

By email: economicregulation@caa.co.uk

15 July 2021

Dear James and Rod,

NERL: consultation on the programmes and projects to be assessed under the capex engagement incentive

Thank you for your recent letter¹ requesting stakeholder feedback on the programmes and projects to be included within the assessment for the capex engagement incentive. It is clear from the initial customer feedback on iSIP21 that the revised structure, range and frequency of engagement with customers, with yourselves and the Independent Reviewer (IR) that we have jointly sought to implement has been positive. More generally, we welcome the CAA's approach to seek stakeholder views on the issues set out in the letter, which will help inform the decision-making process.

Our views on the timing, assessment criteria and programmes / projects to be included are described below.

Timing

We are grateful for the clarity in your letter that confirms the incentive applies only to NERL's engagement on capex in 2021 and 2022 since the relevant changes to NERL's economic licence only happened from the beginning of 2021. We agree that choosing iSIP21 as the basis for the initial assessment is a sensible approach as this will allow the IR to consider the evolution of our programmes since the beginning of the year and how NERL has responded to customers, the IR and the CAA after the incentive has come into effect.

In regard to the final assessment, we believe that using SIP23 is the most appropriate target since it would provide extra opportunities for us, airlines and the CAA to see how this new incentive works in practice and how to optimise it for the next regulatory period, NR23. While this is our preference, we do not strongly oppose the CAA using iSIP22 as the basis for the final assessment as long as it does not exclusively focus on the SIP and takes into account the quality of NERL's engagement with its customers more broadly.

Assessment Criteria

The definitions of performance within the scoring system remains subjective and relies on judgement. This places a significant financial risk on NERL, which could arise through a failure in communication or understanding for each definition. Whilst we are actively engaged with the IR in an attempt to align expectations, we should be grateful for further discussion on how we can meet the baseline expectations ie 'what constitutes a score of 3?' We would be happy to engage with you in order to develop this aspect of the scoring mechanism.

In regard to weighting of the programmes / projects, whilst it is a simple and transparent method to only use the value of planned capex to determine the weighting, this may not always reflect

¹ CAA letter dated 10 June 2021.

what is important to the customer. As this assessment period is relatively short, we do not see a need to urgently address this, however, we would strongly encourage this to be re-evaluated for the next regulatory period to establish whether a more nuanced or qualitative approach is warranted. We are grateful that, in their consultation meeting, the CAA acknowledged the potential for adjustment of the incentive for NR23, which will consider lessons learned in RP3 and we look forward to discussing with the CAA and airlines how this could be done in due course.

Programmes and/or projects to be included

The three potential options set out in your letter were:

- Option 1 – All eight programmes in NEL's baseline programme
- Option 2 – The five largest programmes by forecast spend plus SAIP AD6
- Option 3 – The DP (En Route) and airspace programmes only

We have considered the options presented for assessment under the incentive carefully and agree that there is no "obvious" or "perfect" subset of programmes and projects that should be used and that this should be user-led.

The aim of our investment portfolio is to deliver balanced change that ensures we have a safe, resilient operation now and in the future providing the capabilities and benefits that customers want. We engage with customers on all aspects of the portfolio through the SIP process, Technical Customers' Advisory Board (TCAB), ACOG and other forums and many of our programmes and projects are also very interconnected. With this in mind, our evaluation of Option 3 is that it is too narrowly focussed on two programmes and could have undesired consequences for our engagement with customers as a whole. We therefore recommend that Option 3 is rejected.

The customers who contributed during the short consultation on this topic voiced their preference for the assessment of all eight programmes under Option 1, their reasons being that all programmes are inter-related in some way and moving away from all eight programmes limits the ability to truly assess all the engagement. We agree with this to some extent, but our view is that the three additional programmes to be included in Option 1, compared with Option 2, are relatively small in value and will not likely change the assessment outcome in a material way. The additional compliance cost of Option 1 could therefore be seen as unnecessary.

On balance, our preference would be Option 2. This option covers the majority of the portfolio by value (93%) and therefore has some advantages, including a proportionate approach to regulation and reducing the compliance burden on all parties.

We look forward to the results of the consultation and continuing to contribute towards the development of more meaningful engagement with our customers into the future.

Yours sincerely,



Gary Edwards
Economic Regulation Manager