



M.A.G's submission on approach to terminal air navigation service regulation in RP2

January 2014

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Section 1 - Introduction

1. M.A.G welcomes the CAA's consultation document on its approach to the regulation of UK terminal air navigation services (TANS) for Reference Period 2 (RP2) 2015 -2019 of the Single European Sky Performance Scheme. The CAA has asked for M.A.G views on its proposed approach to developing appropriate targets for capacity and cost-efficiency for RP2.
2. We believe that NATS recognises the need to change the way that it works with airports, and the fundamental importance of reducing its cost base. We favour competition over regulation because regulation would ultimately be more costly and would also be a retrograde step as the air navigation services market evolves in Europe. Nevertheless we recognise that, at present, the alternatives to NATS are limited and there is value in putting in place measures to both encourage the development of a contestable market and provide protection in the interim.
3. We note that the European Commission has made provision to establish an EU-wide terminal cost-efficiency target in 2017, subject to collection of sufficient data. We understand that currently TANS performance plans must contain a target for cost-efficiency and terminal capacity (until 2017 at least). Details on the cost-efficiency indicators are provided in the charging regulation. For capacity, the requirement is for a target at the national level, broken down for monitoring at the airport level. For cost efficiency the requirement is for a target at the charging zone level.
4. We further understand from the CAA's consultation document that the CAA intends to establish a charging zone level target with the expectation that contracting for TANS will provide the mechanism for achievement. The CAA says in its consultation document it will consider:
 - NSL's draft business plan for the provision of TANS; and
 - Capita's study on UK TANS charge/IFR benchmarking.

We have provided our comments on each of these documents in sections 3 and 4 respectively of this submission.

5. Furthermore, the CAA has identified a range of principles to guide the development of any regulation, including that it should:
 - not cut across the provisions in current contracts; and
 - ensure that airports are able to operate a fair and open tender process.

Section 2 – The CAA's Proposed Approach

6. From the consultation document M.A.G understands the CAA will consult on the appropriate UK KPIs for a national terminal performance target for capacity and a charging zone terminal performance target for cost-efficiency when it consults on the Performance Plan in February 2014.
7. M.A.G broadly supports the CAA's approach to cost transparency as outlined in the consultation document, but we believe there is significant scope for cost reductions to be delivered in a relatively

short space of time, and certainly more quickly than appears to be expected by the CAA. A business that has been operating unregulated for a considerable period of time in a market that is not contestable, is likely to have accumulated significant inefficiencies and failed to have kept pace with market norms.

8. We support the provision of cost transparency via the competitive tender process with the caveats outlined in paras 2.23 and 2.24 of the consultation document. We agree that the publication of data by the CAA should be limited to the aggregate charging zone level whereby ANSPs would supply the CAA with data for individual tower operations which it would handle in a way that maintains commercial confidentiality. We agree that ANSPs should share cost data, as appropriate, with their airport customers as part of their bilateral commercial contract negotiations. We will provide further comments on the charging zone level target in the Performance Plan consultation scheduled for February 2014.
9. We understand the CAA's deliberations on the cost of capital at paras 2.16-2.21 of the consultation document. The CAA's suggested approach is not to present a WACC due to various concerns of overlap with price controlled airport charges in the regulated airports, and instead the suggestion that NATS presents profit earned as a pre-tax return on sales on its contracts. Irrespective of the CAA's final approach on this issue, the CAA's objective should be to establish the appropriate level of long term profitability for the types of services provided by an ANSP in a well-functioning market, having regard to the level of commercial risk faced by the company and the level of profitability achieved by other companies operating in similar lines of business.
10. Nevertheless it is not clear what would happen in the hypothetical case where an airport that previously contracted TANS from an outside ANSP such as NSL decided to take this service in house. Furthermore, depending on whether the operator or the service is regulated, this might become difficult to manage especially in the case of a regulated airport, where the proposed approach to cost of capital may become unworkable.
11. M.A.G agrees with the CAA on contracting for KPIs and PIs as outlined in paras 2.27-2.29. We agree that airports should have in mind the performance targets, however the exact transposition of the European KPIs and PIs into a contract may not be practicable or even desirable particularly as the document points out, KPIs by their nature are designed for regulation in the absence of market conditions. But first of all, there is a need to establish if competitive tendering is working and whether or not there is a market failure to correct.
12. The CAA says in its consultation document that airports are best placed to decide the areas and levels of performance needed to deliver the service they require for their customers. We agree with this statement and it should be noted that M.A.G broadly agrees with the approach that the CAA is taking to RP2 as detailed above.

Section – 3 NSL's draft business plan for the provision of TANS

13. In February 2013, at the request of the Department of Transport (DfT), the CAA published a Report (CAP 1004) reviewing the presence of market conditions in the provision of UK Terminal Air Navigation Services pursuant to Annex I of the charging regulation (EU 391/2013). The CAA found a number of barriers to entry that were impacting on the development of competitive market conditions in particular:

- A lack of clarity and uncertainty around the relationship between NERL and the tower operations; and
 - NATS Deed of a Trust of a promise covering pensions for staff employed by NATS at the time of the PPP.
14. NATS has proposed the commitments in Annex A of their Business Plan to address the issues raised by the CAA's Report. However, M.A.G's primary concern is that the draft NSL business plan has been drafted in such a way so as to convey a message that all services provided by NATS will improve in the future but the draft business plan lacks the detail to explain how the services provided by NATS will add value to airports. We remain concerned by the risk that NATS could seek to prioritise the operational and strategic needs of certain airports, over and above those of other airports, particularly where TANS are provided by an alternative supplier.
15. The document implies that NATS will change the way in which it provides services to become an organisation that will work more closely with airports. From a M.A.G perspective, this would be a welcome development but nevertheless the draft business plan provides no critical success measures to evaluate how this could be achieved. A clear example is the relationship between the delay en-route (not at the airport), start-up delay and traditional taxi out time. The document does not specify what the measures of success for NATS are in these crucial areas. This is disappointing as these areas cut across both NERL En Route Services and the services provided by NSL in the tower and it goes to the heart of one of the two key barriers to entry that the CAA identified in its study.
16. Furthermore, the relationship between NATS and its customers is not clearly articulated in the draft business plan. In the past, NATS has often worked more closely with airlines, considering them to be the primary customer rather than the airport. M.A.G would like to see NATS commit to working more closely with the airport as the customer of its air navigation services. The draft business plan provides specific actions in relation to service quality that sit with the airport on page 23 of the draft business plan, but a clearer articulation of the NATS-airport relationship is needed.
17. M.A.G is also concerned that NATS has not always sought to add value to airports by providing customised services. For example, there have been occasions in the past where Stansted has sought more bespoke data in relation to the NATS safety plan, particularly in relation to how the runway is being operated. NATS was reluctant to provide the data without charging a fee and only provided the data linked into its own overarching safety objective. An approach characterised by joint working between the airport and ANSP is needed to achieve the best outcome for each airport.

Proposed Commitment Number One

18. The proposed Number One Commitment (parts 1-4) as currently drafted is not robust or detailed enough to address the 'lack of clarity and uncertainty around the relationship between NERL and the tower operations' identified by the CAA.
19. The first part of the commitment refers to 'the parties'. This term is unhelpfully not defined in the commitment. Therefore it is not clear which parties are being referred to.
20. Parts 1-3 of the proposed commitment are based on the size of the airport and refer to an "interface agreement". It is not clear what is intended to be included in the interface agreement. The CAA should ask NATS to produce a draft containing the key elements of the proposed "interface agreement" to

enable stakeholders to provide comments. Until we have seen what is intended to be included in this document we are unable to comment any further on the proposed commitment because there is currently no substantive content. As a result the commitment in its current form cannot provide the assurance or comfort that it is intended to.

21. In relation to Part 4 of commitment – we do not consider that this is relevant to M.A.G.
22. As a general comment, it would be useful to see further more robust commitments that address the relationship between NERL and NSL which is the key issue raised.
23. At this time, M.A.G does not have any specific comments on the proposed Commitment Number Two.

Section 4 - Capita's report on UK TANS charge/IFR benchmarking

24. In October 2013 the CAA commissioned Capita to benchmark the larger UK airports (Heathrow, Gatwick, Manchester and Stansted) against each other and with comparable European airports. The results of the Report have been mostly redacted to remove commercially-sensitive information.
25. As a result M.A.G is only able to acknowledge the Capita Report, due to the high level of redaction, we are not able to provide any further comments. We further note the CAA has not yet endorsed the content of the study, and we encourage the CAA to identify a practical way for other stakeholders to engage properly with these issues.

Section 5 - Conclusion

26. In summary M.A.G broadly supports the CAA approach to terminal air navigation service regulation in RP2 as detailed in section 2 of this document. However, at the same time we would encourage the CAA to continue with its work to encourage the development of a contestable market for TANS in the UK. We see this as the most sustainable way in the long term to ensure airports' needs are met.
27. We have some reservations about the draft NSL business plan and NSL's past performance in terms of adding value to airports. We note that the draft plan lacks critical success criteria.
28. We do not think that the the draft commitment as currently drafted is strong enough to support market conditions and is not robust enough to address the 'lack of clarity and uncertainty around the relationship between NERL and the tower operations' identified by the CAA. This issue must be a priority for the CAA and NATS in the next phase of work.
29. Finally, we acknowledge the Capita Benchmarking Report but due to the high level of redaction, we are not able to provide any meaningful comments at this stage but would request that the CAA establishes an appropriate way for airports and other stakeholders to comment on these in due course.