

Reference to the CMA of NERL RP3 price controls: CAA response to provisional findings Appendix A – Responding to Covid-19

CAP 1910A

[RP3 reference CAA document 036]

APPENDIX A

Responding to Covid-19

Introduction

- A1 This appendix sets out our proposed approach for how the CMA should respond to the impact of Covid-19 in making its final report, and forms part of our main response to the CMA's provisional findings (PFs) on the NERL RP3 price control referral process, published as [CAP 1910](#). It also sets out at a high level, the steps we intend to take following the CMA's final report.
- A2 The principles and approach set out in this appendix are supported by NERL.
- A3 The appendix is set out as follows:
- Context and challenge
 - Functioning of route charges system
 - Our proposed approach
- A4 The PFs cover a broad range of matters, provide direction and will have enduring value in the future regulation of NERL – for example the approach to capex governance and incentives.

Context and challenge

- A5 In the PFs, the CMA invited stakeholders to provide views on how it should take account of the impact of Covid-19 in making its final report. We set out below what we regard as the most important context and key challenges.

Uncertainty

- A6 It is clear that traffic volumes have fallen significantly in the short term with actual traffic currently about 90% below forecasts for the period, as a result of the Covid-19 pandemic. What is not known is how long traffic will take to recover or what the new, post Covid-19, normal will look like.
- A7 While it is possible to start to identify traffic recovery scenarios, it is likely to be an unknown number of months before we can start to see a path to recovery and sensibly start to consult stakeholders on meaningful options for any changes to price controls to deal with the new normal. Currently many stakeholders who will have important insights are rightly focussed on the immediate financial, and

physical, health impacts on their organisations and the aviation industry more widely.

Regulatory framework and statutory duties

- A8 The existing price control arrangements in NERL’s licence, and those envisaged in both our final decisions and the CMA’s PFs, have a traffic risk sharing mechanism to address certain variations between forecast and actual traffic in a certain year (“year n”), where an adjustment to charges is made two years after the relevant year (“year n+2”). This reflects the requirements of the EU performance scheme.¹
- A9 These arrangements are designed to deal with variations in traffic of up to 10 per cent. We consider that the impact of Covid-19 is likely to be significantly greater and it is clear that using this mechanistic approach to adjust for the current collapse in traffic volumes is unlikely to take into account the full range of relevant factors and considerations in a way which is appropriate.
- A10 Where traffic variation exceeds 10 per cent – and/or the initial data, assumptions and rationales on which the targets were established are to a significant and lasting extent no longer valid – the EU framework² provides for the national supervisory authority (in the UK, this is the CAA) to review and assess whether it is appropriate to revise targets. We consider this is fully consistent with our Transport Act 2000 duties.
- A11 The present level of uncertainty is likely to persist for an unknown number of months. We consider, therefore, that trying to determine whether any and, if so, what changes to price control arrangements will be appropriate for future years, or what revenue correction, if any, should be applied for 2020 and beyond, would not be reasonable or practicable this calendar year. In these circumstances, our view is that the best way forward would involve the CMA putting in place backstop arrangements, which might reasonably be based around the price control revenue per service unit identified in the PFs, with the CAA then reviewing NERL’s price controls in 2021.
- A12 In reviewing the price controls in 2021 we expect to be in a better position to determine what, if any, changes to arrangements would be appropriate for the new normal and any revenue correction that should be applied for 2020 and 2021, consistent with our Transport Act 2000 duties. As set out in our main response to the PFs,³ we consider that it is for NERL’s management, its

¹ Article 27, Commission Implementing Regulation (EU) 2019/317

² Article 18, Commission Implementing Regulation (EU) 2019/317

³ Paragraph 2, [CAP 1910](#) Reference to the CMA of NERL RP3 price controls: CAA response to provisional findings [RP3 reference CAA document 035]

providers of finance and Government to determine how best to address short-term issues associated with liquidity and financeability.

CMA functions

- A13 It is important that the way forward is consistent with the CMA reasonably discharging its functions. We made the reference to the CMA because NERL rejected our RP3 final decisions. The CMA's role, as provided for in the Transport Act 2000, is to make a final report setting out its findings in this regulatory referral process.
- A14 In practice this means the CMA being able to make findings that reasonably take account of the unprecedented uncertainty associated with the Covid-19 pandemic, while meeting its statutory obligations. Our view is that the approach outlined above could form the basis of such a way forward.
- A15 More broadly, it is necessary to take due account of public law principles and the public interest in progressing the referral process. It will be important to balance legitimate expectations in terms of substance and process, with a pragmatic approach mindful of the current context. We consider that the approach described in this appendix allows the CMA to both determine the matters set out in our original reference and to take account of Covid-19 by acknowledging the CAA's intention to carry out a further review of NERL's price controls. As this approach would provide for the CAA to deal with the detail of the impact of Covid-19 in a further review, it would avoid putting the CMA in the position of determining as part of its current review whether major changes might be needed to price control arrangements to deal with Covid-19. These matters should naturally be considered first by the CAA in consultation with NERL and other stakeholders, with a reference to and determination by the CMA only if the CAA and NERL fail to agree appropriate licence modifications at the end of the 2021 review.

Stakeholders

- A16 A broad range of stakeholders have inputted into the RP3 referral process to date, and airspace users in particular into the process that led up to our RP3 decisions. It is therefore important that stakeholders have the opportunity to engage properly both on the CMA PFs, but also the way forward, when considering how to take account of the impact of Covid-19. Any substantive changes to the expected process should allow for effective stakeholder consultation.

Functioning of route charges system

- A17 Regardless of the level of NERL's 2020 unit charges, the airspace users subject to them are facing liquidity challenges. The Member States of Eurocontrol, which provides the Central Route Charges Office and collects and disburses air navigation charges for 41 European States, have agreed to defer payment of charges for February, March, April and May 2020, until late in 2020 and well into 2021. Assuming this facility is not extended beyond May 2020, the next regular scheduled disbursement of charges to Member States will be in August 2020, for June 2020 traffic. Additionally, those Member States have agreed⁴ to centralised measures to support partial funding of ANSPs through Eurocontrol, in the meantime.
- A18 The above measures relate only to NERL's main en route activities and not to its Oceanic services, which are outside of the Eurocontrol route charges system.

2020 charges

- A19 Given the severity of the impact of Covid-19 on air traffic volumes and the ineffectiveness of price control levers in dealing with the short-term impact of these matters, it is for NERL to do what it reasonably can to protect its own liquidity during 2020 and 2021 and for its shareholders to provide support where necessary. NERL should take all reasonable steps to manage its costs efficiently based on the information available to it at the time, while ensuring that the residual level of services provided to users are done so in a way that is reliable and safe.

2021 charges

- A20 As set out above, it is not clear how long the traffic slump will last or the timing of any recovery. We hope that as 2020 progresses the timing and speed of recovery will start to crystallise, but it is likely that significant uncertainty will remain during most or all of the remainder of 2020.
- A21 The charges for 2021 must be agreed in late 2020.⁵ We, therefore, consider it is highly unlikely that during the coming months there will be sufficient information available to make any changes for 2021. In these circumstances our view is that it is reasonable for the CMA to establish backstop price control arrangements in making its final report (as described more fully below). We can then review the price controls to apply from 2022 and consider what reconciliation is required for 2020 and 2021, if any.

⁴ <https://www.gov.uk/government/news/nats-eligible-for-funding-of-up-to-92-million-to-maintain-services>

⁵ Article 29, Commission Implementing Regulation (EU) 2019/317

Our proposed approach

- A22 Recognising the unprecedented impact of Covid-19, we consider that the most appropriate way for the CMA to complete its work on the RP3 referral process is to make its final report taking due account of stakeholder consultation responses submitted in response to the PFs.
- A23 Figure A.1 sets out our proposed way forward, which is described in more detail below.

Review

- A24 As mentioned above and consistent with the EU regulatory framework and our statutory duties, we will conduct a RP3 price control review in 2021 that looks holistically at all the factors that have changed. This will enable NERL to develop and consult on a new business plan, it will enable stakeholders to develop views and priorities for the remainder of the RP3 period and it will also allow time for the development of meaningful traffic and associated forecasts, focussed on the new, post Covid-19, normal.
- A25 In light of the impact Covid-19 and the limitations of the regulatory framework, we would also expect the 2021 review process to include consideration of what revenue correction, if any, should be applied to 2020 and 2021. The review, guided by our statutory duties, will need to consider the following (non-exhaustive) matters:
- whether there is a need for any reconciliation, taking account of evidence from and views of NERL and stakeholders;
 - if so, on what basis – e.g. costs or revenues, etc; and
 - treatment of forecasts in any reconciliation.
- A26 Making a final report in this referral process, would enable the CMA to clearly reach final conclusions and establish precedent across a number of areas already considered as part of its PFs. This would mean the main parties would necessarily need to take account of the final report in developing respective approaches to the 2021 review. Combined with our commitment to consider whether there should be any reconciliation for 2020 and 2021 as part of our review process, this should provide airspace users with assurance that the impacts and current uncertainty arising from the Covid-19 pandemic will be given proper consideration and taken into account.

Stakeholder consultation

- A27 In the 'context and challenge' section above, we note the importance of engaging and consulting with stakeholders. We will ensure our work to develop our approach to the 2021 review, including the non-exhaustive list of factors set out above, is properly informed through stakeholder consultation in due course – it will be important for NERL to engage and consult with users directly too, as part of the review.
- A28 In process terms for this referral process, there may also be merit in the CMA considering whether a further consultation step is appropriate. It could focus on how its final report will take account of Covid-19, following the question posed in its PFs. For example, based on our proposed approach, the CMA could consult on its intention to make its final report, acknowledging that the CAA will conduct a review to of the price controls in 2021.

Timetable for CMA referral process

- A29 The statutory deadline for the CMA to provide its final report to the CAA is currently 18 May 2020. Recognising the need to give proper consideration of how to take account of Covid-19 and to provide flexibility for any further focussed CMA consultation, if required, ahead of making its final report, we are prepared to discuss a reasonable extension to the deadline for the submission of the CMA's final report in this referral process, as provided for under section 12A of the Transport Act 2000.

Figure A.1 – Proposed approach to responding to Covid-19

