



Department
for Transport

Modernising the Licensing Framework for Air Traffic Services

Response to Consultation

Moving Britain Ahead

February 2017

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Introduction

The Government published its consultation on Modernising the Licensing Framework for Air Traffic Services in September 2016. NERL (a subsidiary of NATS) provides en-route air traffic control services in accordance with a licence granted to it by the Secretary of State for Transport. The provision by NERL of services under the licence is subject to economic regulation by the Civil Aviation Authority (CAA).

The Government has proposed changes to the licensing framework for en-route air traffic control services to ensure that it remains fit for purpose and continues to improve on the UK's record on safety, satisfying demand and resilience in order to deliver good outcomes for consumers. In particular, there have been a range of improvements to the economic licensing regimes in other industries, and this is yet to be reflected for the provision of air traffic services. These improvements have been designed to ensure regulators are focused on and are best able to act in the interests of consumers. The Government therefore intends to update the licensing framework governing NERL to ensure consumers and users of air traffic services share the benefits seen in other sectors.

The Government sought consultees' views on three proposals to update the licensing framework by:

- Amending the licence modification process to allow the CAA to make direct changes to the licence after appropriate consultation, subject to the availability of an appeal to an appropriate body;
- Giving the CAA access to a wider range of enforcement tools to improve its ability to respond proportionately, subject to the availability of an appeal to an appropriate body; and
- Extending the NERL licence termination notice period to improve NERL's ability to access more efficient financing.

The consultation ran from 22 September 2016 to 20 October 2016, and was published on the Department's gov.uk website. To ensure that as much evidence as possible was gathered from the consultation, a variety of response methods was made available. These included a stakeholder event to gather responses from airlines, discussions with NERL and the CAA, and an online survey. Consultees were also able to respond directly to DfT.

The Government received 10 responses from airlines, airline trade bodies, the CAA, NERL and other interested parties (see breakdown in Annex 1).

Respondents raised a number of issues in response to the consultation, in particular:

- Grounds for appeal and who should have appeal rights;
- The timing for the introduction of the changes to the licence modification and enforcement regimes;
- NERL raised some concerns on the potential effect of an updated licence modification and enforcement regime on its financing arrangements.

The Government Response sets out the Government's conclusions on the proposals included in the consultation document, focusing in particular on areas where the Government received the most responses.

Summary and evaluation of responses

1 Licence Modification

Background

- 1.1 The Government's consultation in September 2016 set out proposals to change the process by which the CAA may modify conditions in the en-route licence. We proposed to enable the CAA to make changes to licence conditions following consultation, subject to an appeal to the Competition and Markets Authority (CMA).
- 1.2 We asked the following questions in relation to licence modification

Question 1

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

Please explain your reasoning, including any particular comments on:

- the proposed grounds for appeal
- who is given appeal rights
- timings for implementing the changes.

Consultation responses

- 1.3 Overall, respondents welcomed the proposal to update the licence modification process. Airlines noted that the proposed process reflects that already used for airport regulation and licensing at Heathrow and Gatwick, which airlines know and understand.
- 1.4 The CAA agreed that the proposals would allow it make licence changes more efficiently to benefit users and consumers. It considered that the proposals carry the additional benefit of providing greater consistency with its economic functions for airports, thereby creating greater regulatory certainty for stakeholders and efficiency of their operations.
- 1.5 NERL indicated that they would prefer that the existing licence modification process is kept in place because it is part of a Private-Public-Partnership and different to other commercial companies. It also expressed concerns that the proposed changes may adversely affect its existing financing arrangements though it did not specify how this would impact its ability to finance its current activities
- 1.6 However, NERL stated that if the Government considered it necessary to bring the provision of air traffic services by NERL into line with other UK regulated sectors, they

request that the existing duties on the CAA and the Secretary of State for Transport to ensure NERL does not find it unduly difficult to finance its activities is not weakened, keeping the existing process of notification by the CAA to NERL of proposed changes ahead of the consultation and introducing the changes to the licence modification regime in the next regulatory period in 2020 (RP3).

- 1.7 **The Government has considered the points made in the consultation, particularly the financial concerns raised by NERL. We remain of the view that updating the licence modification process proposed in the consultation would be more transparent, effective and streamlined so that the CAA can develop the licence in a way that furthers its duties to users and consumers.**
- 1.8 **This is a modern forward-looking approach to regulation, which is considered to be best practice and it is a suitable approach to regulate NERL, as an established commercial business which is a monopoly provider.**
- 1.9 **We have concluded that NERL's concerns regarding the impact to its current financial arrangements would be mitigated by virtue of:**
 - **The existing duties on the CAA and Secretary of State to ensure that NERL does not find it unduly difficult to finance its activities which remain unchanged;**
 - **a statutory consultation phase before a modification is made;**
 - **allowing a right of appeal in respect of the modification.**

Grounds for appeal

- 1.10 The CAA's response stated that the grounds for appeal are comprehensive, offering a reasonable balance between the need to avoid a complete rehearsal of the whole regulatory decision, which will have already been subject to a consultation process, while allowing targeted appeal rights. They also noted that these are aligned with the grounds for licence modification appeals in respect of airports.
- 1.11 NERL queried whether the grounds for appeals are broad enough and go further than a Judicial Review.
- 1.12 NERL also welcomed the ongoing efforts by the DfT to work with the Commission and other Member States to construct an effective appeal mechanism for price control decisions that affect NERL and other relevant adversely affected parties through the Single European Sky (SES) Regime.
- 1.13 **The Government considers that the proposed grounds of appeal (error of fact, error of law and/or error in the exercise of a discretion), whether singly or in combination, are comprehensive and are sufficient to cover all eventualities for a prospective appeal. It provides a good balance between the need to have a full investigative review of a decision, which is costly and lengthy, and allowing an appropriate right of appeal.**
- 1.14 **In line with the Government's preference for ensuring consistency within and across sectors¹, the grounds for appeals mirror those used in the regulation of**

¹BEIS (2013) Streamlining Regulatory and Competition Appeals: Consultation on Options for Reform
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/229758/bis-13-876-regulatory-and-competition-appeals-revised.pdf

airports under CAA12 and in other regulated sectors, and it is content that the same grounds would be suitable to apply to the air traffic services licensing framework.

- 1.15 Whilst the UK remains subject to the SES Performance Scheme, the Department will continue to work with the European Commission and relevant stakeholders in exploring whether an effective appeal mechanism under the SES regulation is feasible.

Who is given appeal rights and appeal body

- 1.16 Airlines were of the view that they should be given the right to appeal licence modification decisions, and any other parties who can demonstrate that they are materially affected by any licence modification decision.
- 1.17 The CAA agreed with giving symmetric appeal rights to the licence holder and other relevant affected parties. It considered that the relevant affected parties should be specified to provide greater clarity and regulatory certainty. NERL was supportive of giving appeal rights to parties who may be materially affected by licence modification decisions.
- 1.18 The CAA agreed that the Competition and Markets Authority is the appropriate body to hear appeals in respect of licence modification decisions, due to its expertise and ability to tailor the appeals process to the air traffic services licensing framework.
- 1.19 **The Government's view is that the licence holder and certain other persons adversely affected by the licence modification decision should have appeal rights in respect of that decision. The Government intends to confer appeal rights on**
- (a) the licence holder;**
 - (b) airlines whose interests are materially affected by the decision to modify;**
 - (c) airport operators whose interests are materially affected by the decision to modify (likely to be those operators falling within the London Approach Services provided by the licence holder under its licence).**
- 1.20 The Government remains of the view that the CMA should hear appeals concerning licence modification decisions. It is well-placed to undertake economic, legal and financial analysis required to investigate such appeals. The CMA is also the body which hears appeals under the CAA12 for the regulation of airports, and other sectors, therefore bringing consistency across and within sectors, a key aim for the Government in streamlining regulatory and competition appeals¹.

Timings

- 1.21 The majority of respondents agree with the Government view that introducing the new licensing regime as soon as practicable would allow consumers to benefit from the changes without delay.
- 1.22 NERL considers that any change in the licence modification process should come into force in RP3 due to the potentially adverse effect of future modifications on their existing financing arrangements.

- 1.23 The Government intends to bring the changes to the licence modification process in RP2. It considers that the changes to the licence modification regime should be put in place as soon as is possible so that user and consumer interests can be best served without delay.
- 1.24 We do not consider NERL's concern to be enough reason to delay the updates, because the CAA has an existing obligation to ensure NERL does not find it unduly difficult to finance itself.

2. Enforcement regime

Background

- 2.1 We proposed that the CAA be given access to a wider range of enforcement tools to improve its ability to respond proportionately, subject to appropriate appeal rights.
- 2.2 We asked the following questions in relation to an updated enforcement regime:

Question 2

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

Please explain your reasoning, including any particular comments on:

- the proposed enforcement tools
- the proposed appeal rights

Consultation responses

- 2.3 The majority of respondents agreed with the proposal to update the enforcement regime. They cited to deficiencies in the current regime, and a desire to bring the air traffic services regime in line with other regulated sectors which benefit from greater flexibility for enforcement. It was acknowledged that an updated enforcement regime would incentivise behaviour from the licence holder that furthers the interests of users and consumers.
- 2.4 The CAA supported the proposed changes to the enforcement regime and acknowledged that the current procedures limits its flexibility for enforcement. It welcomed the Department's intention to confer on the CAA maximum flexibility to enforce as it considers appropriate in accordance with its duties under the Transport Act 2000.
- 2.5 NERL recognised the need for bringing the current enforcement regime into line with other regulated industries, but expressed concerns regarding the introduction of a penalty regime. They considered that the new regime should ensure it reflects the principles of proportionality, equity, transparency and predictability.
- 2.6 **The Government intends to update the enforcement regime for air traffic services, and believed that the tools proposed would enable the CAA to enforce the licence proportionately.**
- 2.7 **The Government considers that the threat of appropriate enforcement would provide greater incentives for compliance to the licence holder, and therefore would bring benefits to consumers. The proposed approach is considered to be**

regulatory best practice and it mirrors the regime available to the CAA in relation to airports under the Civil Aviation Act 2012.

Enforcement tools

- 2.8 The majority of respondents supported the introduction of the enforcement tools available to the CAA under Part 1 of the Civil Aviation Act 2012 for the regulation of airports. Tools to deal with past breaches and make urgent enforcement orders were particularly welcome.
- 2.9 The CAA agreed with the proposal to introduce the full suite of enforcement tools available to it under the Civil Aviation Act 2012.
- 2.10 The CAA supported the introduction of a penalty regime which is a key tool that incentivises compliance and deters future non-compliance with the licence. It welcomed replacing criminal sanctions with civil sanctions for a failure to provide information required for enforcement action. In particular, it supported the use of civil sanctions as they would allow for greater flexibility in tailoring the sanction to the nature and seriousness of the breach.
- 2.11 NERL considered that proportionality should be taken into consideration in the introduction of a new penalty regime and suggested the size of any maximum penalty needs to take account of the likely impact on economic return of investors. NERL is of the view that turnover in other regulated company's represents a lower proportion of the regulatory asset bases (a proxy for company value), than would be the case for NERL. The impact on investor's return of a 10% fine on NERL could therefore be significantly more and suggested NERL should have a lower maximum penalty.
- 2.12 NERL raised concerns that it may be penalised for a technical failure which could give rise to penalties both under the SES performance scheme as well as breaches of the licence. It requested clarification of the protections that will be put in place to avoid this potential for the imposition of overlapping penalties. NERL suggested that the CAA be given powers to waive or grant concessions in relation to minor breaches, and were of the view that the additional discretion could save administrative costs to the CAA and NERL.
- 2.13 **The Government intends to provide the CAA with a sliding-scale of enforcement tools to enable it to take a stepped approach to enforcement. This means that the CAA could initially impose a less serious sanction and escalate its action if non-compliance continues.²**
- 2.14 **The Government considers that introducing a penalty regime would create an increased deterrent effect against future breaches on the part of NERL by incentivising them to comply.**
- 2.15 **We have considered the question of whether a 10% maximum fine for breaches is appropriate. The CAA will have a view to proportionality in using this power, along with its statutory duties, the Better Regulation agenda, the Hampton Review of the regulatory system³ and the Macrory principles of better**

² Better Regulation Executive (2006) Regulatory Justice: Making Sanctions Effective
<http://webarchive.nationalarchives.gov.uk/201212135622/http://www.bis.gov.uk/files/file44593.pdf>

³ 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

enforcement⁴. The Government considers that a 10% maximum fine is an effective deterrent and this is standard across all regulators except the Financial Conduct Authority, who have unlimited power to fine.

- 2.16 With regards to penalties, the Government's view is that there is a functional separation of the proposed enforcement penalties and existing financial incentive schemes such as the SES performance scheme, because the objectives are different. 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 that 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.
- 2.17 The Government does not agree that the CAA is given discretion to waive minor breaches. Because the CAA will be given the power to enforce proportionately, the Government does not expect it to escalate minor breaches that do not require it, and they are not obligated to do so.

Appeal rights and appeal body

- 2.18 Some airlines believed that they should have appeal rights for enforcement decisions if they are materially affected. One is of the view that airline's knowledge of NERL could assist in helping to correct breaches and ensure the CAA is accountable for its enforcement decisions.
- 2.19 The CAA agreed with the proposals to introduce an appeal regime that allows the licence holder to appeal enforcement decisions. It considers that the grounds for appeal are appropriate and provide the licence holder with targeted rights to challenge decisions made by the CAA. It agreed that the Competition Appeals Tribunal is the most appropriate body to hear these appeals.
- 2.20 The Government intends to confer appeal rights in respect of enforcement decisions on the licence holder only. We are of the view that enforcement is different to licence modifications, because it concerns the licence holder's obligation to comply with the licence and it is the CAA's role as regulator to enforce non-compliance using the tools available. Airlines and other parties will have opportunity to feed into enforcement decisions taken by the CAA through consultations.
- 2.21 The Government considers that the Competition Appeal Tribunal is the appropriate body to hear enforcement appeals. It is of the view that the CAT has the necessary expertise and experience to deal with such cases, and is also the body which determines enforcement appeals under the CAA¹². This is in line with bringing a greater deal of consistency within the aviation sector, a key aim for the Government in streamlining regulatory and competition appeals.

⁴ Better Regulation Executive (2006) Regulatory Justice: Making Sanctions Effective
<http://webarchive.nationalarchives.gov.uk/201212135622/http://www.bis.gov.uk/files/file44593.pdf>

Timings

- 2.22 The majority of respondents were strongly in favour of introducing the new enforcement regime at the same time as the new licence modification regime. They considered that introducing them together as a package would provide regulatory certainty/clarity for stakeholders and ensure all fully understand the timing of the proposed regulatory changes.
- 2.23 In terms of timings, several consultees believed that the overall package of updates should be brought in without delay to ensure the licensing framework can deliver consumer benefits. One consultee noted that whilst NERL could potentially face a greater level of enforcement, this would be balanced with other benefits such as replacing criminal sanctions with civil sanctions for failure to provide information needed for enforcement.
- 2.24 NERL were in favour of bringing the updates in RP3 in 2020 due to the potential impact on their financing.
- 2.25 The CAA disagreed with the proposal to delay implementation until the next regulatory period to provide greater regulatory certainty for NERL, in the context of financial penalties. It considered that introducing a penalty regime as soon as practicable, accompanied by a clear penalty policy, would provide greater regulatory certainty for all parties as they would understand how the regime would work on the ground.
- 2.26 The Government has considered the varying opinions on this matter. We are persuaded that there are benefits to introducing the enforcement and licence modification regime together, as soon as possible, which outweigh the disbenefits. It is of the view that both regimes will work best as a package to ensure the licensing framework can operate efficiently. Bringing the updates in as soon as practical will ensure benefits to users and consumers can be best served without delay.**
- 2.27 The Government is of the view that the uncertainty described by NERL in relation to penalties is mitigated by a penalty only being issued for a severe breach of the licence. The Government also notes that the difference in bringing the enforcement regime in force in RP2 and RP3 could only be around a year.**
- 2.28 The Government does not consider bringing the regime in force in RP2 would provide regulatory uncertainty that cannot be planned for. The CAA intends to produce guidance on its enforcement and penalty regime to provide clarity on how the regime would work in practice for NERL. Furthermore the CAA would be expected to apply proportionality and ensure NERL does not find it unduly difficult to finance itself when issuing penalties.**

3. Licence termination notice period

Background

- 3.1 In the consultation, we proposed to extend the length of the notice period after which NERL's licence can be terminated. We sought views on options for licence length, from the current 10 years, to a period of 15 years or greater. This was aimed at giving NERL and its investors, greater certainty around the longevity of the business. In turn, we expected that a suitable licence length would allow NERL to access cheaper financing for its longer-term investments and therefore lead to lower charges for its customer.
- 3.2 In the consultation, we asked the following questions:

Question 3

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

Question 4

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

Consultation responses

- 3.3 The majority of respondents were supportive of the proposals to increase the length of the licence termination notice period, with two respondents disagreeing and one remaining broadly neutral.
- 3.4 Both respondents who disagreed with the proposal believed that doing so would dissuade other potentially more efficient providers of air traffic services from bidding to run the en-route service in future. One respondent, Ryanair, also believed that extending the notice period would lead to higher costs for users and reduced levels of service.
- 3.5 Other respondents, whilst recognising the risk of higher costs and lower service quality, believed a 15 year notice period provided an acceptable compromise given the expected benefits in terms of cheaper financing. Respondents supportive of the proposal to increase the licence length included both the CAA and NERL, several airlines and airline representatives, and the Department for Infrastructure Northern Ireland.
- 3.6 With the exception of NERL, all those in favour of the proposal supported a 15 year notice period, as opposed to a longer one. The CAA commented that their analysis did not demonstrate a strong case for extending the notice period beyond 15 years. They

were of the view that the financing benefits to NERL of a 25 year notice period were likely to be relatively modest compared to the overall level of determined costs.

- 3.7 NERL disagreed with this conclusion, suggesting that an effective notice period of 20 years would enable them to maintain a long term view and therefore deliver good customer outcomes. It countered that it believed the benefits of extending the notice period were underestimated and the risks overestimated in the consultation document.
 - 3.8 NERL also argued that the risk of regulatory change at European level meant that a 20 year notice period was more appropriate. Should the UK remain as part of the SES initiative following the exit from the European Union, and the remaining flexibility for the regulatory regimes to differ was removed, a 15 year notice period would be insufficient for NERL to finance its investments.
 - 3.9 Additionally, NERL provided comments on the proposal to remove the restriction on the earliest date at which notice to terminate the licence can be served (currently set to March 2021). NERL considered that removing this restriction would introduce a new risk to NERL in the middle of a price control period, in a manner that was not anticipated.
- 3.10 Given the strong support for extending the licence termination notice period, the Government intends to confer new power on the Secretary of State to amend terms of the licence. We intend to use this power in the immediate future to change the duration of the licence notice period to 15 years.**
- 3.11 We agree with the evidence provided by the CAA, and the comments by other stakeholders that a 15 year licence notice period is more appropriate than a 20 year period. As presented in the final impact assessment, the incremental benefit of moving to a 20 year period over a 15 year period is more uncertain, whilst the costs of doing so are much greater. A longer notice period reduces the flexibility of future governments to make changes to the market structure, and risks diluting NERL's incentives to keep costs contained. The latter risk significantly outweighs any potential benefit from extending the notice period to 20 years.**
- 3.12 The Government has however agreed to reconsider the licence length if there is a change to the implementation of SES regulations in future, whilst the UK remains part of the SES initiative.**
- 3.13 We have also considered the evidence provided by NERL in relation to the earliest date at which notice can be served (i.e 20 years from when the licence was granted). The Government intends to retain this restriction. This would have a limited impact on the effective notice period, but would avoid exposing NERL to undue risk in the middle of a price control period.**

Annex 1

List of respondents to the Modernising the Licensing Framework for Air Traffic Services consultation

The Civil Aviation Authority

NERL

Ministry of Defence

Manchester Airports Group

Department for Infrastructure Northern Ireland

Board of Airline Representatives UK

Airlines UK (formerly known as BATA)

British Airways

Virgin Atlantic Airways

Ryanair

Annex 2

Consultation responses

(See separate document)