cap.</p> |

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| | <p>IATA proposes a price cap for RP3, where capex is subject to specific approval and recovery mechanisms; under this proposal, differences between actual and planned capex costs are trued up with a two-year time lag. This is seen to permit greater flexibility within a Reference Period.</p> <p>IATA states that no unapproved capex should be eligible for inclusion in the RAB, with no depreciation or return, to ensure that capex is aligned with airspace users' interests.</p> |
| Prospect | Prospect indicates that a major capex programme is required to modernise NATS' systems. Governance should be proportionate to the investment and focus on the net benefits not solely costs, with no additional incentives required, according to NERL. |
| FFF | |
| NERL | NERL supports the continuation of the FFF, noting that the alternative would require a higher contingency allowance. NERL proposes changes to the existing functioning of the FFF, with i) simplified and proportionate governance, and ii) the small gaps element coming through the DfT/ CAA part of the Unit rate. On the latter, if this does not take place, NERL proposes that it is exempt from performance targets on this element, given that it is outside of its control. |
| Airlines | Airlines stakeholders (British Airlines, Virgin Atlantic and IATA) also support the continuation of the FFF, however with management of these funds covered under the revised capex governance arrangements. |
| Prospect | Prospect proposes the use of contingency funding on both opex and capex, rather than continuing with the FFF. |
| FAS Deployment Steering Group (DSG), Investment Board (IB) and Oversight Management Team (OMT) | <p>FAS DSG, IB and OMT support a FFF-like fund for RP3 to continue to permit project support where benefits accrued to a different party than the investor, in order to improve delivery of Future Airspace Strategy. The FFF is seen as continuing to operate under the SIP process.</p> <p>FAS DSG, IB and OMT proposes changes to the small gaps element of the FFF, with two main changes proposed. The first of these changes involves investigating how small gap funds are collecting from the Unit rate. The second of these involves introducing a cap to ensure that the FFF does not hold too much cash from airspace users.</p> |

| Pensions | |
|-----------------|---|
| NERL | NERL recommends that CAA further develop and clarify the regulatory approach to the remuneration of pension costs. This would give further assurance to Trustees of the scheme. |
| Airlines | Airline stakeholders (British Airways, Virgin Atlantic and IATA) support the level of detail supplied by the CAA on pensions at present, noting that this guidance may benefit from a clearer explanation of CAA expectations and how the two-track process fits with the costs of pension deficit repair. These stakeholders expect NERL to justify how increased pay remuneration in exchanging future pension rights is efficient and the impact on both deficit repair and overall pension costs. |
| Prospect | <p>Prospect notes that NERL's pension scheme has been de-risked in recent years, with members electing to leave or no longer being active members.</p> <p>Prospect supports and expects pass-through arrangements for pension deficit repair costs to continue for RP3, with efforts made to mitigate the costs of the scheme.</p> <p>Prospect criticises the CAA for asking NERL to outline how future surpluses will be treated, as in its view this sets unrealistic expectations and the last pension holiday was seen to exacerbate the current problem.</p> |
| PCS | PCS supports the continuation of pass-through arrangements for pensions, noting that the CAA should not neglect the impact on NERL staff from changes to pension arrangements. |
| CAAPS | CAAPS values the recognition of how important principles around recovery of pension costs are, and acknowledging the distinction between pension deficit repair costs and ongoing costs. |

Financial Issues

| Respondent | Response |
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| NERL | NERL notes that it will consider differences in the cost of capital between the core and wider approaches. NERL will also undertake its own financeability analysis, which will incorporate its debt covenants. |

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| | NERL requests the CAA provide sight of the proposed timing and approach for financeability, and consider whether economy-wide parameters are adopted from the HAL review. |
| Airlines | Airline stakeholders (British Airways, Virgin Atlantic and IATA) recommend that the CAA undertakes its own independent work on the cost of capital and regulatory depreciation. These stakeholders have asked for NERL to illustrate the impact of lower depreciation on efficient financing and how NERL manages its investor portfolio to obtain more efficient finance costs. |
| Prospect | Prospect indicates that where the risk profile for NERL changes, e.g. with incentives, changes should be reflected in the cost of capital. |

Customer consultation

Responses regarding NERL consultation with airlines customers are provided below.

| Respondent | Response |
|-------------------|--|
| NERL | <p><i>Overall:</i> NERL suggests that early engagement already shows an improvement over RP2 and proposes a teleconference with customers and the CAA to develop practical consultation arrangements. NERL notes a willingness to take on a greater coordination and delivery role if supported by stakeholders.</p> <p><i>Role for airports:</i> NERL notes bilateral meetings it has held with airports, on a limited number of topics e.g. capacity forecasts and airspace modernisation.</p> <p><i>Role for overflowed communities:</i> NERL suggests that separate consultation is the more appropriate route for overflowed communities to be heard.</p> <p><i>Role for passengers:</i> NERL considers that airlines are best placed to meet the needs of customers.</p> <p><i>Consultancy studies:</i> NERL provides detailed guidance around developing suitable Terms of Reference for consultancy studies. NERL does not consider that further detail is required in the RP3 Initial Business Plan to support the RP2 ex-post capex efficiency review.</p> |

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| | <p><i>Consultation structure:</i> NERL supports continuation of the RP2 structure, with a customer consultation group and a Joint Chair process.</p> <p><i>Role for Independent Reviewer:</i> NERL does not support a greater role for the Independent Reviewer.</p> <p><i>Met Office:</i> NERL notes the value of Met Office services in RP2 and expect the costs of this service not to be within the NERL element of the Unit rate.</p> |
| Airlines | <p>For responses in this box, airlines represent British Airways, Virgin Atlantic and IATA unless otherwise stated.</p> <p><i>Overall:</i> Airlines suggest the topics for consultation are broadly the same as RP2, but the process places more onus on NERL to develop a plan that takes account of airspace users' priorities.</p> <p><i>Role for airports:</i> Airlines consider there is a role for airports in certain areas e.g. capacity targets, but airports should not be afforded the same weight as airlines given they do not pay user charges. A broader airport role could also jeopardise a clear airspace user voice during consultation.</p> <p><i>Role for passengers:</i> Airlines state they are best placed to represent the interests of passengers, and note aligned interests between both parties.</p> <p><i>Consultancy studies:</i> Airlines note the importance of having external consultancy study findings available early in the process to inform and lead the consultation process. British Airways provide specific recommendations around developing appropriate Terms of Reference for these consultancy studies. British Airways state that it is likely to be too early for an ex-post capex efficiency review for RP2, given that significant changes were only formalised in May 2017 - British Airways propose that this review could instead be used to inform the CAA's view on the revised Business Plan.</p> <p><i>Consultation structure:</i> Airlines support a continuation of RP2 consultation arrangements, with a customer consultation group and a Joint Chair process.</p> <p><i>Role for Independent Reviewer:</i> Airlines support an extended role for the Independent Reviewer, in light of knowledge built up during RP2.</p> <p><i>Met Office:</i> British Airways see value in the work conducted by the Met Office to date and request a formal consultation on how to properly fund</p> |

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|-----------------|---|
| | <p>these costs within the Unit rate in a transparent way.</p> <p><i>Statfor:</i> IATA indicates that capacity planning would be improved if enhanced consultation mechanisms existed between stakeholders and Statfor was implemented.</p> |
| Prospect | <p><i>Overall:</i> Prospect considers that NERL should not bear the costs of wider engagement, in a process that is too long and complex.</p> <p><i>Role for airports:</i> Prospect considers that airports should not be included in the consultation process due to difficulties in arriving at a consensus.</p> <p><i>Role for overflowed communities:</i> Prospect does not consider that overflowed communities are within scope for the NERL Initial Business Plan.</p> <p><i>Role for airlines/ passengers:</i> Prospect considers that passenger needs are best served by ensuring NERL delivers sufficient capacity to meet the needs of safety, efficiency and minimal delays. Prospect considers that a conflict of interest exists for airlines as stakeholders in NATS and their role as airspace users.</p> <p><i>Consultancy studies:</i> Prospect cautions that the CAA consultancy studies could undermine work commissioned by NERL, with little value in undertaking a staff opex study given the specialised nature of service provided.</p> <p><i>Consultation structure:</i> Prospect notes that relations between airlines and NERL has worsened following blame placed on ANSPs for delays and cancellations. Prospect is also critical of airlines' changing views on investment e.g. the change in focus in RP2 between cost reduction and then service delivery irrespective of cost reductions.</p> |
| PCS | <p>PCS notes that there is an extensive process for overflowed communities for planned airspace changes.</p> <p>PCS requests the CAA considers the value of the UK-Irish FAB, when energies are potentially placed co-operating with other ANSPs e.g. in France, Belgium and the Netherlands.</p> |

EU context and timetable

The table below summarises the responses received regarding the future relationship with the EU and comments regarding timetable initially proposed.

| Respondent | Response |
|---|---|
| EU context | |
| NERL | NERL notes the difficulties in developing a business plan when a high degree of uncertainty exists with respect to Europe. |
| Airlines | Airline stakeholders (British Airways, Virgin Atlantic and IATA) propose that areas of the Initial Business Plan affected by Brexit should be clearly identified and discussed. The plan should be updated to reflect UK-EU Brexit arrangements with a material impact on NERL at a later date. |
| FAS Deployment Steering Group (DSG), Investment Board (IB) and Oversight Management Team (OMT) | The impact of Brexit could mean no CEF funds; in RP2, NATS received around €125m from this - if this is missing, there may be requests for government funding and a need for a separate governance process. |
| Timetable | |
| NERL | NERL notes benefits from the CAA and DfT engaging with the European Commission on developing the RP3 framework and relevant EU-targets. |
| Prospect | Prospect requests that the CAA provides clarity on whether they view RP3 as subject to endorsement/ agreement by the European Commission. |

Appendix B

Our duties

The Transport Act 2000 gives the CAA a primary duty to exercise its functions so as to maintain a high standard of safety in the provision of air traffic services.

In exercising its functions the CAA must do so in a manner it thinks best calculated:

- 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;
- to promote efficiency and economy on the part of licence holders;
- to secure that licence holders will not find it unduly difficult to finance activities authorised by their licences;
- 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
- 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.

Commission Implementing Regulation (EU) No 390/2013 of 3 May 2013 laying down a performance scheme for air navigation services and network functions gives the CAA, as national supervisory authority for the UK, responsibility for:

- drawing up of the Performance Plans; and
- performance oversight and the monitoring of Performance Plans and targets.

Appendix C

CAA evaluation of NERL's business plan

We have formulated the key components of our evaluation of NERL's business plan as follows:

- **accountability** – how well has NERL ensured it is effectively accountable to its customers, shareholders and other external stakeholders, consistent with appropriate principles of regulatory corporate governance.
- **quality of stakeholder engagement** – how well has NERL understood the needs of its customers and other external stakeholders, both today's and tomorrow's, and translated that understanding into its business plan
- **shared governance arrangements** – how well has NERL built on the shared governance arrangements for NERL's capital programme, including the role of the Independent Reviewer, in RP2 to develop its proposals for effective shared governance for RP3 and beyond
- **business resilience and risk-management** – how has NERL understood and evaluated the broader risk environment and secured that its business plan is resilient to future uncertainty
- **capital expenditure** – how well has NERL developed
 - its broader business strategy to meet the needs of its external stakeholders
 - its corresponding investment strategy for RP3 and beyond
 - its optioneering of the investment programme
 - the resilience and adaptability of the programme to future uncertainties
 - efficient costings for the purpose of either informing shared governance of the investment programme or the baselines for any financial incentives
- **operating expenditure** (excluding pensions deficit funding) – how well has NERL understood the implications of its customer-focused business and investment strategy for its operating expenditure and how well has it translated that understanding into forecasts of efficient operating cost levels

-
- **NERL/NSL boundaries** – recognising the degree of interaction between NERL and NSL, how well has NERL laid out and evidenced how services between it and NSL are priced on a fair, commercial and arm's length basis and cost allocations are made on an objectively fair basis
 - **traffic volumes** – are NERL's forecasts, including any adjustments to take account of downside shocks, reasonable, balanced and evidence-based
 - **performance targets** – how well has NERL developed its proposed KPIs for safety, environment and capacity during RP3 to meet the needs of external stakeholders and related evidence-based stretching performance target levels
 - **incentive and risk-sharing mechanisms** – how well has NERL designed its proposed incentive and risk-sharing mechanisms to help ensure its management will be effective in benefitting its external stakeholders. This would include providing for
 - a balance between operating expenditure and traffic risk-sharing that relates to the underlying cost elasticity
 - a balance between financial incentives and shared-governance, recognising that shared-governance arrangements are an alternative way to protect the interest of customers
 - a balance between cost and performance incentives that fairly reflects the value to the consumer
 - a residual risk profile for NERL's investors, expressed in terms of impacts on the return on regulatory equity (RoRE), that is consistent with its ability to finance its activities at an efficient cost of capital
 - **pensions deficit funding** – how well has NERL framed its consumer-led strategy for pensions, including how it seeks to manage the risk of stranded surpluses
 - **cost of capital and financeability** – how well has NERL
 - framed its cost of capital assumptions in light of current and emerging views from the CAA, other regulators and other authorities, and
 - developed its plan, in light of a reasonable range of possible estimates of the cost of capital by the CAA, to be consistent with its continuing need to raise finance

- **suitability and integrity of NERL's financial forecasting model** – does its financial forecasting model meet best practice standards for a model used for regulatory price control purposes, including appropriate levels of assurance around its logical integrity and usability

Appendix D

Expectations for customer consultation

1. This appendix sets out the CAA's expectations for the customer consultation process that NERL will undertake with its customers to review and refine its business plan for RP3.
2. The CAA considers that there is considerable merit in consultation between NERL and its customers prior to developing the RP3 performance plan and targets, as well as the RP3 Oceanic price control. The CAA expects that the quality of NERL's RP3 business plan will be improved through understanding customer needs and tailoring the business plan to reflect these.
3. The expectations for the NERL Customer Consultation activity set out below do not detract from our expectation that NERL should consider in its business planning process how it can best meet the legitimate concerns of its wider stakeholders, including overflowed communities¹⁶.
4. This appendix outlines:
 - objectives of the Customer Consultation process;
 - the CAA's expectations of the Customer Consultation process;
 - possible themes for consideration under the Customer Consultation process; and
 - the CAA expectations of participants' roles in the Customer Consultation.
5. The CAA will retain overall responsibility for drafting the relevant parts of the performance plan. In drafting this, the CAA will draw on evidence arising from the NERL Customer Consultation process.

¹⁶ See chapter 6, paragraph 6.12.

Objectives and CAA expectations of the process

Objectives of customer consultation

6. The main objectives of customer consultation are:
 - to ensure that airspace users - and airports, where appropriate - and NERL can effectively share their views and priorities and engage on how NERL might approach key issues in the next reference period.
 - to ensure that the NERL's final business plan is informed by a broad range of views from both NERL and its customers.

CAA expectations of the process

7. The CAA has decided not to outline specific stages of the consultation process; instead, NERL and customers should take account of the principles set out in this appendix, which broadly follow the process established for RP2.
8. The CAA expects NERL to establish an effective Customer Consultation Working Group (CCWG) which will be convened with a fair representation of its airline customer base for a series of meetings, which may also be supplemented by further workshops on particular subjects. The CAA expects the CCWG to establish and agree its Terms of Reference and inform the CAA accordingly.
9. The CAA expects NERL to publish its initial business plan (IBP) on 9 April 2018. This will form the basis of Customer Consultation between NERL and customers before NERL submits a revised business plan (RBP) to the CAA by no later than 26 October 2018.
10. The CAA expects NERL to engage constructively to seek its customers' priorities for RP3 and demonstrate that these are taken into account in formulating its RBP. Where NERL cannot meet these priorities and requests, it should provide a cogent and timely explanation. For the avoidance of doubt, the CAA does not expect the process of Customer Consultation to be a negotiated settlement where NERL and its customers must agree on all aspects of the RBP.
11. Among other issues that NERL and its customers should cover in their discussions (see Section 4 below), the CAA expects outputs on the following:
 - the key airspace user priorities for the RP3 period and beyond for UK En Route, London Approach and Oceanic services.
 - NERL's proposed plan for meeting its customers' needs in RP3, in terms of the four Key Performance Areas (KPA) under the Performance Regulation (safety, environment, capacity and cost-efficiency), and including the steps that NERL is taking to improve its performance across all four KPAs in RP3 and beyond.

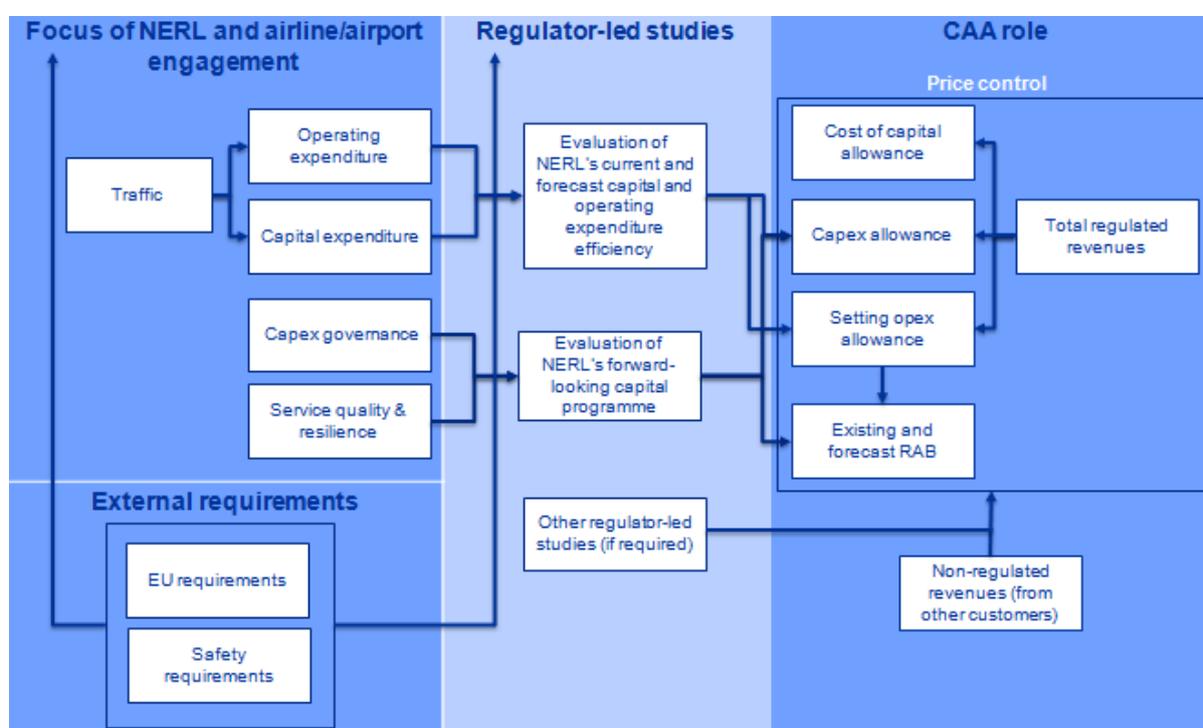
-
- the key components of NERL’s business plan including traffic projections, its capital plan, operating costs, return on capital, depreciation and revenues that form part of the single till.
 - NERL’s programmes (including costs and benefits) required to deliver the Future Airspace Strategy (FAS) and the delayed LAMP2 project.
 - NERL’s ambitions and plans for delivering improved outcomes for users through its collaborative relationships with other ANSPs (for example, through the UK-Ireland FAB (should it continue in RP3) or the Borealis commercial alliance).
 - the use of incentive mechanisms to provide strong financial and reputational incentives to drive NERL’s performance to deliver priorities and improved outcomes for customers.
 - the priorities of NERL’s customers in relation to certain trade-offs relating to strategic choices NERL could make regarding cost and service quality.
12. The CAA expects that the CCWG will prepare a report on the outcome of the Customer Consultation process and submit it to the CAA by the end of September 2018.
13. The CAA expects NERL to use the output from Customer Consultation as part of its evidence base for its RBP, fairly representing the views of customers and fairly describing where there is agreement and disagreement. The CAA will use the CCWG’s report, together with its own independent analysis of NERL’s RBP, to formulate specific proposals for the draft RP3 performance plan and associated targets, which will be published for consultation in the first quarter of 2019.

Themes to consider for customer consultation

14. The following NERL activities are 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.

- the Oceanic price control (note this is subject to a separate price control and is not part of the single till).
15. NSL activity is excluded from the scope of Customer Consultation discussion.
16. As part of the Customer Consultation, NERL and its customers will identify user priorities and assess where scope exists for useful input. Figure 4.1 below shows the CAA's views of the areas of focus of airlines and airports for the customer consultation and how these may interact with the regulator-led studies and the CAA role as the regulator.

Figure 4.1 Focus for RP3 Customer Consultation



Source: CAA

17. The CAA expects NERL and its customers to consider the following (non-exhaustive) themes as part of the Customer Consultation process:
- capital expenditure;
 - operating expenditure;
 - safety;
 - resilience;
 - service quality; and
 - capex governance.

CAA expectations of participants' roles in the customer consultation process*Role of the CAA*

18. As the National Supervisory Authority (NSA), the CAA has the responsibility under European legislation of drafting the RP3 Performance Plan. The CAA has also the responsibility under UK legislation for implementing any changes to the NERL Licence to implement requirements derived from the EU process.
19. To inform these responsibilities the CAA will:
 - promote an effective Customer Consultation process between NERL and its customers;
 - issue this document (*Expectations for Customer Consultation*) to NERL and its customers;
 - request that NERL initiates discussions with airline representatives regarding the appointment of a chair/co-chairs of the CCWG;
 - ensure that the CAA is adequately informed of the progress in and the substance of discussions between NERL and customers. The CAA expects to have a seat at meetings on an observer basis. As part of its review of the RBP, the CAA may request access to relevant papers, submissions or data provided to the CCWG, or minutes and actions arising from its meetings; and
 - expect any party (including those not involved directly in the CCWG exercise) that has any material concerns about the conduct of the Customer Consultation process to engage appropriately in the CAA's own consultation process following NERL's submission of its RBP.
20. The CAA will, in parallel, also undertake its own analysis of NERL's business plan. This analysis will cover, as a minimum, in-depth assessments of NERL's operational cost-efficiency and the appropriate WACC.
21. The CAA will commission studies into NERL's forward-looking capital programme and expenditure efficiency, with two phases of reporting designed to inform NERL's business plan development and customers' engagement in the consultation process.
22. CAA will also engage with EU activities and decisions that also occur during the Customer Consultation process, such as decisions on targets, and will inform the CCWG of relevant updates.
23. The CAA will participate in the Customer Consultation process as an observer and will only intervene where required. CAA will not give a steer on content but will step-in/step-out of the process when required.

Role of NERL

24. As part of preparing its RBP, NERL will need to demonstrate how it has taken account of consultation inputs and outcomes from its customers.
25. NERL should provide its customers with sufficient material in the lead up to the Customer Consultation process, to allow for a constructive and transparent engagement process on the IBP. As a minimum, we would expect NERL to provide the following material to customers at the start of discussions:
- an overview of NERL's business and performance over the RP2 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 RP3 period and beyond, in the following areas:
 - NERL's licensed activities.
 - operating costs (both ongoing and exceptional cost items), including information on forecast efficiencies, breakdown by type of cost, the effects on performance (safety, price, quality and environmental) at different levels of cost, and any associated risks on cost and performance.
 - options for capital investment, including the scope of activities proposed, business cases for major programmes, the effects on performance (safety, price, quality and environmental) and details on any alternative ways of meeting performance targets. The proposed cost of the aggregate programmes should be broken down to show the scope and costs necessary to deliver FAS and LAMP2.
 - where relevant, the level and composition forecast of any restructuring costs.
 - performance forecasts for each year of RP3, including justification for the choice of metrics and the target levels, and the main drivers of any improvements or deterioration compared to RP2.
 - the proposed return on capital, and profiles for regulatory depreciation and the regulatory asset base (RAB).
 - indicative price profiles for UK En Route services, London Approach and Oceanic, highlighting the value of the average price reduction implied over the RP3 period and high level projections for subsequent RPs.

-
- A simplified or ‘ready reckoner’ type model so customers 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.

26. As part of NERL’s consultation on its IBP, CAA expects NERL to account for the regulator-led studies (see Figure 4.1 above) by considering the findings of the studies and how they are relevant to and might impact NERL’s RP3 strategy and business plan.

Role of customers

27. The CAA views the Customer Consultation process as being the responsibility of both NERL and its customers. Customers will play an important role in influencing the development of the RBP through the Customer Consultation process to ensure it reflects their priorities.

28. The CAA expects customers to:

- signal their priorities and engage on options for how to achieve these with NERL for RP3;
- engage internally about what their business needs strategically from the process in order to shape discussions about any tradeoffs around price and service quality;
- 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).

29. The CAA expects both NERL and its customers to:

- agree a plan and code of conduct for proceeding through the Customer Consultation process; 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 airports

30. The main stakeholder group NERL is expected to engage with during the customer consultation is its airline customers. However, CAA encourages NERL to seek views of airports and engage with them where appropriate, for example regarding the London Approach service.