

Proposal to modify NATS (En Route) plc licence in respect
of the Oceanic price condition for 2015-2019:
Notice under section 11(2) of the Transport Act 2000

CAP 1230



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Enquiries regarding the content of this publication should be addressed to: mike.goodliffe@caa.co.uk

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Chapter 1

Introduction

Purpose of this document

- 1.1 This document sets out, for representations, the CAA's provisional decision for a charge control on Oceanic services for the five years 2015 to 2019 inclusive and the formal notice of changes to the Condition 22 of NERL's licence to take effect from 1 January 2015¹.

Views invited

- 1.2 The CAA published a consultation document in July 2014 setting out proposals for a charges control for Oceanic services for the period 2015 to 2019. The consultation closed on 25 September 2014. This document sets out the CAA's provisional decision and reasoning.
- 1.3 Under section 11(1) of the Transport Act 2000 the CAA may modify the conditions of a licence if its holder consents to the modifications.
- 1.4 NERL, as the licence holder, has given its consent to the modified condition in Appendix E.
- 1.5 Under section 11(2) of the Transport Act 2000, before making modifications to the licence the CAA must publish a notice setting out the proposed modifications, their effect and the reasons for the proposal, and must state the period (of not less than 28 days) within which representations may be made regarding the proposed modifications. Accordingly, this document constitutes such a notice and the CAA would welcome comments on the proposed modifications. Any comments should be sent, if possible, by e-mail to economicregulation@caa.co.uk by **12:00 on Monday 15 December 2014**. Alternatively, comments may be sent by post to:

Stephen Gifford
Markets and Consumers Group
Civil Aviation Authority
4th floor, CAA House
45-59 Kingsway
London WC2B 6TE

1 Air traffic Services Licence for NATS (En Route) PLC as consolidated September 2013.

- 1.6 The CAA would expect to make any responses available on its website for other interested parties to read as soon as practicable after the period for written comments has expired. Any material that is regarded as confidential should be clearly marked as such. Please note that the CAA has powers and duties with respect to information under section 102 of the Transport Act 2000 and the Freedom of Information Act 2000.
- 1.7 If you have any questions on this document please contact Mike Goodliffe on 020 7453 6226 (or, by e-mail, to mike.goodliffe@caa.co.uk).

Next steps

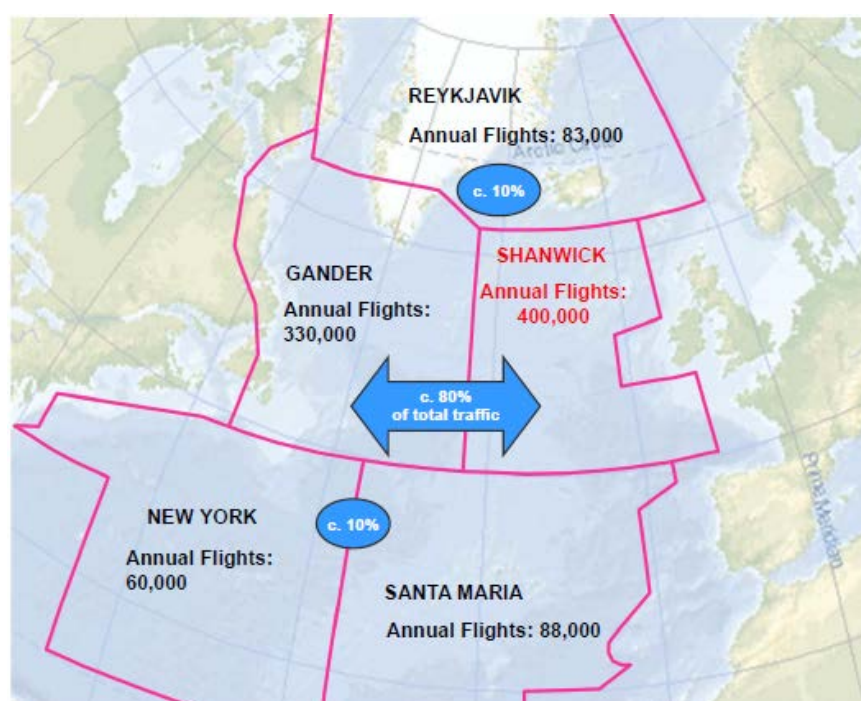
- 1.8 The CAA is allowing 29 days for comments on this document. Subject to the scale and nature of the responses received the CAA plans to publish its final decision on the proposed modification to condition 22 during December 2014. This will allow the conditions to take effect on 1 January 2015.

Chapter 2

Background

- 2.1 The management of the Shanwick area of oceanic airspace over the North Atlantic is delegated to the UK and Ireland by ICAO². The UK is responsible for air traffic service and datalink communications while Ireland is responsible for high frequency communications.

Figure 2.1: Service Providers in the North Atlantic



Source: NERL

- 2.2 As shown in Figure 2.1, the Shanwick area is one of five service providers across the North Atlantic. The management and development of airspace governed by ICAO is through the North Atlantic System Planning Group (NATSPG) and sub-groups. The vast majority of flights (c.80%) are handled by a combination of the Shanwick service and the service provided by Nav Canada from Gander.
- 2.3 Oceanic is a non-surveillance operation (i.e. there is no radar coverage). Separation of aircraft is assured through clearance and management of planned flight trajectories. For transatlantic flights there is an organised

2 International Civil Aviation Organisation - an agency of the United Nations Organisation.

track system (OTS), planned on a daily basis, depending on the position of the prevailing Jetstream, to minimise the adverse effect on westbound flights and maximise the benefit to eastbound flights.

- 2.4 There is considerable collaboration between NATS and Nav Canada at both a strategic and a tactical level. NATS has a long-term strategic relationship with Nav Canada for the provision of the Oceanic flight data processing system and supporting datalink systems. This technology is currently being upgraded and replaced under the COAST programme (collaboration of Oceanic airspace and system tools) based on a high level of commonality with the equivalent systems being implemented by Nav Canada. At a tactical level NATS and Nav Canada share planning of the OTS for Shanwick and Gander with NATS focusing on westbound and Nav Canada on eastbound flights.
- 2.5 The Oceanic business is a relatively small part of the NERL business with costs and revenues representing about 4% and the regulatory asset base representing about 3% of the NERL business.
- 2.6 The CAA currently regulates the maximum that NERL can charge users for Oceanic services by means of a condition in the NERL En Route Licence issued under the Transport Act 2000. The current charge control was set in December 2010. The maximum charge per Oceanic Flight was £64.92 in the year April 2011-March 2012. This maximum was then constrained to fall (in real terms) by the increase in the Retail Price Index (RPI) minus 4 percent (RPI-4%) in each of the three succeeding years until the year ending March 2015.
- 2.7 Although the Oceanic service does not fall under the SES performance scheme, the CAA asked NERL to consider the Oceanic service as part of its mandate for the Customer Consultation process in summer 2013, alongside its proposals for domestic services under SES. The CAA considered that this would be an efficient approach for both NERL and users. The initial business plan issued by NERL in May 2013 prior to Customer Consultation therefore identified its plans for Oceanic services and one of the workshops during the consultation period was devoted to Oceanic.
- 2.8 At the conclusion of Customer Consultation the joint Chairs of the Working Group³ reported that Airlines agreed with the Oceanic strategy presented by NERL in the Revised Business Plan (RBP). Airlines were also keen to engage with NERL on the options and costs for satellite surveillance.

3 The two joint Chairs were nominated respectively by NATS and the airlines.

2.9 In July 2014 the CAA consulted on proposals for a new charge condition that would apply for the five years from 1 January 2015 to 31 December 2019. These proposals would end the current charge condition three months earlier than originally specified in order for it to be aligned on a calendar year basis with NERL's other regulated charges. (It is anticipated that in these circumstances NERL would also change the charging year for Oceanic charges to a calendar year.) The CAA held a workshop on the proposals on 1 September 2014 and the consultation period closed on 25th September 2014. The CAA received submissions from

- British Air Transport Association (BATA)
- British Airways (BA)
- International Air Transport Association (IATA)
- NATS
- NATS Trades Unions Side (NTUS)
- Virgin

2.10 Chapter 4 summarises these responses in terms of overview comments and answers to specific questions posed in the consultation document. The full text of responses is published on the CAA website⁴.

4 <http://www.caa.co.uk/default.aspx??catid=5&pagetype=90&pageid=585>

Chapter 3

Outline of proposal in the consultation document

- 3.1 The consultation document proposed the continuation of a simple price control with the features summarised below.
- 3.2 The control period going forward would be for calendar years rather than the current 31 March year:
- This would mean that the final year of the current price control would be for 9 months ending 31 December rather than a full year.
 - This would have some impact on the profitability, all other things being equal, given that it would bring forward the use of lower traffic forecasts and lower costs for the new control period. It would also imply a gain to NERL due to the benefits of relatively more peak months in the nine months April to December compared to a full year.
 - The CAA proposed not to make any adjustment from the above effects on profitability. The effects of bringing forward traffic and forecasts appear to cancel each other out while the unanticipated benefit to NERL in 2014/5 was not expected to be as great as the revenue shortfall due to lower traffic in that year compared to what was anticipated for CP3.
- 3.3 The correction term would be changed so that it operates two years in arrears, when all the relevant information is known in line with the approach for Eurocontrol Charges. (It is currently specified to operate one year in arrears based on forecasts.)⁵
- 3.4 The price control would take the form CPI-Z* rather than the current RPI-Z:
- This will make the indexation consistent with the requirements for the vast majority of NERL's services regulated under SES and thus avoid administrative complexity.
 - The value of CPI-Z* would be set at an expected level equivalent to what it would have been if specified as RPI-Z.

⁵ In practice this correction mechanism has not been active because NERL has charged at exactly the allowed maximum rate. It remains a technical possibility that NERL could charge at more or less than the allowed maximum rate.

- Consistent with Eurocontrol and London Approach charges, the CAA intends to continue to apply RPI as the appropriate index for revaluing the RAB given that this is the basis on which the weighted average cost of capital has been derived.
- 3.5 In CP3 the CAA applied a rolling incentive designed to provide a constant incentive on the service provider to bear down on costs throughout the reference period by effectively allowing it to retain the benefits for five years. The CAA proposed to honour previous sums accumulated through the RIM but not to apply it further in 2015-2019. This is the approach adopted in the UK-Ireland FAB Performance Plan for services provided in UK airspace under Eurocontrol and given the small scale of the Oceanic business, the CAA proposed a consistent approach for Oceanic.
- 3.6 The CAA proposed that it would be prepared to re-open the Oceanic price control in the event of real technological change where the Licensee is able to demonstrate to the reasonable satisfaction of the CAA that, after proper consultation with users and other interested parties, there is an acceptable level of support for the Licensee's proposals and that they would be in the general interests of Users.
- 3.7 In terms of the projections of the building blocks for calculating the maximum charges the CAA proposed:
- A set of traffic forecasts consistent with the UK-Ireland FAB Performance Plan based on STATFOR February 2014 forecasts.
 - Equivalent cost interventions to those which had been applied in the UK-Ireland FAB plan:
 - To reduce the assumption for increases in average staff costs to the rate of CPI.
 - With respect to the Employee Share Ownership Scheme, to continue to make a cost allowance for the distribution of shares to employees at less than cost but not to make an allowance for the anticipated increase in the liability to eventually redeem shares generally.
 - To remove opex contingency costs.

- For pensions:
 - In respect of the five year reference period, passing through only 80% of the difference between actual contributions and contributions assumed as part of the determined costs when the actual contributions are greater than the assumed contributions (but continuing to pass through 100% of the difference when the actual contributions are less than the assumed contributions).
 - To reduce the contributions assumed for 2018 and 2019 by 10% compared to NERL's Revised Business Plan.

3.8 In the Consultation Document, the CAA also proposed to adopt the capital expenditure in NERL's Revised Business Plan.

3.9 Furthermore, CAA proposed to apply the same cost of capital as CAA had applied to the Eurocontrol business in the UK-Ireland FAB plan.

Chapter 4

Addressing points raised by respondents

- 4.1 This section responds to the points raised by respondents. A comment registry is also attached in Appendix A.
- 4.2 First the CAA notes that none of the respondents argued that Oceanic should not continue to be regulated. The CAA therefore confirms its view that the benefits of applying a simple form of charge cap outweigh the burden on the regulated company and users.
- 4.3 Respondents generally favoured the continuation of a simple form of price cap although IATA argued that CPI-Z* regulation should be replaced by the SES specification from the second year of the control period.
- 4.4 The CAA is not convinced that the SES specification would represent a simple form of regulation consistent with a business of Oceanic's small scale. The SES specification includes traffic risk-sharing mechanisms, incentive mechanisms and separate treatment of exempt costs. Together these would imply more risk for airlines and greater administrative effort. Even if these features were not adopted, the fundamental SES specification is based around correcting for inflation two years in arrears rather than applying indexation ex ante each year at the point that charges are set. Corrections for inflation are thus a feature of the SES specification adding lumpiness and unpredictability to charges whereas a CPI-Z* specification avoids this. The CAA does not consider that adopting an approach more aligned with SES would be proportionate or be in the direct interest of users. It therefore confirms that it continues to consider the most appropriate simple price to be based on the annual change maximum charges to be specified as a measure of inflation (plus or minus a factor).
- 4.5 Respondents generally supported the alignment of the charge control to calendar years. IATA did however believe that there should be an adjustment to the transitional arrangement to return the £0.8 million benefit to NERL would receive back to users.
- 4.6 The CAA confirms that its proposals for the licence modification are based on the calendar years 2015-2019.
- 4.7 In respect of the transitional arrangements, the CAA's provisional view in the consultation document was that while there was an apparent

unanticipated benefit to NERL of £0.8 million from seasonality in 2014/5, it was not likely to be as great as the revenue shortfall due to lower traffic in that year compared to what was anticipated for CP3. The CAA believes that this shortfall is likely to be larger than £0.8million. The CAA is not convinced that it would be appropriate to make a specific adjustment for NERL's unanticipated gain from transition without considering this against the unanticipated losses generally. The CAA therefore confirms that it has not made any adjustments from transition effects in its proposed modification to Condition 22 of the licence.

- 4.8 There was general support for the use of CPI rather than RPI in the price control. BA argued that CAA should swiftly move away from reflecting the difference between CPI and RPI.
- 4.9 The CAA confirms that the specification of the charge cap in the proposed modification to Condition 22 is based on CPI. As regards moving away from reflecting the expected difference between CPI and RPI, the CAA considers that it has to observe the reality that while CPI and RPI are both commonly used measures of general inflation they are defined differently and that there is a systematic difference in expected values going forward. It would be inconsistent for the CAA to ignore this when applying forecasts. The CAA does, however, note that the use of CPI in NERL's price conditions should encourage it to consider variances in input costs against a CPI rather than an RPI yardstick.
- 4.10 In respect of the proposal of the CAA being receptive to change the price control in the event of technological change, there was support from NATS and qualified support from airlines, user bodies and trades unions. User bodies were concerned that such proposals should have a sound cost benefit case which is endorsed by users while NTUS were concerned that the approach should not be unnecessarily bureaucratic.
- 4.11 The CAA agrees that any proposal to re-open the charge cap in these circumstances would have to include both a strong cost benefit case that the introduction of the new technology and higher charges were to the benefit of, and enjoyed widespread support from, users. This does not require a change to the licence given that Condition 25.2.b already covers a licence modification in these circumstances. The CAA would propose that the process would involve as little bureaucracy as possible, subject to establishing that such a licence change was consistent with its statutory duties.

Building blocks

- 4.12 None of the respondents have directly challenged the traffic forecasts although there was a request for more explanation of how they have been derived. More information is attached in Appendix B.
- 4.13 NTUS argued in respect of the cost components that:
- as the pricing structure is different and the service specialised, caution should be taken in racing to reduce costs, particularly set against expected investment in technologies in the upcoming reference periods;
 - in view of the fact that the European Commission has attempted to include Oceanic Services within the Single European Sky legislation, it is politically dangerous and contradictory to then use the rationale applied in respect of the performance scheme; and
 - the imposition of a price cap, whilst using some rationale used for RP2 (without a performance approach and without any of the other areas), seems to lack a sound rationale.
- 4.14 The CAA considers that in general it has adopted similar interventions for both Eurocontrol charges under SES and Oceanic charges not because those assumptions are being driven by EU requirements but because those assumptions are a reasonable and proportionate balance in addressing its duties under the Transport Act 2000. The CAA therefore considers that it is reasonable to apply most of the interventions to both businesses.
- 4.15 NTUS has also challenged the basis of the CAA's intervention on staff costs and the advice of its consultants IDS.
- 4.16 The CAA would re-iterate that in addressing staff costs it is not setting a budget or cap for pay, either collectively or for particular types or grades of staff, nor is it intended to require the company to move to any particular structure. This does not represent any attempt to micro-manage the business. It is the overall charging controls under the charges regulation that NERL will be expected to meet rather than the intermediate components parts of opex.
- 4.17 On pay, as on other building blocks of the cost targets, the CAA is seeking to be transparent about the assumptions that it has adopted in proposing an overall cost efficiency target as a whole. CAA accepts that there can be different approaches taken by practitioners in benchmarking pay and benefits. The CAA concluded in respect of the Eurocontrol business that

when the pensions are taken into account the full benefit package for NERL staff appears very generous compared to appropriate comparators. Differences on the scale found were clearly robust to taking different assumptions concerning other parts of the remuneration package.⁶ The CAA considered that the reasoning it has applied to NERL staff input into the Eurocontrol business also applies to staff input to the Oceanic business.

- 4.18 CAA confirms its assumptions for expected levels of average staff remuneration of no more than CPI growth for pay rates with no further increase to cover the wage drift component of pay progression.
- 4.19 Pensions is the issue which has drawn the widest comments with airlines and user bodies arguing that lower pension allowances, more in line with amounts in other comparable commercial businesses, should be allowed; while NATS and NTUS have focussed on restoring a 100% pass through.
- 4.20 The position in respect of the level of pension contribution for Oceanic is fully aligned with the position for NERL generally. The CAA accepts that the legal restrictions on the Scheme's amendment power broadly prevent an amendment to the Scheme's rules being made to reduce or stop the future accrual of benefits for the pre-existing members of the scheme. The CAA accepts that this precludes NERL from making changes to the scheme on a scale envisaged by users. The CAA considers that in the absence of changes to the scheme itself, placing any dramatic limitation on contributions allowed in user charges would make it unreasonably difficult for NERL to finance its functions and may impact on the continuing provision of services. It therefore considers that in general it should allow a level of contribution to be funded by charges sufficient to remunerate NERL's legal commitments over the long term.
- 4.21 The CAA does however confirm the assumptions made in the consultation document of reducing the level of contributions in respect of the Oceanic service in the last two years of the control period by 10%. This would be after the next triennial valuation of the scheme and the original NERL projections are less certain from that point onwards.
- 4.22 In respect of the rate of pensions pass through there have been further developments since the publication of the consultation document. Further legal arguments have been put forward by NERL and following careful

6 Further analysis in this point can be found at <http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=15841>

consideration, the CAA accepts that the provisions of the EU charging regulation do not permit less than a full (100%) pass through of relevant costs.

4.23 This does not have any direct read-across to the Oceanic business because it is not subject to these charging regulations, or indeed the SES regime generally. However, the CAA considers that imposing a different pension pass-through regime for Oceanic compared to SES would impose a regulatory cost, and given the small scale of the business that cost is likely to be greater than any benefit. The CAA has therefore restored 100% pass through for under recovery. In the context of the proposed amendment to Condition 22 of the licence, this makes no difference to the charge. It will, however, affect the way that values in the Regulatory Asset Base are carried forward between price reviews.

4.24 None of the respondents challenged the capital programme assumed. The CAA therefore confirms that its proposals to modify Condition 22 are based on unchanged capex assumptions for 2015-2019, based on the Revised Business Plan. However, technical errors have been spotted in the calendarising of the 2015 value as well as the conversion from 2012/13 prices into outturn. The corrected figures are presented in Figure 4.1 below.

Figure 4.1: Assumed capital expenditure (£m)

2012 prices	2015	2016	2017	2018	2019	Total
Capex	1.9	1.2	0.8	0.8	1.2	5.9

4.25 In respect of the cost of capital the CAA notes that no respondent has directly argued for a different cost of capital. The CAA notes NATS' comment concerning the higher risk to NERL's return in relation to Oceanic charges. However on the basis of:

- the advice of CAA's consultants PwC was on a cost of capital for NERL rather than specifically directed at the Eurocontrol business;
- a definitive analysis of a separate cost of capital for Oceanic would need to take account of the effective rate of tax;
- no separate analysis was conducted for segments of the UKATS business which were not subject to the Eurocontrol cost sharing mechanism (e.g. the MoD contract);
- the Oceanic business represents only a small segment of the NERL business; and

- in absolute terms the effect of a lower cost of capital on overall Oceanic costs would be small.
- 4.26 The CAA confirms that it has applied the same cost of capital to Oceanic as for the Eurocontrol business - a return of 5.86%.
- 4.27 In respect of profiling, airlines and user groups generally have requested further information. BA went further and stated that it did not support the concept of profiling as it implied a cross-subsidy between users in different years.
- 4.28 Further information on profiling is set out in Appendix C. In respect of BA's general point about cross subsidy the CAA recognises the point in principle but in practice:
- The projections of costs and traffic, on which the price cap is based, are just forecasts. There can be a danger of spurious accuracy where the price cap mimics every expected variance in expected cost some years before the relevant period.
 - To retain the benefits of not correcting retrospectively for inflation the price cap would have to be specified in a CPI-Z format with the value of Z fluctuating (possibly by small amounts) each year.
 - Moreover the issue of cross-subsidy is less of an issue when smoothing costs year by year over a five year period rather than say over the life of a major piece of infrastructure. By and large the distribution of traffic between airlines over this period is not likely to change dramatically - although the CAA recognises that the possibility always remains that it might.
- 4.29 The CAA believes that a profiled approach is not materially detrimental to users and is proportionate in terms of maintaining a simple, easily administered price cap. The CAA confirms that it has adopted this approach in its formal notice of modifications to Condition 22 of NERL's licence.
- 4.30 NTUS argued that the term "Eurocontrol Business" in the licence is somewhat misleading as it could be taken to refer only to the 'cost' part of the performance scheme.
- 4.31 This current document relates to the Oceanic Business. If there is an issue with the Eurocontrol business it would be more appropriate to deal with it elsewhere. The use of the term "Eurocontrol Business" has been used here largely to distinguish this major part of NERL's en route business from the Oceanic Business. Nevertheless, it should be borne in

mind that the Licence granted under the Transport Act 2000 is fundamentally an economic licence so will not cover all the aspects of performance under the SES regime e.g. safety.

Chapter 5

CAA's decision

- 5.1 The CAA's decision, subject to statutory consultation, is as follows:
- for the year commencing 1 January 2015, a maximum permitted average charge per oceanic flight of £64.93 (nominal);
 - annual increases in the underlying base charge per Oceanic Flight for the calendar years 2016, 2017, 2018 and 2019 based on a price cap of CPI-5% per year;
 - a mechanism for over- and under-recovery, two rather than one year in arrears⁷.
- 5.2 A summary of the building blocks is set out in Appendix D.
- 5.3 This proposed licence condition is set out in Appendix E. This constitutes the publication of a notice setting out the proposed modifications of the licence as required under section 11(2) of the Transport Act 2000.

⁷ This recovery mechanism will generally be zero because the maximum allowed can be determined based on known information before the charge is set for the relevant year.

APPENDIX A

Summary of consultation responses

1. Figure A.1 below presents an overview of all consultation responses and the CAA's consideration of points raised.

Figure A.1: Summary of Consultation Responses

Respondent	Comment	CAA Response Reference
General comments		
IATA	Believes that there should be an adjustment to the transitional arrangement to return the £0.8 million benefit to users. IATA seeks that CPI-Z be replaced by the SES methodology after the first year of RP2. Requests clarification of traffic forecasts. Airlines should only pay a pension rate in line with commercial benchmarks.	Paragraph 4.7 Paragraph 4.4 Paragraphs 4.19-4.4.21
NATS	Draws attention to lower than expected returns in RP1 due to traffic variance to highlight the higher risk where there is no traffic volume risk sharing mechanism. Expect consistent pension pass through between the En Route business and the Oceanic business.	Noted. On pass through, see paragraphs 4.19 to 4.23.
NTUS	Caution should be taken in reducing costs. Questions the rationale of CAA adopting any of the SES structure. Suggest a modification of the NATS licence as "Eurocontrol Business" could relate to the cost part of the performance scheme alone.	Paragraph 4.16 Paragraph 4.14 Paragraph 4.31
Virgin	Supports IATA.	Noted.
BATA	Supports IATA & member submissions.	Noted.
Is it appropriate to continue to regulate Oceanic charges so long as that control is simple and easy to administer? If not, why not?		
British Airways	Essential to continue.	Noted. Paragraph 4.2

IATA	Essential to continue.	Noted. Paragraph 4.2
NATS	No concerns with CAA's recommendations.	Noted. Paragraph 4.2
Virgin	Imperative to continue.	Noted.
BATA	Supports IATA & member submissions.	Noted.
British Airways	Supports continuation of simple price cap.	Noted. Paragraphs 4.3-4.4
IATA	Supports price cap and notes ease of administration.	Noted. Paragraphs 4.3-4.4
Do you agree with the proposed form of regulation for Oceanic services? Mindful of the degree of market power, do you consider a different regulatory approach would be more proportionate given the scale of the business? If so, what would that approach comprise?		
NATS	No concerns with CAA's recommendations.	Noted. Paragraphs 4.3-4.4
Virgin	Where possible the cost of regulation should be kept as low as possible by a simple price cap.	Noted. Paragraphs 4.3-4.4
BATA	Supports IATA & member submissions.	Noted.
Should the timeframe for an Oceanic charge control be aligned with the timeframe for the RP2 controls for Eurocontrol and terminal services? If not, why not?		
British Airways	Supports the alignment.	Noted. Paragraphs 4.5-4.6
IATA	Supports the alignment.	Noted. Paragraphs 4.5-4.7
NATS	No concerns with CAA's recommendations.	Noted. Paragraphs 4.5-4.6
NTUS	Harmonising timescales is the right way forward.	Noted. Paragraphs 4.5-4.6
Virgin	Notes the alignment.	Noted.
BATA	Supports IATA & member submissions.	Noted.
Should the basis of indexation of charges be changed from RPI to CPI (subject to the value of X in a CPI-X charge cap being expected to generate the same amount as the value of Z in an RPI-Z cap)?		
British Airways	Supports CPI. Urged the CAA to migrate swiftly away from reflecting the difference between CPI and RPI.	Noted. Paragraphs 4.8-4.9
IATA	Notes the consistency with the use of CPI elsewhere but wants a level of X that reflects	Noted.

	market conditions.	
NATS	No concerns with CAA's recommendations.	Noted.
BATA	Supports IATA & member submissions.	Noted.
Is the approach proposed by the CAA to revise the Oceanic charge cap where the conditions set out in paragraphs 3.16-3.20 of the consultation document acceptable? If not, why not?		
British Airways	Supports.	Noted.
IATA	Notes but rejects trade-off between costs and benefits. Any proposal must be based on a sound cost benefit analysis and be endorsed by users.	Paragraph 3.6
NATS	No concerns with CAA's recommendations.	Noted.
NTUS	Is keen for investments to be made to improve safety and capacity. Important that the facility to re-open the cap is straightforward and not overly bureaucratic.	Noted. Paragraph 3.6
Virgin	A clear cost benefit analysis must take place on any potential improvements to be implemented	Paragraph 3.6
BATA	Supports IATA & member submissions.	Noted.
Is it reasonable to apply assumptions consistent with those adopted in the UK-Ireland FAB Performance Plan for NERL's Eurocontrol business? If not, why not?		
British Airways	Supports in principle.	Noted.
IATA	Welcome alignment in planning but reiterates comments in relation to operating expenses and cost of capital.	Noted.
NATS	Reasonable to apply consistent assumptions for inflation, traffic assumptions and interest rates.	Noted.
NTUS	Believes it will be difficult to justify the exclusion of Oceanic from SES scheme if it applies elements of the SES approach to Oceanic. Believes the definition of businesses in the licence should be clarified.	Paragraph 4.14 Paragraph 4.31
Virgin	Supports IATA.	Noted.
Do you have any comments on the building block assumptions described in paragraphs 4.12-4.28 of the consultation documents?		
British Airways	Broadly supports but believes a higher percentage of pension opex should be disallowed.	Noted.
IATA	Requests further information on the basis of the traffic forecasts.	Appendix B

	Pension rates in line with commercial benchmarks should be applied.	Paragraphs 4.19-4.23 (pensions)
NATS	No comments. (see general comments above)	Noted.
NTUS	Staff cost based on the IDS and pension pass through should be discounted. The reduction proposed by NATS is overly punitive but could accept the NERL RBP figure with the cost of capital intervention. The lack of risk sharing mechanism should be taken into account in not imposing any further interventions.	Paragraphs 4.15-4.16 Noted. Noted.
Virgin	Supports IATA.	Noted.
BATA	Supports IATA & member submissions.	Noted.
Is it reasonable to apply profiling to arrive at a simple CPI-X charge control? If not, why not?		
British Airways	BA does not support because there is cross subsidy between years.	Paragraph 4.28
IATA	IATA requests further information on this calculation.	Appendix C
NATS	Supports	Noted.
Virgin	Notes the merit in smoothing the evolution of charges in the 2015-2019 period, but requests further data in relation to paragraph 4.31 of the consultation document.	Appendix C
BATA	Supports IATA & member submissions.	Noted.

APPENDIX B

Traffic forecast information

1. This appendix sets out more clearly how the forecasts of Oceanic services were derived consistent with the STATFOR forecasts for service units and movements in domestic airspace.
2. Table B.1 below shows:
 - The actual Oceanic movements in 2013 recorded by NERL.
 - The annual percentage growth rates forecast in the February 2014 STATFOR forecasts for Eurocontrol Statistical Reference Area Northwest to North Atlantic⁸. (This was considered to be the best available proxy for Oceanic Traffic in the Swanwick area distinguished in the STATFOR forecasts.)
 - To derive a forecast for Oceanic flights the actual Oceanic flights for 2013 were uplifted by the growth rate assumed for 2014 to make a 2014 forecast. This calculation was then repeated for each year of the control period with the assumed growth rate for each year being applied to the prior year forecast.

Table B.1: Derivation of Oceanic Movement Forecasts

Movements	2013	2014	2015	2016	2017	2018	2019
Actual	402,653						
Assumed growth rate		0.40%	2.00%	1.90%	1.40%	1.60%	1.50%
Forecast		404,264	412,349	420,184	426,066	432,883	439,376

Sources: NERL STATFOR and CAA Calculation.

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APPENDIX C

Profiling

1. In response to a request from users, the following sets out the profiling calculation in more detail.
2. The CAA first considered as inputs:
 - the traffic projections;
 - the cost projections;
 - the discount rate; and
 - the existing charge per flight in the last year of the current review period.
3. The calculation then considers the net present value of the cost projections (i.e. the cost projections discounted by the weighted average cost of capital). It is then possible to consider the present value of the revenue streams resulting from various paths in prices which produce the same net present value. In this case the CAA has considered price paths defined by two parameters:
 - The value of Z in the CPI-Z formula in each year of the review period after the initial year.
 - The equivalent value to the value of Z to reflect the real decrease from the last year of the old price review period and the new (usually referred to as P0).
4. The CAA has set the value of Z to 5% (i.e. the price formula is CPI-5%). It has then sought the value of P0 for which the present value of the resulting present value of the determined cost. This goal seek function in excel has identified that a value of P0 of approximately 1.3 provides the same present value across the control period as a whole (see figure C.1 below).

Figure C.1: The Profiling Calculation

INPUTS		2014	2015	2016	2017	2018	2019	RP2
Traffic			412,350	420,187	426,069	432,885	439,377	
Total determined cost			£24,948,411	£24,245,134	£23,504,524	£22,743,967	£22,236,901	£117,678,937
Cost of capital (%)								5.86%
Discounting Factor			1.0289	1.0892	1.1531	1.2207	1.2923	
2014/15 base charge	£64.53							
PROFILING CALCULATION								
P0			1.3%					
X			5.0%					
Calendar year CPI		1.0450	1.0649	1.0851	1.1068	1.1290	1.1515	
CPI Inflation			1.9%	1.9%	2.0%	2.0%	2.0%	
X or P0		1.3%	5.0%	5.0%	5.0%	5.0%	5.0%	
Price		2014	2015	2016	2017	2018	2019	RP2
Nominal		£64.53	£64.93	£62.92	£61.03	£59.20	£57.42	
2012 prices		£61.75	£60.98	£57.98	£55.14	£52.44	£49.87	
Revenue			£25,143,163	£24,363,733	£23,493,777	£22,699,606	£21,910,599	£117,610,879
PV Revenue	Discounted revenues		£24,437,003	£22,368,039	£20,374,783	£18,595,785	£16,955,339	£102,730,949
PV Costs	Discounted costs		£24,247,721	£22,259,154	£20,384,103	£18,632,125	£17,207,846	£102,730,949
Difference			£189,282	£108,885	-£9,320	-£36,341	-£252,507	£0

Source: CAA calculation

APPENDIX D

Summary of building blocks

Figure D.1: Assumed CPI

CPI	2015	2016	2017	2018	2019
Index	1.0649	1.0851	1.1068	1.1290	1.1515

Source: IMF April 2014

Figure D.2: Determined Cost Summary

Determined costs - CY 2012 prices (£m)	2015	2016	2017	2018	2019
Opex (excluding exceptionals and pensions)	15.0	15.0	15.0	14.8	14.7
Exceptional Costs	0.2	0.1	0.1	0.1	0.1
Cash Pensions	3.3	3.3	3.3	3.1	2.9
Regulatory Depreciation	5.3	4.7	4.2	4.0	3.9
Regulatory Return	1.7	1.5	1.3	1.2	1.0
Other Income	-0.5	-0.5	-0.4	-0.4	-0.4
Total determined costs	24.9	24.2	23.5	22.7	22.2

Source: CAA

Figure D.3: Assumed capital Expenditure⁹

CY 2012 prices (£m)	2015	2016	2017	2018	2019	Total
Capex	1.9	1.2	0.8	0.8	1.2	5.9

Figure D.4: Regulatory Asset Base in Financial Years (year end outturn prices)

Year-End Outturn Prices (£m)	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Opening RAB	31.2	32.0	29.0	26.2	23.4	20.6
Inflation of opening RAB	0.9	1.0	1.1	1.0	0.8	0.9
Total actual net capex	4.8	1.2	1.4	0.7	1.0	1.6

9 NB These figures correct those presented in table 4.8 of the consultation document.

Pension Contribution Variance	0.5	0.0	0.0	0.0	0.0	0.0
Capitalised financing costs (can be negative or positive)	0.3	0.0	0.0	0.0	0.0	0.0
Actual movements in working capital	0.2	0.5	-0.1	0.2	-0.1	-0.1
Allowed Depreciation	-5.9	-5.6	-5.1	-4.6	-4.5	-4.6
Closing RAB	32.0	29.0	26.2	23.4	20.6	18.4
Average RAB	31.6	30.5	27.6	24.8	22.0	19.5

Source: NERL and CAA analysis

APPENDIX E

Condition 22: Proposed licence modification

Replace condition 22 with the following with effect from 1 January 2015.

Condition 22: Oceanic charges

1. Subject to paragraph 2 of this Condition and without prejudice to Condition 25 (Suspension and Modification of Charge Control Conditions) the Licensee shall use its best endeavours to ensure that in each Oceanic Relevant Year beginning on 1 January 2015, 2016, 2017, 2018 and 2019 the Average Charge Per Oceanic Flight shall not exceed the Maximum Permitted Average Charge Per Oceanic Flight calculated in accordance with the following:

$$O_t = U_t + L_t$$

where:	
O_t	means the Maximum Permitted Average Charge Per Oceanic Flight in Oceanic Relevant Year t.
	For the Oceanic Relevant Year beginning on 1 January 2015 the value of O_{2015} shall be £64.93.
	For the Oceanic Relevant Year beginning on 1 January 2016, 2017, 2018 and 2019 the value of O_t shall be: $O_t = U_t + L_t$
U_t	is a base charge per Oceanic Flight in Oceanic Relevant Year t calculated in accordance with the following formula: $U_t = U_{t-1} \left[1 + \frac{CPI_t - Z_t}{100} \right]$ For the purpose of the above calculation for the Oceanic Relevant Year beginning on 1 January 2016 the value of $U_t - 1$ shall be £64.93.
CPI_t	means the percentage points change (whether of a positive or a negative value) in the Consumer Price Index between the index published or determined with respect to August in Oceanic Relevant Year t-1 and the index published or determined with respect to

	August in Oceanic Relevant Year t-2.	
Z_t	means a value set by the CAA in respect of each of the Oceanic Relevant Years beginning on 1 January 2016, 2017, 2018 and 2019 shall have the following values:	
	Year t	Value of Z
	2016	5
	2017	5
	2018	5
	2019	5
L_t	means the correction factor (whether of a positive or negative value) which is calculated in accordance with the following formula:	
	$L_t = \frac{(QO_{t-2} O_{t-2}) - TO_{t-2}}{QO_t} \left[1 + \frac{IO_{t-1}}{100} \right] \left[1 + \frac{IO_{t-2}}{100} \right]$	
	where:	
	$L_{2015} = L_{2016} = 0$	
	Otherwise:	
	QO_{t-2}	means the quantity of Oceanic Flights in Oceanic Relevant Year t-2 attracting an Oceanic Charge.
	O_{t-2}	means the Maximum Permitted Average Charge Per Oceanic Flight in Oceanic Relevant Year t-2.
	TO_{t-2}	means the total Oceanic Revenue in Oceanic Relevant Year t-2.
	IO_{t-1}	means the average of the yield (expressed as an annual percentage interest rate) on 3 month Treasury Bills published weekly by the UK Debt Management Office, during the 12 months from 1 September in Oceanic Relevant Year t-2 where the value of $((QOt-1Ot-1) - TOt-1)$ is positive, or 300 basis points per annum above this average rate where the value is negative.