



Department
for Transport

Modernising the Licensing Framework for Air Traffic Services Consultation

Moving Britain Ahead



September 2016

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Department for Transport
Great Minster House
33 Horseferry Road
London SW1P 4DR
Telephone 0300 330 3000
Website www.gov.uk/dft
General enquiries: <https://forms.dft.gov.uk>



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Executive summary

- 1 NATS Holdings Ltd (**NATS**, formerly National Air Traffic Services) is an air navigation service provider in the United Kingdom, responsible for providing air traffic services within UK and Eastern North Atlantic airspace. NATS is split into two main business units which provide distinct services:
 - NATS (En-Route) plc (**NERL**), provides en-route air traffic control services and a centralised approach service at the London airports.
 - NATS (Services) Limited (**NSL**), provides terminal air navigation services, comprising of approach and aerodrome services.
- 2 NERL provides these services pursuant to a licence granted to it by the Secretary of State for Transport under the Transport Act 2000. It is economically regulated under that licence, by the Civil Aviation Authority (CAA).
- 3 The technological and economic landscape of air traffic services has been rapidly changing in recent years, with demand having grown significantly in the last two decades and continuing to increase. This has led to growing pressure to improve efficiency and resilience, with the UK currently host to some of the most congested airspace in the world.
- 4 The licensing framework managing the provision of en-route air traffic services by NERL needs to be modernised to ensure that it remains fit for purpose and continues to improve on the UK's record on safety, satisfying demand, and resilience. This will ensure the licence is able to deliver good outcomes for consumers.
- 5 In particular, since the establishment of the economic regulatory regime for NERL in 2001, there have been many improvements to licensing regimes in other industries. These improvements have been designed to ensure regulators are focused on and are best able to act in the interests of consumers. It is therefore an opportune moment to update the licensing framework for NATS to ensure users of air traffic services share the benefits seen in other sectors.
- 6 In modernising the licensing framework for air traffic services, the Government's objectives are to ensure the framework encourages a high standard of safety and service continuity, supports economic growth, and promotes efficiency in the provision of air traffic services. The Government also seeks to ensure that the regulatory framework takes into consideration principles of better regulation and is able to accommodate the changing landscape of air traffic services.
- 7 This consultation sets out three proposals to modernise the licensing framework by:
 - Amending the licence modification process to allow the CAA to directly make changes to the licence after consultation, subject to a right of appeal to an appropriate body;
 - Giving the CAA access to a wider range of enforcement tools, subject to appeal to an appropriate body; and

- Extending the NERL licence notice period to promote NERL's ability to finance itself more efficiently.

7 Following analysis of responses received to the consultation, the Government plans to introduce any measures taken forward as part of the Modern Transport Bill.

How to respond

The consultation period began on 22nd September 2016 and will run until close 20th October 2016. Please ensure that your response reaches us before the closing date. Please contact us if you need alternative formats (Braille, audio CD, etc.).

It would be helpful if you would respond online at:

<https://www.gov.uk/government/consultations/modernising-the-licensing-framework-for-air-traffic-services>

Alternatively, you can complete the response pro-forma at Annex B and send your response to:

Shuhana Begum
Department for Transport
Zone 1/25 Great Minster House
33 Horseferry Road
London SW1P 4DR

ATS_licensing_consultation@dft.gsi.gov.uk

When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

Freedom of Information

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the Freedom of Information Act 2000 (FOIA) or the Environmental Information Regulations 2004.

If you want information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the Data Protection Act (DPA) and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

1. Background

What does NATS do?

- 1.1 NATS is split into two main business units which provide distinct services:
- NATS (En-Route) plc (**NERL**), the economically regulated part of the business, provides en-route air traffic control services, as illustrated in Figure 1. The provision of these services operates as a statutory monopoly by virtue of a licence granted by the Secretary of State for Transport under the Transport Act 2000. NERL's charges to its airline users are determined by the Civil Aviation Authority (CAA) with the aim of protecting against the abuse of its monopoly position and furthering the interests of users and customers. The CAA also regulates NERL to maintain a high standard of safety in the provision of air traffic services¹.
 - NATS (Services) Limited (**NSL**), the commercial part of the business, provides terminal air navigation services, comprising of approach and aerodrome services as defined in Figure 1. This is provided in a contestable market and therefore not economically regulated by the CAA. NSL currently provides this service to thirteen of the UK's major airports and Gibraltar Airport.

Figure 1 provides an overview of the main elements and differences between en-route and terminal air navigation services.

¹ The licence regime is complementary to the EU's Single European Sky Performance Framework for air navigation services – see paragraph 1.7 onwards.

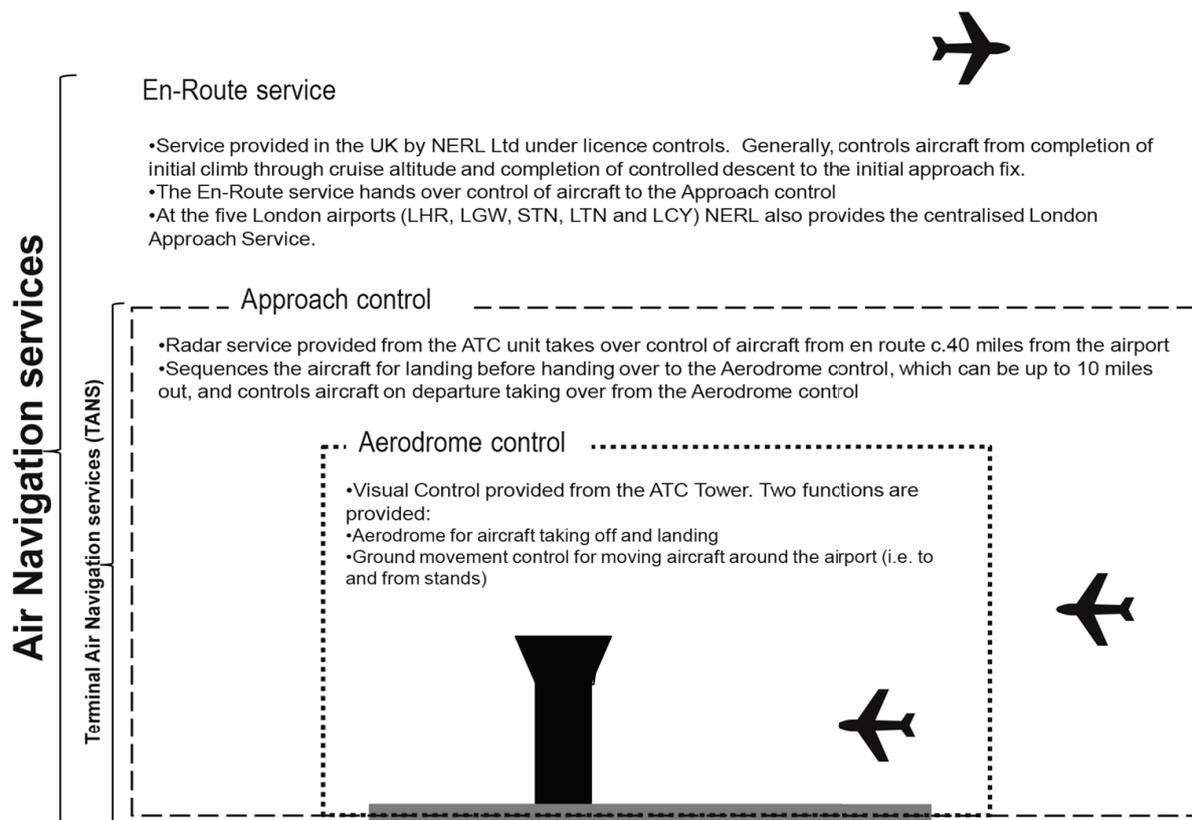


Figure 1 Air Navigation Services²

History of NATS

- 1.2 NATS became a public-private partnership (PPP) in July 2001, before which it was a company wholly owned by the CAA. The establishment of the PPP included the sale of a controlling stake to The Airline Group, a consortium of seven airline companies, as a strategic partner.
- 1.3 As a result of the downturn in air traffic following the events of 9/11, NATS underwent a financial restructuring in 2003, which involved the Government and Heathrow Airport Holdings Limited (formerly known as BAA) providing £65 million of funding each. Heathrow Airport Holdings took a 4% shareholding as part of the restructuring.
- 1.4 HMG currently owns 48.9% of the shares and a Special Share that provides additional rights in certain circumstances – for example restricting share sales of 15% or above. The remaining shares are owned by: TAG Ltd, a consortium of seven airlines and The Universities Superannuation Scheme Ltd (USS) (42%); Heathrow Airport Holdings Ltd (4%); and the NATS Employee Sharetrust Ltd (NESL) (5%). Figure 2 shows a breakdown of the ownership of NATS.

² Civil Aviation Authority (2015) CAP1293: Review of advice on SES Market Conditions for Terminal Air Navigation Services in the UK <http://publicapps.caa.co.uk/CAP1293>

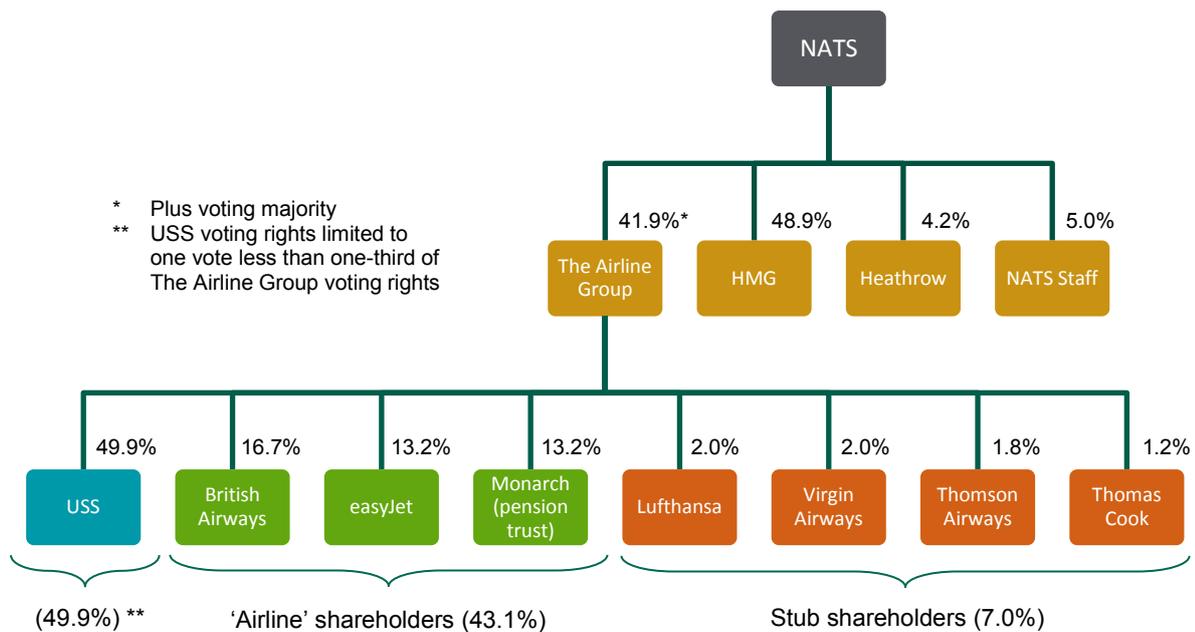


Figure 2 Ownership of NATS

Regulation of NERL

- 1.5 Under its licence, NERL provides en-route air traffic services in the UK and part of the Eastern Atlantic. The Transport Act 2000 confers on the CAA, as the UK's specialist aviation regulator, the role of economic regulator of NERL.
- 1.6 The CAA is responsible for monitoring and enforcing NERL's compliance with the conditions of the licence and with its duties under section 8 of the Transport Act 2000. It also has powers to modify conditions of the licence, subject to its duties under section 2 of the Transport Act 2000. Its primary duty, one shared with the Secretary of State, is to maintain a high standard of safety in the provision of air traffic services. The CAA also has a number of duties secondary to this main duty (of which the first three are shared by the Secretary of State):
 - To further the interests of operators and owners of aircraft, owners and managers of aerodromes, persons travelling in aircraft and persons with rights in property carried in them;
 - To promote efficiency and economy on the part of licence-holders;
 - To secure that licence-holders will not find it unduly difficult to finance activities authorised by their licences;
 - To take account of any international obligations of the United Kingdom notified to the CAA by the Secretary of State; and
 - To take account of any guidance on environmental objectives given to the CAA by the Secretary of State after the coming into force of this section.
- 1.7 The UK is also part of the EU Single European Sky (SES) programme, which is an initiative launched by the European Commission in 1999 to reform the architecture of European air traffic management (ATM). It puts forward a legislative approach to meet future capacity and safety needs at a European rather than at local level.
- 1.8 Key objectives of the SES are:

- To optimise European airspace as a function of air traffic flows;
 - To create additional capacity; and
 - To increase the overall efficiency of the European air traffic management system.
- 1.9 One of the main tools for driving continued improvement has been the EU Single European Sky Performance Scheme for air navigation services and related network functions. The performance scheme consists of EU-wide targets over fixed reference periods in the four key performance areas of safety, capacity (as measured by delay), the environment (as measured by flight efficiency) and cost-efficiency (as measured by determined unit costs). It also requires Member States to set binding national or local targets, consistent with and contributing to the EU wide targets.
- 1.10 The domestic economic regulatory regime under the licence and Transport Act 2000 is complementary to the performance scheme and provides the mechanism to give effect to the national/local targets required. As part of the regime, the CAA regulates the economic activities of NERL including investment activity, controls on the charges they can set, and levels of debt. The CAA is also responsible for detailing the provisions to be made by NERL for future capacity capability. The CAA applies: forecasts of traffic, performance bonus and penalty arrangements and alert mechanisms for the reference period.
- 1.11 Fixed reference periods under the performance scheme usually last over a five year period with the current reference period 2 (RP2) running from January 2015 to December 2019.

Performance since the PPP

- 1.12 Since the PPP, there has been a significant improvement in the safety and financial performance record of NATS. NATS has continued to deliver a high level of service in the face of increasing air traffic, safely handling just under 2.3 million flights during 2015/16 – an increase of 2.8% on the previous year.
- 1.13 In summary, NATS has shown positive performance in the following areas:
- **Safety (Airprox involving NATS)** - An Airprox (aircraft proximity) is a situation in which, in the opinion of a pilot or air traffic services personnel, the distance between aircraft as well as their relative positions and speed have been such that the safety of the aircraft involved may have been compromised. Risk-bearing Airprox reflect situations where safety was reduced significantly below norm.

	2000	FY 2015/16
NATS attributed Airprox numbers	37	8
NATS risk bearing Airprox numbers	3	0

Table 1 NATS attributed Airprox incidents

- **Delays** - NERL attributable delays have been reduced by over 95% from an average of 109.4s in 2002 to 4.3s in 2015.
- **Gearing** - The ratio of a NERL's loan capital (debt) to the value of its ordinary shares (equity), has been reduced from 112% in 2002 to 49.1% in 2016.
- **Capital expenditure** - NATS invested £147million in 2015/16 on its capital programmes up from c£100million a year at the time of the PPP.

- **Financial performance** - NATS has improved its financial performance from an £80m loss in 2002 (after exceptional costs of £84m) following the PPP. A profit of £137million (before tax and impairment of goodwill) was recorded in its 2015-16 accounts³, with total dividends of £82million, HMG receiving £40m.
- 1.14 In recent years, there have been two serious system failures that have prompted reviews of the regulatory framework for NERL, including the enforcement and penalty regime. The first incident, a Voice Communications (VCS) failure on 7 December 2013, which had a particularly disruptive effect on passengers, prompted a wide-ranging CAA review into the NERL licence and regulatory framework. Following a second system failure on 12th December 2014, the CAA and NATS established an independent enquiry into the cause of the failure.
- 1.15 For both failures, the CAA was satisfied that there were no safety issues associated with NATS's handling of the incident and there was no evidence that NATS was in breach of the service obligations in its licence. The independent enquiry into the 2014 system failure however made a number of recommendations to update and modernise the licensing framework⁴.

What lies ahead for NERL?

- 1.16 Towards the end of RP2, the European Commission and Member States will agree new targets for the next reference period – RP3, from January 2020 to December 2024.
- 1.17 It is therefore important that NERL continues to invest in its infrastructure, ensuring that it is operating with modern capability. For example, it has invested in its IT infrastructure to ensure that it is keeping pace with airspace capacity needs and updated regulatory standards.

EU Referendum Outcome

- 1.18 The outcome of the EU referendum on 23 June will see the UK leave the European Union. Until we negotiate our exit, the UK remains a member state of the EU with all of the rights and obligations that this entails, including negotiating, implementing and applying EU legislation. The outcome of the negotiations for leaving the EU will determine the future arrangements that will apply, in relation to EU legislation, when the UK has exited the European Union. In any event, NERL will be subject to economic regulation under the Transport Act 2000 and therefore the licensing regime needs to continue to evolve to ensure it remains fit for purpose, irrespective of the outcome of the negotiations.

³ NATS Holdings Limited (2016) Annual Report and Accounts 2016
http://www.nats.aero/wp-content/uploads/2016/06/NATS5666_Annual_Report_2016_FULL.pdf

⁴ NATS Independent Enquiry (2015) NATS System Failure 12 December 2014 – Final Report
<http://www.nats.aero/wp-content/uploads/2015/05/Independent-Enquiry-Final-Report-2.0.pdf>

2. Scope of the consultation

- 2.1 It has been 16 years since the establishment of an economic regulatory regime for the provision of en-route air traffic control services. Since then, there have been a number of broader improvements to regulatory regimes in other sectors that are yet to be reflected in the en-route licensing framework. These have primarily focused on ensuring regulators in these sectors have clear duties to protect the interests of consumers and have access to the right tools to fulfil those duties.
- 2.2 In light of the changing technological and economic landscape of air traffic control services, we propose updating the licensing framework for NERL to ensure that it is fit for purpose and continues to reflect current best practice. In our review, we have considered:
- The potential of these proposals to improve outcomes for consumers (airlines, passengers, cargo owners, and airport operators);
 - The recommendations of the 2015 independent enquiry into the 2014 system failure;
 - Best practice in regulatory regimes in other industries including airports;
 - Risks and regulatory compliance costs to NERL; and
 - The statutory duties under which NERL provides en-route air traffic services.
- 2.3 This consultation sets out two proposals to modernise the licensing framework for NERL, and a proposal to improve its financeability by extending the duration of the licence.
- 2.4 Following analysis of contributions we receive during this consultation, we plan to introduce any measures taken forward as part of the Modern Transport Bill.

Modernising the licensing framework

(i) Updates to the licence modification regime

- 2.5 We propose updating the current licence modification process to allow the CAA to independently make changes to the NERL licence, subject to a right of appeal to an appropriate body. This would differ from the current process where the CAA can only make changes with the consent of the licence-holder (NERL) or via a determination by the Competition and Markets Authority (“the CMA”). This change will allow the CAA to exercise its regulatory functions and statutory duties in a more efficient manner at the same time aligning it with the process used in other regulated sectors such as airports, telecoms, energy and gas. Other benefits include a more transparent, streamlined process so the CAA can develop the licence in a way that furthers its statutory duties to consumers, airline users, airport operators and cargo owners as they change over time. At the same time, it provides suitable protection to NERL and its investors against unnecessary regulatory intervention, through the

provision of a targeted appeal right to enable it to challenge decisions made by the regulator.

(ii) Updates to the enforcement regime

- 2.6 We propose that the CAA be given access to a wider range of enforcement tools to improve their ability to respond proportionately. The tools proposed in this consultation are more closely aligned to those available to the CAA under the Civil Aviation Act 2012, for enforcing the economic licences of airports. We also propose that these additional tools are accompanied by appeal rights for the licence-holder. These changes will ensure the CAA can effectively enforce NERL's obligations in the interests of users and consumers and will create an increased deterrent effect against future breaches on the part of NERL.

Financeability of NERL

- 2.7 We propose to extend the minimum termination notice period for the NERL licence from the current 10 years, to either 15 or 20 years. A longer notice period will facilitate NERL's access to more efficient financing, by giving investors greater certainty over the ability of NERL to carry on its business in a stable regulatory environment. We consider this in turn will lead to lower charges or a higher quality service for consumers.

Territorial extent

- 2.8 En-route air traffic control is a reserved matter and the licence regime applies to a single provider for the whole of the UK.

3. Part one: Modernising the licensing framework

- 3.1 The following chapter outlines two proposals to improve the CAA's ability to perform its regulatory duties to ensure a safe, efficient and resilient air traffic control service.

Updating the licence modification regime

Current licence modification regime

- 3.2 The Transport Act 2000 sets out the current process for modifying conditions in the en-route air traffic services licence. Currently, the CAA must consult on a proposed licence modification and obtain agreement from the licence-holder before the modification can be made. NERL must consent to any proposed licence modification before it can be implemented. If agreement cannot be reached, the CAA has to either abandon the proposal, change the proposal so as to secure NERL's consent, or make a reference to the CMA. The CMA will independently make a determination on whether the proposed modification meets certain public interest considerations and can be imposed.
- 3.3 The reference to the CMA and subsequent determination can be a costly and time-consuming process, and therefore, the CAA is more likely to seek a compromise position with the licence-holder to achieve a mutually acceptable outcome. This risks both delaying and significantly weakening the benefits to consumers from any licence modification the CAA intends to implement.

Proposed licence modification regime

- 3.4 Following further considerations with the CAA, we consider that the process outlined in Part 1 of the Civil Aviation Act 2012 (which governs the economic regulation of airports), may be a quicker, more cost-effective, and more consumer focussed way to modify licences, whilst still retaining strong protections against regulatory overreach. This process would involve the CAA consulting (as at present) relevant stakeholders about the changes it wants to make and thereafter directing the change to the licence-holder without having to seek consent from the licence-holder. This will allow the CAA to modify the licence in the way it feels best maximises the benefits to consumers, without any unnecessary delay.
- 3.5 Any relevant affected party, including the licence-holder, would have the right to appeal to the CMA **after the decision has been made**. This would also match the licence modification process used in the airports, telecoms, gas and electricity sectors.

Appeal rights

- 3.6 We propose giving relevant parties the right to appeal a licence modification on the grounds that the decision to modify the licence was wrong because:

- The decision was based on an error of fact;
 - The decision was wrong in law; and/or
 - An error was made in the exercise of a discretion.
- 3.7 The CMA, as the appellate body, would be able to quash the decision appealed against, refer the matter back to the CAA to reconsider, or substitute its own decision over that of the CAA.
- 3.8 This approach would ensure there are appropriate checks on the CAA when it makes a licence modification, as the CMA would be able to consider significant economic and factual questions relevant to its determination. We believe allowing symmetric appeal rights (i.e. rights for both the licence-holder and other relevant adversely affected parties) would ensure the CAA retains an appropriate consumer focus. The approach also has the benefit of being familiar to the industry given its similarity to the appeals process prescribed in the Civil Aviation Act 2012.

Summary and timings

- 3.9 Overall, the proposed changes would allow the CAA to take a more direct and independent approach, following consultation and due process, to making the licence changes it considers necessary to protect consumers and respond to changes in air traffic services over time. The CAA's duties, and the right of the licence-holder and any affected airline to appeal the decision to the CMA, remain as effective safeguards against the CAA imposing unnecessary or unreasonable conditions.
- 3.10 We propose these changes come into force as soon as is practicable, rather than delaying implementation until the next regulatory control period, so that passenger interests can be best served without delay.

Question 1

Do you agree with the proposal to update the licence modification process as outlined above? Please explain your reasoning, including any particular comments on the proposed grounds for appeal, who is given appeal rights, and timings for implementing the changes.

Updating the enforcement regime

Current enforcement regime

- 3.11 Under the current enforcement regime, the CAA has access to two tools in accordance with sections 20 to 25 of the Transport Act 2000:
- **Final enforcement orders** - The CAA must make a final order to secure compliance if it is satisfied that the licence-holder is breaching or is likely to breach a condition in its licence or duty in section 8 of the Transport Act 2000 (and which may result in licence revocation if certain conditions are met).
 - **Provisional enforcement orders** - Where there appears to be a breach or likely breach of the licence or section 8 duties, but the CAA is not satisfied that a final enforcement order is justified, it must make a provisional order to secure compliance. A provisional order has effect for a maximum of three months, unless the CAA revokes it or becomes satisfied that a breach has occurred or is likely to occur and therefore confirms the order.

3.12 Also, if it appears to the CAA that the licence-holder may have or may be breaching a licence condition or section 8 duty, it can require they produce any relevant information required to take enforcement action. Failure to comply with this request can result in criminal sanctions. If the licence-holder intentionally alters suppresses or destroys information that is required for such purposes, they can also be subject to criminal sanctions.

3.13 We have identified a number of deficiencies with the current enforcement regime:

- Inflexible statutory enforcement procedures for imposing orders;
- No power to make an enforcement order in respect of a past breach or remedy the consequences of that breach;
- No financial penalty regime in respect of a breach of a condition of the licence or duty under section 8 of the Transport Act 2000; and
- Disproportionate criminal sanctions for failure to provide information required for enforcement action.

3.14 **Inflexible statutory enforcement procedures for imposing orders** – To determine whether or not to make a final or provisional order, the CAA must first consider whether several exemptions apply which limit the flexibility of the regime. These exemptions potentially make it difficult for the CAA to impose an order in the first place, especially if an urgent case requires immediate action. This has the potential effect of letting breaches which cause consumers significant harm go unchecked, especially as there is no penalty regime and limited means for consumers to seek redress. It also has the potential effect of allowing a series of ad hoc or repeated breaches that cannot be addressed.

3.15 **No power to make an enforcement order in respect of a past breach** – The CAA only has the power to make an enforcement order for an on-going or likely breaches. It cannot take action in respect of a past breach that affects consumers, such as delay from a system failure, as the breach has already come to an end. This has the effect of preventing the CAA from directing NERL to remedy the negative effect of a past breach (which may continue once the breach has ended).

3.16 **No financial penalty regime** – The CAA does not have access to a penalty regime for the regulation of NERL; this is contrary to the principles on better regulatory enforcement, as recommended in the Hampton Review of the regulatory system⁵ and the Macrory Review of regulatory penalties⁶. This also makes its enforcement regime inconsistent with those overseen by other regulators. Moreover, the threat of a financial penalty and the resulting publicity and potential reputational damage, is a key tool that incentivises compliance and deters future non-compliance of the licence.

Proposed regime

3.17 We propose giving the CAA access to the full suite of regulatory enforcement tools which is available to it under Part 1 of the Civil Aviation Act 2012 in relation to airport regulation. These enforcement tools are available with respect to the enforcement of the economic licences of airports. The intention is to give the CAA the maximum flexibility to enforce the licence as it considers appropriate in accordance with its statutory duties in the Transport Act 2000. This is consistent with the Government's

⁵ HM Treasury (2005) Reducing administrative burdens: Effective inspection and enforcement http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/prebud_pbr04_hampton.htm

⁶ Better Regulation Executive (2006) Regulatory Justice: Making Sanctions Effective <http://webarchive.nationalarchives.gov.uk/20121212135622/http://www.bis.gov.uk/files/file44593.pdf>

Principles for Economic Regulation⁷ which states that economic regulators should have adequate discretion to choose the tools that best achieve the outcomes prescribed in their statutory duties. Giving the CAA additional flexibility would also allow the regulator to impose a less serious sanction at an earlier stage of regulatory intervention and escalate the sanction if non-compliance continues.

3.18 The proposed tools include additional powers to enable the CAA to:

- **Give a contravention notice for continuing or past breaches** - this confers on the CAA the power to issue a notice if it considers that there is or has been a contravention of the licence. This would replace provisional enforcement orders under the current regime. The giving of a contravention notice does not have any immediate consequences, but it is the first step taken by the CAA before it may make an enforcement order or impose a penalty.
- **Require the licence-holder to take the appropriate steps set out in an enforcement order to return to compliance and remedy the consequences of the breach** - whilst the CAA currently has the power to require the licence-holder returns to compliance, we propose also giving the CAA the power to require the licence-holder to take appropriate steps to remedy the consequences of a breach.
- **Make an urgent enforcement order** - this confers on the CAA the power to deal with cases urgently if a contravention results in, or is likely to create an immediate risk of any of the following:
 - Serious breach of a section 8 duty or licence condition, and
 - Serious economic or operational problems.
- **Impose fines of up to 10% turnover and/or a daily amount up to 0.1% of turnover** - this confers on the CAA the power to impose a financial penalty for breaches of licence conditions and section 8 duties, including past breaches. This statutory penalty regime will operate alongside existing financial incentive schemes such as the SES Performance Scheme. This approach is common in other regulated sectors and does not create a risk of double jeopardy. Whilst the latter is an automatic tool to incentivise performance in specific areas by connecting the licence-holder's level of performance with the charges users pay, the former is a discretionary tool of last resort to be used to target any breach of a licence condition or statutory duty.
- **Replace criminal sanctions for a failure to provide information required for the purpose of taking enforcement action with civil sanctions**

Appeal rights

3.19 In order to ensure the CAA is accountable for its decisions, we propose this suite of new enforcement tools be accompanied by the introduction of additional safeguards for the licence-holder. Such safeguards would inevitably comprise appeal rights to either the courts or an independent body with competence to determine the subject matter of the appeal.

3.20 We propose that the licence-holder should have the right to appeal an enforcement decision on the same grounds outlined in paragraphs 3.6 to 3.8. The licence-holder would be able to appeal in relation to the following matters:

⁷ BIS (2011) Principles for Economic Regulation

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf

- The validity or terms of an enforcement or urgent enforcement order;
- The imposition of a financial penalty;
- The timing of the payment of a penalty; and
- The amount of the penalty.

Timings

3.21 We propose to legislate for these changes as soon as is practicable. However, we propose to delay the implementation of the changes until the start of the next regulatory control period, to provide greater regulatory certainty for NERL, particularly in the context of financial penalties.

Question 2

Do you agree with our proposal to amend the enforcement regime as outlined above? Please explain your reasoning, including any particular comments on the proposed enforcement tools and the proposed appeal rights.

4. Part two: Financeability of NERL

Background

- 4.1 The Secretary of State granted NERL the licence to provide en-route air traffic control services on 28 March 2001. The Secretary of State currently has the power to serve notice of termination of the licence no earlier than 20 years after the date on which the licence was granted (i.e. 2021), and with a notice period no shorter than 10 years. This means that the earliest date on which the licence can be terminated via this route is 2031, but from 2021 NERL will effectively be operating under a licence with a rolling 10 year notice period.
- 4.2 Under section 1(2)(b) and (c) of the Transport Act 2000, the Secretary of State for Transport has a duty to promote "efficiency and economy" on the part of NERL, and to secure that NERL does not "find it unduly difficult to finance activities authorised by their licence".
- 4.3 In 2011, the Department for Transport consulted on a proposal to increase the notice period after which NERL's licence can be terminated, from 10 to 25 years. This followed a request from NATS, as it believed it was likely to face difficulties in raising efficient long-term financing under a 10 year notice period. Following the consultation, the Department decided not to take any action but has kept the issue under review.

Rationale for extending the length of the licence notice period

- 4.4 NERL undertakes regular investments in infrastructure in support of its licence obligations, with asset lives of 15 years on average. Under its economic regulatory regime, NERL is also allowed to earn a return on those investments over a 15 year period. It is generally considered efficient for firms to finance investments over a period matching the economic life of the asset, i.e. over 15 years in the case of NERL.
- 4.5 NATS raised concerns that it would face difficulties securing debt financing with maturity longer than the notice period, and therefore leave it reliant on shorter maturity debt financing. As the effective notice period has reduced from 20 years in 2011 to 15 years currently, these concerns have become more urgent. The Department for Transport formally requested the CAA under section 16(1) of the Civil Aviation Act 1982 to investigate these concerns and provide further evidence and analysis to support a decision on potential changes to the duration and/or structure of the NERL licence. The CAA reported back that whilst there is little evidence of regulated companies being unable to secure debt financing extending beyond the notice period, there is a risk premium associated with such debt.
- 4.6 The CAA has estimated that the removal of this risk premium (by extending the notice period) could save NERL approximately £1 million per annum from 2021

onwards, in lower financing costs. As NERL is economically regulated by the CAA, these savings can be passed on to consumers through a lower price cap.

Proposed amendments

- 4.7 The Government proposes to extend the minimum termination notice period for NERL, to a period of 15 or more years. A notice period of 15 years or more would provide NERL with additional flexibility to ensure efficient financing of its investment programme. Such flexibility may be welcome should NERL wish to finance a package of investments (spanning several years) with a single bond issue. However, this would need to be balanced against allowing future governments to change the licence-holder without unnecessary delay, should it wish to do so. A longer notice period than the current 10 years, would delay the point at which another more competitive entity could take over the licence, if one emerges. The relative merits of the various options for extending the notice period is explored in more detail in an impact assessment in Annex A.
- 4.8 The Government believes that an extension of the notice period to 15 or 20 years, would strike an appropriate balance between allowing NERL to finance itself efficiently and retaining the Government's flexibility to change the licence-holder. However, the Government would welcome any further evidence on the most appropriate length of the licence notice period.

Changes to the wording of the licence

- 4.9 Terms 6 and 7 of the licence currently state:
- 6. In so far as it authorises the provision of air traffic services in respect of the En route (UK) Area, unless revoked in accordance with the terms of Schedule 3 this Licence shall continue to have effect until determined by not less than ten years' notice in writing given by the Secretary of State to the Licence-holder following consultation with the CAA, such notice not to be served earlier than the twentieth anniversary of the grant of this Licence.*
- 7. In so far as it authorises the provision of air traffic services in respect of the En route (Oceanic) Area, unless revoked in accordance with the terms of Schedule 3 this Licence shall continue to have effect until determined by not less than ten years' notice in writing given by the Secretary of State to the Licence-holder following consultation with the CAA, such notice not to be served earlier than the twentieth anniversary of the grant of this Licence.*
- 4.10 We propose to alter these terms to reflect a notice period of 15 (or 20) years and the removal of the restriction on the earliest date that the licence can be terminated.

Question 3

Do you agree with our proposal to lengthen the licence notice period as outlined above? If so, which would be your preferred length? Please provide your comments.

Question 4

Please provide comments on the Impact Assessment at Annex A. In particular, we would welcome comments on the case for extending the notice period beyond 15 years, where the evidence is less certain.

What will happen next?

A summary of responses, including the next steps, will be published within three months of the consultation closing. Paper copies will be available on request.

If you have questions about this consultation please contact:

Shuhana Begum
Department for Transport
Zone 1/25 Great Minster House
33 Horseferry Road
London SW1P 4DR

ATS_licensing_consultation@df.t.gsi.gov.uk

Annex A: Impact assessment: extending the licence termination notice period

Summary: Intervention and Options

A.1 What is the problem under consideration? Why is government intervention necessary?

NATS (En-Route) Ltd (NERL) is currently the sole provider of en-route air traffic control services over the UK, operating under a licence issued by the Civil Aviation Authority (CAA). The current notice period after which NERL's licence can be terminated is 10 years, with 2021 being the earliest time at which notice can be given. This leads to an effective notice period of 15 years (as of 2016) reducing to 10 years by 2021. NATS (NERL's parent company) has asked Government to review the longer-term financing of NERL in line with Secretary of State's duties, arguing that a longer notice period would be more appropriate given its business activities, and would lead to lower financing costs and consequently, better outcomes for users of air traffic control services.

A.2 What are the policy objectives and the intended effects?

The objective of the policy is to ensure the notice period for terminating NERL's licence, is the most appropriate length for achieving:

- 1 a high quality service for users;
- 2 low costs for users of air traffic control services;
- 3 an appropriate environment to ensure that a licence-holder does not find it unduly difficult to finance its activities

A.3 What policy options have been considered, including any alternatives to regulation? Please justify preferred option

Three policy options have been considered in this impact assessment:

- 1 **Do Nothing** – Keep the current licence conditions, such that the length of the notice period reduces to 10 years by 2021, and remains as a 10-year rolling period thereafter
- 2 **Extend to 15 years** – Increase the notice period to 15 years from 2021, such that the Secretary of State could not terminate the licence until 15 years after serving of the notice
- 3 **Extend to 20 years** – Increase the notice period to 20 years, such that the Secretary of State could not terminate the licence until 20 years after serving of the notice
- 4 **Extend to greater than 20 years (e.g. 25 years)** – Increase the notice period to a length greater than 20 years

Evidence Base

Background

- A.4 NATS Holdings Ltd (formerly National Air Traffic Services) provides en-route air traffic control services in the UK and Eastern North Atlantic Airspace and control tower services in the UK and abroad. It is split into two businesses which provide distinct services:
- NATS En-Route plc (NERL) – the economically regulated part of the business which provides en-route air traffic management services to aircraft within the UK and Eastern North Atlantic airspace; and
 - NATS Services Ltd (NSL) – the unregulated part of the business which provides air traffic control services at some of the UK's major airports and Gibraltar, as well as consulting services.
- A.5 The European Union has had competence in air traffic management and air navigation services since 2004, when the first Single European Sky (SES) package was adopted. The SES regime, amongst other things, provides a framework for the economic regulation of air navigation service providers (ANSPs), and requires member states to collectively organise themselves around functional airspace blocks (FABs) with the objective of reducing fragmentation.
- A.6 NATS operates NERL as a statutory monopoly under a licence granted by the Secretary of State on 28 March 2001. The Secretary of State currently has the power to serve notice of termination of the licence no earlier than 20 years after the date on which the licence was granted (i.e. 2021), and with a notice period no shorter than 10 years. This means that the earliest date on which licence can be terminated via this route is 2031, but from 2021 NERL will effectively be operating under a licence with a rolling 10 year notice period.
- A.7 In 2011 the Department for Transport, following an application from NATS, consulted on a proposal to increase the notice period after which NERL's licence can be terminated, from 10 to 25 years. Following the consultation, the Department decided not to take any action but has kept the issue under review.

Problem under consideration and policy objectives

- A.8 In the Transport Act 2000, the Secretary of State has the general duty to ensure that he exercises his functions to:
- Primarily maintain a high standard of safety in the provision of air traffic services; and,
 - Further the interests of operators and owners of aircraft, owners and managers of aerodromes, persons travelling in aircraft and persons with rights in property carried in them;
 - Promote efficiency and economy on the part of licence-holders;
 - Secure that licence-holders will not find it unduly difficult to finance activities authorised by their licences.
- A.9 NATS has proposed a longer licence period than the current 10 years, arguing that greater security around the licence would promote a more efficient financing of NERL's investment programme. As NERL is an economically regulated entity, more

efficient financing of NERL would lead to lower charges on users of en-route air traffic management services and/or a higher quality service.

A.10 This impact assessment therefore is a consideration of the most appropriate length of a licence termination notice period for NERL, given the following objectives in regard to the Secretary of State's duties under the Transport Act 2000:

- 1 Delivering low charges for both current and future users of en-route air traffic management services;
- 2 Delivering a high quality service for both current and future users of en-route air traffic management services;
- 3 Delivering the appropriate environment to ensure that the licence-holder does not find it unduly difficult to finance its activities.

Description of options and issues considered

A.11 We believe that there are three policy options when considering the most appropriate length of the licence termination notice period:

- **Do Nothing** – Keep the current licence conditions, such that the length of the notice period reduces to 10 years by 2021, and remains as a 10-year rolling period thereafter.
- **Policy Option 1: Extend to 15 years** – Increase the notice period to 15 years, such that the Secretary of State could not terminate the licence until 15 years after serving of the notice. An extension to 15 years would bring the notice period in line with the average life of NERL's assets and in line with the period under which NERL's regulatory assets are depreciated under the current economic regulation regime⁸.
- **Policy Option 2: Extend to 20 years** – Increase the notice period to 20 years, such that the Secretary of State could not terminate the licence until 20 years after serving of the notice. A notice period of 20 years would extend beyond the average life of NERL's assets and the depreciation period, to include any lead time in the commissioning of assets.
- **Policy Option 3: Extend to greater than 20 years** – NATS is of the view that a 25-year period would allow optimal financing of their investment programme.

A.12 Given the policy objectives outlined in paragraph A.10, we have considered the following issues when comparing the relative merits of each policy option:

- **Efficient financing of NERL's investment programme** – Firms are constantly optimising the maturity of the debt they issue, depending on refinancing costs, and current and forecast interest rates. If NERL attempts to issue debt maturing beyond the licence termination notice period, it may find that it is unable to do so, or that there is a risk premium attached to doing so. Both of these scenarios will lead to inefficient financing of NERL's investment programme.
- **Ensuring sufficient flexibility to change the licence-holder** – There is a likelihood of either the regulatory environment or technological landscape changing, such that it is necessary to amend the scope of the licence or the licence-holder. A shorter notice period would give the government more flexibility to change the licence should this occur, without having to wait a long time until the

⁸ All of NERL's assets are depreciated over a 15-year period, regardless of the useful life of the asset.

end of the notice period, or having to compensate NERL for terminating the licence before the end of the notice period.

- **NERL's incentives on cost efficiency** – A longer notice period lowers the immediate risk of licence termination, which means NERL management may have less of an incentive to satisfy key stakeholders (regulators and users). As a result, they may have less of an incentive to control costs and/or avoid poor service.

Costs and benefits of each policy option

Do Nothing

- A.13 **Difficulty financing investments and/or more expensive to finance investments** – NATS have raised concerns that NERL will be unable to issue bonds that mature beyond the length of the licence termination notice period (LTNP) and as a result would be forced into inefficient financing arrangements. The average asset life of NERL's investments is 15 years, and the CAA under its economic regulatory regime, depreciates NERL's investments over a 15 year period. Being forced to issue bonds with shorter maturity than the life of the asset it is being used to finance, will lead to additional costs for re-issuing those bonds, as well as potentially less favourable interest rates. Such costs, under the regulatory regime would be passed on to consumers.
- A.14 The CAA has investigated these concerns on behalf of DfT and has concluded that whilst other regulated industries have been able to issue bonds maturing beyond the licence termination notice period, there is a risk premium attached to such bonds of 50 basis points (0.5%).

Policy option 1 – Extend the licence termination notice period to 15 years

- A.15 **Ability to finance longer term investments** – Whilst the CAA in its analysis did conclude that other regulated industries have been able to finance investments maturing beyond the LTNP, there is a possibility that these industries have specific characteristics that do not apply in NERL's case. For example, unlike Network Rail, NERL does not benefit from a government guarantee of its debt. However, on balance, we are minded to accept the CAA's position that NERL will be able to issue bonds extending beyond the LTNP.
- A.16 **Less expensive to finance longer term investments** – As mentioned in the *Do Nothing* section, a longer LTNP would lead to cheaper financing of NERL's capital investment programme. Accepting the CAA's conclusions of a 0.5% risk premium, this would lead to annual savings of approximately £1 million per annum.
- A.17 **Match licence termination notice period to regulatory depreciation period** – Under the current NERL licence, the CAA depreciates the assets in NERL's regulated asset base over a 15-year period. The 15-year period is based on the average life of the assets NERL invests in. Matching the LTNP with the depreciation period will ensure that NERL is able to efficiently raise debt to finance such investments. The maturity of the debt will therefore be closely aligned with the period over which NERL charges back the investment cost to its customers, which in turn means that the size of the debt repayments are more closely matched with the revenue received in any single year. This benefits NERL as it simplifies cash flows and doesn't require NERL to frequently refinance shorter term debt.
- A.18 **Reduced flexibility in making regulatory changes** – There is a possibility that future technological and economic developments would necessitate the termination of the NERL license. A longer LTNP would either mean UK users of air navigation

services having to wait longer before experiencing the benefits of these changes, or the government electing to terminate the license without full notice. The latter option would most likely require the Government to service the outstanding debt finance and compensate NERL shareholders for the loss of value over the remaining length of the notice period.

- A.19 It is difficult to quantify the size of the compensation as it is linked to the difference in the market value of NERL and the value of NERL's regulated asset base (RAB)⁹. The CAA has advised that there is likely to be a premium in the market value of NERL over the value of the RAB, representing shareholder expectation over the company's ability to outperform the regulatory assumptions in each price-control period. Evidence from the water industry suggests this could be as high as 18% over a 10-year period. Intuitively, a longer LTNP would lead to a greater claim for compensation. Whilst the likelihood of an early termination of the licence is very low, the size of any compensation claim is likely to be in the order of several million pounds.
- A.20 **(Potentially) reduced incentives for cost efficiency** – A longer license notice period may reduce NERL's incentives to control costs, if the threat of license revocation becomes a more remote prospect. Under the economic regulatory framework the price control regime, where NERL's charges are determined by the CAA, is designed to incentivise cost efficiency by allowing NERL to make larger profits by beating the efficiency targets set by the CAA. However, it is possible that the threat of license revocation acts as a regulatory backstop to further incentivise cost efficiency. Additionally, this risk is largely mitigated by the price-cap mechanism, which is a more appropriate tool for encouraging cost efficiency.
- A.21 **Delayed introduction of new provider** – Additionally, there may be a change to the market landscape such that, the Government identifies a more efficient provider of air navigation services (ANSP). In such circumstances, it is likely the Government will wish for the more efficient ANSP to replace NERL as the provider of en-route air traffic management services. Under such a scenario, a longer LTNP would mean users would have to wait longer before benefitting from the lower charges from the more efficient provider.

Policy option 2 – Extend the licence termination notice period to 20 years

- A.22 Extending the license termination notice period beyond 15 years would amplify the impacts identified in the previous section. In certain circumstances, it would make it cheaper for NERL to finance its investments. But it would also further reduce the government's flexibility in the event of changes to the regulatory or economic/market landscape.
- A.23 One reason for why 15 years may be insufficient for efficiently financing NERL's investment programme, is because NERL may need to issue a single bond to finance a package of investments. If this package of investments spans several years, it may be more prudent to issue a bond with maturity greater than 15 years in which case a licence termination notice period of 20 years may be more appropriate.
- A.24 An additional consideration is the possibility of future regulatory changes at EU level, and the outcome of upcoming negotiations on Britain's future relationship with the EU. The CAA's regulatory regime for NERL differs from standard European practice under the Single European Sky (SES) regulations in a number of respects. One key difference is that the CAA regime depreciates new investment from the point of

⁹ It is assumed the value of the RAB would be charged back to customers regardless of who the licence-holder is.

spend (over 15 years), whereas the European approach has been to depreciate from the point of use (over the life of the individual asset). Given the lead time of new investments, there exists a gap of several years between the point of spend and the point of use¹⁰. If the remaining flexibility for the regulatory regimes to differ is removed (and Britain continues to be a part of the Single European Sky initiative), then the ideal length of debt maturity may increase to greater than 15 years (assuming a 15 year depreciation period and additional lead time). In this scenario, an LTNP of 15 years would be insufficient for efficient financing of NERL's investments.

Policy option 3 – Extend the licence termination notice period to 25 years

A.25 As with the extension of the LTNP to 20 years, the impacts of a longer notice period would be amplified. However, the longer the LTNP is extended, the smaller the incremental benefit to NERL in terms of cheaper financing, and the larger the incremental cost of reduced flexibility and potentially higher operating costs.

Comparative assessment

A.26 When considering the optimal length of the LTNP, it is necessary to balance the additional flexibility provided to NERL for financing its investment programme, against the reduced flexibility to government for making regulatory changes (including changing the licence-holder). The evidence suggests that there is a robust case for increasing the licence notice period from the current 10 years to at least 15 years, consistent with the Secretary of State's duties.

A.27 It is less clear whether the marginal benefits of extending the notice period beyond 15 years outweigh the marginal costs of doing so. It is largely dependent on the relative likelihood of a number of possible outcomes. There does not seem to be a convincing rationale for extending the notice period beyond 20 years however. As a result, we are currently neutral between extending the notice period to 15 years and extending it to 20 years.

Risks

A.28 **Financing risks to NERL** – the major risk of not extending the licence termination notice period is the difficulty NERL may face in financing its longer term investments. The CAA has produced credible evidence that whilst NERL is likely to still be able to finance such assets, it will do so at a premium. This premium is estimated to cost NERL approximately £1 million per annum, if we are to assume that NERL's future investment programme is of similar magnitude to its current Regulated Asset Base.

A.29 **Risk of regulatory change (NERL)** – as mentioned in paragraph A.24, there are a number of differences between the CAA's regulatory regime for NERL and the regime as prescribed in SES regulations. A 15-year LTNP may soon become outdated if the CAA's flexibility in having a more bespoke regulatory regime is reduced in future. However, there has been no indication that such a move is currently being considered

A.30 **Risks of regulatory change (HMG)** – in the longer term, there is a possibility that there will be a push for further reductions in fragmentation between member states, leading to mergers of ANSPs. These mergers may necessitate a termination of the NERL licence in its current form – and a longer LTNP would lead to either a longer transition period or the licence being terminated without the full notice period being served (which is likely to result in claims for compensation from NERL shareholders).

¹⁰ NATS has informed DfT of lead times of up to 10 years for certain investments.

Wider Impacts

- A.31 **Competition** – NERL acts as a statutory monopoly in the provision of en-route air traffic management services, and is economically regulated by the CAA to mimic competitive pressures on the company. Therefore, the proposals are unlikely to directly have an effect on competition.
- A.32 However, it is possible that the Government in future, may wish to move to a franchise style model for the provision of en-route air traffic management services, where there is competition *for* the market. In this context, a longer licence termination notice period may act as a potential barrier to competition, as there would be a longer wait before a new more efficient provider could be awarded the franchise contract. Nonetheless, there are a number of practical difficulties with implementing a franchise model, which means the potential competition impacts are not currently relevant.

Annex B: Response pro-forma

It would be helpful if you would respond online at:

<https://www.gov.uk/government/consultations/modernising-the-licensing-framework-for-air-traffic-services>

If you wish to respond in writing, please use this response pro-forma and send the completed version to:

Shuhana Begum
Department for Transport
Zone 1/25 Great Minster House
33 Horseferry Road
London SW1P 4DR

ATS_licensing_consultation@dft.gsi.gov.uk

Introduction and consent

Consultation responses, including Government response and next steps, will be published within three months of consultation closing.

I agree that my response may be published by the Government.

- Yes
- No

Personal details

Do you reside in:

- England?
- Scotland?
- Wales?
- Northern Ireland?
- Other?

If other, please provide details:

What is your email address? (if further contact is required)

Are you responding on behalf of:

- Yourself?
- An organisation?

What is the name of your organisation? How were members views gathered?

What category would you place your organisation in?

- Air Navigation Service Provider
- Airline
- Airport
- Other

If other, please provide details:

What we are proposing

1 Do you agree with the proposal to update the licence modification process?

- Yes
- No

Please explain your choice, including any particular comments on the proposed grounds for appeal, who is given appeal rights, and timings for implementing the changes.

2 Do you agree with our proposal to amend the enforcement regime?

- Yes
- No

Please explain your choice, including any particular comments on the proposed enforcement tools and the proposed appeal rights.

3 Do you agree with our proposal to lengthen the licence notice period?

- Yes
- No

If so, which is your preferred length for notice period?

- 15 years
- 20 years
- Greater than 20 years

Please explain your choice, and the reasoning involved.

4 Do you have any comments on the impact assessment at Annex A?

In particular, we would welcome comments on the case for extending the notice period beyond 15 years, where the evidence is less certain

Annex C: Consultation principles

The consultation is being conducted in line with the Government's key consultation principles which are listed below. Further information is available at <https://www.gov.uk/government/publications/consultation-principles-guidance>

If you have any comments about the consultation process please contact:

Consultation Co-ordinator
Department for Transport
Zone 1/29 Great Minster House
London SW1P 4DR
Email consultation@dft.gsi.gov.uk