

## **A consultation on the CAA's process for developing economic regulation for Reference Period Two under the Single European Sky**

### **1. Purpose of this consultation**

- 1.1. The CAA's future economic regulation of UK air navigation services has to achieve the twin aims of furthering its duties under the UK Transport Act 2000 (the Act) and fulfilling the UK's obligations under the Single European Sky (SES) Regulations<sup>1</sup>.
- 1.2. To help achieve these objectives the CAA would like to hear stakeholders' views on how it should best design its process for developing the UK's Performance Plan for SES Reference Period Two (RP2). This is expected to cover the calendar years 2015-2019. The plan is referred to as a Local Performance Plan (LPP) rather than a National Performance Plan because it is envisaged that it is likely to be presented as a joint UK-Ireland plan. An indicative high-level process is set out in this consultation document.
- 1.3. Written comments should be sent by e-mail to [barbara.peratasmith@caa.co.uk](mailto:barbara.peratasmith@caa.co.uk) by no later than 28 September 2012. If you would like discuss this consultation document please contact Mike Goodliffe on 020 7453 6226 or by e-mail to [mike.goodliffe@caa.co.uk](mailto:mike.goodliffe@caa.co.uk).
- 1.4. Any material that stakeholders regard as confidential should be clearly marked and included in a separate annex. Subject to further discussion with the author, and subject to the criteria the CAA has established for treating information as confidential, this material will not be published.
- 1.5. The CAA will acknowledge all consultation responses. It expects to make responses available on its website after 28 September 2012. The CAA expects to issue a Process Update statement in October 2012 based on its consideration of responses to this consultation.
- 1.6. The CAA will host a stakeholder consultation meeting early in October 2012. If you are interested in attending this event, please register your interest with Barbara Perata-Smith at the email address above.

### **2. The European context for the CAA's process of developing economic regulation for RP2**

- 2.1. Under the Regulations, National Supervisory Authorities (NSAs) such as the CAA are required to draw up performance plans at either a Functional

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<sup>1</sup> These Regulations cover the Performance Scheme and Charging Scheme for air navigation services. Commission Regulation (EC) No 1794/2006 as amended by Commission Regulation (EU) No 1191/2010 and Commission Regulation (EU) No 691/2010 as amended by Commission Regulation No 1216/2011.

- Airspace Block (FAB) or national level and hold effective consultations with stakeholders.
- 2.2. The European Commission, advised by the Performance Review Body (PRB), will set EU-wide targets for RP2 in December 2013. The Regulations specify the form of the EU-wide key performance indicators on which targets will be set. These key performance indicators cover four areas: safety, capacity, cost efficiency and the environment.
  - 2.3. Member States then have six months until June 2014<sup>2</sup> when they must adopt and communicate to the European Commission performance plans at either national or FAB level.
  - 2.4. After June 2014, the European Commission will assess all performance plans for their consistency with, and adequacy of contribution towards, the achievement of the EU-wide targets for RP2 set in December 2013. The Regulations set out how the European Commission will undertake this assessment.
  - 2.5. The scope of RP2 will be substantially wider than for RP1. The Regulations envisage that RP2 will cover targets for air navigation services provided at airports in addition to en route services (i.e. a 'gate-to-gate' approach). It also envisages EU-wide targets set for safety and environment key performance indicators in addition to cost efficiency and capacity. These were the two EU-wide targets for RP1, which runs for the three years 2012-2014.
  - 2.6. There is some flexibility in the Regulations. For example, Member States have the ability to establish additional performance indicators and targets as part of their LPPs so long as they are supportive of the EU-wide targets.
  - 2.7. The European Commission is currently considering revising the Regulations so some aspects of the performance scheme could change before the start of RP2. The European Commission expects the amended Regulations to be adopted at the end of 2012 or early 2013.
  - 2.8. The European Commission accepted the UK performance plan for RP1, which contained a contribution to EU-wide cost efficiency resulting from a reduction in NATS En Route Plc's (NERL's) Determined Unit Rate (DUR) of 1.4 per cent in real terms per year. This figure was based on the extensive analysis and consultation the CAA undertook for its last review of NERL's price control. In finalising its assessment, the European Commission has stated that it expects a more significant contribution from NERL for RP2 especially as the UK has the highest DUR in the EU.
  - 2.9. For RP1 it was not possible for the CAA to fully align its processes for reviewing the NERL price control with the evolving processes for the SES performance scheme. As a result, some stakeholders considered this left insufficient scope for consultation on the NERL component of the UK's draft

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<sup>2</sup> One change being considered by the European Commission is to bring this forward to May 2014.

Performance Plan. The CAA is keen to avoid this for RP2 and to fully align its process with the European level processes.

### **3. Developing the UK-Ireland FAB for RP2**

- 3.1. A UK-Ireland FAB comprising the en route services provided by NERL and the air navigation services provided by the Irish Aviation Authority (IAA) was established in July 2008. For RP1 the UK-Ireland FAB provided national plans with an aggregation of targets for information only.
- 3.2. In a recent consultation, the PRB anticipates strengthening the role of FABs for RP2. For example, it considered that RP2 performance plans (including targets) should be established at FAB level and cover all four key performance areas. The PRB said that different charging zones with different DURs could still co-exist within a FAB but would need to be justified and the FAB plan should demonstrate how it took into account the FAB dimension (e.g. synergies, common training, etc). The PRB also expected that investment projects should be assessed on the basis of FAB benefits and there should also be clear accountabilities for delivery of the targets.
- 3.3. Building on RP1, the CAA anticipates that the UK and Ireland will submit a joint FAB plan for RP2. The CAA and Irish National Supervisory Authority (Irish Aviation Authority, Safety Regulation Division [IAA SRD]) are keen to pursue greater economic value for users from the existence of the UK-Ireland FAB. The CAA and IAA SRD are continuing to evaluate what this means in practice for the depth of integration of such a plan.
- 3.4. The CAA and IAA SRD current thinking for the four Key Performance Areas (KPAs) includes:
  - safety – the safety KPAs will be equally applicable across all airspace. The FAB partners need to address Safety Key Performance Indicators (SKPIs) jointly and identify any differences. These would then be addressed through a common FAB safety plan;
  - capacity – there could be a single target at FAB level with proportions attributed to NERL and the IAA air navigation service provider (ANSP) (as for RP1). The CAA and IAA SRD are assessing whether it is possible to go further and consider whether joint accountability could be created for a capacity plan to meet a joint target. Targets for services at relevant airports in the UK would be included in the LPP as supplementary information;
  - environment – the CAA brought forward to RP1 a financially incentivised metric that takes into account both horizontal and vertical aspects of UK en route flight efficiency. The CAA expects to review this metric in RP1 with a view to enhancing NERL's performance in RP2. NERL is exploring with the IAA (ANSP) the practicalities of extending this metric to Irish airspace. The Regulations envisage an EU-wide target for RP2, likely to include a

horizontal target with additional targets for terminal airspace. The CAA currently anticipates these targets will be binding under the meaning of the Regulations – they will form part of the LPP and require corrective action if they are not met. However, the CAA's current expectation is that financial incentives will not be applied to these targets if it continues to apply financial incentives to the horizontal and vertical metric introduced in RP1;

- cost efficiency – the CAA anticipates that there is unlikely to be a common FAB charging zone and common target for cost efficiency for RP2 given the risk of exchange rate fluctuations. As performance is measured in national currencies there is a risk that exchange rate movements could outweigh genuine cost efficiencies. It could also result in a step away from charges being related to costs if a common charge took an average of UK and Irish airspace where the former is much more dense and complex than the latter. The CAA and IAA SRD do, however, expect the FAB plan to identify both the operational benefits and the cost efficiencies that are expected to accrue to users in RP2.

#### **4. Alignment of the SES Performance Scheme with the CAA's duties under UK legislation**

- 4.1. There is a broad measure of alignment between the aims of European and UK legislation. Economic regulation at both the European and UK level is committed to the sustainable development of the air transport system by improving the overall efficiency of the air navigation services across the key performance areas of safety, environment, capacity and cost-efficiency.
- 4.2. There are, however, some differences between the two sets of legislation at a more detailed level. Differences include:
- the EC Regulations require NSAs, at either FAB or national level, to draw up performance plans containing targets consistent with the EU-wide targets and the assessment criteria in the Regulations; and
  - the UK Transport Act<sup>3</sup> requires the CAA to apply economic regulation in the manner it thinks best calculated to secure that licence holders such as NERL will not find it unduly difficult to finance the activities authorised by their licences. Unlike other en route ANSPs NERL is commercially financed. A financing test is not contained in the performance scheme assessment criteria.
- 4.3. The CAA considers that its duties under the Act can be made to stand alongside EU requirements to avoid conflicts, especially if there is close working between the CAA and PRB to assess the reasonableness of targets for NERL. Any evolutions in the Regulations for RP2 may require a reappraisal of this view.

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<sup>3</sup> Transport Act 2000 Section 2.

4.4. If conflict arises between the formal legal requirements, the CAA would expect EU legislation to take precedence.

**5. Preparing for the CAA's economic regulation of NERL's en route services in RP2**

*(a) Aligning NERL's economic regulation with the performance scheme*

- 5.1. The European Commission expects that Member States' relative contribution towards the attainment of EU-wide targets in RP1 should be taken into account when it sets EU-wide targets and assesses LPPs for RP2. It has said it expects significant downward pressure on costs from EU-targets 'well below' the average for RP1. It has also said that ANSPs' return on equity should reflect the real risks faced by the business and is expecting to commission a study of this issue. The CAA would like to contribute fully to this study and therefore have regard to its findings in its workplan for RP2.
- 5.2. Against this background the CAA considers a different approach is likely to be required for RP2 than for RP1 – one that complements 'bottom-up' analysis with 'top-down' challenge for greater unit cost efficiency.
- 5.3. Pending the confirmation of the EU-wide targets the CAA has asked NERL to develop by the end of March 2013 a draft RP2 Business Plan that includes various scenarios for DUR reductions per year. The CAA has asked for the NERL draft RP2 Business Plan to include at least the following scenarios for DUR reductions per year: -2 per cent, -3.5 per cent and -5 per cent. By comparison, the EU-wide DUR target was -3.5 per cent per year in RP1.
- 5.4. These CAA scenarios should not be viewed by stakeholders as regulatory targets for NERL for RP2. They are designed to explore what NERL would need to do to achieve these levels of cost-efficiency together with an assessment of the likely impacts, especially in relation to safety, continuity of service, capacity, and the ability of NERL to finance its licensed activities.
- 5.5. The CAA would expect to test and challenge NERL's analysis and expose it to scrutiny from users who are best placed to advise on the NERL related service propositions that meet their commercial requirements in terms of price, capacity and other outputs.
- 5.6. Regulators in other industries have gone a stage further and developed business plans at arm's length from the company by employing independent consultants. Given the critical importance of safety, complexity and strong interdependencies with other parties (e.g. SESAR (see paragraph 5.7) and the Military etc.), together with the benefits of NERL being accountable for its plans to its customers and others, the CAA is not currently planning to pursue this option. However, it is important that NERL is transparent about its future plans with its customers and its costs are exposed to scrutiny and challenge by users and the CAA. The CAA expects to commission expert consultants to assist it in this regard.

*(b) Aligning NERL's economic regulation with SESAR and FAS investment requirements*

- 5.7. An important pillar of SES is a programme of technological improvement through the Single European Sky ATM Research Programme (SESAR). This programme is expected to move to a deployment phase prior to the start of RP2. The UK is planning local initiatives under its Future Airspace Strategy (FAS), complementary and fully consistent with SESAR, to improve UK airspace performance. This includes the London Airspace Management Programme (LAMP).
- 5.8. The CAA will need to fully understand NERL's investment strategy and plans and how it will contribute to SESAR, FAS and LAMP. The CAA would like to explore with stakeholders how best to incentivise delivery of NERL's obligations under these programmes in RP2. This could include financial incentive mechanisms such as additional revenue or financial penalties.

*(c) Encouraging NERL to explore its users' requirements for RP2*

- 5.9. The CAA sees merit in there being a process whereby NERL is required to explain, justify and tailor its draft Business Plan for RP2 to its users' requirements. For the last NERL price control review, the CAA established a process of customer consultation between NERL and its customers. This process was governed by a mandate issued by the CAA to help provide clarity to the process and define roles and responsibilities.
- 5.10. The CAA recognises such a customer consultation process requires resource and commitment from both NERL and users and therefore it is essential it is designed to add value. For RP2 it is important NERL is transparent about its draft RP2 Business Plan, and takes into account user feedback on outputs and trade-offs, and then sets out the areas for agreement and disagreement before submitting a revised Business Plan to the CAA. The CAA will take into account feedback from NERL's users to help prioritise its own analysis of the draft and revised NERL RP2 Business Plans. Process options to achieve this are discussed more fully in section 7.
- 5.11. The CAA would welcome participation from the IAA (NSA and ANSP) where this would assist in the preparation of a more integrated FAB plan.

## **6. Enhancing NERL's regulatory financial incentives for RP2**

*(a) Safety financial incentives*

- 6.1. No EU-wide or national safety targets and financial incentives were set in RP1. The PRB anticipates that there will be safety key performance indicators (SKPIs) and targets for RP2 with respect to the effectiveness of safety management ('maturity'); the application of a risk severity classification scheme; and application of a just culture.

6.2. The Performance Regulation states that financial incentives should not be applied to safety targets.

*(b) Capacity and environment financial incentives*

6.3. The amount of revenue at risk for NERL for the capacity and the environment incentives in RP1 is a maximum penalty of £24 million per year and a maximum additional revenue allowance of £11.7 million per year<sup>4</sup>. This represents 4.2 per cent and 2.0 per cent respectively of NERL's annual Eurocontrol revenue. Eighty per cent of this revenue at risk is allocated to the capacity related incentives and 20 per cent is allocated to the environment targets.

6.4. The capacity incentives were developed during the customer consultation process between NERL and its users during the CAA's last price control review. The main features of these incentives are summarised in Figure 1.

**Figure 1: Summary of capacity related performance incentives for RP1**

UK capacity target (based on all en route ATFM delay)	<b>C1</b>	Annual en-route ATFM delay per flight for the UK from all causes.
KPIs with Financial Incentives. (Based on ATFM delay attributable to NERL)	<b>C2</b>	Annual NERL-attributable en-route ATFM delay per flight
	<b>C3</b>	Impact Score (placing greater weight on long delays and departures in the morning and the evening peaks)
	<b>C4</b>	Daily Excess Delay Score based on weighted delays exceeding pre-determined thresholds on a daily basis
Financial Incentive	NERL subject to financial incentives on KPIs C2, C3, and C4	

Source: CAA

Note 1: ATFM delay is air traffic flow management occurring when the flow of traffic is constrained within the available capacity to maintain safety.

Note 2: C2, C3 and C4 are the terms used in the National Performance Plan for CP3. They were referred to as T1, T2 and T3 respectively, during the CP3 review.

Note 3: KPIs are the key performance indicators relating to each KPA.

6.5. Following discussions with its users, NERL developed an environment (flight efficiency) key performance indicator for RP1 based on both horizontal and

<sup>4</sup> At 2006 prices.

vertical dimensions of en route flight efficiency. The main features of the incentives the CAA has allocated to this key performance indicator are summarised in Figure 2.

**Figure 2: Summary of environmental related performance incentives for RP1<sup>5</sup>**

The performance indicator is calculated as a combination of:	
Horizontal flight efficiency	Defined as the difference between the great circle distance and the actual flight path flown. Horizontal flight efficiency is measured from the actual entry and exit point into and out of UKFIR.
Vertical flight efficiency	Defined as the difference in altitude between the reference (requested) flight level and the actual altitude of the period of level flight, alongside the time spent in level flight. Vertical inefficiency is split into flight phase (climb, cruise and descent).
For 2012 and 2013	<ul style="list-style-type: none"> <li>• A penalty applies for a year when the performance indicator is above 27 units.</li> <li>• A bonus applies for a year when the performance indicator is below 21 units.</li> </ul>
For 2014	<ul style="list-style-type: none"> <li>• Both the penalty and the bonus thresholds are tightened to 26 units and 20 units respectively.</li> </ul>

Source: CAA

Note 1: UKFIR is the UK Flight Information Region.

Note 2: NERL has estimated that 1 unit of the metric is equivalent to 35,000 tonnes of fuel and 110,000 tonnes of CO<sub>2</sub> in 2010. At an assumed cost of £620 per tonne of fuel, this gives a fuel saving of £22 million per unit reduction in the metric compared to a bonus or penalty rate of £0.2 million unit.

6.6. The financial incentives on capacity and environment performance have helped focus NERL's behaviour towards enhanced outcomes and increasing economic value for users. Improved NERL performance in these areas leads to benefits to users in terms of savings in fuel and staffing costs.

6.7. The CAA will review for RP2 the NERL capacity and environment financial incentive schemes. This may include the definition of the incentives, the level of the targets and the amount of revenue at risk.

(c) *Cost efficiency financial incentives*

6.8. Inherent in the Regulations is a strong inbuilt cost-efficiency incentive. This is because the Regulations move away from the traditional ANSP pricing model

<sup>5</sup> More detail on this performance indicator is available in "Flight efficiency metric and other amendments to conditions proposal and annexes (November 2011)" CAA.



of cost recovery and instead specify a fixed DUR per year. Although the Regulations specify a traffic risk sharing mechanism between ANSPs and users, ANSPs bear cost risk in the RP for any given level of traffic.

- 6.9. The CAA expects to reinforce these incentives by setting a cost-efficiency target within the NERL price control for RP2. The CAA currently expects to take into account both a 'bottom up' analysis of NERL's costs, including the cost of capital, and a 'top-down' perspective taking into account the EU-wide target. The CAA wishes to explore with NERL and its stakeholders how best NERL can rise to the challenge for a more significant contribution to cost-efficiency in RP2.
- 6.10. The Regulations allow for certain costs to be considered separately and for variances in these costs to be carried forward and recovered or returned from charges in the next RP. Types of cost identified in the Regulations include:
- unforeseen changes in national pension regulations and pension accounting regulations;
  - unforeseen changes in national taxation law;
  - unforeseen and new cost items not covered in performance plans but required by law;
  - unforeseen changes in costs or revenues stemming from international agreements; and
  - significant changes in interest rates on loans.
- 6.11. The UK's Performance Plan for RP1 sets out how it intends to use these provisions over this period. For example:
- the variance in cash pension costs for NERL's defined benefit scheme (now closed to new members) subject to the CAA being satisfied that the pension scheme has been well governed throughout RP1;
  - the variance in spectrum costs compared to what had been assumed when setting the NERL price control for RP1, where such variances are driven by changes in the law;
  - adjustments to the NERL Regulatory Asset Base (RAB) to reflect the net present value of actual capital expenditure in the period rather than forecast capital expenditure during the period, which was used to fix charges in advance of the period. This helps to avoid NERL earning a return from investments that are not made during RP1 and also helps to avoid penalising NERL from undertaking efficient investments that were not forecast at the beginning of the period.
- 6.12. The CAA recognises that there is a link between these provisions, the risk associated with NERL's cash flows, and the appropriate cost of capital. This is an important consideration for the CAA's financing duty and the setting of the regulatory cost of capital. It is also an important consideration for users, who expect NERL's reward in terms of its regulatory cost of equity to be set in

relation to the risks that equity bears. Users have also expressed caution over the use of uncontrollable costs in terms of the uncertainties it creates for the evolution of the DUR.

*(d) Operating cost financial incentives*

- 6.13. The CAA has introduced a rolling incentive mechanism (RIM) to enable NERL to keep a full five years of benefit from operating cost efficiencies regardless of the year in which NERL achieves the efficiency. The CAA introduced the RIM to mitigate the risk of NERL having weak financial incentives to reduce its operational costs in the latter years of a reference period (because NERL may expect the CAA to reflect any efficiencies in reductions in charges when the price control is reset).

*(e) Financial incentive mechanisms for en route users*

- 6.14. In addition to financial incentives for en route ANSPs, the Regulations allow incentive schemes for en route users. Such modulation of charges has not been used by the CAA in the past, but there may be merit in exploring whether it should be used in the future to encourage a high level of optimal user equipage.
- 6.15. There will need to be changes to aircraft equipage and usage for the benefits of some FAS and SESAR-related programmes to be fully realised. For example, these initiatives will require a high level of Performance Based Navigation (PBN) capability and usage. One change being discussed by stakeholders in relation to FAS implementation is the concept of 'best equipped, first served'. The CAA would like to explore with stakeholders whether modulation of NERL's charges could be used to strengthen incentives for optimal equipage and usage.

**7. Process options for developing the CAA's economic regulation of en route services for RP2**

*(a) Process challenges*

- 7.1. The last CAA review of the NERL price control involved an extensive process of CAA-led analysis, successive CAA-led consultations (such as Initial and Final Proposals) and detailed NERL-led consultation direct with its users (customer consultation). This process took about two years to complete. It enabled the CAA to consider its proposals in depth in terms of its duties under the Act and consistency with, and an adequate contribution towards, the EU-wide target.
- 7.2. This process also had benefits for tailoring NERL outputs to user requirements. For example, one of the outcomes of the NERL customer consultation process from the last price control review was the requirement for NERL to develop an environment performance indicator that took into account vertical as well as horizontal flight inefficiency.

- 7.3. This extensive evidence gathering and consultation process is not without costs for stakeholders in terms of the investment of time and resource necessary to participate fully.
- 7.4. If the CAA is to undertake a similar process for RP2, a significant part of it would be undertaken before the EU-wide targets are confirmed in December 2013. A further process uncertainty is that the Regulations are subject to amendment at the end of 2012 or early 2013.
- 7.5. There are risks, however, of leaving any detailed CAA analysis and consultation until the EU targets are confirmed. Although the Regulations only require a consultation on a draft LPP, which could comprise a consultation meeting with stakeholders, waiting for the targets to be confirmed would leave just six months before the LPPs are submitted to the European Commission. This would not allow for a NERL-led customer consultation process or much depth of analysis by the CAA. The CAA would not have sufficient time to undertake a traditional approach of successive major consultations, such as issuing Initial and Final Proposals.

*(b) Indicative UK process for RP2*

- 7.6. Figure 3 sets out an indicative high-level process design that would allow for in-depth stakeholder consultation on the design and detail of the development of the CAA's regulation of NERL's en route service. It would also enable the UK process to be fully aligned with the European process.

**Figure 3: Indicative high-level process for NERL component of the LPP**

Process Proposed By PRB		Proposed Complementary Local Process
	End March 2013	NERL publishes initial draft Business Plan. NERL/User customer consultation begins.
PRB consults on initial proposals for EU-wide targets.	July 2013	
EC proposes EU-wide targets.	September 2013	
	Beginning of September 2013	NERL/User customer consultation ends.
	October 2013	NERL issues revised business plan.
EC adopts EU-wide targets.	December 2013	NSAs publish initial draft LPP for stakeholder consultation.
	April 2014	NSAs submit revised LPP to States.
States submit plans to EC/PRB.	May/June 2014	States submit plans to EC/PRB.
EC assesses plans and notifies States.	September 2014	
	October 2014	CAA publishes proposed formal changes to NERL licence conditions.
	December 2014	CAA publishes formal decision.

Source: CAA

- 7.7. Such a process would see NERL prepare its draft Business Plan by the end of March 2013, including the scenarios for DUR trends notified to it by the CAA (see section 5).
- 7.8. The NERL draft Business Plan would then be the subject of two further processes:
- a process of customer consultation between NERL and en route users. Given that some of the wider issues related to Key Performance Indicators (KPIs) under the Regulations are likely to be addressed through the PRB's process, this process of customer consultation may have the greatest value if it focused on required outputs, potential trade-offs, the capital investment programme, and the financial incentive aspects of the NERL price control. The precise scope of customer consultation would be finalised by the CAA issuing a mandate in due course; and
  - a CAA-led process of analysis to consider the elements of the NERL draft Business Plan with a view to examining the scope for potential efficiencies and analysis of those items where it is unlikely that NERL will reach agreement with users through its customer consultation (such as the cost of capital).
- 7.9. Given the consultation on the draft LPP in early 2014 may not afford stakeholders the time for an in-depth consideration of some of the issues, the

CAA would use the time between April 2013 and end October 2013 to engage with stakeholders on some of the detailed issues before the EU-wide targets are confirmed in December 2013.

(c) *Alternative process options*

7.10. The CAA recognises that there may be alternative processes. The following alternative options have the benefit of reducing the level of stakeholder time and resource required but each option has its own drawbacks.

- Alternative A – the period for NERL's customer consultation could be reduced so it begins in August / September 2013 after the PRB publishes draft EU-wide targets. If the NERL draft Business Plan were available from the same date it would reduce the time available for the CAA-led analysis.
- Alternative B – the period from July 2013 to October 2013 could be used by the CAA to have a consultation on Initial Proposals based on some limited CAA-led analysis following its receipt of NERL's draft RP2 Business Plan by the end of March 2013. This would not allow much time for the NERL customer consultation process unless it occurred concurrently with the CAA Initial Proposals consultation.
- Alternative C – The process could involve no NERL customer consultation prior to the CAA-led stakeholder consultation in early 2014 on the draft LPP. This minimises the resource burden on stakeholders but might lead to sub-optimal outcomes for users if NERL's Business Plan and the CAA's proposals do not reflect users' requirements.

(d) *Modifications to the NERL licence*

7.11. The formal mechanism for giving effect to the CAA's price control for NERL is through modifications to its licence granted under the Act. The current price control licence conditions expire on 31 December 2014.

7.12. The CAA is keen to avoid pre-empting the European Commission's approval of the LPP and so it will defer a consultation on modifying the NERL licence until as late as possible before the expiry of the present conditions. The CAA's current expectation is that it will issue its proposals for NERL licence modifications in October 2014 before making a formal decision on changes to the NERL licence in December 2014.

7.13. The CAA is mindful that the LPP may not pass the European Commission's assessment in its first iteration. To mitigate this process risk in relation to the expiry of the licence conditions the CAA can either modify the NERL licence for one year only; or modify the licence for the full RP2 period but make it clear that this is contingent on European Commission approval and the licence may be subject to further modification if such approval is not secured.

(e) *Other elements of the en route DUR*

- 7.14. The CAA expects to set out in its October 2012 process update statement how it will consult stakeholders on Initial Proposals for the Meteorological services (MET) and CAA element of the UK's DUR in Summer 2013.
- 7.15. The CAA and IAA SRD are considering how the Irish and UK elements of the LPP will be consolidated.

## **8. Regulated NERL en route services outside SES**

- 8.1. The UK has joint responsibility with Ireland for an area of Oceanic airspace in the North East Atlantic that is not subject to the Regulations. NERL's Oceanic service is significantly different from its Eurocontrol service and these differences extend to its institutional arrangements, the nature of its operations, and the scale of revenues involved.
- 8.2. The annual turnover of NERL's Oceanic service is about £27 million, which is very small in relation to NERL's annual revenue of £696 million. This makes NERL's Oceanic service one of the smallest businesses in the UK subject to economic regulation.
- 8.3. Given the relative size of the Oceanic service there has been a strong emphasis on a simple and proportionate design for regulation. The CAA sets a limit on the average charge per flight indexed to Retail Price Inflation (RPI) minus a specified efficiency factor. There is no traffic sharing mechanism or service quality incentives (e.g. delay, flight efficiency, etc).
- 8.4. The CAA would like to discuss with stakeholders whether there is a continuing need to regulate this service and, if so, on what basis this should be done. Given it is an institutional monopoly with no immediate prospect of competition for the market or within the market, the CAA currently sees merit in continuing to regulate it but doing so in a way that continues to be proportionate to the scale of the activities involved.

## **9. Preparing for regulation of air navigation services at airports in RP2**

- 9.1. The Regulations apply to air navigation services provided at airports as well as en route air navigation services although in practice binding EU-wide targets were only set for en route services in RP1. In RP2 the full suite of targets may apply to air navigation services provided at airports unless they fall into a category of exemption.
- 9.2. This gate-to-gate approach for RP2 will significantly widen the performance scheme and the scope of the CAA's work in relation to its economic regulation of air navigation services, which to date has focused solely on NERL as the en route service provider. It brings within the ambit of the CAA's regulatory review a broader range of stakeholders including ANSPs at

airports and airport operators. In terms of NATS' activities at airports, it relates to NATS Services Limited (NSL) rather than NERL.

- 9.3. Member States can exclude airports with less than 50,000 commercial air transport movements (CATMs) per year. Member States can also exclude from the application of cost efficiency targets those airports, regardless of their ATMs, which are subject to 'market conditions', the criteria for which are set out in the Regulations.
- 9.4. The Department for Transport (DfT) has notified the European Commission that it has opted for the exemption for all UK airports with traffic less than 50,000 CATMs. For UK airports with more than 50,000 CATMs the DfT has commissioned the CAA to undertake a study on whether the criteria for market conditions apply (Figure 4).

**Figure 4: Airports included within the CAA's assessment of market conditions for ANS at airports**

Airports > 150k CATMs (to be assessed individually)	50K < Airports < 150k CATMs	40k < Airports < 50k CATM
Gatwick Heathrow Manchester Stansted	Aberdeen Birmingham Bristol East Midlands International Edinburgh Glasgow London City Luton Newcastle	Belfast City (George Best) Liverpool (John Lennon) Southampton

Source: DfT Letter to the CAA dated 21 March 2012

- 9.5. If the CAA determines that an airport is not subject to market conditions it will need to consider how to establish a proportionate approach to economic regulation consistent with the requirements of the Regulations.
- 9.6. It should be noted that regardless of the outcome of the CAA's market conditions assessment, binding targets will apply at all airports with more than 50,000 CATMs in relation to the other three KPIs: safety, capacity and the environment.
- 9.7. The CAA's timetable and process for considering regulatory arrangements for services provided at airports is less mature than that for en route services and is subject to the outcome of the CAA's assessment of market conditions. The CAA anticipates that it will hold a stakeholder consultation workshop by the end of 2012 on its emerging thinking. The CAA's assessment may need to

be updated in 2013 if there are changes to the assessment criteria in the Regulations.

- 9.8. The PRB's proposals for terminal targets for the four KPIs are set out in Figure 5. These proposals may be subject to change before the end of 2012/early 2013 when the European Commission expects to revise the Regulations.

**Figure 5: PRB proposals for terminal KPIs in RP2**

KPA	KPI
Safety	Targets for RP2 on existing Safety Performance Indicators for RP1: <ul style="list-style-type: none"> <li>• The Effectiveness of Safety Management (EoSM).</li> <li>• The application of the severity classification based on The Risk Analysis Tool (RAT) methodology to the reporting of occurrences.</li> <li>• The reporting of Just Culture .</li> </ul>
Capacity	<ul style="list-style-type: none"> <li>• EU-wide and State targets set on all Performance Scheme airports for total ATFM<sup>1</sup> delay attributable to airport air navigation services that incorporates severe weather and exceptional events.</li> <li>• EU-wide and State targets set on ATFM slot adherence at all Performance Scheme airports.</li> <li>• Monitor ANS-related delay at the gate using A-CDM<sup>2</sup> data at all Performance Scheme airports.</li> <li>• Monitor airport resilience (e.g. number of days with more than 10% cancellations).</li> </ul>
Environment	<ul style="list-style-type: none"> <li>• EU-wide target set on Taxi Out additional time and additional time in Terminal airspace (ASMA)<sup>3</sup> for co-ordinated airports and monitoring only for the remaining non-co-ordinated Performance Scheme airports.</li> <li>• To develop and monitor a horizontal and vertical performance indicator based on 30 second interval position report data for all Performance Scheme airports.</li> </ul>
Cost efficiency	EU Wide: <ul style="list-style-type: none"> <li>• Terminal Determined Unit Rate performance indicator; and</li> <li>• Terminal ANS Determined Costs performance indicator.</li> </ul> National/FAB: <ul style="list-style-type: none"> <li>• Terminal Determined Unit Rate</li> </ul>

Source: CAA

Note 1: Air Traffic Flow Management

Note 2: An information system for Airport Collaborative Decision-Making. A-CDM is not a mandated requirement and in the UK only Heathrow has been fully implemented.

Note 3: Arrival Sequencing Metering Area; from 100Nm and / or 40Nm until landing.



- 9.9. Although it could be premature to pre-empt the EU-wide key performance indicators, it is important for the CAA to be able to assemble evidence quickly once they are known, particularly if they require data that are not readily available. The CAA will also need to understand the interaction of terminal investments enabling SESAR, FAS and LAMP implementation together with any cost benefit issues.
- 9.10. The CAA would expect to consult with ANSPs, airports, users and other interested parties during 2013 in order to inform its drafting of the LPP. In light of the need to avoid duplication across 16 or so airports, the CAA will consider what process would be most efficient (e.g. a common consultation across all airports co-ordinated by CAA, perhaps involving consultation workshops). This process may need to consider how best to interact with the process the ANSPs at airports must adopt for developing their Business Plans required by the SES Regulation for Common Requirements.

**CAA July 2012**