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UK Civil Aviation Authority
Aviation House
Beehive Ring Road, Crawley,
West Sussex, RH6 0YR
United Kingdom
Email: economicregulation@caa.co.uk

By email

Re: Economic regulation of NATS (En route) plc: consultation on approach to the next price control review.

Dear Sir/Madam,

I refer to the above issue and the CAA's invitation for views published on 2 December.

Ryanair welcomes the present consultation to review the approach to the economic regulation of NATS (EN Route) plc (NERL) in light of the impact of the COVID-19 pandemic, subject to the following comments.

1. Affordability

Paragraph 7 on page 8 recognises that *"part of the interests of users are served by NERL's charges being at a level that supports users in re-establishing and operating services, given the difficult circumstances created by Covid-19."* It follows that, under the current circumstances, affordability for airlines **must** be defined simply as a reduction in charges. The high level of unpredictability during the current crisis has placed the responsibility and risk of retaining (and restoring) capacity to pre-COVID-19 levels on airlines. As such, it is crucial that industry stakeholders such as NERL play their part by using every available mechanism to revive the industry, including, for example, requesting State aid, [1] to reduce unit rates.

We would support a medium-term approach towards price controls (approx. 5 years) to allow stability in rebuilding operations. However, these price control measures must be stringent enough to facilitate industry growth which, for the avoidance of doubt, must include a reduction in unit rates. We therefore agree on a commencement date of the new price control review in 2021 to ensure that NERL can support its airline partners through price controls in this critical period. As noted above, these price controls should last 5 years to overcome the risk of short-term regulatory

[1] E.g. through the Covid Corporate Financing Facility.

uncertainty. This is in line with Eurocontrol predictions that traffic recovery may take until 2029 to reach pre-COVID19 levels.

2. **Reconciliation of Traffic Risk Sharing (TRS) arrangements for 2020 and 2021, pension costs and financeability**

Regarding TRS arrangements, section 2.14 states *"our initial view is that if it were essential to support affordable charges, we would consider additional measures in the exceptional circumstances of Covid-19. These could include a solution where NERL does not recover all the shortfall in revenue from 2020 and 2021 that will derive from the mechanistic application of the TRS from users, perhaps with shareholders bearing a proportion of the shortfall."* We agree that airspace users must not be responsible for covering NERL's revenue shortfall as this shortfall is due to Government travel restrictions. Any revenue shortfall should not be pushed on to airspace users, which have themselves been dealing with the catastrophic reductions in revenue due to COVID-19. It is absolutely essential to support affordable charges using every available and economically appropriate means. Therefore, measures including the utilisation of shareholder support and/or State aid to NERL to reduce the deficit burden on users **should be strongly considered**. This should be further supported by the proposal in Section 2.15 *"that there may be circumstances such that to protect the interests for users, we would need to consider whether it is appropriate in setting price control arrangements to assume shareholders bear a proportion of any significant cost increases."* In this regard, paragraph 3.7 on page 28 states that "*As a minimum, it will therefore be necessary to make modifications to NERL's licence to implement updated TRS arrangements before January 2022."* Ryanair welcomes this approach towards ensuring there is not an unaffordable spike in user charges in 2022 due to under-recovered 2020 revenue. We also note the recent announcement regarding changes to NERL's licence.

Regarding financeability, section 1.11 states that *"if any acute financeability issues were to arise, we will consider appropriate regulatory actions in line with our duties. But, it is important to recognise there will be limits to these regulatory levers where passing additional costs and increases in charges to users would not be affordable and would not support recovery in the sector. Therefore, it is important that NERL seeks out cost efficiencies and takes other steps necessary both to maintain its financeability and to protect the affordability of its charges."* Again, given the current circumstances, passing any additional costs to users is not affordable, will hinder recovery in the sector and will ultimately have a negative impact on NERL. We agree that NERL must seek out cost efficiencies to reduce current unit rates. NERL should be put under a regulatory obligation to outline and deliver opex efficiency plans and justify capex costs and have detailed oversight applied to opex and capex plans to ensure unnecessary costs are not being passed through to users.

Pension costs, as set out in Appendix C, need to be managed very carefully. While this is considered to be a 'pass-through' cost, this should only increase NERL's focus on the impact these costs will have on users.

3. Rolling forward the current regulatory framework

While we agree with the need for consistency and stability, the current approach towards the regulatory framework/efficiency must be revised in the context of a post-COVID environment. This should include improved incentives for efficiency. Commentary on the proposals as follows:

a) *Making strong efficiency assumptions with respect to estimating the operating cost and capital expenditure allowances that will be used to help calibrate NERL's price controls for the period from 2022.*

   This is acceptable provided that the cost impact of failing to adhere to these targets/assumptions is not borne by the airspace user.

b) *Ensuring that the assumptions on costs that will be used in the TRS reconciliation reflect assumptions on efficient costs rather than simply reflecting actual costs incurred by NERL.*

   This is acceptable provided that the cost impact of failing to adhere to these targets/assumptions is not borne by the airspace user nor is the airspace user to be impacted disproportionately as a result of the TRS mechanism. It should be furthered by imposing appropriate cost reduction targets as 'efficient costs' are subjective.

c) *Calibrating the forward-looking TRS arrangements in a way that ensures changes to NERL's future revenues that occur because of changes in traffic reflect the way NERL's cost change. For example, if traffic changes, future revenues under the TRS are no more than the additional incremental costs that NERL would likely incur, or costs it would avoid, if it is operating efficiently. This would necessarily take due account of specific constraints in terms of training and capital investment lead times.*

   NERL should always work towards the most efficient and lowest cost operating model. We agree that NERL's costs for which it is to reimbursed should reflect the costs of an efficient operator. The key will be an appropriate identification of an efficient operator's costs.

d) *Setting greater incentives for capex efficiency and ensuring NERL retains incentives for efficiency across both capital expenditure and operating costs.*

   This is acceptable. NERL should continue to focus on delivering long-term investment that reduces operating costs and increases airspace capacity.

4. Longer-term challenges around maintaining the affordability of charges and financeability

In addition to the previously mentioned topics, deferral of the start of depreciation charges in addition to increasing the number of years in which it is recovered, should be strongly considered as a measure to support affordability. Further, and, unlike the past, foregoing dividend payments should be mandatory prior to considering any cost increases for users. For the year ending March 2019, NERL paid its shareholders a dividend of £59M (+3.5% compared to 2018) when ATC service levels had collapsed in the UK and delays increased by 85%. It would be unacceptable that the shortfall in revenue be entirely borne by airlines, rather than NERL's shareholders. NERL must now prioritise operational performance and cost efficiency ahead of shareholder profits.

5. **Section 2.13 in page 24 states that "*there could be plausible scenarios where the combination of improved incentives for efficiency and the better profiling of revenue does not result in affordable charges, to support recovery in the short-term*"**

This is not a scenario that can be considered. Affordability of charges is imperative to developing the industry and supporting its recovery. This is recognised in Section 2.11 namely, *"Affordable charges will make more routes viable, which should support the recovery of air traffic, thereby bringing in more revenue to cover NERL's costs and providing more choice and services for passengers."*

6. **Airspace modernisation programmes**

We agree that airspace modernisation programmes and long-term investments that will reduce cost and improve capacity/operational efficiency should continue.

7. **The approach to the 2020/2021 reconciliation of revenues/cost as discussed in Appendix D**

Where any financial impact is to be borne by users (which should be minimised), Ryanair would support a **variance analysis type approach** as users should be able to review all significant costs to identify instances where NERL was unable to meet the ambitious targets set for cost efficiency/reduction. In these instances, a provision should be made available for users to contest these variances and refer them to independent adjudication.

In cases where reconciliation/review is conducted on a forecast basis, we would suggest that they are revisited at a later stage and with any decrease in cost being passed on to airspace users. Cost increases will not be accepted if NERL exceeds the given allowance.

8. **Selection criteria for reconciliation review**

It is concerning that at no point in the selection criteria set out in Appendix D are the users' needs openly considered. While we agree with the criteria listed, namely, proportionality, targeted, and transparency, we put forward that an additional category entitled "customer focus" should be added to ensure that the customers' financial and operational needs are taken into account in every step of the process.

Being one of the largest airlines in the UK, the Ryanair Group is one of the main parties affected by this consultation. We therefore trust that our comments will be taken on board when the CAA makes its final determination.

Please do not hesitate to contact us if you have any queries or would like to discuss.

Yours sincerely,

Eoin Kealy
Head of Competition and Regulatory

cc Paul Smith – Civil Aviation Authority (Paul.Smith@caa.co.uk)
cc Matt Claydon – Civil Aviation Authority (Matt.Claydon@caa.co.uk)