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Mr. Stewart Carter
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Dear Mr Carter

IATA Response: UKCAA CAP 2934 Initial Proposals for the next price control review ("NR23")

IATA welcomes the opportunity to submit a written response on the initial proposals set out by the UKCAA in CAP2934 and its associated annexes. Aviation is critical to the UK economy. Airline's priorities, despite the challenges presented by the COVID 19 Pandemic, continue to be: safety; cost efficiency; resilience and flexible adaptation to a challenging and uncertain environment; provision of sufficient capacity, adapted to demand, and operational measures oriented to more environmentally friendly flights. It must be pointed out that despite the UKCAA Initial proposal to reduce NERL's enroute Determined Costs in NR23 from £3,238 million in NERL's business plan to £2,990 million (£ -248M) it still represents an average 29% increase in unit rates for 2023, which is in the top 3 when compared to neighboring states in Europe.

Within the UK, airspace modernization remains the top strategic priority for our members, while we note a level of ambition with the NR23 plan to achieve this, we are presented with a challenge that already existed at the start of RP2 (2014-2019) namely, that the current technological infrastructure continues to be a barrier to achieving the required airspace change. The Airspace user community are concerned that legacy escape, continues to be just that a legacy!

Given the challenging timelines around delivery of our response we have chosen to formulate it around the key questions posed by the UKCAA. IATA has engaged and coordinated with interested airlines and through that process we have endeavoured to deliver as complete a response as possible, reflective of the majority of our airline members views. We remain available for further discussion, either bilaterally or through an extended process in early 2023.

Our key feedback is summarized in line with the questions posed in CAP 2934:

General Consultation Remarks

- IATA support the intention for the UKCAA Initial proposal to reduce NERL's enroute Determined Costs in NR23 from £3,238 million in NERL's business plan to £2,990 million (£ -248M
- While the impact of the COVID pandemic on aviation is still to be fully reconciled, we expect that all the latest traffic forecast information and macroeconomic data is considered before the UKCAA issue its final recommendation.

- The airline community maintain the view that NERL is a relatively low risk business and as such has greater access to financial independence than our members. As a result, we support the revision of the proposed WACC in the UKCAA initial proposal.

- IATA welcome and support the action taken on pensions. The advice and expertise of GAD in highlighting certain, more technical, concerns relating to the funding of pensions in the NERL BP drives significant structural savings to the original proposal. We support their measures on adjusting funding levels with the aim of reducing the chance of a trapped surplus and challenging some of the assumptions, such as the discount rate and transition to the long-term funding strategy. We further welcome the suggestion for a new DC scheme for new starters as a long-term solution to the problem of pension provision costs significantly in excess of market benchmarks.

- IATA support the level of ambition in the UKCAA targets on Environment and Capacity in your initial proposals and in fact would advocate that perhaps more stretch could be delivered.

- The airline community is mindful that the domestic and oceanic plans operate under different regulatory frameworks under different jurisdictions. We would encourage the UKCAA to separate the regulation of oceanic services from the domestic in due course and we encourage the CAA to provide greater transparency on the process for concluding the regulation of oceanic services.

Have the UKCAA adopted a reasonable approach to assessing the affordability of NERL's charges

The CAA must only include allowances for efficient operating expenditure in the NR23 price control. Appropriately calibrated allowances allowed across the price controls building blocks and that NERL is appropriately incentivised to become more efficient over the course of the period. We note that comparisons have been given to the situation in France, Germany, and Spain, however we would caution this as and from 2024 these states will undergo a new round of economic regulation and their future unit rates are likely to be further reduced below the projected levels for NERL in NR23.

- IATA support the initial proposals put forward by the CAA but urge that the CAA ensures it has appropriately calibrated allowances across the price controls building blocks, recognising the interdependencies between them and that benefits are appropriately recognised and accounted for.

- On staff costs, IATA support the UKCAA`s assessment on benchmarking NERLS wage costs on independent reports and those allowances must reflect the required and efficient level to attract staff without development of excessive packages above market rates or having a longer-term impact on the pension liability.

- IATA is supportive of the actions the UKCAA has proposed to make regarding Pension costs. Pension costs represent 20% of NERL's total operating costs; with NERL planning on them increasing through the course of NR23 by some 17%. Ensuring that such a high proportion of the cost base is reasonable and efficient must be a major focus of the NR23 process. Opportunities identified and presented in the GAD report to reduce the costs of pension provision need to be fully and carefully considered

- IATA welcome and endorse the CAA proposal to determine NERL's non-staff OPEX at 1% below that in NERL's business plan based on your assessment of:

    - the removal of CAA fees in NR23

    - expected OPEX efficiencies

    - removal of UTM development costs (based on user pays principal)

- not allowing real increases in the DB pension management costs

- IATA also advocate that the alterative “stepwise” deployment plan developed by Steer, should nbe further considered along with any other challenge to the NERL plan that could reduce costs and deliver benefits earlier. This is driven by our ongoing concerns related to asseet management costs associated with the delayed implementation of DP Enroute and running “dual“ new and legacy systems.

- NERL’s business plan set out a capital plan with reasonable objectives for investment in NR23 that is principally led by the sustainment of existing systems complemented by airspace modernisation and DSESAR requirements; however, we have questioned if the significant increases in sustainment costs and the balance between sustainment and modernisation are efficient.

Whether UKCAA are providing appropriately challenging efficiency targets for NERL.

The CAA appears to have proposed an efficient baseline for NERL’s operational costs in the period 2020-2022 and has allowed an appropriate allowance for NERL’s debt restructuring costs consistent with its estimates for the cost of new debt. We support these recoveries to be made over a ten-year period, evenly split between NR23 and NR28 and profiled to present a flat price path in NR23.

The CAA must only include allowances for efficient operating expenditure in the NR23 price control, ensuring it has appropriately calibrated allowances across the price controls building blocks and that NERL is appropriately incentivized to become more efficient over the course of the period.

- The application of higher ATCO productivity appears to require further assessment to identify the benefits and their allocation derived from investments and developments made by NERL but does not seem unreasonable given historic improvements, traffic forecasts, anticipated OPEX improvements, such as synthetic training developments, and capex deliveries, particularly DP En Route.

- We support the adjustment of graduate headcount on the basis that NERL’s retention rate appears too pessimistic in comparison to market levels.

- IATA supports the reductions made to non-staff OPEX in the initial proposal but wish to further gain a better understanding of the efficiency (or otherwise) of the current implementation and deployment plan relating to DP En Route and the extended period (and therefore higher costs associated with) dual running of legacy and new systems. Steer’s ideas about an alternative, potentially more efficient deployment plan must be fully considered prior to the final proposal.

- The CAPEX plan holds reasonable strategic objectives, key to which is delivering the infrastructure requirements necessary for airspace modernization; however, it seems appropriate that the CAPEX plan is consulted based on Steer’s assessment suggesting a rebalancing of the plan between sustainment and modernization.

- The significant increase in cost estimates and reprofiling of the DP En Route programme since NERL’s business plan was published is a major concern and due to the lack of quality information shared by NERL to the CAA and customers to enable appropriate assessment

- IATA support the UKCAA position to not include a TRS mechanism for Oceanic traffic and remain fully supportive of the need for an independent cost/benefit review of the introduction of SB ADS-B data charges as well as the development of quantitative and qualitative metrics to measure its benefits against plan, as outlined in the CMA review and CAP 2351

- IATA Support that the incentive schemes for 2020/2021 should not be considered, due consideration should also be given to suspension of 2022, due to the continued underperformance of traffic recovery, which currently stands at -19.6% below plan in terms of Service Units.

How UKCAA should respond to changes in the macroeconomic environment and traffic forecasts, which we have started to explore in the alternative scenarios.

IATA is cognizant that trying to forecast the immediate future in terms of flight movements and service units is very challenging, we would highlight the accuracy of Eurocontrol` s STATFOR Scenario forecasting throughout the past reference periods and point to the ongoing scrutiny it has endured during the pandemic, as a basis to support the application of the latest October 2022 STATFOR Base for UK Domestic and London Approach. The situation with Oceanic, specifically North Atlantic traffic requires far more scrutiny and at this present moment it is difficult for airlines to support.

- IATA supports the application of STATFOR's October 22 base scenario. STATFOR has proven to be very accurate and is, furthermore, comparable to the forecasts used in other countries of Europe, providing a guarantee of cross-border consistency and a homogeneous approach.

- The Oceanic traffic forecast is more challenging, and the mechanism used to apply STATFOR methodology and dataset as mentioned in the reports is not entirely clear. We understand that the current forecast is a NATS "derived" model, it is difficult for airlines to accept that, considering that NATS are also proposing to implement a Traffic Risk Sharing (TRS) on the North Atlantic. To our knowledge, the ICAO EFFG group is also working, but finding difficulties in delivering in a reliable traffic forecast for Oceanic traffic in the North Atlantic.

- Given the significant disparity between the RP3 and NR23 forecast, that the Tango forecast generated by NERL is also scrutinised and forecast drivers assessed. It is crucial that in the absence of an independent Oceanic set of forecasts, the CAA adopts a process that allows the airlines to engage in the assumptions used and transparently review the forecast model.

- It must also be acknowledged that the current situation in Eastern Europe may affect the expected post-pandemic traffic recovery. With fuel prices now at record highs, this will have a material impact on any immediate airline scheduling decisions.

Is the 10-year recovery period for NERL's TRS revenues from the pandemic appropriate

We have been very clear in our earlier response to the NERL `s BP that Airspace Users should not fully mitigate the revenue gaps of NERL during 2020/21. This situation is solely caused by the measures taken by States to fight the COVID-19 pandemic and therefore, the States and or shareholders must take a level of responsibility for covering this gap. The traffic risk sharing concept was adopted to incentivise ANSPs to deliver performant services irrespective of normal variations of traffic resulting from airlines business decisions or circumstances. It has not been conceived as an absolute protection of ANSPs including for events caused by the global pandemic. No under recoveries should not be regarded in the WACC calculation, the under recoveries are derived from an exceptional circumstance, outside of the airlines ` control, not a commercial decision by airlines to stop operating. Airlines have no regulatory protection need to offset the loss in the year of the event.

We note that no update on any financial assistance from the UK Government, and instead that the UKCAA now intend to move forward with a 10year recovery period for the TRS.

- IATA recognize that the UKCAA have taken considerable steps to minimize the impact by spreading the recovery over 10years, which could be seen as a significant assistance to airlines, however this could also lead to significant inflationary adjustments in the coming years which could drive up the cost further. The "cost" has already occurred and for that matter it is not supported to incorporate this cost in the RAB and apply increased inflation rates on it.

- We acknowledge the work done by the UKCAA to reduce the impact in its initial proposals during the reconciliation review

- We do however reiterate that IATA opposed applying the allowed WACC to the TRS revenues, noting that the impact of the covid-19 pandemic was outside the control of airlines, and the full WACC was not applied by several European states notably France and Germany

- In relation to the future development on TRS, IATA would propose that consideration should be given to removal of all Cost/Inflation/Traffic risk sharing and development of a pure price Cap scheme to better reflect the market evolution and to truly incentivise NERL to manage its business in an efficient manner.

Whether the quality of service and environmental targets are sufficiently stretching and whether we should adopt a new trigger for quality-of-service incentive payments to NERL

IATA support the intent of performance incentives to drive an improvement in the operating environment for our members. It is appropriate that targets reflect the benefits generated from NERL's planned CAPEX and OPEX alongside airspace modernization changes. Investments must be reflected with improved performance and or reduced operating costs. In our view the appropriate incentive should be a penalty only scheme, for all areas, however we acknowledge UKCAA have in effect maintained the asymmetrical mechanism that shows that penalties outweigh the bonus for most areas. Overall, on the various targets:

Environment

- IATA Support the continuation of 3Di as the appropriate metric for NR23 which is subject to an annual review.

- IATA support the UKCAA position on the starting point, which better reflects that the traffic level forecast in 2023 is lower than 2019 and that forecast in RP3, particularly in 2020 and 2021 where NERL faced comparable 3Di targets the starting point development.

- Support the more challenging 3Di targets suggested by the UKCAA and the inclusion of benefits derived from the CAPEX programme.

- Support the decision to not include NERL suggestions on the modulation or reopeners due insufficient evidence to support introducing adjustments to targets for changes in traffic levels during the period.

- On the inclusion of a 0.6 adjustment for non-revenue flights IATA would request a more systematic method for addressing these categories of flights impact on 3Di scores, the UKCAA should consider conducting such a review for the round of NR23 for inclusion into the Final Proposals.

Capacity

- As with environmental targets, it is important that incentives are appropriately calibrated with building block allowances, reflect the benefits derived from investments and airspace changes whilst also representing stretching but achievable goals to appropriately incentivise improved performance over time.

- Whilst we welcome the more challenging capacity targets, basing NERL's NR23 targets on average RP2 performance appears too simplistic; NERL's significant outperformance of targets in a number of years in RP2, achieved against the backdrop of notably higher traffic levels than those forecast in setting the RP2 price control, combined with the drastic variance in NERL's performance determines that a deeper analysis is undertaken than that presented in the CAA's proposals to assess the core drivers behind NERL's capacity performance, reflection of investments and calibration across price control building blocks.

- IATA support the reduction in exemption days in the initial proposal from 150 to 100. The scale of the CAPEX programme proposed by NERL for NR23 is substantially smaller than that of RP3 and we also support that no reopening mechanism should be included for Capacity as sufficient flexibility already exists.

- IATA believe there could be merit in redefining the incentive mechanism on C1 delay targets, however further information and options must be presented before a full decision can be taken on this proposal.

NERL's updated timescales and scope for the DP En Route programme in NR23 and whether these changes include appropriate protections for the interests of NERL's customers and users

IATA acknowledge that significant work was done in coordination with the Airline community during the 2020/2021 SIP meetings to reduce and prioritize the proposed CAPEX programme for the remaining years of RP3. We also agree that the 2+5 Approach may drive better outcomes, in terms or options and benefits for the airline community. Our overall comments on the CAPEX plan as presented are:

- This plan claims to have reduced costs from the previous RP3 version, which is appreciated. Decommissioning seems, however, to have suffered delays, which will cause overlapping of both new and old technology, increasing costs. We need transparency and reconciliation of what has been deployed when and to what effect?

- We are concerned that NERL has not supplied sufficient information on the impact of the significant increase in cost estimates and reprofiling of the DP En Route programme since NERL's business plan was published and NERL's ongoing investigations into it enhancing its delivery capabilities

- The principles driving investment: continuity of a safe and resilient service, systems modernization and appropriate changes in airspace seem oriented in the right direction.

- Despite the significant increase in investment for sustainment in 2022- 2024, it seems that the technical resilience risk only starts getting significantly improved from 2025. This requires further explanation

Approach to assessing NERL's WACC and financeability

The approach to estimating the WACC is broadly consistent with UKCAA decisions on H7, particularly for its market wide parameters, and the overall range is comparable to the CMA's RP3 vanilla WACC range of 2.41-3.74%. As a result, several long-standing concerns that have been raised by stakeholders during the H7 price control process continue to apply.

- IATA Support the methodology associated and Proposed range for the RPI-real vanilla post-tax WACC of 2.04%-3.59%, with a point estimate of 2.81%.

- The CAA's IPs are based on a cut-off date for data of 31st March 2022. This is unhelpful given the material relevance of data available between the cut-off date and the October 2022 date of publication.

- We request that the CAA takes account of the latest available evidence in developing its final proposals and ensures that calculations are made accurately and critically without bias particularly where volatility in the underlying data may make conclusions more sensitive to timing assumptions than would ordinarily be the case.

- We disagree with the CAA's estimation of a pandemic uplift as applied to NERL for NR23

- We would welcome further engagement with the CAA and our members on these issues to help ensure they consider all relevant evidence and arguments.

The discussion of NERL's capex engagement incentive also raises a number of detailed points where we are seeking respondents' views

IATA support the ongoing role of the independent reviewer in assessing the quality of the customer engagement. Although there have been improvements over RP3 and the NR23 Consultation in terms of NERLs CAPEX engagement, we would agree that there is still room for improvement. We still lack information from NERL on the business cases and their evolution, which underpin the CAPEX portfolio. As an example, we point to the fact that large programmes such as DP Enroute was originally considered as part of RP2, with delivery expected by 2020. DP Enroute is now pushed to 2027, with increasing cost for new technology and sustainment of legacy systems.

We are concerned that the UKCAA have also found issues NERL has not provided sufficient detail around the business cases associated with the programmes and projects included in its plan" and that "at an overall plan level, it is difficult for us, or stakeholders, to understand the degree of efficiency of the spend proposed, or the benefits that consumers can expect to derive for the plan (other than at a very high level)." The underlying business cases should be examined to ensure that the cost and benefits are still aligned and fit for purpose. We also caution that CAPEX is discussed in different consultations (SIP/ACOG/AMS/TCAB) and it is not always clear where the accurate plans are presented. We also suggest that additional simplification and continuity be established to ensure we are being consulted on the same material, with the same level of detail.

The proposed changes to the metrics appear to be founded in experience and as such we welcome them and the improvement in engagement standards that should follow.

- IATA support the UKCAA proposed changes to the CAPEX engagement incentive and that it remans a penalty only scheme

- IATA support the simplification of the scoring process and understand that this should drive stronger users' engagement

We remain available for further discussion and look forward to further engagement with the UKCAA`s before finalisation of your proposal during 2023

Yours sincerely,

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IATA