Ms Judith Ross
NATS/CAA Regulatory Appeal
Competition & Markets Authority
The Cabot, 25 Cabot Square
London E14 4QZ

By post & email to: nats.caa@cma.gov.uk

29th June 2020

Dear Ms Ross,

Re: NATS En-route Limited (NERL) Price Determination – approach to COVID-19 consultation

We are in receipt of your consultation of 24th June 2020, regarding *"the approach the CMA should take to allow for uncertainty and change in circumstances caused by COVID-19 when reaching its final determination"* in the matter of the reference made to you by the CAA, following the rejection of its proposed licence modifications by NATS. We note that that this a supplementary consultation to the previous of 24th Match 2020, regarding the CMA's provisional findings determination, in which you also sought representations on how the CMA should take account of impacts of COVID-19 in its final determination.

On 24th June, the CMA advised that having considered representations made in response to the previous consultation - and following further discussions with responding parties, it is proposing to take a different approach from that set out in its provisional findings and had therefore elected to conduct a short consultation on the new proposed approach. As an interested party, IAG herein responds to the CMA's new proposals:

- that the CMA should not make specific adjustments to its provisional findings to take account of impacts of COVID-19; and
- that the period for the price control that will be determined in the CMA final report should be limited to three years.

Introduction

The regulated rate of return enjoyed by NATS rewards investors for risk; although, for many years none had materialised. Now that it has, it would be perverse to retrospectively adjust the regulated rate of return, just as it would have been to do so when risk didn't materialise.

In principle, the same rationale applies to reducing the regulatory period from five to three years; however, IAG pragmatically recognises the current profound lack of certainty in aviation and expects that in three years' time the situation will have improved.

Specific Adjustments

In line with our previous consultation response, IAG continues to support the CMA's proposal that it should not make specific adjustments to the provisional findings, to take account of impacts of COVID-19.

It is a widely held view (with which IAG concurs) that there is no realistic prospect of early recovery from the current COVID-19-related downturn in demand for air-travel, even after the immediate health crisis subsides. There will be fewer passengers flying to fewer destinations. IAG anticipates that there will be fewer airlines – and they will be smaller than they are today.

IATA's outlook for the next five years shows that international air travel is unlikely to recover to 2019 levels until 2023/2024 and IAG's strategic plans are aligned with this outlook; however, there is considerable volatility in current planning. IAG's forecasts remain subject to ongoing and significant change, brought about not only by unpredictable demand, but also by various travel restrictions imposed by the UK and other governments.

IAG agrees with the CMA that:

- the likely duration of the COVID-19 pandemic remains unknown and its long-term impacts cannot yet be fully appraised;
- there is a lack of data that would enable the CMA to make reliable revised estimates, before the statutory deadline, particularly regarding numbers of flights, volume-related costs and corresponding anticipated revenue;
- it will be impossible to reliably forecast traffic or to assess the full financial impact of the COVID-19 pandemic on NERL's business, by the statutory deadline;
- it is consequently too early for the CMA to make material revisions to previous OPEX or CAPEX allowances and incentives, or to adopt revised traffic forecasts, forecasts of non-regulated income or pension costs allowances; and
- it would be inappropriate to undertake further analysis on the cost of capital, for which there would be insufficient evidence.

The one area of the determination that should be reviewed by the CMA now is that of bonuses, payable to NERL by industry, in the event that NERL achieves certain service targets (in terms of delay, safety and the environment), as these have been rendered meaningless by the very considerable reduction in traffic. All targets will doubtlessly be achieved in all foreseeable circumstances. Bonuses should therefore be removed from this determination, at least until such time as the CAA undertakes a subsequent planned price control review. (To be clear, IAG does not support the principle of service quality bonuses to monopoly suppliers.)

Period for price control

The considerations put forward by the CMA, in support of a view that the period for the price control should be limited to three years are persuasive.

IAG agrees that NERL will no longer be able to execute its RP3 Business Plan – and that NERL's Business Plan created in October 2018, the CAA's RP3

Decision published in August 2019 and the CMA provisional findings, all require adjustment, if they are to align with the needs of industry, as it emerges from crisis. Under the circumstances, it seems reasonable for the CMA to conclude that it would not be in the public interest for the price control resulting from the final report to apply for longer than necessary. IAG consequently supports a time limit on the period of the price control of three years until December 2022.

The CMA has advised that the CAA has suggested reviewing 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. 2021 would be too early to be able to confidently forecast traffic volumes - and without details of a proposed review process, which would require the CAA to review price controls beyond 2023 and 2024, IAG cannot support such a broadly scoped proposal. In the advent of greater clarity concerning roles of NERL's stakeholders (including airline customers) in shaping NERL's business plan, in future it may be possible to support such a review.

Further commentary

IAG sees some merit in NERL's suggestion that elements of the CMA's findings could provide an *'anchor of principles'* in key areas of dispute between the CAA and NERL, to the extent that they could be used by the CAA, when it becomes feasible to reset NERL's price control. Whilst there would be merit in anchoring issues such as CAPEX governance and the regulated rate of return, IAG does not agree with NERL's position that ADS-B charges and non-regulated income should also be *'anchored'* in this way. In neither case does the situation lend itself to an anchoring principle; they are both relatively fluid and subject to variation. Indeed, in the case of ADS-B charges, the CAA is yet to organise a workshop, aimed at assessing the progress of ADS-B and the delivery of benefits.

The significant reduction in traffic over Shanwick seriously compromises the ability to analyse any benefits that could be associated with the introduction of ADS-B surveillance on the North Atlantic. It is extremely doubtful that airlines would be able to generate any meaningful cost-savings, as a result of the introduction of ADS-B and it is much more likely that the cost of the North Atlantic Data Charge will simply increase airline costs. This may very well remain the case for some considerable time and so it would be wrong to *'anchor in principle'* that industry should be burdened with cost that provides little or no benefit.

Yours sincerely,

[redacted]

Ian Clayton
Group Head of Regulatory Affairs