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IATA Response to NATS Enroute Limited (NERL) NR23 Business plan

Dear Mr Carter

IATA welcomes the opportunity to submit a written response on the development of NERLS NR23 Business Plan. Aviation is critical to the UK economy. It is critical to the UK's competitiveness, supporting trade, inward investment, and tourism. It also creates and sustains thousands of jobs in every region of the UK. In 2019, 1.6 million UK jobs were directly or indirectly supported by aviation and tourists arriving by air to the UK. The industry supported US$86 billion of GDP and spending by foreign tourists supported a further US$34 billion of the country's GDP. With this in mind, it is essential that the NR23 price control delivers an air traffic service that is resilient, cost effective, that meets the industry`s sustainability needs, while delivering a modern fit for purpose airspace.

IATA has engaged in the lengthy consultation process during October /November 2021. While we understand that NERL were not in a position to discuss the final draft plan at that stage, the condensed nature of the process, while lacking key information meant that much time was spent discussing aspects that may not have been necessary. We understand the necessity to run a condensed process, however, would encourage NERL to develop a more completed draft for future consultations. Similarly, when the original NR23 plan and Annexes was published in February, many of the sections were redacted, the subsequent update delivered 03 March, while more complete, left very little time for a deep analysis and response. We have endeavoured to deliver as complete a response as possible, given the tight timelines, but remain available for further discussion, either bilaterally or when the STEER interim report is published, which we understand will be later this month.

Our key feedback is summarized in line with the Chapters contained in the recently updated NERL NR 23 Business plan:

General Consultation Remarks

- The proposed approach to airspace modernization captures well the high priority which the airline community places on this essential reform.
- While the impact of the COVID pandemic on aviation is still to be fully reconciled, the airline community maintain the view that NERL is a relatively low risk business and as such has greater access to financial independence than our members.
- The airline community is mindful that the domestic and oceanic plans operate under different regulatory frameworks under different jurisdictions. We would encourage the UKCAA to separate the regulation of oceanic services from the domestic in due course and we encourage the CAA to provide greater transparency on the process for concluding the regulation of oceanic services.

Chapter 2, Customer and Passenger Priorities
Airline's priorities, despite the challenges presented by the COVID 19 Pandemic, continue to be: safety; cost efficiency: resilience and flexible adaptation to a challenging and uncertain environment; provision of sufficient capacity, adapted to demand, and operational measures oriented to more environmentally friendly flights.
Within the UK, airspace modernization remains the top strategic priority for our members, while we note a level of ambition with the NR23 plan to achieve this, we are presented with a challenge that already existed at the start of RP2 (2014-2019) namely ; that the current technological infrastructure continues to be a barrier to achieving the required airspace change. The Airspace user community are concerned that legacy escape, continues to be that: a legacy!

Chapter 3,Traffic Outlook

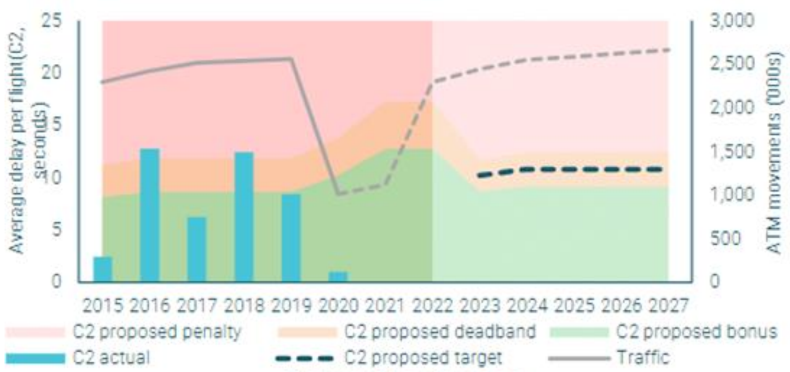
IATA is cognizant that trying to forecast the immediate future in terms of flight movements and service units is very challenging, we would highlight the accuracy of Eurocontrol` s STATFOR Scenario forecasting throughout the past reference periods and point to the ongoing scrutiny it has endured during the pandemic, as a basis to support the application of the STATFOR Base for UK Domestic and London Approach. The situation with Oceanic, specifically North Atlantic traffic requires far more scrutiny and at this present moment it is difficult for airlines to support.

- IATA supports the application of STATFOR's October 21 base scenario. STATFOR has proven to be very accurate and is, furthermore, comparable to the forecasts used in other countries of Europe, providing a guarantee of cross-border consistency and a homogeneous approach.
- The Oceanic traffic forecast is more challenging, and the mechanism used to apply STATFOR methodology and dataset as mentioned in the reports is not entirely clear. We understand that the current forecast is a NATS "derived" model, it is difficult for airlines to accept that, considering that NATS are also proposing to implement a Traffic Risk Sharing (TRS) on the North Atlantic. To our knowledge, the ICAO EFFG group is also working, but finding difficulties in delivering in a reliable traffic forecast for Oceanic traffic in the North Atlantic. We are concerned that the numbers included in the plan also show a traffic decline in 2024, despite all years preceding and after showing marked increase. No rationale or reason for this is supplied within the material and as such, significant additional work and knowledge sharing on oceanic traffic forecasts is required and supported.
- It must also be acknowledged that the current situation in Eastern Europe may affect the expected post-pandemic traffic recovery. With fuel prices now at record highs, it is clear that this will have a material impact on any immediate airline scheduling decisions.

Chapter 4, Performance Outcomes and Metrics

The comments in the BP prospectus from NERL state that there is broad support for continuation of the service performance metrics, while this is evident the scope and nature of the targets, we feel require further scrutiny.

- The proposed level of ambition in C1 and C2 is insufficient. The previous RP3 plan targeted 13.8 secs for C1 while in NR23 targets move between 14.7 and 15.3 with less forecasted traffic. C2 remains in NR23 at the same levels as in the previously presented RP3 Plan (10.8 secs), also with less or similar expected traffic.
- The proposed incentives scheme is not supported since the targets are not ambitious enough. As the chart included in the document shows, results of precedent years (2016, 2017 and 2019), were below the targets (2018 being a quite exceptional year in the whole Europe), with similar or higher traffic levels.



Projected C2 performance

- The bonus threshold seems to be on the same level as 2019, which is not supported because traffic has not yet recovered to 2019 levels, this is not forecasted until the latter years of NR23.
- NERL proposes 150 exemption days to be used over the five years (days that would be exempt from financial penalty under the C3 (weighted delay term) and C4 (variability term)). This means an average of one month (30 days) every year. According to the text the CAA allocated in RP3 an average of 20 days per year. IATA is of the opinion, that while exemption days can be allowed, for large scale airspace and system changes, 30 days per year is not viable. We encourage the UKCAA to revert to a number similar to the RP3 allowance, considering there was significantly more changes scheduled during the period.
- The proposed mechanism of modulation is not supported.
    - The mechanism and the agreed targets should be valid in a tolerance range wider than +/- 4%
    - The thresholds in case of traffic variations upwards vary much more than when the traffic varies downwards. No matter the (current) exponential nature of delay with respect to traffic increase, actions should be taken precisely to avoid such an exponential increase.
    - The modulation of the target in the same way as the bonus/penalties is also not supported, since it would not drive the right behaviour (it relaxes the ambition for both the target and the penalties).
    - As an example of the last two points, let's assume that traffic varies +/ 10% with respect to forecast and calculate the effects of the proposed modulation mechanism (for 0.90xforecast (90% of traffic) and 1.1xforecast (110% of traffic)) respectively:

$Upper(1 + \frac{2(Actual - 0.96 \times Forecast)}{Forecast})$	$Upper(1 + \frac{8(Actual - 1.04 \times Forecast)}{Forecast})$
Upperx0,88	Upperx1.48
For a value 10.8 results in a new target of 9,5 secs	For a value 10.8 results in a new target of 16 secs

Chapter 5, Service Delivery

IATA acknowledge that significant efforts were made during the pandemic by NERL to control costs and continue to provide a level of service, despite the challenges associated with the COVID pandemic. Short term actions such as cancelling training may have a material effect, if the return of traffic outstrips the STAFOR base forecast, however what is lacking is a clear plan on how NERL can scale down, if the forecasted traffic does not manifest.

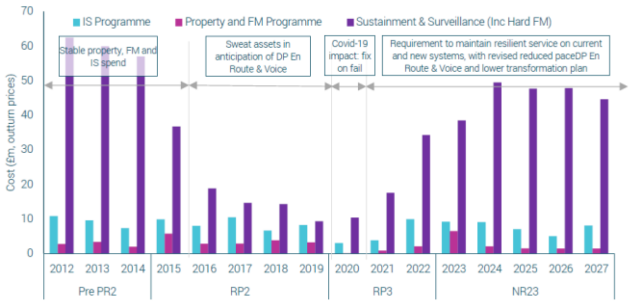
- Human resources plans raise some concerns about whether the number of ATCOs will be sufficient, especially in the short term if traffic recovery materializes at the expected speed or higher. The plan presented seems to rely on the possibility of overtime to cover potential gaps in staffing.

- Maximization of training, especially in the first years of the period, to catch up and ensure sufficient resources is supported. However, we note that at the proposed rate of training, during certain periods in 2025/26 NERL appears to have a significant ATCO surplus. We ask what measures have been developed to minimize the impact of this surplus and adapt the capacity to demand, through different training intakes , new employment contracts or flexible labor agreements?
- IATA support increased efficiency in the ATCO training process, however it remains unclear, and we lack sufficient justification, despite a list of generic benefits , as to how applying synthetic training can improve success rates from 75% to 100%, considering the system has yet to be purchased or employed in the current training set up.
- It is also unclear how pension schemes and pension costs are related and could be effected in the different scenarios of ATCO retirement.

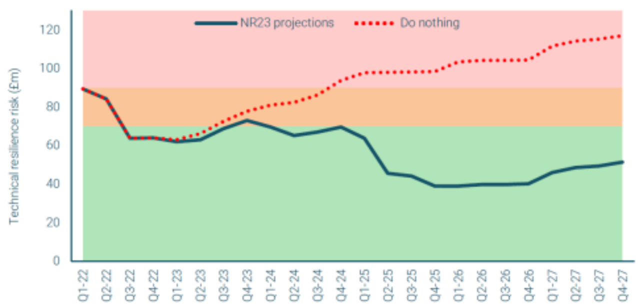
Chapter 6, Capital Investment

IATA acknowledge that significant work was done in coordination with the Airline community during the 2020/2021 SIP meetings to reduce and prioritise the proposed CAPEX programme for the remaining years of RP3. We also agree that the 2+5 Approach may drive better outcomes, in terms or options and benefits for the airline community. Our overall comments on the NR23 CAPEX plan as presented are:

- This plan claims to have reduced costs from the previous RP3 version, which is appreciated. The fact that, after decommissioning of some existing systems, a reduction of operating costs of 10M/year is expected is also welcome and raises high expectations for NR28. Decommissioning seems, however, to have suffered delays, which will cause overlapping of both new and old technology, increasing costs. We need transparency and reconciliation of what has been deployed and when
- Many initiatives claim to provide benefits in next period NR28, but quick wins of the presented program are unclear.
- Quantification of benefits in terms of expected KPIs improvement is welcome in the airspace and operational enhancement program. However, the benefits shown in page 20 do not correspond exactly with the projects listed immediately before.
- The principles driving investment: continuity of a safe and resilient service, systems modernization and appropriate changes in airspace seem oriented in the right direction.
- It is mentioned that higher investment in "sustainment" during NR23 is needed, especially with respect to the initially planned for RP3. The text mentions that decommission of 155 assets was expected but at least 89 should be finally replaced. A question arises about how this may result in delay to the technology modernization plan and how rationalization is affected.
- Despite the significant increase in investment for sustainment in 2022- 2024, it seems that the technical resilience risk only starts getting significantly improved (i.e., it is really away from the orange area) from 2025. This requires further explanation



Sustainment programme capital investment costs



Technical resilience risk

Chapter 7, Determined Costs and Prices

It should be noted that when using 2019 as a base year for comparison for NR23, it was a year when NERLs actual cost exceeded its determined by some £40m STG or +7%. IATA do not support the approach by NERL to use London Heathrow as a comparator, ANSP`s are far more regulatory insulated as monopoly service providers than airports are, such as traffic and cost risk sharing:

- Cash pensions show a significant increase from 2023 on which deserves further explanation. Despite the text explaining that DB is not an option since 2009 the numbers show increases in its costs, also despite texts explaining that some employees are moving from DB schemes to PCA.
- More clarity is needed about the graduates' program and associated costs, since there seems to be a significant increase in the expected number of graduates hired, but a reduction in their cost with respect to pre-COVID levels.
- It is noted that the headcount of contractors is significantly reduced, who will be taking over the tasks previously performed by them? Is there a risk to service or technical delivery? Also, what is the impact of having FTE vs Contactors
- The manpower plan to increase management and support functions far outstrips the plan for operational ATSA positions and others, we also expect this will drive significant associated wage costs. Despite some information the reasoning for this increase lacks justification and requires further rationale. and serious investigation.
- The increase of asset management costs by 11M (around one third of the total) raises some concern, since the explanation is that not only maintenance of legacy systems continues increasing costs but also that "the costs of running new systems are higher than for our ageing systems" and, for a while, both the costs of the new systems and the recently renewed ones will coexist.
- IATA maintain our position of opposing the full application of the WACC on the TRS debtor. The traffic risk sharing concept was adopted to incentivise ANSPs to deliver performant services irrespective of normal variations of traffic resulting from airlines business decisions or circumstances. It has not been conceived as an absolute protection of ANSPs including for events caused by the global pandemic. Under recoveries should not be included in the WACC calculation, the under recoveries are derived from an exceptional circumstance, outside of the airlines control, not a commercial decision by airlines to stop operating. Airlines have no regulatory protection needed to offset the loss in the year of the eve or any subsequent period. . We would also draw the UK CAA's attention to what has occurred in France and Germany to support the airline community. France: will not apply any WACC on the under recoveries deriving from the loss of traffic in 2020 & 2021. Similarly, in Germany the BAF has not allowed DFS to apply any return on equity during RP3 and therefore only the average interest on debts is applied, this gives rise to a cost of capital pre-tax being on average below 0.9% for 2023 onwards.
- On the change in gearing ratio, IATA would point to the well-established and tested EU PRB methodology on efficient gearing which suggests that for a monopoly ANSP that 70% of the capital employed should be financed by debt. While NERL propose to increase this to 50% for NR23, IATA do not accept the evidence that the cost of debt would go up significantly by maintaining the CMA set gearing of 30%.

Chapter 8, Oceanic Plan

Regarding the ongoing situation on the North Atlantic we are concerned that despite the UKCAA undertaking to run a formal review, as required by the CMA ruling, to review the Space Based ADS-B (SB-ADS-B) operation, both in 2021 and early 2022, we still do not have sight of when this will happen?

In the absence of the review it appears that NERL has developed an Oceanic plan, which once again lacks airline engagement and acceptance, especially in the context of the key measurable metrics. Instead we are presented with a theoretical mathematical review of its effectiveness in delivering safety benefits, all while north Atlantic traffic is at its lowest levels in decades.

As previously highlighted; SB ADS-B has never been mandated by ICAO. For the reasons explained in earlier submissions, there was no regulatory need for SB ADS-B (and the associated charges and cashflow implications for airlines) to have been implemented. However, IATA maintains a keen interest in being part of the informal consultation process and we reiterate that the UKCAA's consultation on the independent review must take place as soon as practicable and address the following elements:

- Airlines must be able to participate in the review by working with the stakeholders to provide reliable information on flight efficiency benefits that have occurred over the period under review.
- Determine whether these matters were affected by the impact of the Covid-19 crisis. This will be particularly relevant when considering whether the claimed efficiencies are properly attributable to the addition of SB ASD-B services.
- Assess whether the loss of revenue due to the Covid-19 crisis, negatively impacted other areas of the operation, or offered an opportunity to remove inefficient and costly technology to reduce the overall charges.
- Determine, retrospectively, whether the charges levied so far were based on recovery of costs for services provided, and whether the charges outweighed the benefits actually received by the operators (and whether there ought to be reimbursement of charges to reflect this)
- Determine, prospectively, whether the benefits outweigh the costs, having regard to the provision of services and the availability of alternative technologies, and of SB ASD-B services offered by other providers. Effective consultation needs to allow all parties to share their views and these views must be properly assessed and considered before proposals / decisions are made, especially if such proposals / decisions are likely to result in higher charges in the short-, medium- or long term.
- Any decision (especially those involving an increase of costs) must be based on accurate data and a fair assessment.
- As stated in the traffic section, traffic forecast deserves further explanation, especially for the year 2024 when a drop in traffic with respect to 2023 seems to be expected with no apparent reason (it is already the recovery period and in 2025 traffic levels similar to 2019 are expected)
- The previous point also leads to unjustified higher unit costs in 2024.
- Approximately 1/3 of Oceanic unit costs is ADS-B. How would TRS in oceanic reconcile with the variable pricing of the ADS-B data supplier to NERL (cost-risk sharing mechanism mentioned in the text, according to which the ADS-B costs are also adjusted by volume of traffic)?

Chapter 9, Regulatory Mechanisms and Prices

We have been very clear in our communication to DG MOVE, the EC as well as the UKCAA and state representatives that Airspace Users are not able to and should not mitigate the revenue gaps of ANSPs during 2020/21. This situation is solely caused by the measures taken by states to fight the COVID-19 pandemic and therefore, the States and or shareholders must take a level of responsibility for covering this gap. From the beginning of our engagement, we have advocated for a flexible approach towards EC or state support in mitigating the liquidity crisis in the European Aviation system. Airlines are charged for a service delivered to them. They are not financially responsible for maintaining a full service that they do not use. This is the responsibility of the States/ Shareholders

- IATA again reiterate that no WACC is applied on TRS, it would imply that substantial profits to be made for losses incurred by airlines, which were out of their control. Airlines have no regulatory mechanism to recover their losses from 2020/1. We highlight that both France and Germany have not allowed DSNA and DFS to recover WACC or ROE on their losses incurred
- IATA do not support the implementation of a TRS Mechanism on the North Atlantic nor any retroactive application of same. Notwithstanding our earlier comments on the 'derived forecast' there are no clear definition of how and when this TRS would be applied. Equally, the traffic risk sharing concept was adopted to incentivise ANSPs to deliver performant services irrespective of normal variations of traffic resulting from airlines business decisions or circumstances. It has not been conceived as an absolute

protection of ANSPs revenues including for events caused by the global pandemic, Jet Stream position or Volcanic Activity. To retroactively add an additional £15stg PA to the core cost is unviable.

- We see no reason for increasing the WACC with respect to the one fixed for RP3 by the CAA (3,54% versus 3,05%). We note that other ANSPs in their revisions of RP3 plans have reviewed downwards (or eliminated as mentioned above) the WACC.
- We also recognize the intention of lengthening the recovery of 2020/21 under recoveries as far out as NR28. With 75% recovered during NR23, however we reiterate that this should not be the sole responsibility of the airline community.
- We understand NERL's considerations around the traffic risk sharing mechanism being extended to up to 30% traffic variation, however IATA does not support the increase in margin. The traffic risk sharing concept was adopted to incentivise ANSPs to deliver performant services irrespective of normal variations of traffic resulting from airlines business decisions or circumstances. It has not been conceived as an absolute protection of ANSPs including for events caused by the global pandemic, Jet Stream position or Volcanic Activity.
- ANSP`s are continually monitoring their actual traffic counts and Service units , it is incumbent on NERL that if traffic is fluctuating significantly above +/- 10%, for a prolonged period there is need for:
    - Cost containment procedures to keep the unit cost stable
    - An overall redrafting of the business plan might be necessary

In conclusion, we appreciate the well-established consultation process run by NERL and the UKCAA, however as evidenced by our submission, we believe considerable work is still required before the airline community can be fully supportive of the NR23 business plan.
We remain available for further discussion and look forward to the UKCAA`s interim decision during the summer.
Yours sincerely,

Rory Sergison,
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