

NATS (En Route) Plc /CAA Regulatory Appeal

Approach to COVID-19 – consultation

Introduction

1. The Civil Aviation Authority (CAA) made a reference to the Competition and Markets Authority (CMA) on 19 November 2019 following the rejection of the CAA's proposed licence modifications by NATS (En Route) plc (NERL). The CMA was to report on the matters specified in the reference within a period of six months. On 6 May 2020, the CAA extended the reference period to 17 November 2020.¹
2. On 24 March 2020 the CMA published its provisional findings in its determination. As well as inviting representations on the provisional findings, we also invited representations on how we should take account of the impact of COVID-19 in our final determination. We received responses on this issue from ten third parties, as well as from the main parties.
3. Having considered all the representations, and following further discussions with the parties, we present our provisional conclusions on the appropriate approach to take in this reference concerning the impact of COVID-19. As these lead to significant differences from the approach anticipated in our provisional findings, we decided to conduct a short consultation on our proposed approach.²
4. This document summarises parties' views on how the CMA should take forward this reference in the current circumstances, from the responses to our provisional findings. We then set out our provisional assessment of the appropriate approach to COVID-19 post provisional findings for this reference.
5. A brief description of the effects of COVID-19 on NERL, and on the aviation sector in relation to UK and Oceanic airspace, is provided in Annex 1.

Impact of COVID-19 on the Reference

6. As we prepared our provisional findings, it was clear that the pandemic was having a significant impact on the air traffic industry (see Annex 1), and that many of the assumptions in the NERL business plan and on which the CAA RP3 decision and CMA redetermination were based would no longer be valid. We therefore invited comments on the approach the CMA should take to allow

¹ [CAA response to CMA request to extend reference period](#)

² This consultation focuses only on the process to determine NERL's price control, and does not cover the substance of the price control, which will be set out in our final determination.

for the uncertainty and change in circumstances caused by COVID-19 when reaching its final determination.

CAA's view

7. The CAA submitted that the COVID-19 pandemic had created very large challenges for the aviation sector, including in respect of the liquidity and financeability of the businesses of many sector participants, including NERL. The CAA submitted that NERL's price control did not provide levers that could deal with issues such as liquidity, and that short-term issues associated with liquidity and financeability should be addressed by NERL's management, its providers of finance and Government.³
8. The CAA submitted that given the unprecedented circumstances, the CMA should come to a final decision in the referral procedure to form an interim price control to cover at least the period 2020 and 2021. The CAA said this should be based on the CMA's provisional findings, with the CMA retaining the level of allowed price per service unit as in its provisional findings. The CAA suggested that 'the CMA may take the view that little purpose would be served by further fine tuning'.⁴ To the extent that the CMA carries out further substantive work, this should focus on the areas that are likely to be relevant and important precedent for the regulatory framework in the medium term which the CAA considered to be the overall balance of the CMA's approach, the treatment of non-regulated revenue and costs, the CMA's approach to estimating asset beta and the arrangements for capex governance. The CAA would then review NERL's price control arrangements in 2021, when the timing and shape of the recovery in air traffic should at least be starting to become clear.⁵
9. The CAA subsequently provided more detail of its proposals for the post-provisional findings process for the reference,⁶ which we considered in arriving at our view of the appropriate process.

NERL's view

10. NERL submitted that there is not enough certainty about the impact of COVID-19 on the aviation industry to enable the CMA to refine any numbers in its provisional findings into a final determination for this reference, either

³ [CAA Response to the provisional findings, 24 April 2020](#), paragraph 2

⁴ [CAA Response to the provisional findings](#), paragraph 4

⁵ [CAA Response to the provisional findings](#), paragraphs 3, 4 and 10

⁶ [CAA Response to the provisional findings, Appendix A](#), 29 April 2020

now [May 2020] or following a 6-month extension. NERL asked the CMA to reach its final conclusions for this reference as efficiently and quickly as possible, subject only to final clarification of the remaining issues that have been requested from the CAA, on the understanding that NERL's RP3 business plan will need to be significantly revised later on in light of COVID-19.⁷

11. NERL submitted that the business plan NERL created for RP3 in October 2018, the CAA's RP3 Decision published in August 2019 (which is the focus of the CMA's reference) and the provisional findings are no longer reflective of the underlying operational circumstances. NERL also told us that traffic forecasts are either unavailable or are much more likely to be wrong than normal. In NERL's view, a price control reset 'does not work in the current situation' due to the degree and severity of uncertainty that impacts the entirety of NERL operations.⁸
12. NERL submitted that the CMA's provisional findings (supplemented with further work where appropriate) would provide an 'anchor of principles' in key areas that were in dispute between the CAA and NERL (for example capex governance, WACC, ADS-B charges and non-regulated income), and can be used by the CAA when it becomes a viable option to reset NERL's price control, possibly for 2022. NERL considers that the CMA's final determination will be turned into new Licence Conditions for NERL and will form a new baseline 'from which an interim plan and ultimately a reset of RP3 can be assessed'.⁹
13. NERL did not make any further submission specifically about the process to be followed, but reviewed and commented on the CAA response on this question¹⁰ before the CAA submitted it to the CMA.

Third parties' views

14. We received comments on this issue from ten third parties (see Annex 2 for details of third party comments).
15. There was a difference of opinion amongst the third parties over whether the CMA should take the changed circumstances into account in its final

⁷ [NATS Response to the provisional findings, 24 April 2020](#) , paragraph 8

⁸ [NATS Response to the provisional findings](#), paragraph 28

⁹ [NATS Response to the provisional findings](#), paragraph 32

¹⁰ [CAA Response to the provisional findings, Appendix A](#)

determination, or whether the usual regulatory mechanisms¹¹ should be relied upon to deal with the shock to the industry.

CMA provisional assessment of appropriate approach to COVID-19

16. We are considering how to take into account in our report not only the responses we received to our provisional findings, but also the consequences for air traffic of the COVID-19 pandemic, and the effect on air traffic of measures taken to control the pandemic.
17. In view of the sharp decrease of air traffic volume, and the resulting measures taken by Eurocontrol and the UK Government, it is now clear that NERL will no longer be able to execute its RP3 Business Plan as conceived. Similarly, the CAA's RP3 Decision, and most of the financial assumptions and forecasts we relied upon to reach our provisional findings, are now largely outdated.
18. The reduction in flights and resulting loss of revenue and operational impact resulting from the COVID-19 pandemic is likely to be a largely temporary occurrence, but its duration remains unknown. The COVID-19 pandemic may also have a long-term impact that cannot yet be fully appraised. We consider that it is not yet possible to make traffic forecasts with any degree of certainty, nor to assess the full financial impact of the COVID-19 pandemic on NERL's business by our statutory deadline.¹²
19. We consider that it is not possible, given the current lack of data, to make reliable revised estimates before the statutory deadline for our report, as regards the number of flights, volume-related costs, and the corresponding revenue expected in the years up to the beginning of 2025. The Parties have submitted that the impact of the COVID-19 pandemic on the aviation sector will remain uncertain for the foreseeable future, and at least until after the statutory deadline for publication of our final report.
20. In these circumstances, after taking into account the submissions made by the CAA, NATS, and third parties following our provisional findings, we are considering continuing to base our final report on our provisional findings, without making specific adjustments to take account of the impact of the COVID-19 pandemic. The changes to our provisional findings that we propose to make are outlined below.

¹¹ Such as the traffic risk sharing mechanisms, which IAG submitted were well established and created specifically and precisely to address these types of externalities ([International Airlines Group \(IAG\) Response to the provisional findings, 15 April 2020](#)), and the consultation processes in place to manage change during the regulatory period ([Virgin Atlantic Response to the provisional findings, 15 April 2020](#))

¹² We consider this to be the case even after the CAA has granted a time extension until 17 November 2020.

21. In line with the CAA's submission, we consider that refining our assessment in detail following our provisional findings would not be appropriate, as it would not allow us to reach more accurate figures for the purpose of the Charge Conditions. For example, we agree with the CAA, NERL, and a number of third party respondents that it is too early to make material revisions to opex allowances, capex allowances and incentives, and to adopt a new forecast of traffic volumes, at this stage. Any such new figures would need to be reviewed again during the price control period, to produce appropriate charges for the whole period. The same applies to non-regulated income, pension costs allowance, and the Oceanic charge control. Similarly, while we received submissions on a number of issues related to the cost of capital, we do not consider that it would be appropriate to undertake further analysis on the cost of capital as any changes would still result in a cost of capital which is not based on evidence of, and is/would be largely disconnected from, NERL's financial circumstances after COVID-19. We therefore limited our work on these elements mainly to correcting inaccuracies identified in our provisional findings, and have furthered our assessment only in so far as it could be susceptible to having a longer-term impact, irrespective of COVID-19.
22. While the price control will be determined in our final report, we consider that it would not be in the public interest for the price control resulting from our final report to apply for longer than strictly necessary. We are considering limiting the period of the price control to three years at most, until December 2022. We consider this should be sufficient time for the CAA to complete its review of a new price control, based on a new Business Plan and updated forecasts and financial assumptions. We consider that the CAA should aim to complete that review as soon as feasible, when the situation of the aviation sector reaches an adequate level of stability. This may result in a new price control being implemented sooner than December 2022.
23. We consider that, as part of this review, the CAA should also conduct a reconciliation exercise, with reference to actual flight volumes and costs over the period since the start of 2020. We consider that this would be a relevant consideration for the CAA in setting the new price control for NERL.
24. Elements of the price control relating to capex incentives and governance are unaffected by the uncertainties created by the COVID-19 pandemic. We have conducted a more thorough review of these elements following our provisional findings, as they are intended to have longer term application and should not be included in the reconciliation exercise mentioned above.
25. For these reasons we consider that this approach would meet the requirements of our reference, and would be in the public interest, having regard to the

statutory studies set out in the Transport Act 2000, while allowing for the possibility of the relevant figures to be updated as necessary.

Consultation questions

26. We welcome views on the following provisional conclusions:
- that we should not make specific adjustments to our provisional findings to take account of the impact of the COVID-19 pandemic;
 - that the period for the price control that will be determined in our final report should be limited to three years.
27. Representations on these questions should be sent by 1 July 2020 to NATS.caa@cma.gov.uk.

Impact of COVID-19 on NERL operations

Air traffic volumes

1. Worldwide aviation has reduced significantly since the spread of COVID-19 prompted travel restrictions. According to the Pew Research Centre, nine out of ten people are living in countries with travel restrictions due to COVID-19.¹³
2. Aviation using NERL's air traffic control services, measured on 20 April 2020, had fallen by around 90% in comparison with 2019.¹⁴
3. As a result, NERL's income has fallen considerably compared with forecasts based on the charges in its current specifications and previous traffic forecasts.
4. At the same time, airlines are facing financial challenges, as their revenues have fallen.
5. Eurocontrol has reported that flight numbers across Europe started to recover slightly from late April 2020.¹⁵ However its future scenarios envisage that traffic volumes across its 41 member countries' airspace will still be materially below 2019 levels in February 2021.

Measures taken to mitigate impact of COVID-19

Airline sector

6. On 7 April 2020, Eurocontrol announced an agreement by its 41 member states (including the UK Government, which has a 10% voting share), to ease the financial burden on airlines operating in its airspace.¹⁶ The decision allows airlines to defer ATC charges for the months February to May 2020, for between eight months (for February 2020 charges) and fourteen months (for May 2020 charges).¹⁷
7. This ability to defer payments applies to airlines' use of NERL's En Route services. Charges for Oceanic and London Approach air traffic control

¹³ <https://www.pewresearch.org/fact-tank/2020/04/01/more-than-nine-in-ten-people-worldwide-live-in-countries-with-travel-restrictions-amid-COVID-19/>

¹⁴ NERL

¹⁵ <https://www.eurocontrol.int/news/eurocontrol-nm-publishes-network-recovery-plan>

¹⁶ <https://www.gov.uk/government/news/uk-airlines-to-save-millions-as-navigation-charges-deferred>

¹⁷ <https://www.eurocontrol.int/press-release/eurocontrol-states-assist-airlines-11bln-deferral>

services are managed by NERL and are outside the Eurocontrol route charges billing system.

8. On 16 April 2020, the UK Government announced that up to £92 million would be available to NATS, 'to continue providing services, supporting cargo and repatriation flights as well as ensuring the organisation can return to full operations at the appropriate time, to help the recovery of the aviation sector.'¹⁸ This will be funded from a loan arranged by Eurocontrol on behalf of all its member states.
9. These measures are designed to mitigate the immediate financial effects on the sector and Air Navigation Service Providers, in the Eurocontrol region. They are not permanent.

NERL

10. In its response to our provisional findings, NERL told us that in response to the pandemic it had reduced its daytime staffing levels and non-essential services, which had enabled social distancing at work for ATCOs in the context of much lower traffic volumes.¹⁹
11. It had also taken some additional steps to reduce costs, either temporarily (by deferral) or absolutely (by one-off reductions).²⁰

¹⁸ <https://www.gov.uk/government/news/nats-eligible-for-funding-of-up-to-92-million-to-maintain-services>

¹⁹ NATS Response to the provisional findings, 24 April 2020, paragraph 17

²⁰ NATS Response to provisional findings, paragraph 19

Impact of COVID-19 on the reference: comments from Parties and third parties

CAA's view

1. The CAA submitted that the COVID-19 pandemic had created very large challenges for the aviation sector, including in respect of the liquidity and financeability of the businesses of many sector participants, including NERL. The CAA submitted that NERL's price control did not provide levers that could deal with issues such as liquidity, and that short-term issues associated with liquidity and financeability should be addressed by NERL's management, its providers of finance and Government.²¹
2. The CAA submitted that given the unprecedented circumstances, the CMA should come to a final decision in the referral to form an interim price control to cover at least the period 2020 and 2021. This should be based on the CMA's provisional findings, with the CMA retaining the level of allowed price per service unit as in its provisional findings, suggesting that 'the CMA may take the view that little purpose would be served by further fine tuning'.²² To the extent that the CMA carries out further substantive work, this should focus on the areas that are likely to be relevant and important precedent for the regulatory framework in the medium term which the CAA considered to be the overall balance of the CMA's approach, the treatment of non-regulated revenue and costs, the CMA's approach to estimating asset beta and the arrangements for capex governance. The CAA would then re-open NERL's price control arrangements in 2021, when the timing and shape of the recovery in air traffic should at least be starting to become clear.²³
3. The CAA subsequently provided more detail of its proposals for the post-provisional findings process for the reference,²⁴ which we considered in arriving at our view of the appropriate process.

NERL's view

4. NERL submitted that there is not enough certainty about the impact of COVID-19 on the aviation industry to enable the CMA to refine any numbers in its provisional findings into a final determination for this reference, either

²¹ [CAA Response to the provisional findings, 24 April 2020](#), paragraph 2

²² [CAA Response to the provisional findings](#), paragraph 4

²³ [CAA Response to the provisional findings](#), paragraphs 3, 4 and 10

²⁴ [CAA Response to the provisional findings, Appendix A](#), 29 April 2020

now [May 2020] or following a 6-month extension. NERL asked the CMA to reach its final conclusions for this reference as efficiently and quickly as possible, subject only to final clarification of the remaining issues that have been requested from the CAA, on the understanding that NERL's RP3 business plan will need to be significantly revised later on in light of COVID-19.²⁵

5. NERL submitted that the business plan NERL created for RP3 in October 2018, the CAA's RP3 Decision published in August 2019 (which is the focus of the CMA's reference) and the provisional findings are no longer reflective of the underlying operational circumstances. NERL also told us that traffic forecasts are either unavailable or are much more likely to be wrong than normal. In NERL's view, a price control reset 'does not work in the current situation' due to the degree and severity of uncertainty that impacts the entirety of NERL operations.²⁶
6. NERL submitted that the CMA's provisional findings (supplemented with further work where appropriate) would provide an 'anchor of principles' in key areas that were in dispute between the CAA and NERL (for example capex governance, WACC, ADS-B charges and non-regulated income), and can be used by the CAA when it becomes a viable option to reset NERL's price control, possibly for 2022. NERL considers that the CMA's final determination will be turned into new Licence Conditions for NERL and will form a new baseline 'from which an interim plan and ultimately a reset of RP3 can be assessed'.²⁷
7. NERL did not make any further submission specifically about the process to be followed, but reviewed and commented on the CAA response on this question²⁸ before the CAA submitted it to the CMA.

Third parties' views

Airlines

8. There was a difference of opinion over whether the CMA should take the changed circumstances into account in its final determination, or whether the

²⁵ [NATS Response to the provisional findings, 24 April 2020](#) , paragraph 8

²⁶ [NATS Response to the provisional findings](#), paragraph 28

²⁷ [NATS Response to the provisional findings](#), paragraph 32

²⁸ [CAA Response to the provisional findings, Appendix A](#)

usual regulatory mechanisms²⁹ should be relied upon to deal with the shock to the industry.

9. The International Airlines Group (IAG) considered that the CMA should not take account of the ongoing COVID-19 situation in its final determination, which should be based solely on the specific grounds in the reference. It did not consider that re-opening the entire price control would serve consumers' interests. It considered that the CMA should base its determination on the STATFOR forecast last published prior to the suppression of air traffic volumes due to COVID-19, and the established risk sharing mechanisms should deal with the shock (noting that the European Commission may review the traffic risk sharing mechanisms in place). IAG considered that NERL, CAA and airlines will be able to address the impact of COVID-19 during RP3 using the consultative processes that are in place for the management of change.³⁰
10. Virgin Atlantic expressed the same view as IAG, suggesting that the CMA should not take account of COVID-19 as part of its final determination, and should allow the CAA, NERL and the airlines to work together to address the impacts of COVID-19.³¹
11. In contrast to IAG and Virgin Atlantic, Ryanair suggested a number of specific changes that the CMA should make to its determination to allow for the challenges of COVID-19.³²

Other aviation sector organisations

12. Prospect, the trade union representing the ATCOs, stated that the CMA should conclude its process swiftly, perhaps ruling on areas of principle. It suggested that the RP3 process should be re-opened next year when there is more clarity on any short-term recovery and longer-term air traffic demand.³³
13. Heathrow suggested that the CMA should revise its provisional findings with updated traffic and revenue forecasts for 2020 onwards, and update other market and financial data in light of the latest economic developments. It also suggested that the CMA should introduce a mechanism to adjust NERL's RAB so any shortfalls in revenue beyond 10% (of the revenues NERL would

²⁹ Such as the traffic risk sharing mechanisms, which IAG submitted were well established and created specifically and precisely to address these types of externalities ([International Airlines Group \(IAG\) Response to provisional findings, 15 April 2020](#)), and the consultation processes in place to manage change during the regulatory period ([Virgin Atlantic Response to provisional findings, 15 April 2020](#))

³⁰ [IAG response to provisional findings](#)

³¹ [Virgin Atlantic response to provisional findings](#)

³² [Ryanair Response to the provisional findings, 15 April 2020](#)

³³ [Prospect Response to the provisional findings, 15 April 2020](#)

have been expected to be entitled to recover based on existing projections) are added to the RAB and recovered over a longer period.³⁴

14. IATA focused primarily on the Oceanic charge, and specifically its view that the case for SB-ADSB should be reassessed, given the steep drop in anticipated air travel and drop in traffic density. IATA also considered that the CMA should consider the increased financial pressures on airlines, and the risks to their cashflow.³⁵
15. Airlines UK noted that the European Commission might take action with traffic risk sharing mechanisms due to COVID-19 and was concerned that UK airlines might be at a disadvantage to European airlines if the CMA decided to use a COVID-19 impacted traffic forecast.³⁶

Other third parties

16. Northumbrian Water considered that the CMA should reach its determination based on the best information available to it at the time of that determination. It suggested that regulatory mechanisms should be used as appropriate to take account of any ongoing uncertainties.³⁷
17. There were also comments on the likely impact of COVID-19 on the appropriate cost of capital to be used. Ofwat noted that the impacts of COVID-19 on allowed return on capital parameters are uncertain and could be negative or positive, both in terms of duration and magnitude. It said it was plausible that economic impacts could decrease as well as increase individual parameters used to calculate the allowed return on capital.³⁸
18. Citizens Advice noted that regulated utilities are seen as safe havens for investors in the current climate, supporting its previous arguments that these businesses are less risky than regulators have estimated in the past.³⁹

³⁴ [Heathrow Airport Limited \(HAL\) Response to the provisional findings, 17 April 2020](#)

³⁵ [International Air Transport Association \(IATA\) response to the provisional findings, 15 April 2020](#)

³⁶ [Airlines UK Response to the provisional findings, 15 April 2020](#)

³⁷ [Northumbrian Water Response to the provisional findings, 15 April 2020](#)

³⁸ [Ofwat Response to the provisional findings, 15 April 2020](#)

³⁹ [Citizens Advice Response to the provisional findings, 9 April 2020](#)