



British Airways plc
Waterside
PO Box 365
Harmondsworth UB7 0GA

Civil Aviation Authority
Westferry Circus
Canary Wharf
London EH14 4HD

cc: economicregulation@caa.co.uk

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British Airways response to CAP2160
Economic regulation of NATS (En-route) plc ("NERL")
Further update on approach to the next price control review ("NR23")

Thank you for the opportunity to respond to your latest consultation on the Economic Regulation of NATS (En-route) plc ("NERL"); we set out below our views on the Civil Aviation Authority's ("CAA") proposals and implications for the wider policy environment.

Executive Summary

The NR23 price control will be of critical importance to the aviation industry, with its emergence from the Covid-19 pandemic presenting a number of challenges for the NERL business and its economic regulation framework.

As a result, British Airways is keen that the NR23 periodic review performs an effective function in resetting the price control, replacing the arrangements established by the Competition and Markets Authority ("CMA") for RP3.

We have a record of good engagement and partnership with NATS to date, and we expect its NERL business plan to be of high quality, tackling these challenges head on. Our priorities remain consistent over time: safety is always our highest priority, and we are confident that NATS also holds safety in the highest regard.

In addition, we are keen to achieve greater efficiency in flight planning – particularly through the realisation of airspace modernisation – alongside continuous improvement in tactical flight efficiency that takes advantage of more efficient routings and allows more proactive recovery of service when weather disruption occurs.



Ultimately, we would like to see a price control that allows NERL to provide a service that does not constrain users in their recovery of traffic levels, and provides a resilient service balanced with efficient opex to ensure that charges represent value for money as a result. This should be supported by efficient levels of capital investment that contributes to the above objectives.

A summary of our key points is as follows:

- a) In establishing the timetable, we want to ensure that NERL has the **greatest opportunity to develop a high quality business plan, and ensure appropriate customer engagement in the process**; therefore, a commitment that NERL will achieve a high level of customer engagement from June to October 2021 should support the delivery of the business plan in February 2022
- b) Considering the limited flexibility remaining within the timetables, **we are concerned that any delay to the periodic review might result in a delay to the implementation of NR23** in January 2023
- c) We suggest the CAA have a **clear backup plan should unexpected circumstances result in a delay to the periodic review for whatever reason**, rather than a continuous slip of the timetable that might result in limited options at a later point
- d) We **agree with the CAA that the business planning guidance set out by the CAA for NERL in the RP3 periodic review remains largely relevant and appropriate** for the NR23 periodic review
- e) Regarding principle 1, we **agree that it is important for NERL to set out scenarios**, within which the CAA and customers are able to establish how NERL's plans might change within different traffic scenarios, and these might be based upon different traffic levels and implementation of airspace modernisation
- f) Regarding principle 2, we **agree that NERL's business plan information should enable stakeholders to understand the key variables that drive NERL's costs**, particularly the linkages between different areas that enable trade-offs to be considered, and **NERL should ensure a rigorous bottom up approach in establishing its cost building blocks, with robust supporting evidence**
- g) Regarding principle 3, we **agree with the CAA that traffic, costs and service delivery are linked** and also the requirement as a result for a clear and consistent set of assumptions for these elements and **we agree with the CAA that airline customers will have an increased focus on value for money**
- h) Regarding principle 4, we agree with the CAA that the **NR23 periodic review provides an opportunity for uncertainty to be managed through the regulatory framework**, but that the Traffic Risk Sharing mechanism will need updating since its optimal design is dependent both upon regulatory economic incentives and calibration across the whole price control

- i) Regarding principle 5, we **agree with the CAA that it will be important for NERL to demonstrate it has conducted a high-quality consultation and engagement** with its customers, but that if any consumer engagement takes place, this must be with consumers who are appropriately informed
- j) Regarding customer consultation, we **agree that it is important that NATS provides information about its NERL plans to stakeholders in a timely and transparent fashion**, to enable us to provide informed views on the developing business plan, and that **following our experience of a productive and collaborative process for RP3, the format used at that previous review should be continued as far as is possible**
- k) We **support the deferral of the 2022 reconciliation review to allow the NR23 periodic review to take place without distraction**; but that this should result in a true-up in 2023 when actual costs for the whole of 2022 are available
- l) Finally, we support the CAA in its requirement to consult on modifications to NERL's licence later this year to **prevent the automatic recovery of the revenue shortfall based on the current TRS with a two-year lag**

1. Timetable

- 1.1. We note the CAA's proposal to extend the deadline for NERL to deliver its business plan to 7th February 2022, **allowing further time for NERL to develop its plans while still allowing sufficient time for the CAA to develop its price control**
- 1.2. We appreciate NERL's rationale that extending the time period from December **will ensure it has similar time to develop its plans as compared to RP3, however caution that the CAA's original timetable was already compressed**
- 1.3. Nevertheless, **we want to ensure that NERL has the greatest opportunity to develop a high quality business plan, and ensure appropriate customer engagement** in the process; therefore, the CAA should only allow NERL to deliver its business plan in February 2022 alongside a commitment that NERL will achieve a high level of customer engagement
- 1.4. Otherwise, we might risk a situation where NERL develops an extensive business plan that is misguided in some areas, and where **consultation would have helped keep it on track and consistent with customers' expectations**
- 1.5. To that end, we **support the CAA's focus on meaningful stakeholder engagement in the time available**, and the removal of the requirement for NERL to produce further iterations of its business plan throughout the periodic review, which could be to the detriment of engagement, and jeopardise the delivery of a new price control by January 2023

- 1.6. A **building block update in December 2021 would allow the CAA to begin its analysis of NERL's plans, and ensure the periodic review remains on schedule**; we would recommend that this focusses on the more material building blocks to allow directional analysis to take place, and allow early calibration of the price control model
- 1.7. However, an **update to key building blocks in response to the CAA's initial proposals should remain fully integrated** across its component parts; there is a risk that when only updating key building blocks at that latter stage, integrated logic across price control might be less than in the fully-integrated plans NERL would have previously developed in February 2022
- 1.8. Therefore, we **would not want to dissuade NERL from responding to initial proposals on an integrated basis** and fully updating its business plan numbers at each stage of the periodic review; this will ensure plans remain integrated without undue burden to update the whole business plan at each stage
- 1.9. We note that the CAA plans to publish its final notice of licence modifications in January 2023, with retrospective application once they apply; considering the limited flexibility remaining within the timetables, we are **concerned that any delay to the periodic review might result in a delay to the implementation of NR23** in January 2023
- 1.10. As a result, we **suggest the CAA have a clear backup plan should unexpected circumstances result in a delay to the periodic review for whatever reason**; rather than a continuous slip of the timetable that might result in limited options at a later point in 2022, a clear backup plan would ensure that both NERL and airlines have clarity over what might happen
- 1.11. In setting out any backup plan, the **CAA should set out to stick to its primary proposed timetable as far as possible, rather than allowing it to slip knowing a backup plan exists**; this will avoid a situation of continual drift and slippage in the primary timetable as far as reasonably possible
- 1.12. Since the relevant provisions of the Air Traffic Management and Unmanned Aircraft Act 2021 ("ATMUA Act 2021") have not yet come into force, this would be a prudent course of action, **particularly since implementation of the periodic review might be altered by such provisions, meaning the primary timetable could become unrealistic**, bearing in mind the CAA is relying upon provisions that are not as yet finalised
- 1.13. Whilst it appears sensible for the CAA to assume "that the statutory framework that will govern the licence modification process will be the new regime in the

Transport Act 2000 as amended by the ATMUA Act 2021"¹, **this cannot be fully assured however, until actual implementation**

- 1.14. We **support the deferral of the 2022 reconciliation review to allow the NR23 periodic review to take place without distraction**; this will undoubtedly reduce workload at the CAA, NERL and amongst airline customers who are all resource constrained at present, and otherwise engaged on a number of other consultations

2. Business Plan Guidance

- 2.1. We **agree with the CAA that the business planning guidance set out by the CAA for NERL in the RP3² periodic review remains largely relevant** and appropriate for the NR23 periodic review
- 2.2. A **limited update of those guidelines for the present circumstances also remains appropriate**, particularly following the Competition and Markets Authority ("CMA") review of the RP3 periodic review, alongside considering the Covid-19 pandemic
- 2.3. It **would also be useful for the CAA to clarify whether it intends to fully move to a CPI-based inflation indexation for the Regulated Asset Base ("RAB")** as a result of previous comments on the topic in RP3³, and clarify that the NR23 price control will be for a standard duration
- 2.4. Our comments on these additional principles are as follows:

Principle 1: Scenarios

- 2.5. It is **important for NERL to set out scenarios, within which the CAA and customers are able to establish how NERL's plans might change** within different traffic scenarios
- 2.6. These **should be integrated across the building blocks of the price control**, thus ensuring that operating costs, and capital expenditure plans are relevant to the different traffic levels set out within each scenario
- 2.7. For example, these might be set at 40%, 60%, 80%, 100% and 120% of 2019 traffic levels or alternatively at different rates of recovery to 2019 traffic levels, and **demonstrate how capital plans would change in their quantum and phasing, along with the manner in which operating costs, service quality and other revenue generation might be scaled** to accommodate those different scenarios

¹ [CAA CAP2160, para 1.12](#)

² CAA CAP1625, "Guidance for NERL in preparing its business plan for Reference Period 3"

³ CAA CAP1758, "RP3 Consultation Document" para 7.5, p78

- 2.8. In addition, a **scenario based upon airspace modernisation should also be developed** (as further noted below in the operating cost section), since **significant benefits might be reaped from simplification, allowing greater controller flexibility across different sectors of airspace** as a result
- 2.9. The CAA should consider how the existing Traffic Risk Sharing (“TRS”) mechanism might be updated to accommodate the uncertainty of the traffic levels at present; this is important, since incentives will have less effect should the TRS be applied to a single, central forecast as in RP3
- 2.10. The **purpose of the TRS mechanism might therefore be modified to accommodate traffic uncertainty at its heart**, and reduce the need for a central forecast to be established, whilst keeping economic incentives effective at all potential different traffic levels
- 2.11. We expand on these points regarding TRS in the section below that relates to the CAA’s principle number four: managing uncertainty
- 2.12. This **could also require some modification of the capital expenditure regime** – perhaps a Development and Core capital allowance framework – this is unlikely to be onerous or create instability for NERL given the relatively mature nature of NERL’s capital plans and NERL’s existing plans to implement a rolling forward look of capital within its customer consultations
- 2.13. **It would also be useful for the CAA to set out how other aspects of capital expenditure regulation might apply to NERL in future** following best practice and regulatory innovations in other sectors; for example, wider capital efficiency incentives might apply, or delivery obligations could ensure stated long-term benefits are achieved – with implementation of oceanic ADS-B being a good example of why this might be required
- 2.14. The CAA should also be clear what form and level of agreement NERL and airlines should be seeking in developing scenarios; it is unlikely that NERL and airlines could agree on the exact profile of recovery, however **it could be possible to agree upon a range of different, plausible scenarios or actions in response to different traffic environments that arise**
- 2.15. The most **productive conversations regarding scenarios will arise within each building block**, considering how capital expenditure might be profiled, and operating costs efficiently minimised whilst ensuring service quality remains appropriate; this should be applied in a way that ensures economic incentives are as consistent as possible at different out-turn scenarios
- 2.16. **Airspace modernisation remains a key priority for our business, and NERL should continue work to ensure it remains in a position to be delivered** at an appropriate time considering the work of others on the project

Principle 2: Supporting evidence

- 2.17. We agree that **NERL's business plan information should enable stakeholders to understand the key variables that drive NERL's costs**, particularly the linkages between different areas that enable trade-offs to be considered
- 2.18. The **choice of operating cost expenditure or capital expenditure is fundamentally driven by the economic incentives within the price control**, and the CAA should ensure the most appropriate economic outcomes result from the price control
- 2.19. We agree with the CMA that "opex can be sensitive to changes in the assumed timing of different components of NERL's investment plan"⁴ and we agree that it **should be clear what operating cost savings (or additional costs) are generated by investment in different capital programmes**
- 2.20. However, mere transparency on this point alone is not sufficient to ensure the most appropriate decision on operating cost or capital solutions are chosen, as **this can only be effective when operating in conjunction with an effective incentive on customer engagement**; this allows customers to fully explore different implementation options for any solution
- 2.21. We further agree with the CMA that it is "important that the **assessment of the costs that users be required to bear take[s] proper account of the ways in which circumstances might evolve**"⁵
- 2.22. As noted above, airspace modernisation remains one of our key priorities for NR23, and with uncertainty over the timing and delivery of this important project dependent upon multiple stakeholders, **NERL's NR23 price control should reflect only appropriate operating costs**
- 2.23. This might therefore also be considered as an additional scenario under the CAA's first principle; however, **the CAA should also consider how to integrate this into the price control to ensure that only efficient costs are incorporated into pricing**
- 2.24. This will **ensure that NERL neither faces a situation in which it has to incur additional operating costs than assumed at this periodic review due to later delivery of airspace modernisation than assumed, nor achieves a windfall gain as a result of earlier than expected delivery**
- 2.25. Neither scenario would likely wholly result from the direct skill of NATS in its management of NERL, and **mis-setting the operating cost allowance would result in inefficient pricing for customers**; it might be better that the operating costs

⁴ [CMA Final Report, para 8.41, 9.127](#)

⁵ [CMA Final Report, para 8.68](#)

assumptions could flex in order to reflect an efficient value based upon alternate external situations, but that **this efficient level should still be set ex ante at this NR23 periodic review**

- 2.26. Throughout its business planning, **NERL should ensure a rigorous bottom up approach in establishing its cost building blocks, with robust supporting evidence** provided to allow customers to assess the appropriateness of its assumptions; we commit to fully-engage with NERL at the periodic review to ensure appropriate oversight and challenge throughout

Principle 3: Cost and service outcomes

- 2.27. We agree with the CAA that **“traffic, costs and service delivery are linked”**⁶ and also the requirement as a result for a clear and consistent set of assumptions for these elements
- 2.28. We note the existing environment has resulted in significant out-performance where service quality incentives have been set on the basis of a single traffic assumption, and the present levels of traffic are easily accommodated as a result
- 2.29. As a result, it **may be better that service quality incentives – set at an appropriate level – might be scaled** to reflect different levels of operating cost expenditure to incentivise delivery of the same service in different traffic environments
- 2.30. This would **ensure a consistent incentive over NERL at different stages of the recovery, and incentivise NERL to work collaboratively with customers in any traffic environment** and to improve performance where possible
- 2.31. Fundamentally, it will be **important for us to be able to understand how “cost requirements may vary for a range of service outcomes”**⁷ since it “is important for stakeholders to be able to make informed input on different options and trade-offs”⁸
- 2.32. Furthermore, we agree with the CAA that airline customers will have an **“increased focus on value for money in NR23”**⁹ and that benchmarking to demonstrate efficiency of cost forecasts will be of vital importance
- 2.33. In addition to our focus on value for money, **safety will remain our highest priority, supported by efficiency in flight planning, efficient delivery of service to meet demand, a resilient service supported by appropriate operating costs**, and a service that remains aligned and coordinated with that of neighbouring European Air Navigation Service Providers (“ANSPs”)

⁶ CAP1940, criterion C06

⁷ [CAA CAP2160, para 2.19](#)

⁸ Ibid.

⁹ Ibid.

Principle 4: Managing uncertainty

- 2.34. We agree with the CAA that the **NR23 periodic review provides an opportunity for uncertainty to be managed in a manner that provides “additional flexibility through the design of the regulatory framework”¹⁰**
- 2.35. It must also be the priority of the CAA to **ensure that the price control can effectively manage the current uncertainty in the interests of customers and consumers**; the CAA should therefore consider also leading efforts to deal with uncertainty where this derives from learnings in regulating other companies and sectors
- 2.36. Neither NERL nor customers can realistically provide all solutions to all the problems that might exist as a result of the pandemic, and the **CAA must use its position as independent regulator to recalibrate the price control in a manner that ensures the incentives remain consistent and effective**
- 2.37. The **TRS is a good example of where modifications are likely to be required** (see earlier comments above), especially since optimal design of the TRS is dependent both upon regulatory economic incentives and calibration across the whole price control
- 2.38. It is our view that **any TRS should ensure economically efficient pricing results at all out-turn scenarios, in order to ensure the effectiveness of the incentives within the broader price control**
- 2.39. In addition, the **existing dead band has implications for the incentive effects at the shoulders of those dead bands, which are more likely to be encountered with variable traffic volumes** during the recovery from the pandemic
- 2.40. The application of the recovery for **the TRS mechanism might also be updated to ensure that recovery mechanisms in either direction remain appropriate in more extreme traffic scenarios**, ensuring both that notional NERL remains financeable and charges remain appropriate, whilst ultimately still recovering those values
- 2.41. Significant academic literature has been published that analyses the application of many hybrid price controls, and **the experience of other regulators – particularly those in the UK – should be considered when updating the TRS** at this periodic review
- 2.42. The **CAA should guard itself against suggestions of inappropriate “innovations”, which are to the detriment of economic incentives** that remain fundamental to the effective operation of the price control

¹⁰ [CAA CAP2160, para 2.21](#)

- 2.43. CAA comments¹¹ suggest that the exact nature of the price control might need to be developed as well (with consideration of cost-risk sharing mechanisms, trigger mechanisms or re-opener provisions); **these are fundamental questions at the heart of NERL's price control, and therefore should attract due attention from the CAA early in the NR23 periodic review**
- 2.44. Within this context, the **CAA might also consider whether the exact form of price cap applied remains appropriate, or might require modification to accommodate any change in incentive properties** resulting from the application of scenarios and any changes to the TRS mechanism
- 2.45. **It would be unhelpful to allow such questions to drift, as the nature of NERL's business plans would likely be different under such alternative regulatory regimes;** any such regime should be designed to fulfil the CAA's statutory requirements under the ATMUA Act 2021, which after its primary duty to safety, require the price control to promote economy and efficiency amongst other items

Principle 5: Customer and consumer focus

- 2.46. We agree with the CAA that it will be **important for NERL to demonstrate it has conducted a high-quality consultation and engagement with its customers;** as one of the direct customers of NERL, airlines provide an appropriately informed viewpoint of consumers' priorities for the periodic review
- 2.47. The CAA also require that NERL should "demonstrate a clear link between outcomes for consumers and its future plans under each of the business plan scenarios"¹²; **we support this in relation to ensuring value for money outcomes that ultimately deliver benefits for consumers**
- 2.48. However, **if any consumer engagement takes place, this must be with consumers who are appropriately informed,** to prevent misguided business plans resulting that contain excessive focus on areas that do not result in value for money outcomes
- 2.49. In addition, NATS should seek out consumer opinion from those affected by its business rather than the loudest voices; we believe that it is **essential for our industry to seek out diverging opinions and remain receptive to other schools of thought, particularly where this will strengthen the quality** of any plan
- 2.50. Any work undertaken in this regard should be performed to dovetail with any work on airspace modernisation; the **NR23 business plan must be consistent with the work performed by the DfT, CAA and ACOG** to ensure airspace modernisation remains on course, since inconsistency would delay or diminish outcomes

¹¹ [CAA CAP2160, para 2.24](#)

¹² [CAA CAP2160, para 2.25](#)

- 2.51. It would be **useful for the CAA to publish the views of its Consumer Panel in relation to CAP1994**, since these do not appear to be available either within the minutes of the panel or in response to CAP1994 on the CAA website

Customer consultation

- 2.52. We agree with the CAA that “it is essential that NERL, its customers and other stakeholders seek to engage in a meaningful way on this review as the outcome of **the review is likely to have a direct and material impact on how NERL acts to support the recovery in air traffic levels over the coming years**”¹³
- 2.53. It is therefore **important that NATS provides information about its NERL plans “to stakeholders in a timely and transparent fashion**, to enable them to provide NERL with informed views on its developing business plan”¹⁴
- 2.54. It is particularly important that in the iterative approach to consultation, **customers are engaged on a more frequent and deliberate basis in order to allow a high-quality business plan to emerge**; we therefore agree with the CAA therefore that dialogue should be maintained between June 2021 and the in-depth consultation sessions in October or November 2021
- 2.55. We have responded to the NATS pre-consultation on NR23 that covers much of this ground, and set out our view that following our experience of the **productive and collaborative process throughout the RP2 and RP3 consultations, our preference is for joint NATS and airline co-chairs** under a similar structure to RP3
- 2.56. This system provided balance and representation between NATS and airline stakeholders, efficiently highlighting areas of agreement and disagreement; **this structure could be supported by industry bodies in a secretariat role** – like that fulfilled by IATA in other consultative committees – to ensure efficient use of everyone’s time when developing the response to the NR23 business plan
- 2.57. The **establishment of a Customer Consultation Working Group (“CCWG”) therefore appears appropriate** in order to ensure a governance structure is established to support engagement at the NR23 periodic review
- 2.58. The CAA have rightly identified that the compressed timescales mean it is more important than ever to ensure common understanding is established early; whilst ensuring that there is no undue influence and that airspace users have an opportunity for engagement, **the CAA will be better placed to act as facilitator on certain topics**, at certain points in time through the periodic review

¹³ [CAA CAP2160, para 2.31](#)

¹⁴ Ibid.



2.59. This is particularly the case in areas as identified in the earlier sections above – such as updates to the TRS or the regulatory structure – where a **lack of clarity over certain aspects could lead to a materially different and suboptimal business plan**

3. Business Plan Guidance

- 3.1. As noted above, we **support the deferral of the 2022 reconciliation review to allow the NR23 periodic review to take place without distraction**; we note that for 2022, the CAA propose to reach a preliminary view on the efficient cost baseline based on actuals and forecasts available at the time
- 3.2. For consistency, **this should result in a true-up in 2023 when actual costs for the whole of 2022 are available**; it is not clear otherwise how “significant” might be defined, or whether such forecasts might be applied across costs as a whole or on individual cost line items
- 3.3. For example, **in the case of the former scenario above, this could mask significant deviation in costs on a line item basis**, that ultimately result in inefficient pricing if not reconciled
- 3.4. Nevertheless, the **proposed scope of the reconciliation review appears appropriate in the circumstances**, yet agree further that it should remain flexible
- 3.5. Finally, we note the requirement to consult on modifications to NERL’s licence later this year, and **support the CAA in doing so “to prevent the automatic recovery of the revenue shortfall based on the current TRS with a two-year lag”¹⁵**

Yours sincerely

Alexander Dawe
Head of Economic Regulation
Networks & Alliances
British Airways Plc

¹⁵ [CAA CAP2160, para 3.12](#)