

NATS (EN ROUTE) PLC
REGULATORY ACCOUNTS 2009/10

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The regulatory accounts were approved by the Board on 1 July 2010 and signed on its behalf by



Finance Director

Nigel Fotherby

1. RESPONSIBILITIES IN RESPECT OF THE PREPARATION OF THE REGULATORY ACCOUNTS

The Air Traffic Services Licence issued to NATS (En Route) plc ("NERL") requires NERL, in consultation with the Civil Aviation Authority (CAA), to draw up Regulatory Accounting Guidelines governing the format and content of the regulatory accounts and the basis on which they are to be prepared, and to prepare and publish regulatory accounts in conformity with the Regulatory Accounting Guidelines. The Guidelines currently in force (Issue 9, dated 7 June 2010) were approved by the CAA for application to this year's accounts on 8 June 2010.

2. PURPOSE AND BASIS OF PREPARATION

2.1 Purpose of the regulatory accounts

The purpose of the regulatory accounts, as set out in the Licence and the Regulatory Accounting Guidelines, is to make available such regulatory accounting information as will:

- (a) enable the CAA and the public to assess the financial position of NERL and the financial performance of the UK Air Traffic Services Business ("UKATS") and the En Route (Oceanic) Business ("Oceanic") on a consistent basis, distinct from each other and its affiliate or related undertakings;
- (b) assist the CAA to assess NERL's compliance with this Licence;
- (c) assist the CAA and the public to assess performance against the assumptions underlying the current price control; and
- (d) inform future price control reviews.

2.2 Basis of preparation

These accounts are prepared on the basis set out in the Regulatory Accounting Guidelines.

The regulatory accounts compare NERL's actual performance with the projections underlying the CAA's decision on the price controls, and are prepared on the basis used by the CAA when setting the price controls.

The current price controls, for Control Period 2 (CP2), were set by the CAA in December 2005¹. The price controls for the UKATS business are on a calendar year basis and cover the five years starting 1 January 2006, while the Oceanic price controls are set on a financial year basis and cover the five years starting 1 April 2006. The regulatory accounts are presented on a financial year basis.

The accounts are prepared using amounts derived from the statutory accounts which are prepared on the basis of International Financial Reporting Standards (IFRS), details of which are given in the accounting policies note to the NERL statutory accounts. The Regulatory Accounting Guidelines require that these accounts do not reflect the adoption of IAS23: Borrowing Costs.

• Regulatory performance

The comparison of performance with the regulatory assumptions shows the derivation of UKATS and Oceanic regulatory profit and regulatory return, measured on a basis consistent with the basis used by the CAA when setting the price controls. The main changes compared with the statutory accounts basis are as follows:

- o Operating costs are stated excluding accounting depreciation charges. The CAA's allowed regulatory depreciation (comprising underlying depreciation and, in the case of UK Air Traffic Services, the CAA's backlog adjustment to depreciation) is shown separately on the face of the table. See pages 6-9.

¹ "NATS Price Control Review 2006-2010, CAA Decision" issued by the CAA in December 2005.

- Operating costs include cash pension costs instead of accounting pension costs. For Existing Employees (as defined in the pension cost pass through²) the cash pension cost is shown separately on the face of the table. For New Joiners (as defined in the pension cost pass through), where the company bears the risks of variations from the regulatory assumptions, the cash pension cost is included in the operating cost figure. See pages 6-9.
- Operating costs exclude any profit/loss on disposal of assets, as the disposal of assets is dealt with through the Regulatory Asset Base, rather than in the performance statement.

- **Movement in the regulatory asset base**

The statement on the Regulatory Asset Bases (RABs) shows the movements in the UK Air Traffic Services and Oceanic RABs. The closing RAB is the opening RAB plus capital expenditure less the CAA's regulatory depreciation and plus/minus movements in working capital, with adjustments for the pension contribution variance and capitalised financing costs.

Capital expenditure differs from the statutory accounts by £0.1m as IAS23: Borrowing Costs is not applicable for the purposes of these accounts in accordance with the Regulatory Accounting Guidelines.

- **Operating cost efficiency roll-forward**

This statement records the incremental out/(under)-performance against the profile of operating expenditure assumed by the CAA when setting the UK Air Traffic Services and Oceanic price controls.

The five-year price control provides that NERL is able to retain, for up to five years, any out-performance achieved in the first four years of the control period, starting from 2006/07, through an increase to the RAB, providing the out-performance is sustained until the last year of the control period. Savings achieved in the final year of the price control will be accounted for in the CP3 review. Year by year the regulatory accounts will record the actual operating expenditure compared with the CAA projection, and calculate the out-performance compared with the previous year. The cumulative effect of operating cost out-performance by 2009/10 is the focus of this incentive mechanism. CAA anticipates that, if NERL does out-perform under this measure, it will make an adjustment in the price control for CP3 by increasing the value of the RABs at the start of the third control period.

- **RAB Clawback**

A 12% addition to the UK Air Traffic Services RAB was agreed as part of the financial restructuring in 2003. Part or all of this addition will be clawed back in 2011/12, at the start of Control Period 3 ("CP3"), if NERL's cash flows exceed a benchmark.

The benchmark was set at 80% of NERL's Base Case cash flows (expressed in present value terms) at the time of the financial restructuring. The starting value of the UK Air Traffic Services and Oceanic RABs in 2003/4 will count as a negative cash flow contribution, and the closing value of the UK Air Traffic Services and Oceanic RABs in 2009/10 will count as a positive cash flow contribution.

40% of the present value of the excess of the actual cash flows over the benchmark cash flows will be deducted from the RAB at the start of CP3. The adjustment to the RAB is subject to a ceiling and cannot exceed the initial 12% uplift.

A record of the NERL operating cash flows, together with the benchmark figures set out in the CAA Decision, is being maintained for the purpose of this calculation, which will be carried out in 2010.

- **Traffic levels**

A record of actual traffic levels is maintained, showing Chargeable Service Units (CSUs) and distance flown (kilometres) for Eurocontrol, and chargeable flights for Oceanic, together with the traffic assumptions used by the CAA when setting the price control.

² For explanation of the pension cost pass through, see the Regulatory Accounting Guidelines, Annex 4, section 6.

3. INDEPENDENT AUDITORS' REPORT TO THE CIVIL AVIATION AUTHORITY ("CAA"), THE DIRECTORS OF NATS (EN ROUTE) PLC ("THE COMPANY") AND NATS HOLDINGS LIMITED ("NHL")

We have audited the Regulatory Accounts of NATS (En Route) plc for the year ended 31 March 2010 which comprise the comparison of performance with the regulatory assumptions on pages 6-9, the movements in regulatory asset bases on pages 10-12, the operating cost efficiency rolling incentive mechanism on page 13, the record of cash flows for the purpose of the regulatory asset base clawback calculation on page 15, the record of the retail price index used in the regulatory calculations on page 15 and the record of traffic levels compared with the regulatory assumptions on page 16. These Regulatory Accounts have been prepared under the accounting policies set out therein.

This report is made solely to the Directors of the Company, NHL and the CAA ("the Regulator") in accordance with NERL's Air Traffic Services Licence ("the Licence"). Our audit work has been undertaken so that we might state to the Company, NHL and the Regulator those matters that we have agreed to state to them in our report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility for our audit work, for our report, or for the opinions we have formed to any other person other than those to whom we have agreed in writing to accept responsibility.

Basis of preparation

The Regulatory Accounts have been prepared under the historical and current cost conventions (as applicable) and in accordance with the Company's Regulatory licence, Regulatory Accounting Guidelines ("the RAGs") approved by the Regulator and the accounting policies set out in the statement of the basis of preparation. The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared wholly under the basis of International Financial Reporting Standards ("IFRS"). Financial information other than that prepared on the basis of IFRS does not necessarily represent a true and fair view of the financial position of a Company as shown in the financial statements prepared in accordance with the Companies Act 2006.

Respective responsibilities of the Regulator, Directors and auditors

The nature, form and content of Regulatory Accounts are determined by the Regulatory Accounting Guidelines which have been drawn up by the Licensee in consultation with, and approval from, the Regulator. It is not appropriate for the auditors or the Directors to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The Directors are responsible for preparing the Regulatory Accounts in accordance with the Regulatory Accounting Guidelines as set out in the responsibilities in respect of the preparation of the regulatory accounts on page 2.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the "Basis of audit opinion" below, and having regard to the guidance contained in Audit 05/03 "*Reporting to Regulators of Regulated Entities*".

We report to the Directors of the Company, NHL and the Regulator our opinion as to whether the Regulatory Accounts have been properly prepared in accordance with the Regulatory Accounting Guidelines, and on that basis fairly present the regulatory financial performance of the Company, analysed between each separate segment as defined in the Regulatory Accounting Guidelines, and the regulatory financial position of the Company. We also report to you if in our opinion the

Company has not kept proper accounting records or if we have not received all the information and explanations, which we consider necessary for the purposes of our audit.

We read any other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the UK Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts. It does not include an assessment of whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by the Regulatory Accounting Guidelines. Where the Regulatory Accounting Guidelines do not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the regulatory accounts are consistent with those used in the preparation of the statutory financial statements of NHL.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from the opinion on the statutory financial statements of the Company on which we reported on 1 July 2010, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "statutory" audit) was made solely to the Company's members, as a body, in accordance with Chapter 3 of part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our statutory audit work, for our statutory audit report, or for the opinions we have formed in respect of that statutory audit.

Opinion

In our opinion the Regulatory Accounts have been properly prepared in accordance with the Regulatory Accounting Guidelines, and on that basis fairly present the regulatory financial performance of the Company, analysed between each separate segment as defined in the Regulatory Accounting Guidelines, for the year ended 31 March 2010, and the regulatory financial position of the Company at 31 March 2010.



Deloitte LLP

Chartered Accountants and Registered Auditors
Southampton, United Kingdom

1 July 2010

4. COMPARISON OF PERFORMANCE WITH THE REGULATORY ASSUMPTIONS

UK Air Traffic Services (UKATS)

£ million <i>B/(W) = Better / (Worse)</i>	<u>2009/10</u>			<u>2008/09</u>		
	Actual	CAA's CP2 Projection	Variance <i>B/(W)</i>	Actual	CAA's CP2 Projection	Variance <i>B/(W)</i>
Eurocontrol revenue	495.9	510.6	(14.7)	523.5	509.4	14.1
London Approach revenue	8.3	10.0	(1.7)	8.4	9.6	(1.2)
Price controlled revenue	504.2	520.6	(16.4)	532.0	519.1	12.9
Other income (Note 2)	57.2	54.7	2.5	55.6	54.2	1.5
Intercompany income	16.1	10.6	5.5	16.0	11.8	4.2
UKATS Revenue (including intercompany revenue)	577.5	585.9	(8.4)	603.6	585.0	18.6
Operating costs (Note 3)	345.7	400.5	54.8	386.0	391.3	5.3
Pension cash cost for Existing Employees (Note 4)	29.4	29.4	-	31.6	31.6	-
Underlying depreciation (Note 5)	133.9	133.9	-	126.5	126.5	-
Backlog adjustment to depreciation (Note 5)	(21.9)	(21.9)	-	(21.8)	(21.8)	-
Total costs	487.1	541.9	54.8	522.3	527.5	5.3
Regulatory profit	90.5	44.1	46.4	81.3	57.5	23.8
Capitalised Financing Costs for the year (Note 7)	(0.5)	-	(0.5)	(4.8)	-	(4.8)
Regulatory return	89.9	44.1	45.9	76.5	57.5	19.0
Average Regulatory Asset Base (RAB)	1,087.2	1,131.2	(44.0)	1,033.8	1,149.2	(115.4)
Regulated rate of return (Note 8)	8.27%	3.90%	4.38%	7.40%	5.00%	2.40%

See notes on pages 7 - 9.

ANALYSIS OF OTHER UKATS INCOME

£million	2009/10	2008/09
North Sea Helicopters	7.1	7.3
MoD	44.0	44.9
Consented services	0.5	-
Other external services	5.5	3.5
Total	57.2	55.6

As required by Condition 5, paragraph 12(a)(v) of the NERL Licence, the external turnover of £5.5m arising from any other business as defined in the Licence does not exceed 3% of the aggregate turnover of the En route (UK) and En route (Oceanic) Businesses as defined in the Licence. Furthermore, as required by Condition 5, paragraph 12(b), the aggregate amount of all investments by NERL in the businesses described in paragraph 12(a)(v) has not at any time exceeded 1% of the share capital in issue, share premium and consolidated reserves of NERL as shown by its most recent audited historical cost financial statements.

Consented services are those where, under Condition 5 of the NERL Licence, NERL has been granted specific consent by the CAA to conduct activity beyond core and specified services. These services are not included in any other business, as defined by Condition 5, paragraph 12(a)(v) of NERL's licence.

Oceanic

£ million <i>B/(W) = Better / (Worse)</i>	<u>2009/10</u>			<u>2008/09</u>		
	Actual	CAA's CP2 Projection	Variance <i>B/(W)</i>	Actual	CAA's CP2 Projection	Variance <i>B/(W)</i>
Shanwick Oceanic Control Area charges	21.7	23.6	(1.9)	23.0	23.6	(0.5)
Other revenue (Note 2)	0.5	-	0.5	0.5	-	0.5
Total revenue	22.2	23.6	(1.4)	23.5	23.6	(0.1)
Operating costs (Note 3)	15.3	17.6	2.3	17.7	18.1	0.4
Pension cash cost for Existing Employees (Note 4)	1.4	1.4	-	1.6	1.6	-
Depreciation (Note 5)	3.0	3.0	-	3.0	3.0	-
Total costs	19.7	22.0	2.3	22.3	22.7	0.4
Regulatory profit	2.4	1.6	0.9	1.2	0.9	0.3
Capitalised Financing Costs for the year (Note 7)	0.5	-	0.5	0.3	-	0.3
Regulatory return	3.0	1.6	1.4	1.5	0.9	0.6
Average RAB	28.9	23.1	5.8	27.3	25.0	2.3
Regulated rate of return (Note 8)	10.27%	6.80%	3.47%	5.61%	3.56%	2.06%

CHARGES TO NERL FROM OTHER GROUP COMPANIES (Note 3)

£million	2009/10	2008/09
Charges from NATS Ltd	10.9	10.9
Charges from NATS (Services) Ltd	15.7	15.8
Total	26.6	26.7

Notes

- Performance is compared with the projection for CP2 included in the CAA's Decision (December 2005). The methodology and formulae underlying the CP2 settlement are set out in Annex 4 of the Regulatory Accounting Guidelines.
- In the case of UK Air Traffic Services, Price Controlled Revenue is the revenue for Eurocontrol and London Approach, and Other Income is other external income included within UK Air Traffic Services. Other UKATS Income is analysed in the table on page 6. In the case of Oceanic, Other Income is income from the Height Monitoring Unit.
- Operating costs:
 - For the purposes of the price control, operating costs (which are derived from the statutory accounts and are on an accounting basis except where otherwise stated) are stated excluding accounting depreciation, accounting pension costs, and profit/loss on disposal of assets. The disposal of assets is dealt with through the Regulatory Asset Base (RAB), rather than in the performance statement. For pensions and depreciation, see notes 4 and 5 below.
 - Operating costs include charges for services from other group companies; these charges to NERL, from NATS Ltd and NATS (Services) Ltd ("NATS Services"), are shown in the table above. To the extent that seconded staff also provided services to

NATS Services, NERL recovered the costs of these services through an appropriate recharge. The cost of staff providing group head office type services are borne directly by NATS and recovered from both NERL and NATS Services through inter-company recharges.

- o Operating costs are stated after deducting capitalised internal labour costs. These amounted to £35.5m and £2.0m for UK Air Traffic Services and Oceanic respectively, compared with the amounts assumed in the CAA projections of £15.3m and £0.1m respectively.
- o From 2006/07 onwards, operating costs include cash pension costs for New Joiners (see note 4 below).
- o Operating costs include significant contributions to several European development initiatives, the costs of which were not anticipated within the original scope of the licence. These additional costs are expected to increase towards the end of CP2 and throughout CP3. The table below shows net costs/profit relating to these initiatives.

Emillion		2009/10	2008/09
Consented services:			
SESAR Joint Undertaking	Income	0.5	0.0
	Operating costs	<u>(1.4)</u>	<u>0.0</u>
	Net cost	<u>(0.9)</u>	<u>0.0</u>
Other external services:			
SESAR research project	Income	0.1	0.7
	Operating costs	<u>(0.2)</u>	<u>(0.8)</u>
	Net cost	<u>(0.1)</u>	<u>(0.1)</u>
EGNOS	Income	0.1	0.4
	Operating costs	<u>(0.1)</u>	<u>(0.4)</u>
	Net (cost)/profit	<u>0.0</u>	<u>0.1</u>
Intercompany:			
NATSNV/ESSP	Income	0.6	0.0
	Operating costs	<u>(0.5)</u>	<u>0.0</u>
	Net profit	<u>0.1</u>	<u>0.0</u>

4. NERL's cash pension costs are added back in.
 - o For Existing Employees (as defined in the pension cost pass through) the cash pension cost is shown separately on the face of the table. The CAA's assumption on cash pension costs for Existing Employees is shown in the Actual column of the Regulatory Performance Statement because any variance between the actual and CAA's assumed cash pension cost for Existing Employees is dealt with through the RAB.
 - o For New Joiners (as defined in the pension cost pass through), where the company bears the risks of variations from the regulatory assumptions, the actual cash pension cost incurred by the company is included in the operating cost figure.
 - o The CP2 pension arrangements came into effect for 2006/07 onwards; therefore the figure for 2005/06 is not analysed between Existing Employees and New Joiners and instead it is stated as in the regulatory accounts for 2005/06.
5. The CAA's allowed regulatory depreciation is shown separately on the face of the table. In the case of UKATS, the CAA's allowed depreciation comprises underlying depreciation and the CAA's backlog adjustment to depreciation.
6. The CP1 capitalised financing cost is the amount in respect of CP1 as calculated by the CAA during the CP2 price review and is added to the RAB in the 2005/06 accounts for the start of CP2.

7. Capitalised financing costs for the year in respect of the capital expenditure variance and the pension contribution variance are added to or deducted from the RAB to enable remuneration in future price review periods. These financing costs are added to or deducted from the regulatory profit for the calculation of the regulatory return.
8. The rate of return in the CAA's projection column for the years in CP2 averages to the allowed rate of return over CP2. The profile of the returns year by year within CP2 is shown below; the derivation is shown in Annex 3, section 4 of the Regulatory Accounting Guidelines.

	2006/07	2007/08	2008/09	2009/10	2010/11
UKATS	10.03%	6.47%	5.00%	3.90%	6.23%
Oceanic	7.52%	7.30%	3.56%	6.80%	7.69%

9. The amounts are stated in terms of average prices for the year. Hence some of the figures are slightly different from those in section 5 (Movements in the RAB) which are at year-end prices.
10. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.
11. The Eurocontrol revenue shown for 2009/10 is net of a one-off discount to the 2010 unit rate of £0.37/CSU, which formed part of NERL's response to the economic downturn and its effects on airline customers.

5. MOVEMENTS IN THE REGULATORY ASSET BASES

5.1 Movement in the UK Air Traffic Services regulatory asset base (RAB)

£ million	UK Air Traffic Services					
	Year ended 31 March 2010			Year ended 31 March 2009		
	Actual	CAA's projection	Variance	Actual	CAA's projection	Variance
Opening RAB as at 1 April in opening prices	1,028.9	1,124.7	(95.8)	1,008.9	1,140.6	(131.7)
<i>The figures below are all at year end prices</i>						
Opening RAB restated at year end prices	1,074.6	1,174.7	(100.1)	1,005.1	1,136.2	(131.2)
plus total capital expenditure at year end prices (Note 2)	137.9	84.7	53.2	139.8	86.5	53.3
plus pension contribution variance (Note 3)	22.4	-	22.4	9.2	-	9.2
minus capitalised financing costs for the year (Note 4)	(0.6)	-	(0.6)	(4.8)	-	(4.8)
minus CAA's allowed underlying depreciation (Note 6)	(137.0)	(137.0)	-	(124.4)	(124.4)	-
add back CAA's backlog adjustment to allowed depreciation (Note 7)	22.4	22.4	-	21.5	21.5	-
plus/(minus) increase/(decrease) in working capital (Note 8)	29.4	(5.8)	35.1	(17.5)	4.8	(22.3)
Closing RAB as at 31 March	1,149.2	1,139.1	10.2	1,028.9	1,124.7	(95.8)

See notes on pages 11 and 12.

5.2 Movement in the Oceanic regulatory asset base (RAB)

£ million	<u>Oceanic</u>					
	<u>Year ended</u> <u>31 March 2010</u>			<u>Year ended</u> <u>31 March 2009</u>		
	Actual	CAA's projection	Variance	Actual	CAA's projection	Variance
Opening RAB as at 1 April in opening prices	27.3	23.7	3.6	26.5	25.5	1.0
<i>The figures below are all at year end prices</i>						
Opening RAB restated at year end prices	28.6	24.8	3.8	26.4	25.4	1.0
plus total capital expenditure at year end prices (Note 2)	2.8	0.6	2.2	3.1	1.3	1.8
plus pension contribution variance (Note 3)	1.1	-	1.1	0.6	-	0.6
plus capitalised financing costs for the year (Note 4)	0.5	-	0.5	0.3	-	0.3
plus CP1 rolling incentive adjustment (Note 5)	-	-	-	-	-	-
minus CAA's assumed ordinary depreciation charge (Note 6)	(3.1)	(3.1)	-	(2.9)	(2.9)	-
plus/(minus) decrease in working capital (Note 8)	0.6	0.1	0.6	(0.2)	(0.1)	(0.1)
Closing RAB as at 31 March	30.6	22.4	8.2	27.3	23.7	3.6

Notes

1. The methodology and formulae used by the CAA in the CP2 settlement are set out in Annex 4 of the Regulatory Accounting Guidelines.
2. Capital expenditure for the purpose of this table is expenditure on property, plant and equipment. It includes expenditure on fixed assets required under IFRS to be reclassified from tangible to intangible (principally software and assets relating to airspace re-sectorisation projects). It is stated net of proceeds of disposal and other contributions to fixed assets.
3. The pension contribution variance measures the difference between actual cash pension contributions for Existing Employees and the amount assumed by the CAA when setting the price control. The table in section 5.3 records the cumulative pension contribution variance included in the RAB at each year end.
4. Capitalised financing costs for the year in respect of the capital expenditure and pension contribution variances are added to or deducted from the RAB to enable remuneration in future review periods.
5. An adjustment was added to the Oceanic RAB in 2006/07 for the out-performance against the rolling incentive mechanism in CP1.

6. The RAB is reduced by the allowed depreciation assumed in the price control, not by accounting depreciation.
7. In the case of UKATS, the CAA included a backlog adjustment to the amount of depreciation it allowed in setting the CP2 price control. This amount adjusts for the difference between the depreciation allowed during CP1 (including the price profiling adjustment) and what depreciation would have been based on actual capital expenditure in CP1.
8. Working capital for RAB purposes is defined as debtors and creditors, accruals and prepayments arising from trading (including transactions in respect of attributable fixed assets). It excludes any amounts relating to financing, tax, distributions and pension contributions.
9. The amounts are stated at year end price levels. Hence some of the figures are slightly different from those in section 4 (Regulatory Performance) which are stated in terms of average prices for the year.
10. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.

5.3 Closing Cumulative Pension Contribution Variance included in the RAB

	2006/07	2007/08	2008/09	2009/10
£ million				
UK Air Traffic Services	2.2	0.6	10.1	34.5
Oceanic	0.2	0.3	0.9	2.2

The closing cumulative pension contribution variance is the cumulative value of the pension contribution variances over CP2. At each year end, it is calculated in accordance with the formulae in the Regulatory Accounting Guidelines and is stated at year end prices.

The closing cumulative pension contribution variance includes the capitalised financing costs relating to the pension contribution variance accrued up to the end of the year. It is therefore slightly higher than the pension contribution variance for the year recorded in the RAB statements above, where the financing cost on both the pension contribution variance and the capital expenditure variance are shown in a separate line item.

As at 31 March 2010, the cumulative pension contribution variances imply additions of £34.5m and £2.2m to the UKATS and Oceanic RABs respectively at the start of CP3.

6 OPERATING COST EFFICIENCY ROLLING INCENTIVE MECHANISM

£ million, 2003/04 prices	2006/07 (restated)	2007/08 (restated)	2008/09 (restated)	2009/10
<u>UK Air Traffic Services</u>				
Operating costs assumed by CAA	311.0	307.8	297.8	317.5
Actual operating costs	296.0	299.1	280.4	272.0
Out-performance	15.0	8.7	17.4	45.6
Incremental out/(under)- performance compared with previous year	n/a	(6.3)	8.7	28.2
<u>Oceanic</u>				
Operating costs assumed by CAA	14.6	14.5	14.4	14.3
Actual operating costs	12.8	12.9	13.5	11.7
Out-performance	1.8	1.6	0.9	2.7
Incremental out/(under)- performance compared with previous year	n/a	(0.2)	(0.7)	1.8

<u>Note for information: actual operating costs at outturn (actual) prices</u>				
UK Air Traffic Services	324.8	341.9	330.1	321.6
Oceanic	14.1	14.8	15.9	13.8

Notes

- The methodology for the operating cost efficiency rolling incentive mechanism is set out in the Regulatory Accounting Guidelines, Annex 4, section 5 and summarised in section 2.2 above. The objective is to provide an incentive to NERL to make continuing savings in operating costs. In summary, the key steps are:
 - Each year, the out-performance of actual costs against the CAA's assumptions is calculated.
 - From 2007/08 onwards, the incremental out-performance is calculated by comparing the out-performance for the year with the out-performance with the previous year.
 - At the end of the Control Period, the CAA carries out a discounted summation of the year-on-year incremental out-performances and adds this to the opening Regulatory Asset Base at the start of CP3.
- The definition of operating costs for the purposes of the operating cost efficiency rolling incentive mechanism is the operating cost from the Regulatory Performance statement less: bad debt costs, the costs of major site redundancies and major site staff relocations, and pension costs and for 2009/10 the benefit of a rates rebate for Swanwick of £6.4m that was backdated from 2005 to 2009. This rates rebate has been excluded to ensure that this one-off benefit does not overstate the RIM adjustment which will be reflected in the CP3 settlement by way of an adjustment to the RAB. In the case of Oceanic, and consistent with the basis used in the CAA projections, operating costs exclude the costs relating to the Height Monitoring Unit as these are remunerated outside the price control.
- Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.
- The table above applies the RIM methodology in accordance with the CAA's CP2 decision. Through the detailed reviews performed for CP3, the CAA noted that there was a significant timing difference between the CP2 assumption and the actual profile of the £20m LTIP (Long Term Investment Plan) contingency. In light of this, NERL acknowledged that the company could unfairly benefit from the profile across CP2 of

these costs in the original CP2 baseline for the RIM, and that it would be appropriate to exclude the LTIP contingency from the RIM baseline calculation. The net effect of this would be to increase the incremental out-performance shown in the table above for 2007/08 and 2008/09 by £1.0m and £4.0m, respectively and to decrease the incremental out performance for 2009/10 by £25.5m to £2.7m.

5. Following detailed reviews performed prior to the submission of its Business Plan for CP3 (March 2010), NERL notified the CAA of an adjustment required to exclude the cash pension costs of new joiners (defined as joiners since 1 January 2006) from the actual operating costs disclosed in the 2007, 2008 and 2009 regulatory accounts, used for determining the operating cost efficiency rolling incentive mechanism in CP2. The operating cost efficiency rolling incentive mechanism table above has been re-stated and an additional table has been provided to demonstrate the impact of the re-statement. There is no impact on any of the other regulatory statements.

Note for information: Re-statement of Out-performance to exclude pension costs for new joiners			
2003/04 prices - See note 4			
	2006/07	2007/08	2008/09
UK Air Traffic Services			
<u>Out-performance</u>			
2008/09 Regulatory accounts	14.5	7.6	14.3
Pension costs for new joiners	0.5	1.1	3.0
2009/10 Regulatory accounts	15.0	8.7	17.4
<u>Change to incremental out/(under)performance compared with previous year</u>			
2008/09 Regulatory accounts	n/a	(6.9)	6.7
Pension costs for new joiners	n/a	0.6	2.0
2009/10 Regulatory accounts	n/a	(6.3)	8.7
Oceanic			
<u>Out-performance</u>			
2008/09 Regulatory accounts	1.8	1.5	0.8
Pension costs for new joiners	0.0	0.1	0.2
2009/10 Regulatory accounts	1.8	1.6	0.9
<u>Change to incremental out/(under)performance compared with previous year</u>			
2008/09 Regulatory accounts	n/a	(0.2)	(0.8)
Pension costs for new joiners	n/a	(0.0)	0.1
2009/10 Regulatory accounts	n/a	(0.2)	(0.7)

7 RECORD OF CASH FLOWS FOR THE PURPOSE OF THE CLAWBACK OF THE UKATS RAB UPLIFT

£ million	31 March								31 March	
	2003	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010	
ACTUAL DATA										
Actual figures from the regulatory accounts										
UK Air Traffic Services RAB at 31 March 2003	725.5									
UK Air Traffic Services RAB at 31 March 2010										1,149.2
Oceanic RAB at 31 March 2003	13.6									
Oceanic RAB at 31 March 2010										30.6
Total RAB at 31 March 2003	<u>739.1</u>									<u>1,179.8</u>
NERL cash flows:										
Cash generated from operations		194.8	246.1	233.6	217.0	243.0	181.6	158.0		
less: cash flow from purchase of fixed assets		(80.7)	(108.2)	(152.3)	(139.9)	(138.6)	(140.3)	(139.1)		
Total NERL actual cash flow		<u>114.1</u>	<u>137.9</u>	<u>81.3</u>	<u>77.1</u>	<u>104.4</u>	<u>41.3</u>	<u>18.9</u>		
Actual figures at 2001/2 prices										
RAB at 31 March 2003	714.5									
RAB at 31 March 2010										929.6
Annual cash flow		108.7	127.4	73.2	66.9	87.1	33.4	15.2		
Present values (discounted using regulatory cost of capital to 1 April 2001 values)										
RAB at 31 March 2003	615.4									
RAB at 31 March 2010										492.9
Annual cash flow		90.3	98.2	52.4	44.6	54.4	19.5	8.3		
BENCHMARK DATA										
RAB at 31 March 2003 (as stated in CAA Decision, discounted to 1 April 2001)	618.2									884.1
										468.8
NERL's forecast base case cash flows in 2001/2 prices		91.6	34.8	93.7	59.7	70.8	58.5	70.0		
Present value of NERL's forecast base case cash flows (2001/2 prices)		76.1	26.8	67.0	39.8	44.2	34.2	38.4		
Benchmark: 80% of NERL's forecast base case cash flows in present value terms (2001/2 prices)		60.8	21.5	53.6	31.8	35.4	27.4	30.7		
Note: discount factor back to 1 April 2001 present value	1.161	1.204	1.298	1.398	1.500	1.601	1.709	1.824		1.886

Note: The methodology for the RAB clawback mechanism is set out in the Regulatory Accounting Guidelines, Annex 4, section 7, and summarised in section 2.2 above.

8. RECORD OF THE RETAIL PRICE INDEX USED IN THE REGULATORY CALCULATIONS

	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Average for year/mid year	166.4	171.3	173.9	177.5	182.5	188.2	193.1	200.3	208.6	214.8	215.8
At 31 March (year end)	n/a	172.2	174.5	179.9	184.6	190.5	195.0	204.4	212.1	211.3	220.7

9. RECORD OF TRAFFIC LEVELS COMPARED WITH THE REGULATORY ASSUMPTIONS

UK Air Traffic Services				
Calendar Year	CSU (000s)		Distance (chargeable kilometres, millions)	
	CAA assumption	Actual	CAA assumption	Actual
2006	10,015	10,269	741	763
2007	10,198	10,739	756	794
2008	10,504	10,873	776	793
2009	10,876	9,728	798	705
2010	11,293	n/a	823	n/a
Financial Year				
2006/07	10,071	10,400	745	772
2007/08	10,279	10,850	761	799
2008/09	10,578	10,601	780	771
2009/10	10,975	9,564	804	694
2010/11	11,389	n/a	829	n/a

Oceanic		
Financial year	Flights	
	CAA assumption	Actual
2006/07	390,900	394,416
2007/08	406,000	420,267
2008/09	421,800	413,600
2009/10	437,300	386,163
2010/11	454,200	n/a

Note: Actuals are chargeable Oceanic flights.