

Economic Regulation of NATS (En Route) plc: Final Decision for the NR23 (2023 to 2027) price control review (London Approach and Oceanic)

CAP 2597a

Published by the Civil Aviation Authority, October 2023

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First published 2023
First edition

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Chapter 8

London Approach

Introduction and context

- 8.1 The London Approach service consists of the control and sequencing of flights by NERL's Swanwick centre between NERL's en route service and the control tower services at Heathrow, Gatwick, Stansted, Luton, and London City airports. The London Approach service was established to realise safety and capacity benefits from managing congested London terminal airspace centrally.
- 8.2 The London Approach service is regulated through a separate price control under NERL's licence. NERL levies a per flight charge, calculated based on aircraft weight, on flights to or from these airports. The charge is part of NERL's regulated charges that are subject to price control.
- 8.3 In regulating the London Approach service, we apply the same duties under TA00 as for the regulation of the UK en route and Oceanic services. As such, our primary duty when exercising our economic regulation functions in relation to the London Approach service is to maintain a high standard of safety, and when exercising such functions, we must do so in the manner we think best calculated to apply the secondary duties. We consider the secondary duties which are particularly relevant in this case are: to further the interests of customers and consumers, to promote efficiency and economy on the part of NERL and to secure that NERL will not find it unduly difficult to finance its licensed activities.
- 8.4 The London Approach service is provided from the Swanwick en route centre and uses resources and equipment that are shared with the UK en route service. As such, we do not assess the costs and other revenues for London Approach separately from the assessment we use to determine NERL's charges for providing its UK en route service. Instead, the London Approach charge is derived as a proportion of the total UKATS (UK en route and London Approach) Determined Costs. We consider that setting efficient allowances for operating and capital costs according to this approach is the best way to secure that the CAA discharges its duties under the TA00 appropriately.

Our Provisional Decision

- 8.5 In developing our Provisional Decision, we were mindful of the advantages of a stable regulatory framework and that continuing the relatively simple, straightforward and proportionate approach to setting the London Approach price control would be an appropriate means of securing this.

8.6 Consistent with our approach to the UK en route business, our Provisional Decision was based on the STATFOR March 2023 base case traffic forecast.

8.7 In our Provisional Decision we:

- retained the present approach to cost allocation between London Approach and en route charges, with around one-third of London Approach costs allocated to the London Approach charge with the remainder allocated to NERL's en route charges;
- continued to use the same TRS mechanism as we do for en route charges;
- used the same TRS debtor as we do for en route charges; and
- continued to require NERL to publish its London Approach service quality performance in its quarterly performance reports.

8.8 The London Approach Determined Costs and Determined Unit Costs in our Provisional Decision are set out in Table 8.1 below.

Table 8.1 Provisional Decision for London Approach

2020 prices CPI	2023	2024	2025	2026	2027
Determined Costs (£000)	13,042	12,780	13,412	13,784	13,876
Terminal forecast units (000)	955	1,003	1,022	1,039	1,054
DUCs (£)	13.66	12.74	13.12	13.27	13.17

Source: CAA for costs, STATFOR March 23 for traffic forecast

8.9 London Approach charges are affected by adjustments for inflation, differences between actual and forecast traffic, TRS, other revenues and over- or under-recoveries from the use of a temporary unit rate as well as by Determined Costs.

8.10 The reasons supporting our Provisional Decision in relation to the London Approach price control were set out in paragraphs 8.13-8.16 of our Provisional Decision, and our approach also took into account the reasoning in paragraphs 8.14-8.28 of our Initial Proposals.

Summary of stakeholders' views

8.11 Only British Airways commented on our Provisional Decision on charges for the London Approach service. It supported our proposals to:

- retain a stable regulatory framework that is relatively simple, straightforward and proportionate;
- keep cost allocation unchanged for NR23;
- align the London Approach TRS with the en route TRS;
- use the same TRS debtor as we do for en route charges; and
- require NERL to continue to report on service quality performance.

Our views

- 8.12 In our Provisional Decision for London Approach charges, we considered NERL's overall UKATS costs and non-regulatory revenue in the round, provisionally setting a price control that would allow NERL to maintain its current high standard of safety in providing its UK en route and London Approach services. Our Provisional Decision was also consistent with our secondary duties, including our duties to exercise our functions in the manner we think is best calculated to further the interests of customers and consumers by setting efficient allowances for operating and capital costs.
- 8.13 We welcome British Airways' support for retaining a stable, relatively simple, straightforward and proportionate regulatory framework and we have decided to continue with this framework for NR23.
- 8.14 As the London Approach service benefits aircraft overflying South-East England as well as those landing at London airports, we have continued with the previous approach to cost allocation and allocated around one third of London Approach costs to the London Approach charge with the remainder allocated to the en route charge. We note that during the RP3 price control review NERL submitted evidence on the allocation of approach functions between en route and terminal charges used by ANSPs in Europe. NERL found that the allocation was consistent with the cost allocation we used in RP2 and subsequently used for RP3. Given this evidence, the support of British Airways, and the advantages of maintaining a stable regulatory framework, we have decided to retain the cost allocation used for RP3 for the London Approach service for NR23.
- 8.15 We welcome British Airways' support for continuing to align the London Approach TRS mechanism with that used for UK en route charges and note the lack of any dissenting comments from other stakeholders. As set out in paragraph 8.20 of our Initial Proposals, we consider that, as traffic uncertainty applies to London Approach traffic in the same way as it does for en route traffic, the policy issues are the same for both price controls. Therefore, we have decided that the TRS mechanism for London Approach in NR23 should continue to be aligned with the approach for the UK en route control. Consistent with this,

we have also adopted the same approach to the TRS debtor as set out in the Provisional Decision.

- 8.16 In our Provisional Decision, we said that NERL should continue to report on its service quality performance for London Approach in its quarterly operational performance reports produced under Condition 11 of its licence. As this reporting is primarily for the benefit of users and the proposal was supported by British Airways we have decided to continue to require NERL to report on its London Approach performance in NR23.
- 8.17 In our Initial Proposals we noted that we had investigated NERL's London Approach performance in both Project Oberon and Project Palamon but had not concluded in either case that we should introduce financial incentives on NERL's performance. In our Provisional Decision, we said we would not introduce financial incentives, but would monitor the information NERL provides during NR23 and may return to this issue in the future if it is appropriate. This remains our position in this Final Decision.

Our Final Decision

- 8.18 We have decided to:
- retain the approach to cost allocation between London Approach and en route charges used for RP3 in setting the charges for the London Approach service during NR23;
 - continue to use the same TRS mechanism as we do for en route charges;
 - use the same ten year TRS debtor as we do for en route charges; and
 - continue to require NERL to publish its London Approach service quality performance in its quarterly performance reports.

- 8.19 Table 8.2 shows our Final Decision on Determined Unit Costs for NR23.

Table 8.2 Final Decision for London Approach

2020 prices CPI	2023	2024	2025	2026	2027
Determined Costs (£000)	13,042	12,780	13,412	13,784	13,876
Terminal forecast units (000)	955	1,003	1,022	1,039	1,054
DUCs (£)	13.66	12.74	13.12	13.27	13.17

Source: CAA for costs, STATFOR March 23 for traffic forecast

- 8.20 The actual charges that NERL will set in NR23, will also be affected by other factors: adjustments for inflation, differences between actual and forecast traffic, TRS, other revenues and over- or under-recoveries from the use of a temporary unit rate. The amounts of these other factors are unknown now, but will be known when NERL sets its charges during NR23.
- 8.21 The effects of our price control decisions are to allow NERL to set charges which should maintain a high standard of safety and quality of service in providing the London Approach service and, as such, is, consistent with our primary and secondary duties.

Next steps and implementation

- 8.22 We have decided to modify Condition 21a of NERL's licence to implement our decision on London Approach charges for NR23. The modifications we have decided to make are set out in CAP 2597b appendix E.
- 8.23 As indicated in paragraph 8.16, we will continue to monitor the information NERL provides on its London Approach service performance in NR23 and keep under review whether we should introduce financial incentives on NERL's performance for NR28.

Chapter 9

Oceanic

Introduction and context

- 9.1 NERL's Oceanic service provides air traffic services and datalink communications in the Shanwick airspace area for flights across the North Atlantic, while Ireland is responsible for high frequency communications. In 2019 NERL introduced a space-based automatic dependent surveillance broadcast (ADS-B) system to its Oceanic service, using satellites to provide more accurate and timely aircraft positioning information compared to the then existing procedural approach.
- 9.2 NERL's Oceanic service is subject to the TA00 and regulated through a separate price control under the NERL licence. It is not part of the UK performance plan required under the Eurocontrol Principles.
- 9.3 In regulating the NERL's Oceanic service, we apply the same duties under TA00 as for the regulation of the UK en route and London Approach services. As such, our primary duty when exercising our economic regulation functions in relation to the Oceanic service is to maintain a high standard of safety. So, our main priority when setting the NR23 Oceanic price control is to allow NERL to employ sufficient resources (such as staff, equipment and systems) to enable it to maintain a high standard of safety.
- 9.4 When setting the price control for Oceanic, we must do so in the manner we think best calculated to apply the secondary duties. We consider the secondary duties which are particularly relevant in this case are: to further the interests of customers and consumers, to promote efficiency and economy on the part of NERL and to secure that NERL will not find it unduly difficult to finance its licensed activities.
- 9.5 The Oceanic service is a relatively small part of NERL's overall business, consisting of about 7% of NERL's opex costs in NR23, and 6% of total costs (which include capex). The Oceanic RAB represents about 2% of NERL's total RAB.
- 9.6 This chapter sets out our Final Decision for NERL's Oceanic service for NR23.

Our Provisional Decision

- 9.7 In our Provisional Decision, consistent with a proportionate approach to regulation, we largely followed the approach we used for setting the efficient cost baseline for the UKATS building blocks, only varying our approach where there

was a clear case to do so given our statutory duties. These building blocks include:

- staff, non-staff and pensions opex;
- capex;
- non-regulatory revenues;
- allowed return on the RAB (WACC); and
- regulatory depreciation.

- 9.8 As STATFOR does not publish a specific Oceanic traffic forecast, we used NERL's traffic forecast which was based on STATFOR's March 2023 forecast. We explored the availability of other forecasts for the Oceanic service, however, after assessing that NERL's forecast was reasonable and in the absence of other reliable published forecasts since the covid-19 pandemic, we decided that the use of NERL's forecast would be the most appropriate approach.
- 9.9 Since our Initial Proposals, NERL had forecast an increase in ADS-B costs of £20 million for North Atlantic flights and a decrease of £5 million in such costs for Tango flights over NR23. In our Provisional Decision, we only accepted £10 million of the forecast increase, adopting NERL's updated exchange rate, but rejecting its proposed increase in average flight hours and using updated traffic and inflation forecasts. We accepted the revised Tango costs and noted that these reflected its negotiated price with Aireon.
- 9.10 We said that, when the review of the costs and benefits of ADS-B was completed, we would consider whether we should:
- reconsider the regulatory allowance for ADS-B and any efficiency adjustments; and
 - specify service quality targets and metrics for NERL, which it would then be required to report on in its quarterly performance reports.
- 9.11 We proposed not to include a traffic risk sharing mechanism for Oceanic, as we considered it might introduce unnecessary complexity with limited benefits for customers, and because a substantial portion of the Oceanic service costs was already protected from traffic risk under NERL's contractual arrangements with Aireon, the ADS-B data provider.
- 9.12 Our assumptions on the Oceanic cost building blocks and the overall level of the price control set out in our Provisional Decision are summarised in Tables 9.1 and 9.2 below.

Table 9.1 Oceanic building blocks (Provisional Decision)

£m, 2020 prices	2023	2024	2025	2026	2027
Operating costs (staff and non-staff)	19.2	18.1	15.7	16.1	15.0
Exceptional items ¹	0.1	0.1	0.1	0.1	0.1
Pensions	5.7	5.5	3.5	3.2	3.0
Regulatory depreciation	6.6	6.9	4.5	4.8	4.9
Return on RAB	1.2	1.1	1.0	1.0	1.0
Tax	1.1	1.3	0.4	0.9	1.1
Other Oceanic revenue	-0.5	-0.5	-0.5	-0.5	-0.5
Total core costs	33.4	32.5	24.8	25.7	24.7
Traffic forecasts North Atlantic (000s)	483	519	528	535	542
Traffic forecast Tango (000s)	24	26	27	27	27
Unprofiled core charge per flight (£)	65.9	59.7	44.7	45.8	43.4
ADS-B data costs North Atlantic (NA)	14.9	15.8	16.9	17.1	17.8
ADS-B data costs Tango	0.04	0.14	0.15	0.14	0.15
Unprofiled ADS-B data charge per NA crossing	30.9	30.5	32.0	31.9	32.9
Unprofiled ADS-B data charge per Tango area crossing	1.5	5.2	5.4	5.3	5.5

Source: CAA calculations

¹ Includes: exceptional costs and spare cash provisions.

Table 9.2 Provisional Oceanic Price Control

£ 2020 CPI prices	2023	2024	2025	2026	2027
Base charge	65.9	59.7	44.7	45.8	43.4
Atlantic ADS-B charge	30.9	30.5	32.0	31.9	32.9
Tango ADS-B charge	1.5	5.2	5.4	5.3	5.5

Source: CAA calculations

Summary of stakeholders' views

9.13 In response to our Provisional Decision, NERL:

- accepted our cost totals and agreed with our overall approach to setting the cost allowance, except in relation to ADS-B costs, as discussed below;
- was disappointed with our exclusion of the proposed increase in projected ADS-B costs for higher flight hours. It submitted further analysis based on more recent data;
- was pleased to see that the ADS-B review will proceed as planned;
- appreciated our recognition of its ongoing engagement for service performance measurements and targets. It said that the ADS-B workshops would provide an opportunity to refine and enhance the measures based on the review findings;
- disagreed with our rationale for not introducing a TRS mechanism, this is covered in chapter 7 (Regulatory incentives and mechanisms); and
- queried the declining profile of charges over NR23 period. It considered that users would be better served by a simple flat charge in real terms over the period, this is covered in chapter 5 (Financial framework).

9.14 Airlines for America:

- supported our Provisional Decision not to introduce a TRS mechanism, as this would create additional complexity without generating significant benefits for users; and

- strongly supported the need for an independent cost benefit review of ADS-B data charges, as well as development of quantitative and qualitative metrics to measure benefits against plan.

9.15 British Airways:

- supported our calculation of Oceanic costs and use of the latest traffic and inflation forecasts;
- said that since the Oceanic traffic forecast is calculated by NERL because an independent forecast is unavailable, we should disclose the traffic forecast and its calculations to users for transparency and to allow stakeholders a reasonable opportunity to assess;
- did not support NERL's consideration of using extended flight times for calculating ADS-B costs, as the observations were based on data in the twelve months to June 2022, representing a significantly outdated period when the impact of the covid-19 pandemic was still severe. British Airways also said that we should consider any credible updates to the data, including in relation to the USD:GBP exchange rate;
- supported the ADS-B review and updating the price control for any efficiency adjustments that it might point to; and
- supported our Provisional Decision not to introduce a TRS mechanism, as a significant proportion of the Oceanic service is already protected from traffic risk through NERL's contractual arrangements with Aireon. It said there would need to be a clear and substantial benefit to customers to justify the additional complexity.

9.16 IATA:

- supported our Provisional Decision not to introduce a TRS mechanism; and
- remained fully supportive of the independent cost benefit review of the introduction of ADS-B data charges as well as the development of quantitative metrics to measure benefits against plan.

Our views

- 9.17 Bearing the above in mind we are retaining the approach set out in our Provisional Decision and largely following the methods used for setting the efficient cost baseline for the UKATS building blocks, only varying our approach where there was a clear case to do so given our statutory duties. Our assessment of the price control building blocks relating to costs is set out in chapter 4 (NERL costs), our approach to regulatory depreciation and returns is

set out in chapter 5 (Financial framework), and our approach financeability is set out in chapter 6 (Charges and financeability).

- 9.18 We note British Airways' request for transparency on NERL's traffic forecast and understand that NERL has shared the results of its traffic forecasting along with a high level explanation of its methodology with airlines.
- 9.19 In calculating ADS-B costs for Atlantic traffic in our Provisional Decision, we used the assumptions for average flight times used in NERL's business plan, rather than revised figures (for the twelve months to July 2022) NERL submitted in April 2023. In response to our Provisional Decision, NERL provided new information on average Oceanic flight hours for the twelve months to end July 2023. This showed that in the twelve months to end July 2023 average flight hours were lower than in the twelve months to end July 22, but were still above the levels in its business plan, which we had used in our Provisional Decision.
- 9.20 NERL said the main reasons for the increased flight hours were: the aircraft fleet mix, airport pairs flown and the tracks flown across the ocean. Using the numbers for the twelve months to July 2023 would increase NERL's costs by £2 million over NR23.
- 9.21 As the average flight hours continue to change, it remains unclear whether the higher flight hours will be sustained and we also note that changing to an approach calculated by reference to the average flight hours in the twelve months to July 2023 would not make a material difference to the price control. As we do not consider it is in the interests of customers and consumers to allow higher costs that have not been fully justified, we have decided to continue to use the numbers set out in NERL's business plan to calculate Atlantic ADS-B costs in the NR23 price control.
- 9.22 We continue to support the review of the costs and benefits of the use of ADS-B for the Oceanic service. NERL currently expects the review to start in Autumn 2023 and end in July 2024. When the review is complete, we consider that it is in line with our statutory duties (in particular, to further the interests of customers and consumers) to take account of its findings in our consideration of whether to change the regulatory allowances for ADS-B costs and the service quality metrics which should be included in NERL's quarterly performance reports.
- 9.23 We are not introducing a TRS mechanism to the Oceanic price control. More detail on our reasons for not doing so is in chapter 7 (Regulatory incentives and mechanisms).
- 9.24 NERL asked us to explain the declining profile of charges in our Provisional Decision. The profile reflected the declining forecast Determined Costs and increasing forecast traffic numbers as shown in Table 9.1 of our Provisional Decision. As we have explained in chapter 6 (Charges and financeability), we have decided to retain this approach for this Final Decision.

Our Final Decision

9.25 We have decided to:

- use the same approach for calculating the building blocks of the Oceanic price control as we have used for calculating NERL's en route price control;
- continue to use the business plan numbers for calculating Atlantic ADS-B costs in the NR23 price control;
- continue to support the review of the costs and benefits of NERL's use of ADS-B for the Oceanic service;
- not introduce a TRS mechanism for Oceanic; and
- not use a flat profile of charges for NR23.

9.26 There are some very small (no more than £0.2 million) changes in the return on RAB and tax from our Provisional Decision. These are due to updating in respect of actuals for 2021 and 2002 and correcting some modelling errors. These changes are described in more detail in chapter 6 (Charges and financeability). Taking this approach leads to the calculation of the building blocks for the Oceanic price control set out in Table 9.3 Oceanic building blocks (Final Decision) and the charges set out in Table 9.4 Oceanic price control (Final Decision) below.

Table 9.3 Oceanic building blocks (Final decision)

£m, 2020 prices	2023	2024	2025	2026	2027
Operating costs (staff and non-staff)	19.2	18.1	15.7	16.1	15.0
Exceptional items²	0.1	0.1	0.1	0.1	0.1
Pensions	5.7	5.5	3.5	3.2	3.0
Regulatory depreciation	6.6	6.9	4.5	4.8	4.9
Return on RAB	1.0	0.9	0.8	0.8	0.8
Tax	1.2	1.5	0.6	1.1	1.2
Other Oceanic revenue	-0.5	-0.5	-0.5	-0.5	-0.5

² Includes: exceptional costs and spare cash provisions.

£m, 2020 prices	2023	2024	2025	2026	2027
Total core costs	33.4	32.5	24.8	25.6	24.6
Traffic forecasts North Atlantic (000s)	483	519	528	535	542
Traffic forecast Tango (000s)	24	26	27	27	27
Unprofiled core charge per flight (£)	65.8	59.7	44.7	45.6	43.2
ADS-B data costs North Atlantic (NA)	14.9	15.8	16.9	17.1	17.8
ADS-B data costs Tango	0.04	0.14	0.15	0.14	0.15
Unprofiled ADS-B data charge per NA crossing	30.9	30.5	32.0	31.9	32.9
Unprofiled ADS-B data charge per Tango area crossing	1.5	5.2	5.4	5.3	5.5

Source: CAA calculations

Table 9.4 Oceanic price control (Final decision)

£ 2020 CPI prices	2023	2024	2025	2026	2027
Base Charge – Provisional Decision	65.9	59.7	44.7	45.8	43.4
Base Charge – Final Decision	65.8	59.7	44.7	45.6	43.2
Atlantic ADS-B charge – Provisional Decision	30.9	30.5	32.0	31.9	32.9
Atlantic ADS-B charge – Final Decision	30.9	30.5	32.0	31.9	32.9
Tango ADS-B charge – Provisional Decision	1.5	5.2	5.4	5.3	5.5
Tango ADS-B charge – Final Decision	1.5	5.2	5.4	5.3	5.5

Source: CAA calculations

- 9.27 Charges during NR23 will also include adjustments to Oceanic revenue for inflation, traffic variations and variance in the 2023 unit rate, which we have set to be recovered over the NR23 period to smooth the impact on the charge in 2024, which are not reflected in the charges in the tables above.
- 9.28 The effects of our decision is to set a price control for the Oceanic service that allows NERL to employ sufficient resources (such as staff, equipment and systems) to maintain its current high standard of safety and is consistent with our secondary duties, including to further the interests of customers and consumers as well as ensuring that it is not unduly difficult for NERL to finance its Oceanic activities, and to continue to require NERL to commission an independent review of whether the benefits of providing a fully ADS-B based service outweigh the costs of providing the service.

Next steps and implementation

- 9.29 We have decided to modify Condition 22 of NERL's licence to implement our decision on the price control for the Oceanic service for NR23. The modifications we have decided to make are set out in appendix E (CAP2597c).
- 9.30 We have amended the date of the ADS-B review to a date determined by the CAA after reasonable consultation with NERL and other interested parties and with the terms of reference being agreed with the CAA. When the review is complete, we will take account of its findings and, if appropriate, in accordance with our statutory duties, bring forward any necessary changes to the regulatory allowances for ADS-B costs and/or the reporting requirements on NERL in relation to service quality metrics to address such findings.