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Luton, January 14, 2021

easyJet Response to Economic regulation of NATS (En Route) plc: Consultation on approach to the next price controls review CAP 1994

Dear Sir/Madam,

We are writing in response to the Consultation proposed by the CAA to review the next price control of NATS (EN Route) plc (NERL) and we welcome the opportunity to offer our view on the proposed licence modifications.

The COVID-19 pandemic has impacted the aviation industry in unprecedented ways. The prolonged crisis, and the resulting uncertain economic and social environment, has left carriers with remarkably low demand, unsustainable costs and extremely challenging prospects for the coming years. IATA has noted that global passenger traffic recovery will not reach 2019 levels before 2024. Against this backdrop airlines have been cutting costs while striving to maintain a viable schedule and will keep doing so for the foreseeable future.

In order for airlines to survive in such an environment, the whole industry will need decisive actions by its main players and by lawmakers. The measures on RP3 currently in place in Europe are failing, in our view, in this respect. The whole financial burden of under-recoveries of ANSPs from 2020 and 2021 will only be only postponed if it is solely carried by Airlines. Airspace Users should also not be financially responsible for maintaining a full service they do not use. It is wholly inappropriate to maintain a regulatory framework that was set at a time when no one could have predicted the unprecedented and sustained decrease in air traffic due to the ongoing Covid-19 crisis. It disproportionately lays the financial burden on airlines, key players in the industry chain, thus slowing down the recovery of the whole sector.

The revenue gaps incurred by ANSPs in 2020 and 2021 are a direct consequence of the policies and travel restrictions imposed by the Member States, often at very short notice and on the basis of different criteria. It should therefore be the responsibility of the Member States to support the financial recovery of those ANSPs.

We believe that the guidance regarding the possible financing alternatives for NERL as set out by the CAA in the document CAP 1994 in Chapter 2 is a step in the right direction and represents a sensible and reasonable approach for discussion.

We have set out our views on the specific points raised in the consultation below.

Short-Term Challenges (2020-21)

- Traffic Risk Sharing arrangements for 2020 and 2021

We acknowledge that the current mechanism in NERL's licence allows for a recovery from Airspace Users of the revenue losses incurred in 2020 and 2021, due to the significant drop in air traffic, from 2022. In the current circumstances, these arrangements simply cannot and should not be endorsed by Airspace Users without putting at risk their very survival. There are several reasons why it would be inappropriate for Airspace Users to absorb the COVID-related costs:

- The Traffic Risk Sharing Mechanism is not designed to mitigate such an exogenous traffic risk, but to protect the quality of the service delivered by ANSPs irrespective of the strategic business decisions of the airlines. Asking the Airspace Users to carry the massive financial burden of the under-recoveries incurred in a global pandemic would result in an abuse of the market power that the current regulation is supposed to protect against.
- We believe that Airspace Users should not be charged (or financially responsible) for a service delivered to them they are not using.
- The revenue gaps from 2020 and 2021 of the ANSPs are a direct consequence of the travel restrictions imposed by the Member States across Europe, which the airlines have had no control over (but have also suffered massive financial losses as a result). Thus, it is the Member States that should be assisting the ANSPs in their financial recovery.
- If airlines were required to fund the recovery of ANSPs at a time when they are dealing with their own significant losses, it would put at risk their own survival. This would cause further damage to the industry as a whole and jeopardise the recovery that is so desperately needed to support the Member States' economies.

Given the considerations above, we are open to any alternative proposal that protects the financial sustainability of the Airspace Users and ensures that NERL can continue to deliver safe and high-quality air navigation services. This is an opportunity for the whole industry to collaboratively address the short falls of the current regulatory framework for air navigation service providers

These alternatives, as the use of shareholder's funding outlined in the consultation document, should not put Airlines in the very situation they are actually trying to avoid, that is absorbing the COVID-related costs

For this reason, we believe that:

- State-funding should be the primary source for sustaining the 2020 and 2021 revenue gaps, for the reasons outlined above;
- Any excessive profit from RP2 should be used to partially offset the losses in the current RP3;

- The revenue losses from 2020 and 2021 should be spread out over a 10 year period from 2023, further improving the provisions of the current EC' s RP3 extraordinary measures, as referred in paragraph 2.12 of the consultation document CAP 1994;
- Additional support from the equity finance providers and also from the debt capital markets should be sought by NERL to help mitigate those losses, as outlined in paragraph 2.16 of the consultation document CAP 1994;
- NERL should not recover the entire shortfall in revenue from 2020 and 2021, as indicated in paragraph 2.14 of the consultation document CAP 1994. No economic entity in a competitive environment, with such market conditions as the ones currently disrupting this industry, can expect to profit or even recover their losses. The regulation should limit such market asymmetries in the case of entities that have significant market power. This should be possible without compromising the long-term ability of NERL to deliver the much needed UK airspace modernisation projects and safe and high-quality services.
- In reference to Appendix D of the consultation document CAP 1994, NERL should make accounts available to be reviewed by Users and the UK CAA in order to provide a satisfactory basis for determining the costs to be recovered. The costs for providing air navigation services in the 2020 and 2021 low traffic environment should be duly assessed by the Regulator and should be shown to be efficient and reasonable, bearing in mind that Airspace Users should not be charged for services they do not use. It is in this way that traffic risk-sharing can be reasonably adapted to support recovery in the sector and affordability of user charges. The Regulator should have access to all the necessary data to carry out this reconciliation exercise. Where NERL is not able to provide data for part of 2021 we agree that it would be appropriate to revisit data forecasts and make any necessary adjustments as part of a future price control review.

Finally, in our view, it will be important to clearly define a comprehensive plan for assessing the additional costs deriving from the loss of revenues in 2020 and 2021, separated from the process for annual air navigation charges. In this way, Airspace Users will be able to assess the current cost of the air navigation service and the cost relative to the traffic risk sharing mechanism from 2020 and 2021.

- **Financeability of NERL**

We believe that a regulatory framework that supports efficient and sufficient financing, along with the appropriate actions being taken by NERL, are important to guarantee a proper level of financeability for the service provider. We fully agree with what is suggested in paragraph 1.11 of the consultation document CAP 1994, that NERL must seek out aggressive cost efficiencies and take advantage of any available means, including equity support or debt, in order to protect its operational performance and, most importantly during the traffic recovery phase, the affordability of its charges. Just like airlines, the service providers must seek to offer the best service at the lowest price for its customers, by resorting to all possible and appropriate financing means.

- **Pension Costs of NERL**

Appendix C, Section 1, of the document CAP 1994, states that “*Airspace Users should only pay for Pension Costs that are reasonable (...)*” and we agree to that. It is imperative that any current shortfall in the NATS pension fund, especially any shortfall arising from the impact of the COVID crisis is not passed on to the Airspace Users. Therefore, we will require the CAA to carefully monitor the pension costs as part of its regulatory duties.

Long-Term Challenges (from 2022) - Policy Options for the Next Price Control Review

- **Affordability of the Charges**

We would like to stress that, given the current economic environment, NERL should not be passing on additional costs to Airspace Users, jeopardising the recovery of the aviation sector in the UK. Affordable charges in the current circumstances would at the very least be a freeze on current charges until traffic has recovered to its previous levels.

NERL should be compelled to seek aggressive initiatives to generate cost efficiencies and effective capital expenditure and Users’ views must be taken into consideration through proper and regular consultation processes on those initiatives.

- **Timetable and Processes for Stakeholders’ engagement**

The CAA must ensure that affordable charges are put in place and that the financeability of NERL is guaranteed to operate safely and to effectively enable the modernise of UK airspace.

In order to reach those objectives and evaluate the proper financing and fairness of the charges, the CAA should ensure that NERL provides Airspace Users and other stakeholders with the full disclosure of financial information, forecasts and assumptions to demonstrate the fair basis for charges, cost-relatedness and cost efficiencies. That includes traffic forecasts, operating expenditures, investments, depreciation, regulated asset base and cost of capital. NERL should also consult with Airspace Users on that detailed information to fully evaluate the basis of the charges, on new projects and with updates to ensure cost-monitoring and efficiencies. The CAA should also ensure that Airspace Users are adequately consulted in a transparent and non-discriminatory way and that their view is taken into consideration when setting the unit rates for the next charging period. Deviations of NERL from agreed efficiency targets should be discouraged as they would not be able to recover the agreed costs through Users’ charges. In the same way, quality targets should be set for NERL to deliver.

In terms of timing and duration of the next Price Control, we would support the 5-year approach, given that it could be an opportunity to effectively shape the recovery of the industry in the most effective way possible. It would thus be crucial to adapt the next price control to the current environment as soon as possible, starting from next year 2022.

Traffic risk will persist after 2021 and new mechanisms for calibrating and reconciling risk sharing arrangements must be discussed. Ideally, to respond to such extraordinary circumstances, these would involve air navigation charges being applied on a revenue neutral basis over the 5-year period, which could include a reduction in charges for the first couple of years. In this way Airspace Users could be financially relieved during those most difficult years.

The charges would then gradually increase over the course of the 5 years, favouring an improving traffic environment from 2022. That improved traffic conditions could make Users much more able to sustain increased charges in later years. This could be supported by additional state aid granted to NERL.

Given the circumstances, the next pricing control period should provide more flexibility than usual. Planning a medium term price control of 5-years will not be easy in such an uncertain environment, as forecasts on costs and traffic will need to be made. But projections based on possible scenarios could be produced and targeted efficient costs could be determined and linked according to traffic developments, setting up annual risk sharing mechanisms if traffic deviates from the range.

Each traffic range projection could thus reflect certain efficiency target levels each year. To foster recovery, the revenues of NERL could then be spread over 5-years, in such a way that charges are not fully covering the costs in the first years.

We are open to discuss any other alternative regarding shorter price-control periods to deal with the uncertainty. In any event, an update of traffic and costs as early as possible, in 2022, would still be the priority, even as an interim format for that year, waiting for a full review of the price control for the longer period, when more information and more clarity will hopefully become available.

- **Financeability of NERL**

For the next price control period, we reiterate that NERL should be financed by all available means, including equity and debt financing and state aid funding. This would help to apply a 5-year charging dynamic as described above, in which, especially during the first few years, Airspace Users are relieved from the burden of sole responsibility for the full cost recovery of NERL.

We are available to discuss further on the policy options to continue to ensure a steady path to a modern and efficient airspace, even in these unprecedented times.

Sincerely,



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