Mr. Stewart Carter
Programme Director NR23
Consumer & Markets
UK CAA
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London,
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United Kingdom

August 7th, 2023

By email to economicregulation@caa.co.uk Stewart.Carter@caa.co.uk

Dear Mr Carter,

Aer Lingus Response: UKCAA CAP 2553 Provisional Decision for the next price control review ("NR23")

Aer Lingus is grateful for the opportunity to respond to this consultation by the CAA. In this response, we limit ourselves to some selected high-level comments due to the shortened consultation period. In addition, we have seen, and fully support the more detailed submissions made by IATA and British Airways in their responses to this consultation. For the avoidance of doubt if we do not comment on an aspect of CAP 2553, the CAA should not assume that we agree, but rather that we support the position adopted by BA and IATA.

Aer Lingus finds much to support in the CAA's Provisional Decision. For example, we agree with the CAA that the primary focus should be that of safety and that NERL should deliver that in the most economically efficient way. We agree with the CAA that NERL's proposals do not represent an efficient cost and that the true efficient cost is significantly less than NERL claim.

We support the CAA's decisions to update its proposals using the latest STATFOR forecasts and advocate for the CAA to continue to update its proposals as new forecasts and evidence become available.

We share the CAA's disappointment in NERLs behaviour around the changes in its capital plan, agree with the strengthening of the capex engagement incentive and support the CAA's proposal for further engagement on NERL's capex plan and potential refinement of capex delivery and efficiency incentives. We look forward to the Egis report being published and consultation on its outputs.

However, we believe that the CAA has missed the opportunity to set a charge that reflects an efficient level of costs for NERL, and at present, risks rewarding NERL for inefficient spend. This is evidenced by the CAA's proposals for a 26% year on year increase, which in the context of the fragility of aviation's recovery and current macroeconomic situation is at best ambitious and at worst positively damaging to recovery. It also means that NERL's charges remain high against comparator ANS providers and provides evidence of consumer detriment for those passengers who travel through NERL controlled airspace.

There are a number of areas where we believe that the CAA is at risk of failing to carry out its statutory duties by rewarding NERL for inefficient costs. For example, on the issue of pay and reward. We consider that the CAA should further assess wage levels and benchmarking, further assessing areas unresolved or conflicting in the Steer and NERA (for NERL) reports. Leaving such a fundamental cost contribution to NERL's cost base appears inappropriate and in our consideration is at odds with regulatory precedent. For example in its annual price control of Smart DCC, Ofgem requires the regulated business to prove that salaries, reward and consultant fees are efficient against multiple benchmarks. If Ofgem is not fully satisfied that the spend is efficient it disallows the spend. The CAA should do the same with NERL.

With respect to the DC new joiners pension scheme, the CAA's own advisers, the Government Actuaries Department (GAD), evidence the DC employer contribution rate for FTSE100 companies in 2021 of 11%, at a stable position since 2015, excluding pension law changes. This peer group presents a much more representative comparator basis of the largest UK listed companies and should form the basis of the CAA's allowance for this element of its proposals. In our view the comparator group used in the Steer assessment is too small to be a fair representation and the inclusion of economically regulated entities raises further concerns for the comparator group as being unrepresentative of an efficient cost level. We would also like to raise the query that Steers report represents a maximum contribution rate, something most employers vary by employee grade and being an area the CAA should consider further as its establishes the introduction of a new pension scheme cost point which has the potential for long term implications.

Consequently, there is clear and objective evidence that the CAA is allowing NERL to charge for opex that is in excess of the efficient rate.

In terms of the reconciliation of the impact of covid, we have a number of issues with the CAA's proposals. We do not oppose the recovery of efficient costs incurred by NERL under the pre-existing TRS mechanisms in NERL's licence, but we do question the level of deemed efficient costs, particularly those associated with the Voluntary Wage Reductions and the Voluntary Redundancy scheme. We disagree with the CAA on what constitutes an efficient level of VR related costs. NERL should and could have acted sooner to terminate its pre-existing Redeployment & Redundancy Agreement (RRA), something we question why it had not already done before covid-19 given the inflated levels of compensation it entailed that Steer have assessed as being so overly generous and inefficient, NERL should furthermore have followed the most cost efficient timeline for executing its redundancy programme. We question the assumption by Steer of a 12-month payback representing the efficient level given the cost of the comparators Steer include in its report and also the number of companies, including airlines, that made Compulsory Redundancies in the height of the pandemic at much lower cost levels. The reduction in wages for furloughed staff as applied by many UK companies and airlines also appears underestimated by the CAA in its current proposals. The CAA's current proposal overstate the efficient costs in terms of the level of costs deemed efficient by the CAA's own experts (Steer) at £26m disallowed, and that the scheme did not reflect the voluntary salary reductions (c20%) that employees in airlines and other efficient companies took during the covid period.

With respect to the TRS and the impact of covid, we recognise that the CAA has attempted to mitigate the impact of this cost recovery by choosing to spread the cost over two control periods. Aer Lingus appreciates and supports this approach.

We welcome the CAA's decision to appoint EGIS to conduct a capex review and look forward to their report. We note that this is not the first time that NERL has dramatically changed its capex plans. We would encourage the CAA to ensure that the EGIS review should consider not just the absolute cost of a capex programme (eg did NERL pay the right price for a piece of kit), but also a range of other issues such as:

- Was the capex proposal for the most efficient solution (i.e. benefit to cost ratio), and indeed whether the business case process is robust;
- the accuracy of NERL forecasting (both in terms of demand, but also programme costs);
- was the capex programme efficiently procured through competitive tender and the best deal negotiated;
- was the programme efficiently and effectively managed.

In short, whilst the Aer Lingus supports many features of the CAA's proposals, we believe that the CAA's proposals will set a level of charges that are damaging for both industry growth and recovery, are artificially high and run the very real risk of rewarding NERL for inefficient spend.

We look forward to the opportunity to discuss our response with you.

Yours sincerely

Marta Drozdz

Airports Commercial Manager