

Review of advice on SES Market Conditions for Terminal Air Navigation Services in the UK

CAP 1261 – non-confidential

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CHAPTER 1

Introduction

- 1.1 The CAA has conducted a study to consider whether terminal air navigation services (TANS) are provided under market conditions in the UK. This study has been conducted against the test set out in Annex 1 of Commission Implementing Regulation 391/2013 of 3 May 2013 and updates the study conducted by the CAA and published as CAP 1004 in 2013.¹

Reason for conducting the study

- 1.2 The CAA has conducted this study in response to a request from the Director General of Civil Aviation at the Department for Transport (DfT). The DfT requested that the CAA assist the Secretary of State under section 16 of the Civil Aviation Act 1982.² Under this section, the CAA has a duty to provide advice to the Secretary of State for Transport when requested to do so.
- 1.3 The request from DfT follows a number of significant changes within the provision of TANS in the UK. These include the progression of the transfer of the TANS service in house at Birmingham airport and the recent announcement by Gatwick Airport Ltd (GAL) that it has decided to award its TANS contract to Deutsche Flugsicherung GmbH (DFS).

Legal Framework for the analysis

- 1.4 This review assesses the provision of TANS in the UK against the test set out in Annex 1 of EC Regulation 391/2013. The CAA has not carried out a full competition assessment using its concurrent competition law powers, for example a market study under the Enterprise Act 2002, or an investigation under the Competition Act 1998. Further, the CAA does not consider that the Annex 1 criteria constitute a test of whether the market for

¹ See CAP 1004 - SES Market Conditions for Terminal Air Navigation Services in the UK url: www.caa.co.uk/cap1004

² Letter to Andrew Haines CEO (CAA) from Patricia Hayes Director General of Civil Aviation (DfT), 10 August 2014 paragraphs 3 to 5 url: <http://www.caa.co.uk/docs/589/140819%20PH%20letter%20to%20AH%20section%2016.pdf>

TANS is fully competitive, whether any individual operator holds a position of significant market power or whether there are any other features of the market that may have an appreciable effect on competition that might be considered separately by the CAA under its competition powers. Rather, the test asks whether there are the conditions for the market process to exist. The existence of market conditions is a necessary, but not sufficient, condition for effective competition to exist.

- 1.5 Therefore, as part of the present assessment, the CAA is not required, nor has it sought, to define the scope of the market(s), assess any potential market dominance and/or address actual or potential behaviour(s) displayed by any party.
- 1.6 As such, the CAA does not consider that it is bound by its assessment under this test in relation to any potential investigatory or enforcement action it may take in the future using its concurrent competition law powers, or any other powers. Where issues are raised as part of this assessment, the CAA will consider separately whether or not it would be appropriate to take action using its concurrent powers or any other powers on an issue by issue basis. This study may, therefore, form the background to further work.
- 1.7 The CAA notes that the European Commission is yet to publish guidance on the application of the test set out in Annex 1 of EC 391/2013. The CAA has conducted its study in line with its earlier CAP 1004 assessment.

Timetable and how to respond

- 1.8 This section sets out the CAA's process to date, its timetable for delivering its advice to the Secretary of State and how to respond to this consultation.

Process to date

- 19 August 2014: request for further advice made by DfT.
- 11 September 2014: the CAA opened dialogue with the airport operators and air navigation service providers (ANSPs) involved in recent tender processes.
- 26 September 2014: the CAA called for evidence to industry regarding recent changes in the provision of TANS in the UK.
- 7 November 2014: the CAA call for evidence closed with six responses.
- 25 November 2014: the CAA published a notice on its actions in light of the court action between NATS (Services) Limited and Gatwick Airport Limited.

- 17 December 2014: the CAA communicated that the court action had been settled and it would be progressing with its analysis and aiming to consult in February 2015.

Timetable

- 30 March 2015: the deadline for written responses to the consultation
- May 2015: the CAA publishes advice to the Secretary of State.

How to respond

- 1.9 This document is open to consultation until 30 March 2015. Please email your response to thomas.carr@caa.co.uk by close on 30 March 2015.
- 1.10 Given the short timeframe, it is unlikely that the CAA will be able to accept submissions made after the deadline.

Structure of this document

- 1.11 The remainder of this document sets out the CAA's analysis and findings. It is structured as follows:
- Background;
 - Summary of relevant findings from CAP 1004;
 - Evidence collection;
 - Analysis;
 - The market conditions test; and
 - Next steps.
- 1.12 This document is the non-confidential version where. The [X] symbol has been used where text has been excised to protect commercially sensitive information.

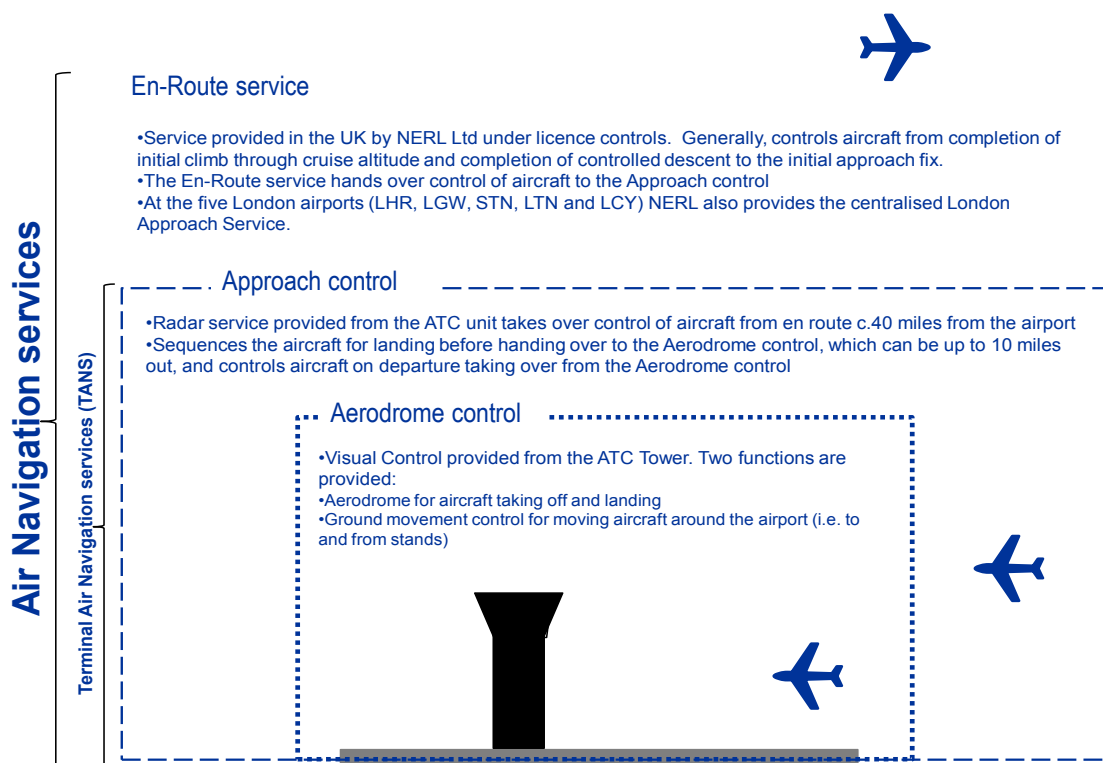
Chapter 2

Background

- 2.1 This chapter outlines the development of TANS in the UK to date and covers milestones that have led to this study. It is structured as follows:
- definition of TANS; and
 - history of UK TANS provision.

Definition of TANS

- 2.2 Air traffic services are separated into the “en-route” service, which controls traffic during the cruise phase of the flight away from the airport environment, and the terminal air navigation service (TANS). The TANS service itself normally consists of two elements: (a) the “radar approach and departure” (approach) service and; (b) the aerodrome service. The approach service typically controls the aircraft within 40-50 nautical miles from the airport. The approach service for a number of airports can be combined and, in the case of the airports within the London terminal manoeuvring area, these have been centralised for safety and efficiency reasons. The unified approach service, the so called “London Approach” service, is provided by NATS En Route Plc (NERL) under its licence granted under the Transport Act 2000 (TA00). This service is provided from the control centre at Swanwick for Heathrow, Gatwick, London City, Luton and Stansted airports.
- 2.3 For the purposes of this study, the CAA has maintained the definition of TANS adopted for CAP 1004. This includes both the approach and aerodrome control functions, and associated management and engineering activity. However, the CAA has not examined the London Approach service as this is provided under licence by NERL and is not subject to competition. Figure 1 below illustrates the scope of TANS.

Figure 1: Illustrative definition of TANS

History of UK TANS provision

1972 to 2003

- 2.4 The UK TANS market has never been subject to a statutory monopoly. However, prior to the entry into force of TA00, air traffic services for all en route services and for TANS at most large UK airports were provided by the CAA. From 1972 to 1996 National Air Traffic Services was a division of the CAA. In 1996, in anticipation of future privatisation, NATS was formed into a company wholly owned by the CAA.
- 2.5 TA00 paved the way for the privatisation of NATS through a Public-Private Partnership (PPP). Ownership of NATS was subsequently transferred from the CAA to the Government. This created a clear division between the provision of air traffic services and the regulation of those services. The PPP was completed in July 2001 with the sale of 46% of shares to the Airline Group (a consortium initially of UK airlines)³ and 5% to the staff of NATS with the balance held by the UK Government.

³ In late 2013 the University Superannuation Scheme, one of the largest pension schemes in the UK, purchased 49.9% of the Airline Group

- 2.6 At the time of the PPP NATS was restructured into a group with an ultimate holding company (NATS Holdings Ltd), a subsidiary (NATS Ltd) with two further operating subsidiaries - NATS En Route Plc (NERL) and NATS Services Ltd (NSL). NERL was granted a licence by the Government in 2001 to operate the en route airspace exclusively for a period of 10 years. NSL continued to operate TANS at the airports where it was then present under commercially negotiated contracts between the air navigation service provider (ANSP) and the airport operator. Providers of TANS are exempt from the need to hold an economic licence under TA00 until at least 31 December 2019.⁴
- 2.7 Following the events of 11 September 2001 and the significant fall in air transport use in the immediate aftermath, the financial model supporting the privatisation of NATS came under significant stress. As a result, NATS went through a financial restructuring with additional investment by the Government and BAA (now Heathrow Airports Group Limited). BAA took a 4 per cent share of NATS with a corresponding reduction in the Airline Group's share. The restructure was finally completed with a successful bond issue in late 2003.

2004 to 2013

- 2.8 In March 2004, the European Parliament and the Council of the European Union adopted the first Single European Sky (SES) legislative package. This set out the initial framework for a pan-European approach to the regulation and governance of airspace. Since 2004, the SES legislation has provided the underpinning framework for the regulation of TANS.
- 2.9 In June 2008, this was amended through the second SES legislative package. SES II was heavily focussed on the performance of ANSPs and introduced a number of institutions to support it, notably the development of "Functional Airspace Blocks" and the concept of a "Network Manager". The SES packages also set out the common performance and charging schemes for air navigation services.

⁴ The TANS exemption is set out under Air Traffic Services (Exemption) Order 2011 (SI 2011/425).

- 2.10 In January 2008, following a request from the Secretary of State, the CAA published its first assessment of market conditions under Annex 1 of EC Regulation 1794/2006.⁵ This concluded that the market was contestable under the conditions of the test. This was a forward looking assessment and considered the potential impact of a number of SES initiatives such as European Licensing of ANSPs and air traffic control officers (ATCOs). It did not weigh heavily some of issues that have been identified in the later study as being matters that limit contestability, such as the lack of alternative providers. At the time, however, there were no requirements to set targets on TANS.
- 2.11 In 2011, London Luton Airport Operations Ltd (LLAOL) conducted the first public tender process for TANS. The contract was awarded to the incumbent, NSL. This was followed in 2012 by a public tender by Birmingham Airport Limited (BAL), which resulted in a move to self-supply, a process that is currently being implemented and is the first of its kind since the PPP.
- 2.12 In February 2012, at the request of the DfT, the CAA published a fresh consideration of contestability under Annex 1 of the EC Regulation 1794/2006. This assessment found that the market was not contestable under the conditions of the test due to a much lower level of competitive activity in the provision of TANS in the UK than had been expected since the PPP. The advice was published in February 2013⁶ as CAP 1004 and raised three areas of concern around limited contestability:
- the relationship between NSL and NERL in terms of identity and branding, and regarding the transparency of dealings between the TANS operator and the NERL service;
 - historic commitments to employees with respect to pension arrangements, which could affect the availability of staff, or the terms and conditions of transferring staff; and
 - a general lack of competitive tenders and evidence of contracts changing hands.
- 2.13 Consequently, the DfT did not seek derogation for TANS from the SES Performance Scheme⁷ regulatory requirements for Reference Period 2,

⁵ Now Annex 1 of EU 391/2013 : <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:128:0031:0058:EN:PDF>

⁶ This was prior to the BAL and GAL decisions.

⁷ Now Annex 1 of EU 390/2013 : <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:128:0001:0030:EN:PDF>

which started on 1 January 2015.

2013 to present day

- 2.14 Following the publication of our advice to the Secretary of State in February 2013, there have been a number of changes in the regulation and provision of TANS in the UK.
- 2.15 In December 2013, following a formal request from the DfT, the CAA published a consultation on its approach to the regulation of TANS under the Performance Scheme. The CAA's decision on the approach was published in February 2014.⁸
- 2.16 In May 2014, the CAA submitted its regulatory package (the UK-Ireland Performance Plan) to the DfT and the Irish Department of Transport Tourism and Sport, which adopted the recommendations and submitted the Plan to the European Commission. This set out a cost efficiency target of for TANS amounting to an average reduction of 2.3 per cent a year between 1 January 2015 and 31 December 2019 in the overall cost of provision. It also set out a capacity target on delay attributable to ANSPs of 0.87 minutes average delay in 2015 and 0.78 minutes of average delay in 2016 to 2019.
- 2.17 Based on 2013 data, NSL accounts for around 60 per cent of aircraft movements at Airports in the UK. The remaining 40 per cent is self-supply. There are no third party ANSPs currently providing TANS at commercial airports. However, a number of contracting events have taken place at UK airports which will see this change in the future. The events include:
- change of provider for the TANS service at Birmingham Airport from NSL to Birmingham Airport Air Traffic Ltd (BAATL);
 - NSL was awarded a further five year contract by Belfast International Airport in April 2013;⁹
 - NSL was awarded a further five year contract by Cardiff Airport in January 2014;¹⁰
 - the announcement by GAL in July 2014 that it would be awarding its contract for TANS to DFS;¹¹ and

⁸ Available on the CAA website at www.caa.co.uk/cap1157

⁹ See url: <http://www.nats.aero/news/belfast-and-gibraltar-airports-renew-contracts-with-nats/>

¹⁰ See url: <http://www.nats.aero/news/nats-secures-five-year-contract-cardiff-airport/>

¹¹ See url: <http://www.mediacentre.gatwickairport.com/News/Gatwick-announces-contract-award-for-air-traffic-control-services-921.aspx>

- NSL was awarded a 10 year contract by the Manchester Airports Group (MAG) in August 2014 to provide TANS at both Manchester and Stansted airports.¹²

2.18 The remainder of this paper updates the advice provided to the DfT as CAP 1004.

12 See url: <http://www.nats.aero/news/mag-nats-announce-ten-year-deal/>

¹² See url: <http://www.nats.aero/news/mag-nats-announce-ten-year-deal/>

Chapter 3

Summary of the relevant findings from CAP 1004

- 3.1 This chapter summarises the findings in CAP1004 and explains how the CAA addressed each of the criteria on market conditions set out in Annex 1 of Commission Regulation (EC) No 1794/2006 (the Regulation).

Criterion one

- 3.2 Criterion one is:

"The extent to which service providers can freely offer to provide or withdraw the provision of these services:

- a) The existence or otherwise of any significant legal or economic barriers that would prevent a service provider from offering to provide or withdrawing the provision of these services;*
- b) The contract duration; and*
- c) The existence of a procedure allowing assets and staff to be transferred from one air navigation service provider to another."*

- 3.3 CAP 1004 considered that seven issues were relevant to its assessment of this Criterion. These were:

1. NSL's interface with NERL;
2. NATS Trust of a Promise (ToaP) and the transfer risk of ATCOs;
3. ATCO career progression;
4. the applicability of competition law;
5. duration of contracts;
6. air navigation services asset ownership arrangements; and
7. the treatment of the manual of Air Traffic Services Part 2 (MATS Pt2).

- 3.4 The CAA's analysis in CAP 1004 found no significant concern with items 3 to 7. It did, however, highlight reservations over items 1 and 2, which were both considered to constitute a barrier within the meaning of Criterion 2.

NSL interface with NERL

- 3.5 CAP 1004 found that both airport operators and ANSPs had concerns that the close relationship between NSL and NERL provided NSL with an advantage over potential rivals. This was due in to the joint ownership of the companies by NATS (Holdings) Ltd.
- 3.6 Although no specific evidence was brought forward of less favourable treatment being given to non-NATS providers, there was a view that the risk of such behaviour formed an economic barrier within the meaning of the Criterion. This was particularly the case at those airports within the scope of the London Approach service.
- 3.7 It was suggested that this concern may fall away should (a) a successful transfer be observed and/or (b) standardised and transparent terms and conditions of service be provided by NERL to airport operators and TANS providers.

NATS ToaP and the transfer risk of ATCOs

- 3.8 As set out in CAP 1004, ToaP provides NATS employees employed at the time of the privatisation with additional rights in relation to the provision of pensions.
- 3.9 ToaP places an obligation on NATS to maintain the pension arrangements of that group of employees, including taking steps in the event of a sale or transfer of part of the NATS business, for example in instances where the Transfer of Undertaking (Protection of Employment) Regulation apply. In the event that NATS is not able to assure employees of the continuation of these pension benefits when such a transfer occurs, the affected employees have the right to refuse to transfer to the new employer. In this case, NATS may have an obligation to continue to employ those employees.
- 3.10 The 2012 advice set out that ToaP increased the risk in bidding for and the cost of transition of ANSPs seeking to take on a NATS operated tower. This was due to the uncertainty over whether staff would transfer and the additional cost of training replacement staff. NATS presented evidence at the time that similar arrangements exist in other sectors and that, through FerroNATS, similar issues were faced in its recent acquisition of the business at Spanish towers.
- 3.11 On balance, however, the advice considered that ToaP was a relevant economic barrier within the meaning of the Criterion.