

Study on Implementation Rules for Economic Regulation within the Framework of the Implementation of the Single European Sky (SES)

AEA Position Paper – 10 September 2003

Reference is made to the above study prepared for the European Commission Directorate-General of Energy and Transport – Tender No. TREN/f2/28-2002. The Association of European Airlines (AEA) presents the following comments on the Draft Final Report of July 2003 (*text shown in italics is quoted from the RPI Draft Final Report*)

A. Introductory Remarks

- Some of the readers found parts of the study very academic, and judging the consequences and implications of its thoughts was considered difficult, for example regarding the change in the formula discussed section 6 or the function and power of the proposed European ATM infrastructure manager. Some detailed explanations and examples might help. AEA expects that during the presentation and hearing on the study on 7 October, the necessary supporting information will be given.
- The study does not give strong recommendations in favour or opposed to some ideas. RPI rather tries to explain some possible consequences of decisions and tries to establish the impact on the behaviour of system users and providers in a sense that it will increase capacity, allow for better usage of existing capacity or improve the risk sharing. The AEA would welcome a more decisive position expressed in the study.
- AEA is grateful that RPI took up a lot of the points that were raised by airlines at various consultation meetings, such as the criticism of the Eurocontrol Enlarged Committee and the present consultation process. Given the importance of user involvement, RPI sees a clear justification for a substantial change according to the position voiced by airlines. AEA strongly supports this. RPI seems to favour a European forum for consultation with possibly regional sub-groups. By all means, airlines claim closer involvement in the future decision making.
- RPI seems to favour the implementation of an infrastructure manager and/or a system manager. However, if a new body is being established, it must have a real role to play, and their existence has to be matched by the abolition of other supra-national or national bodies or departments (within Eurocontrol or ANSPs) so as to avoid additional costs.
- AEA refers to and reiterates its views laid down in its Position Paper on the subject submitted to RPI and the European Commission by letter of 3 June 2003.

B. Specific Comments

B.I Study Findings Strongly supported by AEA

2.2 Dimensions

An Airspace Charging Block (ACB) is a block of airspace in which en-route charges are fully harmonised. By this is meant that charges are either the same or are set jointly, either by a single organisation or collectively by a group of co-operating organisations

2.4.1 (d) Operational restructuring

There is, for example, the possibility that the creation of new, upper airspace centres will simply give rise to extra assets and extra costs, without leading to offsetting reductions in assets in lower airspace provision (which is one of the concerns surrounding CEATS, about which see below). In that case, although en-route unit costs and charges in upper airspace can be expected to fall, unit costs and charges for ATM in lower space will simply rise, and, on average, network users may be no better off, and possibly worse off, than before.

2.4.1 (d) Regulation Is Key (RIK) view:

... the central task is not to create particular airspace structures, whether in terms of particular configurations of FABs and ACBs, in order to drive performance improvements, but rather to put in place regulatory arrangements and processes that will provide the necessary encouragement and pressures (the carrots and the sticks) for restructuring (where appropriate) and improved performance...

3.6 Incentive Regulation

Put simply, the provider becomes more customer-focused, and this alone can lead to major changes in business conduct.

3.7 Investments

Allowing providers to secure revenues on a cost-plus basis, including a reasonable return on capital, will, if unsupported by other measures, tend to lead to 'gold plating'

4.2.1 Multilateral Arrangements

In our consultations with users, significant concerns were expressed concerning the adequacy of the Enlarged Committee in terms of providing a forum for user representation. Significant weaknesses of this process have also been highlighted recently by the EUROCONTROL Performance Review Commission, and its most recent performance review – PRR6¹ – provides a useful account of some of the problems with current multilateral arrangements.

4.6.1 Disclosure of CNS costs

The paragraph deals with the separation of infrastructural costs and the costs of service provision. AEA strongly supports the paragraph and would emphasise the need for better supplier control (procurement) by ANSP's, transparent through CNS disclosure.

4.6.2 Forum for dialogue

In particular, if the Enlarged Committee is understood to be a political or a regulatory decision-making body, then it may be considered that a main source of weakness is the fact that some states are represented by ANSPs. The key problem here is that there is not a clear separation between service provision and regulation (and as the PRC have noted, this can give rise to well recognised conflicts of interest).

As noted above, users can only attend meetings of the Enlarged Committee on an observer basis. Given the importance of user involvement, a substantial change in this position is justified.

4.7.2. (c) Potential Developments

Perhaps more significantly, and as discussed elsewhere in this report, this could result in failures of co-ordination within the European ATM network, both because individual ANSP's may be potentially unaware of relevant investments that are being undertaken in neighbouring regions, and, perhaps more importantly, because ANSPs are not required to account for their investment decisions within a common framework and forum.

6.3 (b) Pre-approved credits lines

An alternative option for smoothing user charges in times of falling traffic might be through the establishment of pre-approved lines of credit by service providers. The establishment of credit lines would allow service providers to access additional financing in times when traffic falls below forecast levels in order to mitigate the impact on user charges.

An advantage of this mechanism as compared to the establishment of a solidarity mechanism is that it gives the service providers the flexibility to determine, on the basis of their own assessments, when they need to access additional financing. It also has the advantage of only allowing service providers to access funds when they actually require them and therefore avoids the concerns of airlines about 'pre-financing'.

8.6 General Conclusions on Charging Structure Options

....it is unlikely that structures of charging will have substantial effects on overall ANS performance. The main pressures for performance improvements are much more likely to come from a combination of more effective regulation of charge levels (rather than structures) ...

B.II Specific Comments on the Study

2.3 Recent Developments

It needs to be said that the CRCO simulations were conducted without a proper User involvement. Conclusions drawn from these simulations are therefore not entirely shared by the airlines.

Further research on the effect of proposals on airline finance and operations is required.

2.4.1 (d) Operational Restructuring

Regulation Is Key (RIK) vs. Upper Airspace Restructuring is Key (UARIK) view:

“the central task is not to create particular airspace structures, whether in terms of particular configurations of FABs and ACBs, in order to drive performance improvements, but rather to put in place regulatory arrangements and processes that will provide the necessary encouragement and pressures (the carrots and the sticks) for restructuring (where appropriate) and improved performance”

We support the RIK view. To limit eventual restructuring to Upper Levels (UARIK) would cause severe concerns on possible increasing costs due to duplication of overhead costs for ANSP's (more providers per airspace, Upper / Lower)

3.2 Regulation

One of the major benefits of regulation should be an efficient provision of service. To ensure this, the hybrid solution as proposed by RPI should strive for:

- Efficiency (cost reduction)
- Quality of service
- Customer focus

3.3 Price-cap regulation

The study reads: The more significant drawback of the price-cap approach is that it may create incentives to degrade the quality of service.

AEA would like to raise a number of questions on this:

- Is this an estimated effect or has this been proven? Air Traffic Control (ANS) has a proven history of safety awareness.
 - Which part of the service would be degraded?
 - Is this a concern of unions?

3.9 (a) Introduction of competition

The study mentions two forms of competition:

- *Service-to-service competition, in which different suppliers compete for the business of customers in a normal way*

This is already in place by freedom of choice between routes. The problem here is the fact that the choice is based on more factors (fuel, time etc) and therefore is artificial.
- *Where this is not feasible, and it remains preferable to retain one service provider, competition for the franchise to provide the service (e.g. provision is procured via competitive tender).*

AEA supports this *latter* option, although continuity has to be taken in mind as well. Strong regulation on the procedural side would be required to prevent users from incurring costs at the transition moments.

The study indicates, in section 7.4.1, that the former MFUR scheme of Eurocontrol had its merits. The thinking is that RSO introduced sort of a competitive element, but this works only with small countries, while big countries are not really being affected by this, and it may not be efficient when considering the European ATC-system in total. While this might be correct in principle, AEA is still reluctant to drop the idea of losing this slightly competitive element, and going back to an MFUR-type calculation. We believe that the study is wrong when stating that the change from MFUR to RSO was initiated or pushed by states/ANSPs: the contrary is the case.

3.9 (f) Incorporating Customers

RPI mentions multi-party agreements between users and providers. AEA believes that strong market players could take a leading role in these contracts. A service provider at a home base for a network carrier contributes to a large extent to the economic performance of the airline. Bilateral agreements should therefore also be possible, providing they are not discriminatory.

4.5 (table 4.1) Contractual Arrangements

The provided steps are very useful. It has to be carefully examined how the review body is established

4.6.1 (d) The Quality of Cost Data

RPI mentioned the FIFU taskforce, looking into state compliance with charging principles. It does not clarify what the outcome has been. The users are very critical with regards to the willingness of states to accept independent control of accounts. There are great differences between states and not all states complied with the requests for FIFU information. It is of great importance to create an independent body with teeth to investigate accounts by states.

4.6.3 Review/Advisory Bodies

We fully support the PRC work as done in previous year. It needs to be said that although the Provisional Council has endorsed many recommendations, almost none have been implemented. To use the PRC as the example of a good functioning review body would be partially true. Recommendations of a review body as PRC should be binding for ANSP's, users and states. Recommendations should be placed in a defined schedule, with clear identification of actions and subject owners.

4.7.2 (a) Investment Plans

It is essential to create another consultation process between ANSP's and users. Where the financial consultation is a direct result from the technical requirements as laid down by ANSP's, Eurocontrol and the users. This could be formalised by creating a User Requirement Consultation. The entire consultation process could be formalised between ANSP's and users with an annual timeline.

- 1) Consultation on User Requirements
- 2) Cost benefit analysis process
- 3) Agreement on investment plans
- 4) Financial consultation

Secondly it needs to be said that investments also have a strong link with neighbouring ANSP's and the European network. It could also be considered to only allow infrastructural investments if they are adopted for all ACAC members (e.g. ATC system harmonisation)

5.2.4. Infrastructure Financing Options

Aviation is one of the transport sectors that historically has paid for its own infrastructure while the benefits are far greater than only for the Users/ ANSP's. Many states consider it of great national importance to have a good infrastructure but are reluctant of bearing those costs, this in contradiction to other forms of transport as railways and roads, mostly funded through public means. This needs further explanation/emphasising by RPI in the final report.

6.1 Traffic volatility in ATM

With regards to (I) "Technical failures":

In the current situation ANSP's bear no risks for these failures. All operational and financial risk is with the users. Another way of dealing with these risks could be for ANSP's to contract their equipment suppliers on performance as well. Non-performance or malfunction should be dealt with as in a normal business environment: Discount, claims or insurance. This would share the risk between ANSP and user (financially)

RPI suggests a change in formula in section 6 with the aim to allow for the smoothening of the unit rate and introduce a sort of risk-sharing. There is, however, no clear statement that risk-sharing requires a commitment from the owners of the ANSPs to financially support their companies in bad times. So the question actually is, whether the whole proposal is only a mechanism to spread the recovery of the full costs without really sharing the risk.

6.3 (a) Rate Stabilisation Fund

An additional problem with a rate stabilisation fund is that there is no guarantee that the money paid by individual users is returned to their benefit in the future: In other words: Those paying the charges for the fund now may not be operating when the fund is required. This may in particular lead to use of the fund to the benefit of new airlines in the market. Also the timing on establishing a fund would be crucial: Establishing it under the current situation when the market is at its lowest point could prove potentially dangerous because charges would raise even more. A fund financed by user charges is comparable to a solidarity fee born by the airlines, while the benefit of it would also apply to the ANSPs. moreover, there is a serious risk that the management of the fund would generate its own expenses. AEA therefore rejects the idea of a fund as long as it is created with user charges and appreciates the study's general opposition to the idea of a solidarity fund.

The study raises the idea of funds to be used by a possible infrastructure manager. Those funds could either be from EU (RPI does not believe that this would really happen, as other

modes of transport would compete for the same money), or from “project funding” – whatever that means. I think it means loans, which of course would have to be recovered through charges sooner or later. That raises some questions, how this will be done, if the infrastructure manager pays for example for a multilateral project.

6.3 (c) Reserves Through Over-recovery

As indicated to RPI earlier the airlines strictly oppose this option. The aviation sector is in no position to leave money idle. It would open the way for ANSP’s for abuse.

6.4 Revenue Recovery Imbalance Account

The CANSO / ANSP idea is well known in the airline community. Our main concern with the idea is not so much the account itself but the way it is to be created. One of the main reasons why financial deficits occur in these difficult times is the lack of response by ANSP’s to the market demand for lower costs. To simply add a level for an imbalance account would neglect this concern by the airlines.

We therefore would like to propose an alternative approach:

CANSO proposal

AEA Proposal

6.5.1 The Basic Formula

More explanation on the effects of this formula for the total level of costs is required.

Basic rule: The total level of costs should not increase as a result of a different formula (see picture above) Additional revenue for ANSP’s should only be allowed if the total level of costs would decrease. In other words: With a lower level of costs additional revenue as reward could be allowed.

Section 7 – The Structure of Route Charges

The study findings in Section 7 are largely supported by AEA, for example

- there is really no strong case for changing the weight factor;
- turning down the proposal to introduce weight groups;

- turning down also the idea of having a fixed component per country;
- in principal turning down a fixed component of the charge per flight (regardless how many countries are being overflown) as well (the argument being that this would be only justifiable, if there are costs clearly attributable on a per flight basis, and the study states that this is not the case, or only so little that it is negligible).

7.2.3. (b) Non-Discrimination

The document does almost not take the individual airline position in to account. Effects of the way ANSP's operate on the economical performance of airlines are also key to the future direction. In the current situation some airlines have substantial benefit by the way some ANSP's allocate their costs. (home carrier vs. overflights). As laid down in this paragraph it is not considered discrimination as all airlines can operate in all countries. Practice is different. If a country chooses not to levy meteorological costs to terminal navigation charges but 100% to en-route, this substantially benefits carriers operating on that airport (=homebase carrier). As long as not all competing airlines are working in the same country some have a far better financial "home base" than others, sponsored through ATC charges. Solution: Accounting methods, pricing structures and cost allocation should be transparant and harmonised throughout Europe and should be under close independent review.

7.3 (c) Charging by Passenger

The study indicates that this would create difficulties in setting charges for cargo aircraft. This is however already implemented in airport charges where 100kgs cargo accounts for 1 passenger. The study also states that charging by ticket tax would dampen the incentive on airlines to actively pursue lower charges. This is currently the case, but due to the fact that airlines have almost no influence on the level of charges as they are only observers and have no means to oppose ATC charges. Charging passengers directly, on the other hand, would increase the attention by media and politics on the level of charges and could be in line with the idea of a review body for ATC charges, representing the customers, eventually being the passengers. As a result, AEA recommends to investigate further the idea of charging directly passengers.

7.4.2. Congestion Pricing

As also indicated in the consultation we strongly oppose any pricing structure that attempts to influence market behaviour. All airlines try to optimise the use of their fleet. Congestion pricing would not lead to a change in use of capacity but would only increase the total costs for airlines. Secondly this would penal network reliant airlines more than charters and low-cost carriers with ability to shift schedules. Our position is therefore strongly opposed.

Section 8 – Alternative Options for ATM Charging Structures

In section the study discusses three options for charging: Further development of the current scheme into a more coherent point of origin – point of destination – distance structure, upper/lower airspace charging and ACC-related charges.

However, some ideas mentioned, such as simplifying the charging by using only two or three unit rates for most of the current EU geographical area questionable with regard to cost-relatedness. Also lower origin/destination charges for smaller airports compared to the big hubs is most certainly not cost-based at all. We strongly believe in site-specific TNC or origin/destination charges, that would automatically mean lower charges at the big airports.

An upper/lower charging differentiation would lead to an increase of terminal ATC charges, thus affecting negatively the competitive position of European carriers in relation to other worldwide operating carriers. All other continents in the world have charging schemes that substantially benefit local traffic over over-flights by offering discounts for landing traffic or by not even charging terminal charges. Lowering upper level charges would only benefit non-European overflights. AEA strongly opposes this option and think this opposition should be taken into account in the report.

In AEA's view, the EU-wide harmonisation of charging structures and a cost base for the funding of future developments that is jointly agreed (including airspace users) is a value in itself.

8.7 General Conclusions on Charging Structure Options

AEA wholeheartedly supports the the statement: *....it is unlikely that structures of charging will have substantial effects on overall ANS performance. The main pressures for performace improvements are much more likely to come from a combination of more effective regulation of charge levels (rather than structures) ...*

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