Economic regulation of NATS (En Route) plc: consultation on approach to the next price controls review

CAP 1994

Submission by Prospect to the Civil Aviation Authority Consumers and Markets Group

12 January 2021

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Introduction

1. This document outlines the formal written response to CAP 1994 on behalf of Prospect's Air Traffic Control Officers (ATCOs') and Air Traffic System Specialists (ATSS) Branches. With 2100 members in the Air Traffic Control Officers' Branch, 800 members in the Air Traffic System Specialists Branch, and over 250 ATC workers in other branches – including the CAA - we represent effectively the entire workforce of professionals involved in UK ATM.
2. Prospect is a key stakeholder in the operation of NERL and the wider UK Air Traffic Management (ATM) System. Historically, Prospect has had a good working relationship with NATS and we operate a 'Working Together' approach focused on problem-solving in our day-to-day work. For well over a decade, this has allowed NATS and NERL to modernise and to achieve the outstanding results it has when it comes to aviation safety and high-quality service to air traffic in the UK. However, we note that this relationship has come under considerable strain since the deepening of the pandemic in Spring 2020.
3. Following the emergence of the pandemic, it soon became obvious that the impact of lockdown and travel restrictions on ANSPs and airports would be deep and enduring. Prospect recognised early on that ANSPs would come under significant pressure, particularly because they represented, in large part, a fixed cost for the airlines. We proposed two solutions to ensure the viability of ANSPs, recognising their role as part of the UK's critical national Infrastructure.
4. The first proposal concerned airport services, seeking to ensure the continuity and viability of airport ANSPs and other safety-critical services through our airport capacity retention scheme (22 April 2020, Appendix A).
5. Our second proposal formed part of a broader aviation package and sought government support to cover NERL's catastrophic loss of revenue and thus ensure continuity of service and NATS' investment programme (10 June 2020, Appendix B). We take the opportunity to reiterate this position: in our view, **a number of the challenges identified in CAP 1994 can best be addressed by the Government stepping in to directly fund, subsidise or underwrite en-route air navigation services for the period of pandemic-related disruption.**
6. As well as being a NATS shareholder (with a 'golden' share) and ultimately a 'lender of last resort', the UK Government has international obligations and responsibilities for the continued provision of ATM. Either way - whether by increasing its equity, or ultimately having to rescue NERL- the onus falls on government to ensure that NERL's operations continue even if the business fails (e.g. if NATS becomes unfinanceable) or if a recovery in revenues is weaker than forecast. It is in the Government's – and, thus, the CAA's - interest to ensure that this price controls review does not impede NATS' financeability. This might not be compatible with affordability – at least, not without subsidy. That said, **we comment on the concept of affordability and its relevance to this review at some length**.
7. Many infrastructure investments benefit the nation and public at large, rather than just its direct users. Prospect believes that NATS' funding model grants airspace users disproportionate influence over the scale, direction and purpose of its capital programme. It may not be appropriate for airspace users to pay for public goods such as infrastructure upgrades if they cannot afford to, or wish to challenge public good improvements (e.g. environmental benefits). In particular, DP En-route and airspace redesign will deliver long-term UK-wide benefits. As with other large scale UK infrastructure projects (e.g. HS2 and motorways), there is a compelling argument that investment capital should come from the government – especially if the airspace users are unable or unwilling to fund it.
8. In line with the discursive approach of CAP 1994, rather than addressing the questions raised in turn or summarising them separately, we have highlighted our key points in **bold**.

Current Situation

9. The entire aviation industry has suffered a catastrophic year. Traffic numbers across the European network are approximately 63% lower than 2019 levels for the same seven-day rolling period.[1] The challenges have been immense, from immediate safeguarding of sites and our members to ensure they are protected as far as possible whilst at work, to aiding NATS and other ANSPs with immediate liquidity issues. We then moved into a steadier state looking at longer-term operational issues. We are still reacting dynamically to challenges as they present themselves in order that our members can continue to provide the essential service that they do.

10. Given the reduction in traffic levels, those aircraft that are flying have benefited from an enhanced level of service with the removal of many restrictions and the provision of direct routes both for convenience and environmental benefit. It is arguable that **the suspension of capital programmes last year was a lost opportunity** - reduced traffic levels could have provided space and human resource to accelerate modernisation, had the funds been available to do so.

11. Within NERL our members have risen to the challenge by being incredibly flexible in terms of working arrangements and the use of furlough and have directly assisted with NERL's short-term cashflow problems by deferring the agreed 2020 pay award, reverting to 2019 pay rates from April 2020. The staff also contributed as shareholders by not receiving dividend payments this year.

12. The key issue to stress here is that the last year has been spent managing a crisis against a background of a catastrophic loss of income for the entire industry. **Emergency actions should not be used to inform decisions on the future.**

13. Crucially, the future remains hugely uncertain. Even as CAP1994 was published the situation changed again, with another significant lock down and stricter travel restrictions. This has deepened and lengthened the downturn in traffic and passengers. A significant recovery in demand this summer now looks much less likely. For the purposes of this price controls review, **the CAA should come to a view on traffic forecasts and a range of probable outcomes for the pace and scale of a recovery** in the interim and for the duration of a new Reference Period. The CAA should consult on this forecast to secure broad acceptance of what will be a foundation planning assumption for the Review.

Regulatory Approach

14. Some of the key questions raised in this consultation can only be answered in the context of a reasonable and realistic traffic forecast. How should the traffic risk sharing / revenue recovery mechanism work? When should RP4 start and how long should it last? Which capital programmes are still required and which are volume dependent?

15. A key component of every Control Period is to have a level of confidence in the Traffic Forecasts over the regulatory period. For RP3 there was debate about the use of NATS internal forecasts or the use of STATFOR but most importantly, it should be expected that there is a broad level of industry agreement to the forecasts being used, this fundamentally underpins the translation of Determined Cost into the unit rate. Whilst the current Covid-19 situation across the UK, Europe and globally remains volatile, until we gain the benefit of mass immunisation, the levels of tolerance of any traffic forecasts remains wide and outside the realms of what would normally be deemed acceptable/desirable margins of error during a normal regulatory review.

[1] https://www.eurocontrol.int/sites/default/files/2021-01/covid19-eurocontrol-comprehensive-air-traffic-assessment-07012021.pdf

16. It is irrefutable that traffic forecasts are currently unreliable. At the time of writing another significant lock down has been ordered, with potentially even stronger travel restrictions on the horizon. The knock-on effect on the industry is that it is still very uncertain as to the timing and extent of a recovery. **We therefore strongly believe that a target to commence the next regulatory period from 1 January 2022 would be both impractical and unachievable.**
17. Notwithstanding this, there are two aspects of the regulatory approach that we want to touch on: first, the regulatory framework as a concept and its suitability for ATM; and second, the extent to which the existing framework should be amended or continued as a result of the current crisis.
18. As a concept, regulation of monopoly utilities acts as a proxy for the market and, in doing so, regulators tend to focus on cost. This is often not conducive to long-term planning and there will always be a tension between the pursuit of lower costs and the maintenance and improvement of safety standards. Considering that there are severe financial constraints on the industry as a result of the current crisis, this is simply not the time to risk safety in pursuit of what would be negligible cost savings per ticket/per passenger. We address specific issues on the detail of the regulatory model itself - including its impact on staffing - later in this submission.
19. Notwithstanding our fundamental disagreement with the model, Prospect welcomes the proposal to continue with the *status quo* in the short to medium term. That is essential in a crisis as serious as this one. The *status quo* is what all stakeholders are used to. Applied properly, against a reasonable forecast, it should provide consistency and stability for NERL, its customers and other stakeholders. However, that does not mean details cannot be amended.
20. We address the issue of the length of the interim period shortly. But there is a significant factor within CAP 1994 which we have to challenge: affordability. ‘Afford’, ‘affordability’ and affordable are used 53 times in CAP 1994. Contrast this with CAP 1758 (the draft RP3 performance plan) where it was used just twice. As the CAA acknowledges, it has “not yet crystallised a clear definition of affordability” and it invites the views of stakeholders (CAP 1994, para 7). **We challenge the introduction of the affordability criterion as being outside the scope of the Transport Act** shortly.
21. Notwithstanding that challenge in principle, if we take as a starting point the definition of affordability, ‘ability to pay’, then we need to have an accepted measure of the proportion of the customers’ costs that is accounted for by ATM charges. And we need to be able to assess customers’ ability to raise the revenue to cover those costs - primarily a function of ticket prices and passenger numbers. If it is to assess affordability, then the CAA needs to set out its approach. And our earlier point re the traffic forecast is reinforced.
22. Whether analysed against ‘affordability’ criteria or not, we recognise that the reconciliation exercise for 2020/21 (and perhaps 2022 - see below) over an extended period of time will inevitably be a major factor in air navigation charges for the rest of the decade.
23. Cost efficiency is an objective in the Transport Act. But efficiency must not be viewed narrowly through the lens of the last year. Decisions should be taken for the long-term. We saw in RP2 the consequences of not getting this balance right and, despite the inevitable pressure on costs we can expect from airspace users, it is important not to overreact in the face of the current crisis. Again, our point re the traffic forecast is reinforced.
24. CAP 1994 suggests the NERL should provide “a flexible response in line with changes in traffic forecasts” (CAP 1994, para 1.19 i) is an impossible ask, even if there was certainty in the forecast. We have seen time and time again that striving to make air traffic service provision truly scalable is fruitless. The complexities of the task along with ATM’s capital-intensity and long lead-in times - eg for training and major projects - mean this is an industry which cannot, by its nature, react easily to dynamic and short-term pressures.

2020-2022 and the reference period

25. Since March 2020 there have been many challenges and rapid changes in government policy and guidance and in airline schedules. In making immediate decisions to safeguard the service, its workforce and its viability as a company, NERL could only be expected to make decisions on the basis of known facts and reasonable expectations. Whilst it is for NERL to defend its decision making it is crucial to assess these decisions in the context that they were taken, and not in hindsight. Everyone in NERL and the wider ATM industry is acutely aware of the mistakes of the past, particularly the consequences of cuts in capacity in downturns, and it is therefore to be expected that NERL has been very cautious in its approach to providing a resilient and fit-for-purpose service, one that will support any wider industry recovery.

26. We support the general statement of purpose re reconciliation of costs for 2020 and 2021 set out in CAP 1994 para 1.9, although we believe that the reconciliation period should be longer (ie 2020, 2021 and 2022). This belief has been strengthened by the recent downgrading of industry forecasts for 2021, which suggests that recovery will probably be far from complete – or even stabilised at a lower, new normal' - by summer 2022.

27. **2020, 2021 and 2022 should be taken as one COVID-19 affected, exceptional period, treated separately from the established N+2 arrangements. This should be followed by a new Reference Period (RP4 or CP4?) commencing 2023 for five years.**

28. There is still huge uncertainty about what a reasonable forecast for 2022 traffic looks like, meaning that significant adjustments are likely to be needed up to the end of 2021 and even beyond. In addition, the administrative burden of preparing a new reference period to start in 2022 would be considerable - for NATS, the CAA and the customers - and we are yet to be convinced that there would be any benefits in aiming to reset in just 12 months. There would, however, be significant risks – operational and commercial.

29. Furthermore, if the UK is to use the European settlement for years 2020 and 2021 as a benchmark (see below), extending the interim period by a year - allowing some semblance of normality to return to the industry – would provide greater certainty for airspace users, NERL and the CAA and help ensure that RP4 can be much more stable. It is our firm opinion that taking 2022 as the starting point for the next full RP would be unwise. A new five year plan commencing in January 2023, would be based on a much clearer picture of the pace and extent of the recovery in traffic levels and would be able to take into account the *actual* COVID-'losses' incurred so they can be factored-into the recovery element of the plan. This would also avoid an 'N+2' recovery for losses in 2022 disrupting the plan for 2023 and beyond.

Traffic Risk Sharing Mechanism

30. The TRSM generally works quite well. It is important not to allow the current crisis to obscure the fact that, since its inception, the scheme has allowed two disparate business models (the ANSPs and the airspace users) to complement each other and provide some certainty.

31. The risk sharing mechanism is fundamental to the financeability of NERL. As we have stated many times, the provision of ATM services requires long-term strategic thinking. In order to achieve this, a degree of certainty and predictable levels of income is enables sound financial planning. Any changes in the scheme which introduce additional risk to NERL (eg changing thresholds) could have an adverse effect on the cost of capital. In the light of recent CMA decisions, very careful consideration must be given to any amendments that introduce added risk and ultimately result in airspace users bearing additional costs.

32. With respect to 2020 and 2021 (and our proposal above for 2022) it is obvious that some amendments will be required to account for the current crisis. It is widely accepted that it is unreasonable to expect customers to cover the application of the current N+2 mechanism to extraordinary circumstances. **The European Commission's amendments to the Performance and Charging Scheme provide a reasonable basis for reconciling these charges and this would be a good starting point for the UK too.**

33. **To provide some regulatory certainty for the refinancing that NATS has to organise this year, it is essential that the CAA sets out its position on amendments to the traffic risk sharing mechanism in good time and ahead of the outcome of its further work on the future price control**.

34. Changes to the existing mechanism must enable NATS to continue to be financeable. There is a clear tension here with any requirement that charges are affordable for airspace users, although we would note that an increase in NATS' financing costs will be passed through to users in some form. A smoothing of the recovery over a number of years would lessen the immediate impact on airspace users while allowing NERL to plan appropriately and refinance with a degree of certainty.

Affordability

35. As we noted earlier, when considering the issue of affordability, it is incumbent on the CAA to determine what it deems to be affordable - in particular for the passenger and, to a lesser extent, the airlines. It is worth considering that ATM charges make up a small proportion of an airspace user's cost base. Consequently, changes in ATM charges, which might seem a tempting target when looked at aggregated in cash terms, when broken down on a per flight basis or more importantly per passenger (keeping in mind the CAA's duty to consumers) the impact of even significant changes in the unit charge is negligible.

36. We note that Section 2 of the Transport Act 2000 sets out the CAA's general duties as follows:

    (1) ... to maintain a high standard of safety in the provision of air traffic services; and that duty is to have priority over the application of subsections (2) to (5).

    (2) The CAA must exercise its functions under this Chapter in the manner it thinks best calculated—

    (a) to further the interests of operators and owners of aircraft, owners and managers of aerodromes, persons travelling in aircraft and persons with rights in property carried in them;

    (b) to promote efficiency and economy on the part of licence holders;

    (c) to secure that licence holders will not find it unduly difficult to finance activities authorised by their licences;

    (d) to take account of any international obligations of the United Kingdom notified to the CAA by the Secretary of State (whatever the time or purpose of the notification);

    (e) to take account of any guidance on environmental objectives given to the CAA by the Secretary of State after the coming into force of this section.

    (3) The only interests to be considered under subsection (2)(a) are interests regarding the range, availability, continuity, cost and quality of air traffic services.

37. In previous consultations, Prospect has cautioned the CAA against taking safety as a given, rather than something that needs to be secured and maintained; which inevitably has a cost. We will not labour the point here, but note that the Act gives the safety duty primacy.

38. The Act does not mention affordability and, although cost [of air traffic services] is specified as a factor, there is no duty on the CAA to take into account airspace users' (or, indeed, passengers') ability to pay (nor their willingness to pay). The duty is simply to assess that the costs are 'efficient'.

39. We ponder whether, in regulating NERL, **the CAA places too much emphasis on the interests of the airlines (and the interests of the airlines as the airlines perceive them)**. Airspace users are synonymous with 'the customers', whereas instead they should be seen as a conduit. What direct consultation is there with passenger groups to establish *their* interests when it comes to ATM?

40. Constant pressure on en route costs on behalf of 'the customer' appears to be applied on behalf of the airspace users. Cost efficiencies for airspace users are rarely passed on to passengers anyway. In reality, any efficiencies which are practically achievable will amount to a few pence per ticket, making no material difference to fares. But we doubt they are even passed on at all, but rather simply go to increasing airlines' margins.

41. When it comes to air traffic services, we suggest that many passengers (and other users such as freight companies) would probably place safety and reliability/punctuality above cost. **We believe that passengers would continue to accept the approximate average rate of around £1.00 per flight in order to secure and maintain the safety and quality of service they have become used to is a price worth paying. Further attempts at marginal cost reductions are likely to jeopardise that efficiency.** We would add that, in the medium to long term, it is highly likely that technological advances will yield ATM efficiency savings far in excess of any that will result from salami-slicing opex, but without the attendant risks to resilience and safety. As for the other side of the ticket price equation: in the longer-term it is reasonable to forecast that fuel prices and environmental measures - not least reduced aircraft capacity if electric propulsion becomes a given - will increase fares to a degree that any variation in ATM charges will be 'lost in the noise'.

42. With respect to determining 'affordability' the only real benchmark is to look to Europe and other comparable ANSPs. NERL does consistently well in comparison with other European ANSPs, and indeed the recent amendment to the European Performance and Charging Regulation, which has been through an extensive consultation and legislative process, would tend to suggest that its approach is 'affordable'. As previously mentioned, it would seem sensible to have broad alignment with Europe, albeit with different timescales and to include 2022.

Financeability

43. We noted the CAA's responsibilities on NERL financeability as per the Transport Act earlier. We urge the CAA to take a more holistic approach to financeability to include the quality of air traffic services and not just the cost. This should of course include the issue of safety, and other key elements such as long-term decisions on capex that will affect the quality of the service our members can provide in the future, or the continuance and in some cases improvement of staffing to ensure the service is fit for purpose. It also harks back to our previous comments on the role of the consumer and the negligible price in a ticket for the provision of quality air traffic services.

44. Furthermore, Prospect has been campaigning for strategic financial intervention in the ATM market since the outbreak of the crisis (see previously noted appendices). Unfortunate ATM is not currently viewed as critical national infrastructure in similar fashion to other core services such as the rail network. The UK runs the risk of not being in a position to recover in 2024 and beyond when traffic is forecast to return if the proper provisions for investment and opex costs are not in place.

45. In paragraph 15 of the consultation, it is noted:

> 'where other more conventional measures are unable to deliver affordable user charges [...] we may need to consider wider measures.'

46. Although the CAA's role as laid out by the duties in the Transport Act may be limited in certain circumstances, it might be prudent to consider or propose 'wider measures' that are sufficiently flexible as part of the consultation process given the dire state of the traffic situation in the immediate few years. Some guidance on the issue could be taken from recent progress as part of the amendment to Performance and Charging Regulation that has taken place at a European level, and subsequent calls from the Performance Review Body for state intervention in terms of funding. That aligns with our suggestion of direct UK Government support. In being pre-emptive in this way, any actions that need to be taken can be done with haste to protect this critical national infrastructure.

Efficient Costs

47. NERL has undertaken a considerable Voluntary Redundancy program in response to Covid-19 which has resulted in a reduction in headcount of almost 400 employees (320 posts) across engineering, administrative and management grades. We presume that this has significantly reduced the cost base of the organisation, but it is unclear what it means for the NERL staff costs baseline for the future price control, as has arguably been established by the CMA determination on RP3. What cannot be in doubt is that the VR programme will have reduced the proportion of that cost base spent on what one might describe as 'overheads'. That said, it is important that NERL retains a core of expertise to support its ongoing operational responsibilities and to support its capital program. We have some concerns that the disproportionate contribution to the staff cuts from Technical Services is likely to increase the costs of the LTIP by increasing the requirement for contractors and consultants to support projects.

48. NATS has told us that the cost of the VR scheme will be covered by reduced staff costs over two years. As we said earlier, the VR programme helped NATS reduce its overheads and, by and large, operations staff were excluded from the scheme. However, it is inevitable that the reductions will have an impact on the operation. Due to the fact they are employed within Technical Services, the operational engineering workforce (the shift engineers in the Centres) were eligible to apply and that cadre has shrunk to a point that we believe is dangerously un-resilient.

49. With respect to capital costs there is a unique opportunity for infrastructure to be improved without the pressures of operating a service stretched to capacity. Again, it would be all too tempting to significantly cull capital expenditure on renewal of the UK's ATM infrastructure, but to do so would delay the implementation of significant technological upgrades that will have capacity, cost and environmental benefits. Airspace design is again an area that must continue to have investment, as it is unlikely we will ever have such an opportunity to redesign and implement airspace changes without the pressures of operating at full capacity. Whilst it is right that the investment plan should be examined, and consulted with the airspace users, the CAA should take a broader UK view and allow NATS to invest so that in the latter part of the decade it is ready and able to meet a resurgence in traffic.

50. On the issue of opex, Prospect continues to call on the CAA to ensure that NERL has adequate revenues to cover staffing costs and, as with all other aspects of the process, staffing should not be looked at in the context of the crisis and the downturn in traffic. Strategic planning is needed to ensure staffing is in place for when air traffic returns to 2019 levels (currently projected to be in 2024). We do, however, agree with some of the criticism of NATS' workforce planning capability and it should be a condition of any new settlement that this is addressed.

51. That said, these shortcomings are not solely down to NATS. There are other factors at play here, as illustrated by the staffing of the London TMA approach functions. In 2019, the CAA provisionally found NERL to be in breach of its licence as a result of staffing issues.

52. Actions taken by the CAA in the cost-cutting regime for RP2 meant that opex funding was inadequate. In our response to the Project Palamon provisional findings, we noted:

> *In its revised business plan (RBP), NERL stated, 'the scale of the cost savings needed to achieve lower prices in RP2 requires us to take further action now to cut our cost base.'*
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> *[...] After reviewing Palamon, it seems that the CAA has washed its hands of the problem and chosen to distance itself from the consequences of the actions it set in motion nearly ten years ago. [...] The [Prospect ATCOs'] Branch feels that it is now time for the CAA to respond to the question of the impact of the economic regulatory regime. Recent announcements[2] on ATCO training should not go unremarked.*

53. The traffic downturn may have obscured the issue for now, but the staffing problem within NERL remains, and will continue to do so for years to come. In fact, the closure of the NATS college for the foreseeable future as a result of the crisis has arguably ensured that the problem will be worse when it resurfaces, which it inevitably will.

54. **We cannot stress enough that any test of efficient costs must not be applied retrospectively to the extraordinary circumstances of the current crisis. Traffic forecasts show that previous traffic levels will return in the coming years. The UK will need a properly resourced en-route ANSP to be able to support the recovery of the UK aviation industry. Experience shows that ill-conceived decisions based on short-term thinking have a longer-term detrimental effect.**

Capex funding

55. Capex funding will be a key tension in the forthcoming price control. It is right that airspace users are consulted on NATS' plans, but this must be balanced with a wider and longer-term view given that the airspace users will have a very short-term focus on cost, and will have limited resources to properly assess and understand the benefits of longer-term investment. NERL's investment program is critical to the modernisation of the UK ATM system as a whole - both in technology and airspace modernisation – and, as such, benefits consumers as well as airspace users. There is a very real risk that investment could be curtailed or that a lack of suitably skilled internal resource, particularly with the recent VR exercise, which we are concerned was rather indiscriminate in its application. The exercise appeared to be driven by numbers rather future requirements. There is a risk that this will set capacity and efficiency back many years. Such curtailment of the funding to replace NERL's legacy systems will result in increased sustainment cost, reduced resilience and greater overall cost which in our view is not in the interests of service users. As it is the delay to the LTIP caused by COVID-19 will already curtail the implementation of improvements.

56. We have an important opportunity with the downturn in traffic to reallocate (whilst traffic is quiet) resource to the LTIP program (particularly operational resource) and this requires imaginative thinking and courage. Improvements can be delivered without having to finely balance the distribution of resources with direct service delivery. **It will be important for the CAA to take a greater leadership role in this area, as the custodian of UK aviation and to resist any counter-productive proposals from airspace users that may ultimately detriment UK infrastructure.** As noted elsewhere in our response there may well be incompatibilities between desired improvements and affordability. In that case the CAA should start to investigate direct government funding for ring-fenced infrastructure improvements to benefit the UK as a whole.

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[2] https://prospect.org.uk/news/union-condemns-dismissal-of-122-trainee-air-traffic-controllers-and-calls-for-urgent-halt-to-nats-plans/

Airspace modernisation

57. As we've noted in previous price control consultation submissions, the question around the funding of airspace modernisation is as important as establishing both the process itself, and who is in charge of the various elements. **Airspace modernisation should be viewed as strategic investment by the government into critical national infrastructure and as such requires leadership.** Whilst NERL has an important part to play in implementing future airspace modernisation, it cannot do this alone and requires support across industry, both airport operators and airspace users acting in a coordinated manner to facilitate the much needed change. It is also essential to help achieve the government's environmental targets such as those laid out in the Environment Bill 2020. With this in mind, and considering the rhetoric on affordability for the airspace users and the consumer, a more high-level approach is required on the issue of funding for airspace modernisation with searching questions as to where the funding should be coming from. The consequences for it not being properly funded, especially now given when traffic levels are artificially low, should be well understood.

Pensions

58. The mechanisms for managing the costs of NATS' Defined Benefit (DB) pension scheme are limited by the Deed To Establish Trust Of A Promise enacted in 2001, shortly after the Public Private Partnership (PPP) and, as such, are protected in law. We view this as a key part of our members' terms and conditions for those in the DB scheme and due to these constraints there is limited action that can be taken.
59. We have been acutely aware and mindful of the ongoing costs of the scheme and have mitigated these significantly as we have outlined countless times in previous responses by:
    a) Closing the scheme in 2009 to new members.
    b) The agreement of a Memorandum of Understanding (MOU) with NATS (2009) which capped pensionable pay rises.
    c) Agreeing the Supplemental MOU (2013), which not only removed the link to RPI replacing it with CPI for future accruals, but also introduced a more limiting cap for pensionable pay rises.
60. In addition, over the past four years, many of our longest-serving members have opted to leave the scheme, taking the Pension Cash Alternative. This had a very positive effect on the deficit in the last triennial valuation, reducing ongoing liabilities and de-risking the scheme considerably. It still proves to be a very popular option for members and provided the current terms of the Pension Cash Alternative remain, we fully expect it to continue the positive effect on any deficit.
61. Every price control the DB scheme seems to come under increased scrutiny with various work around proposals being tabled in some way to reduce costs. Time and time again these prove to be unworkable and in our view the costs largely should be accepted for what they are, and left to NATS and the trustees - who have a track record of excellent stewardship - to continue to manage them appropriately.
62. **Prospect welcomes the inclusion of a Regulatory Policy Statement (RPS) on pensions.**
63. We view the purpose of a RPS to give direction and confidence to NERL, its financiers and the DB scheme trustees of the regulatory approach of the CAA with respect to its allowance for pension cost provision. Enabling NERL to feel confident about pension provision, in turn, allows the Trustees to feel confident about the Covenant with the DB Scheme. This should result in more modest deficit repair contributions and ongoing costs. A benefit not only to NERL, but also to its customers, as less cost would be passed through.

64. Section 1 seems to largely contain a list of expectations from the CAA to NERL and the Trustees, many of which are already covered in pension law and are outside the scope of the CAA. In terms of providing regulatory certainty it is a little superfluous.

65. Section 2 is the useful element of the RPS and we welcome the CAA setting out its approach to DB pension cost allowances. It gives clarity with respect to pension cost pass through, and it is welcome to see the CAA set out its position so fully. This can only increase certainty and confidence for the trustees and NATS and strengthen the employer covenant, which will ultimately lead to lower prices for customers.

Incentives

66. It is our long-held position that incentives are inappropriate in safety-critical industries. They skew thinking, often causing short-term decisions to be made that ultimately are detrimental to the long-term interests of NERL. This is particularly pertinent to capacity, where targets are chased which then impact longer-term service provision (e.g. diverting instructors from training to operational positions resulting in a lack of new controllers or extension training – a causal factor in Project Palamon).

67. However, as a favoured tool of regulators, should incentives be introduced then they should not be set for 2020-2021 (nor 2022). Moving forward to a new control period, incentives should not be benchmarked against the current situation. Measures such as delay and 3Di (below) will be artificially low due to the significant reduction in traffic. Furthermore using incentives on efficiency to manage issues of affordability and financeability is fraught with danger and extremely risky. This is not a sound tool with which to manage these issues, and as previously mentioned, affordability and efficiency in the short term may simply not be compatible. Using such a blunt tool would introduce any number of unintended consequences which would almost certainly detriment the airspace users and consumers in years to come, just as they have before. We must learn from mistakes of the past.

68. There are noticeably few references to environmental targets in this consultation, nor any references to 3Di which has been a measure for NERL's delivery on environmental targets for several years and would continue to do so. There are nuances that must be considered as part of the just and proper application of this measure which include issues around the impact of weather, unforeseen circumstances and wider points including airspace modernisation; we have gone into more detail in our submission on RP3 and these elements remain current.[3] **Prospect has always supported this metric as a more rounded approach to environmental targets** and it is a concept that is very familiar to the ATCOs and our members.

Timescales

69. To summarise a point we made previously, given the levels of uncertainty in the aviation industry, **we strongly suggest that a new price control time period commences in 2023 and spans 5 years**. 2022 should be included in the mechanism applied for 2020 and 2021. We believe that, given the amount of work required for a new price control (set against a very uncertain traffic forecast), it would be prudent to delay a new price control until 2023. This allows a longer timescale over the second half of 2021 and 2022 to fully assess the direction and recovery of the industry, with what will be a more comprehensive and accurate traffic forecast. It will of course also allow the CAA a period of regulatory cooldown in order to be best positioned to tackle a whole

3 https://www.caa.co.uk/uploadedFiles/CAA/Content/Accordion/Standard_Content/Commercial/Airspace/Air_Traffic_Control/prospect_RP3response.pdf

new financing period. Finally, it will allow the inclusion of the impact of COVID-19 on consumer behaviour post vaccine with respect to travelling and the use of aviation.

Review of Space-Based ADS-B

70. Prospect is fully supportive of NERL's introduction of ADS-B. This is new technology that is required for ICAO compliance, significantly improves safety and will enhance environmental (and therefore fuel cost) benefit. We welcome the CAA approach that has supported the introduction of this technology despite the reluctance that airspace users have shown. We understand the CAA's view with respect to data gathering needed for its review process and will await its formal consultation. That said this is a prime example in which the narrow views of airspace users, particularly focused on short-term costs could affect greater technological improvements for the benefit of the system. Whilst NERL should be expected to introduce any new systems in an efficient manner, that they bear an additional cost will never be to airspace users' liking. However, the reluctance of users to pay it is not a sound enough reason for these improvements not to be implemented, particularly pertinent when safety and environmental benefits can be realised.

Appendix D views on approach to reconciliation

71. During the late summer and autumn, the prospects for recovery of traffic seemed promising, however the current situation with a third lockdown and traffic levels being once again suppressed to very low levels suggest a level of uncertainty over the recovery of traffic volumes that would merit a longer period of cost reconciliation in hand with the new regulatory period not beginning before 2023. It is simply impossible to forecast future traffic levels with a required degree of confidence at the current time.
72. We recognise that decisions had to be taken quickly during the early days of the crisis and for NATS that included a need to implement measures to ensure financial resilience and solvency. Whilst measures taken by NERL will have avoided some cost in the short term, it should be noted that to some degree that the measures will simply be a deferment of cost, though some benefit will have been gained through external measures such as the furlough scheme.
73. **We do not see merit of an ex-post scrutiny of NATS expenditure during 2020 on a line-by-line basis**. It is very easy to question the measures taken with the benefit of hindsight but in reality, the costs incurred were reasonable and necessary and defined by the RP3 business plan. We would question the benefit and purpose of a line-by-line evaluation of costs during this exceptional period. The industry is in a crisis, and it must be recognised that these are, effectively, "sunk costs".
74. NERL, following recent experience has also shown necessary caution and ringfenced operational staff from its voluntary redundancy program. Due to the level of uncertainty around traffic we view this as a prudent measure given the significant time that it takes to recruit and train operational staff to replace those who leave the business. Therefore, the CAA should bear this in mind when conducting its reconciliation exercise.