

Initial proposals on modifications to NATS (En Route) plc licence in respect of Governance and Ring-fencing

CAP 1287

Published by the Civil Aviation Authority, April 2015

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Enquiries regarding the content of this publication should be addressed to:

Markets and Consumers Group, CAA, 4th Floor, CAA House, 45-59 Kingsway, London WC2B 6TE.

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Executive Summary

Overview

1. As the UK's monopoly en route air traffic services provider, NATS (En Route) plc ("NERL") is critical to the provision of a safe, efficient and sustainable air traffic service. NERL is subject to economic regulation by the CAA through a licence issued under the Transport Act 2000 (the Act).
2. NERL's licence contains conditions – the "ring-fence" conditions - that are designed to ensure that the assets, cash flows and other financial resources of NERL are used solely for the benefit of its regulated monopoly business. These rules are designed to protect stakeholders (including the ultimate consumers whose fares ultimately fund the business) by making it less likely that NERL will suffer financial distress or failure.
3. Since NERL's licence was amended in 2007 to remove a requirement to comply with to the Code of Corporate Governance, the CAA has not sought to set standards for Board leadership and governance for NERL. Instead, the CAA has chosen to focus on ensuring that there is appropriate ring fencing of the regulated company to protect it from risks arising elsewhere in the NATS group.
4. However, since these obligations were introduced, the world of corporate governance, and the regulatory oversight of it, has changed. In many regulated industries, including those in which there were already rules dealing with corporate governance, standards have either been introduced or tightened, sometimes in the wake of significant failures. Past issues from which these changes have evolved include the financial difficulties and break up of Hyder, and the failures of Railtrack and Enron, as well as more recent and high profile financial failures and bail outs.
5. Given that the existing ring-fence has been in operation through a period when the UK and world economies have experienced the most significant financial crisis since the 1930s, and NATS has not itself encountered significant financial difficulty arising from that crisis, it could be argued that the conditions work well. However, it is important that the ring-fence conditions are seen to be robust over a reasonable period into the future and to be agnostic as to the ownership structure of NERL/NATS so that they are fit for purpose irrespective of who owns it.

6. It is also fair to say that perceptions and awareness of risk have changed in recent years, with consumers being less willing to tolerate poor service or service disruptions. Clear examples of the reaction to these disruptions can be seen in the media response to incidents such as recent failures in air traffic control and railway engineering overruns. At the same time, we consider that public acceptance of perceived failure of the regulatory regime to protect consumers is also lower.
7. In response, many economic regulators have already enhanced the regulatory oversight of corporate governance in recent years. New rules have been introduced without substantially affecting the ability of the owners of the business to be represented on the board of the regulated company or to exercise their ownership rights. In some cases, the requirements are very extensive, including for independent directors to outnumber executives, the chair of the regulated company to be independent and for board members to have particular expertise or be approved by the regulator.
8. Within that context, starting with the Ad-Hoc Review of NATS-related risks in 2012/3, we have undertaken a thorough review of the existing governance and ring-fencing arrangements for NERL and have identified areas in which we consider that changes to the licence would provide greater protection for users of air transport services.

Issues identified

9. Our work has found that there are weaknesses with the corporate governance of NERL that may lead to stakeholders' (including consumers') interests being harmed. In particular, the board of NERL does not contain any independent members (unlike the NATS Holdings board) and board meetings of NERL are "nested" within the board meetings of the NATS group. Each of these elements of NERL's board governance makes it more likely that, especially at times of financial or other difficulty, the members of the board of NERL are at risk of becoming exposed to conflicts as a result of duties they hold as members of the boards of other companies within the NATS group.
10. In addition, we have provisionally found that the existing financial ring-fence may not, in its current form, be sufficiently robust. In particular:
 - the reporting and certification of resources obligations in the licence do not provide the CAA with sufficient transparency over the ongoing stability of the business, including whether it is operating effectively in accordance with its obligations;

- while NERL provides an annual certificate that it has sufficient resources to continue operation for the next two years, it does not have to explain how it reached this conclusion or detail the factors it has taken into account in providing the certificate;
 - NERL currently has no obligation to certify compliance with specific licence obligations prior to declaring a dividend or other distribution of capital. Such a requirement is a feature of a number of licences observed in other regulated sectors;
 - Some of the obligations in the licence (for example in relation to cross subsidies) are insufficiently clear either for NERL to comply with them easily, or the CAA to oversee and enforce them; and
 - NERL does not have any plans in place to provide appropriate assistance to a special administrator in the event of its insolvency.
11. The CAA considers that the current arrangements are significantly less robust than those prevailing in other regulated sectors and are, in many respects, an 'outlier' of regulatory practice.

Initial proposals

12. The CAA's overall aim is to ensure that NERL's financial ring-fence and corporate governance arrangements, taken as a package, make sure that it maintains sufficient financial and non-financial resources to conduct its regulated activities and that it avoids exposing stakeholders and consumers to unacceptable risks arising from either its financial structure, or from NATS' activities outside the regulated business. These latter risks could arise, for example, through its relationship with its unregulated subsidiary NATS Services Ltd (NSL). In addition, the CAA wishes to receive direct assurance that the appropriate policies and procedures are in place to achieve this outcome.
13. In practice, this is likely to require the regulatory regime to deliver the following outcomes:
- appropriate mitigation of any risks and conflicts of interest faced by the boards of NERL and NATS Holdings, the parent company of the group;
 - a management of NERL that is sufficiently focussed on that business rather than the broader interests of the NATS group so that risks are not traded off between NSL and NERL;

- that the apparent culture of regulatory compliance within NERL can be easily observed by the CAA and maintained in the future;
- protection for the funds provided (indirectly) by consumers through NERL's regulated revenues for the benefit of the regulated business;
- sufficient transparency for the CAA as to the ongoing financial and operational robustness of NERL; and
- clarity and lack of ambiguity in NERL's licence obligations, so that the licence can apply with as little as possible need for consents or comfort letters.

14. The CAA considers that delivery of these outcomes will mitigate the likelihood of a range of high impact events which, although the probability of them occurring may not be high, could cause disruption to NERL and, in doing so, harm the interests of consumers. In order to deliver these outcomes, the CAA has identified a range of potential changes to the governance and ring-fence arrangements of NERL that it considers will address these problems and bring regulation of air traffic services more into line with best practice observed elsewhere.

15. On governance, the key proposal is to mandate NERL to appoint at least two non-executive and independent directors with appropriate skills to promote greater rigour in its corporate governance and enhance NERL's compliance culture, and ensure that two of them are required to be present for the board to be quorate. We also propose that the licence make clear that where potential conflicts exist between the interests of NERL and those of any other part of the NATS group, the directors of NERL must act independently and ensure that they have regard exclusively to the interests of NERL.

16. On the financial ring-fence, we have identified a package of proposals:

- re-focussing NERL's annual directors' resources certificates to give additional clarity to, and emphasis on, operational as well as financial resources;
- new statements from the directors setting out the processes used and factors considered in issuing the resources certificates;
- new certificates from NERL's directors that the licensee has complied with certain ring-fence elements, such as not to enter into cross defaults nor give or receive cross-subsidies;

- a new requirement to re-state the compliance certificates prior to the declaration of dividends; and
 - maintenance of an intervention plan to assist a special administrator in the event of insolvency.
17. Overall, the CAA considers that the proposed changes set out in this consultation are incremental and build on the protections that already exist. We consider that, when taken as a package, these changes will ensure that the ring-fence is as robust as possible without imposing unnecessary burdens on NERL, or completely eliminating the possibility of financial failure, which, of itself, encourages discipline on the part of the company's management.

Next steps

18. We welcome views from stakeholders on all of the issues considered in this consultation document and particularly the CAA's assessment of options set out in Chapters 4 and 5. Having considered responses, we currently expect to issue statutory licence modification proposals during August 2015 with a view to modifying the licence formally in October 2015 such that the proposed changes will take effect from 2016.
19. Under Section 11(1) of the Act, the CAA may modify the conditions of a licence if its holder consents to the modifications. Should NERL choose to withhold its consent to any of the changes the CAA decides to make following this consultation, the CAA will have the option under Section 12(1) of the Act of making a reference to the Competition and Markets Authority to investigate and report upon whether any matters specified in the reference and which relate to the provision of air traffic services by or on behalf of a licence holder operate against the public interest or may be expected to do so.

CHAPTER 1

Introduction

Purpose of this document

- 1.1 This document sets out, for consultation, the CAA's initial proposals on how the air traffic services licence of NATS (En Route) plc ("NERL") should be amended to meet concerns first identified in the CAA's Ad Hoc Review of NATS-related risks in 2012/13. That Review found that the current arrangements for governance and ring-fencing may need to be strengthened to ensure that users are adequately protected from risks which arise outside of the regulated business.
- 1.2 In light of that finding, the CAA has undertaken a thorough review of the existing ring-fence conditions and identified areas in which we consider that changes to the rules in the licence would provide greater protection for consumers.
- 1.3 In particular, this document invites representations on proposals by the CAA to:
 - modify Condition 5: Availability of Resources and Financial Ring-Fencing in the licence held by NERL to:
 - re-focus the annual directors' resources certificate to introduce a new certificate related to operational resources which will be separated from the existing requirement related to financial resources;
 - include new statements from the directors setting out the processes used and factors considered in issuing the certificates;
 - require new certificates from NERL's directors that the licensee has complied with specific elements of the ring-fence; and
 - require certificates of compliance with the ring-fence conditions to be issued each time the licensee declares or recommends a dividend;
 - introduce a new Licence Condition requiring NERL to maintain an intervention plan to assist a special administrator in the event of insolvency; and

- introduce a new Licence Condition which will ensure the independence of the NERL board's decisions and contain a requirement that at least two 'Mandated Independent Directors' must sit on the NERL board and that these directors should sign the certificates referred to above.

1.4 The CAA also welcomes views on initial proposals to simplify the licence in relation to the prohibition on giving or receiving cross subsidies which is explained further in this document.

Terms used in this document

- 1.5 For the purposes of this document, references to NATS relate to NATS Holdings Limited, which is the ultimate parent company of the NATS group of companies. References to NERL or the regulated or monopoly business relate to NATS (En Route) plc, which holds a licence for provision of en route services under the Transport Act 2000 (the Act). The prices NERL can charge users and certain quality standards, such as its capacity/delay performance, are subject to economic regulation by the CAA. References to NSL relate to NATS (Services) Limited, which is a subsidiary of NATS that provides terminal air navigation services (TANS) at airports, as well other commercial services, in the UK and overseas.
- 1.6 References to consumers and stakeholders are to include (among others) operators and owners of aircraft, operators and managers of aerodromes, passengers and other users of aircraft and persons with rights of property carried in them. References to Air Traffic Administration are to the special administration regime under sections 26 to 33 of the Act.

Views invited

- 1.7 We welcome views on these initial proposals. Any comments on this document should be sent, if possible by e-mail, to economicregulation@caa.co.uk by 12:00 on 8 June 2015. Alternatively, comments may be sent by post to:

Stephen Gifford
Markets and Consumers Group
Civil Aviation Authority
4th floor
CAA House
45-59 Kingsway
London WC2B 6TE

- 1.8 This consultation document provides interested stakeholders and finance

providers with an opportunity to comment on these initial proposals that represent the CAA's current thinking. We are particularly keen to minimise any risk of unintended consequences. Respondents are encouraged to respond in detail and, where they consider that we should take an alternative approach to that set out in these initial proposals, to provide detailed and fully reasoned responses (and, where relevant, proposals) which fully address the issues set out in the consultation document.

- 1.9 Having considered any responses, we expect to issue our final proposals and a statutory licence modification under Section 11 of the Act during August 2015.
- 1.10 The CAA expects to make submissions available on its website for other interested parties to read as soon as practicable after the period for responding expires. Any material that is regarded as confidential should be clearly marked as such. Please note that the CAA has powers and duties with respect to information under section 102 of the Act and the Freedom of Information Act 2000.
- 1.11 If you would like to discuss any aspect of this document, please contact Stephen Gifford (stephen.gifford@caa.co.uk) or Robert Toal (robert.toal@caa.co.uk).

Structure of this document

- 1.12 The remainder of this document sets out:
- the background to the CAA's proposals in this area including the relevant statutory framework, the findings of the Ad Hoc Review of NATS related risks carried out during 2012 and the impact of subsequent developments (Chapter 2);
 - the purpose of this review which is to achieve the strategic outcome of ensuring that NERL maintains sufficient financial and non-financial resources to conduct its regulated activities and that it avoids exposing users to unacceptable risks arising from outside the regulated business (Chapter 3);
 - the initial proposals to strengthen governance arrangements of NERL (Chapter 4);
 - the initial proposals to strengthen the NERL financial ring-fence (Chapter 5);
 - a summary of the areas which CAA does not intend to change at the moment (Chapter 6);

- a summary of the costs of the proposed changes (Chapter 7); and
- an overall summary of the CAA's proposals and proposed next steps (Chapter 8).

1.13 The Appendices provide illustrative drafting of the licence modifications that would be required if these initial proposals were implemented in their present form.

Chapter 2

Background

- 2.1 This chapter sets out the context for and background to the CAA's proposals. It puts these proposals in their wider context and describes the statutory framework for the economic regulation of NERL. It goes on to consider how governance and ring-fencing was addressed by the CAA during an Ad Hoc Review of NATS related risks that was carried out in 2012. The chapter concludes by summarising the detailed work programme that the CAA has subsequently carried out to inform these initial proposals.

Context

- 2.2 How a company is governed and led plays an important part in how it performs. A lack of strong Board leadership and governance can lead to problems with financial stability and service delivery. Furthermore, for regulated companies, Board oversight is crucial in creating a culture which ensures compliance with both the letter and spirit of the regulatory rules which are designed to protect consumers generally. For NERL, these rules include the financial ring-fence protecting consumers' funding of the regulated company.
- 2.3 Many regulators in other sectors have reviewed or enhanced the regulatory oversight of corporate governance in recent years. Ofwat, Ofgem, ORR and new regulators, such as the FCA, have taken a strong line in this area. These reviews have seen governance rules develop over time since the significant failures of Railtrack and Enron, and the high profile banking crisis.
- 2.4 As with many other regulated businesses, NERL is responsible for providing a vital public service: it is clearly in the interests of all consumers that this service is provided not only safely, but also with as little interruption as possible to the levels expected (and ultimately paid for) by consumers. While NERL has not experienced the same or similar financial difficulties since the implementation of the Composite Solution to its funding after the events of 9/11, NERL remains liable to:
- situations of financial stress (for example as a result of a prolonged airspace closure);
 - suffering significant outages (most recently in December 2014); and

- increased consumer expectations in relation to the quality and continuity of service that they receive.

- 2.5 Each of these factors has focussed attention more closely on the management of NERL and NATS more generally.
- 2.6 If the financial position of NERL were to deteriorate significantly, harm may arise to consumers. In particular, harm may arise as a result of a diminution or discontinuity in service and/or through greater costs being imposed on consumers (whether as a result of an Air Traffic Administration or otherwise). Specifically, NERL may find that it is unable to continue to invest appropriately in its people, technology and systems to enable it to maintain its monopoly air traffic business and safely and reliably to deliver en route air traffic services. In time, this may threaten the reliability and safety of that service.
- 2.7 The CAA does not take the view that it is appropriate to seek to eliminate the possibility of NERL experiencing financial stress or entering Air Traffic Administration, not least because the possibility of this, and the consequent loss to shareholders acts to discipline the company and its board. In any event, the CAA does not consider that it is possible to eliminate (rather than reduce) this risk in all circumstances: to attempt to do so would be likely to result in unacceptably onerous conditions being put on NERL (for example in relation to guaranteeing the availability of working capital).
- 2.8 However, the CAA does consider that the regulatory regime should reduce the risk of financial distress by constraining the conduct of the company, ensuring its resources are not diverted and that it is not exposed to undue risk. The presence of appropriate ring-fencing and governance rules helps to reassure the CAA that NERL will remain in a position to finance its functions and consumers' interests are not adversely affected.
- 2.9 Furthermore, if financial distress were to occur such that NERL entered Air Traffic Administration, the CAA is of the view that the administrator should have all the resources necessary available to conduct the administration as efficiently and effectively as possible with the minimum disruption to consumers.
- 2.10 We have conducted the review that underpins this consultation in this context, being mindful of the impact that a failure of NERL would have on interested parties more widely.
- 2.11 In this broader context, it appears that the time is now right to revisit the

issue of whether, and to what extent, the CAA should oversee the corporate governance of NERL, as the regulated company delivering the monopoly en route service within NATS.

CAA duties under the Transport Act 2000

2.12 The provision and economic regulation of air traffic services in the UK is governed by the Act. The Act establishes a system of licensing and regulation, including the Air Traffic Administration regime. The licence granted to NERL is designed to satisfy the statutory duties of the Secretary of State and the CAA set out in section 2 of the Act. In summary these are:

- an overriding duty to maintain a high standard of safety in the provision of air traffic services, accompanied by duties:
 - to further the interests of operators and owners of aircraft operators and managers of aerodromes, passengers and other users of aircraft and persons with rights of property carried in them;
 - to promote efficiency and economy on the part of licence holders;
 - to secure that licence holders do not find it unduly difficult to finance their authorised activities;
 - to take account of the UK's international obligations;
 - to take account of any guidance from Government on environmental objectives (no such guidance has been issued to date); and
 - to impose on licence holders the minimum restrictions consistent with the exercise of those functions and not to impose undue burdens on licence holders.

The NERL licence

2.13 The NERL licence includes a number of conditions initially set by the Government in 2001 but which can be modified by the CAA under the provisions of the Act. These include conditions that relate to ring-fencing and governance of certain elements of NERL's business.

2.14 The CAA has the function of enforcing and making modifications to the licence conditions. The procedure for making modifications to licence conditions is found in sections 11 to 14 of the Act which provide that:

- the CAA may modify the conditions of a Licence if the licence holder consents to the modification. The CAA must publish a formal notice of the proposed modifications and consider representations before making a decision; and
- the CAA may make a reference to the CMA at any time requiring it to investigate and report on whether any specified matters relating to the provision of air traffic services operate or might be expected to operate against the public interest. If the CMA does find that such matters operate or might be expected to operate against the public interest, then the licence is modified so as to remedy or prevent the adverse effects identified by the CMA.

2.15 The effect is that modifications can be made either with the agreement of the licensee or, if the licensee does not consent, following a reference to the CMA.

The financial ring-fence

2.16 The regulatory framework to which NERL is subject is designed to promote efficiency while meeting its legal duties, including the duties found in Section 8 of the Act in relation to providing a safe and reliable service. The CAA has, through the regulatory regime, arrangements in place to monitor the financial health of NERL and to respond in the event that that health deteriorates. The ring-fence regime and associated licence conditions are an important part of these arrangements, placing certain constraints on NERL to ensure that the resources consumers provide through the regulated revenues of the monopoly business are available for that business.

2.17 Although we have a duty to ensure that licence holders do not find it unduly difficult to finance their authorised activities, as stated above, the regulatory rules are not designed to remove the threat of bankruptcy, or to remove the responsibilities of the Directors of NERL to manage the business in a responsible manner, given the privilege that NERL has as a monopoly operator. We would, however, expect NERL to inform us at as early a stage as possible of any potential or actual issues. The earlier that we were aware of any such issues, the more able we would be to choose different options for responding to mitigate or contain the situation.

2.18 The directors and shareholders of NERL have the primary responsibility, to decide on the most effective operational, structural and financial arrangements for their business. We do not consider that intrusive intervention by the CAA would be desirable, in the consumer's interest or

consistent with our statutory duties. NERL is tightly integrated with other NATS companies as a consequence of the NATS public-private partnership (PPP) arrangements. Other NATS companies that are not economically regulated owe no duty to the CAA, and we have very limited powers over them. This underlines the importance of NERL's Directors in safeguarding its interests.

2.19 The ring-fence regime, therefore, has the following broad objectives:

- reducing the onset of financial or operational distress by constraining the conduct of the company, ensuring that its resources are not diverted and that it is not exposed to undue risk;
- reassuring the CAA that NERL remains in a position to finance its activities by providing warning signals when symptoms of financial or operational stress appear or threats are identified;
- mitigating the effects of financial or operational stress if it occurs; and
- facilitating the reopening of the price control or the operation of the Air Traffic Administration regime if either becomes relevant.

The CAA's Ad Hoc Review

2.20 During 2012, the CAA carried out a high level review (the Ad Hoc Review) of the strategic outcomes it wished to secure through its regulation of NERL. The review was carried out by a board-level working group in the context of a number of trends, challenges and risks that could potentially frustrate its ability to secure these strategic outcomes including:

- forecasts for long-term traffic and increasing congestion which could challenge traditional approaches to safety management;
- NATS, through its subsidiary NSL, aiming to develop significantly its business outside its en route monopoly;
- NERL taking an increasingly commercial view in its provision of regulated services;
- the ongoing development of the Single European Sky (SES) programme which was expected to challenge NERL's performance outlook, especially in terms of its cost-efficiency; and
- the prospect of changes in ownership of NATS and/or NERL.

- 2.21 The interim findings of the Ad Hoc Review were published in September 2012¹ and a final report was published in January 2013². That report confirmed the strategic outcomes that the CAA wished to achieve as well as the actions it considered would be best designed to help pursue those outcomes.
- 2.22 Broadly speaking, the CAA concluded that many of the risks identified through the Review could be mitigated, but not eliminated, through the CAA taking a different approach to its use of existing regulatory levers. For example, there were a number of areas where more proactive scrutiny by the CAA of NERL's business plans would be desirable. This included the CAA's oversight of NERL's long-term business plans from a safety delivery and assurance perspective and the CAA's oversight of NERL's financial resources.
- 2.23 In relation to governance and ring-fencing, the review did not reach firm conclusions but rather set out the CAA's high-level objectives that would shape a separate review. In particular, the CAA noted that there were various options that it would like to see considered either individually or in combination.
- 2.24 The options identified included both 'preventative' and 'curative' approaches that could be pursued either individually or in combination which would help to strengthen the financial ring-fence. Preventative approaches included options such as requiring NERL pro-actively to confirm compliance with certain conditions before paying dividends, drawing a ring-fence around the whole of the NATS operating companies, and requiring NATS Holdings to underwrite the performance of group service providers on which NERL depends.
- 2.25 Curative approaches related to ensuring that, in the event of financial distress, the CAA could discharge its duties and there would be a smooth and successful process of Air Traffic Administration. The Ad Hoc Review also raised a specific question as to how NERL could demonstrate it had adequate resources when it is required to contract for its staff resource with a NATS business that is not regulated and outside the NERL licence ring-fence.
- 2.26 The CAA noted that it would consider these issues further as part of the future work programme on NERL governance and financial ring-fencing.

¹ <http://www.caa.co.uk/docs/2492/NATSRisksReviewInterimReport.pdf>

² <http://www.caa.co.uk/docs/5/NATSRelatedRisksFinalReport.pdf>

2.27 In light of the findings of the Ad Hoc Review, the CAA established a work programme to consider the application of the governance and ring-fencing arrangements in greater detail. As part of this work programme, the CAA has held a number of meetings with representatives of NATS and requested further information from NATS in order to understand the issues. The substance of this work programme included:

- a detailed assessment of the structure of the Public Private Partnership (PPP) which underpins NATS corporate governance arrangements, including a review of the way the NATS employs staff within its group structure;
- a detailed gap analysis of the existing NERL licence to identify weaknesses; and
- a review of regulatory best practice, which was deemed to be particularly relevant as regulators in the rail, energy, water, health and financial services sectors have all recently considered parallel and comparable risks.

2.28 In the meantime, the December 2013 system failure at Swanwick and the receipt in July 2014 of NATS' comprehensive report on that failure prompted a further wide-ranging CAA review of the NERL licence and regulatory framework. The implications of this work are considered in the next section.

Chapter 3

Purpose and objectives of the Governance and the financial ring-fence proposals

Overall objectives and outcomes

- 3.1 The overall aim of this review is to ensure NERL's licence obligations and corporate governance arrangements, taken as a package, meet the objectives set out in paragraph 2.19, ensuring that NERL maintains sufficient financial and non-financial resources to conduct its regulated activities, and that it avoids exposing en route airspace users to unacceptable risks arising from NATS' activities outside the regulated business. The ring-fence conditions are, therefore, intended to prevent difficult to predict events whose probability may not be high and, as such, form, an important part of the regulatory framework which is designed to protect consumers' interests. As part of this, the CAA should be given direct assurance to confirm that the appropriate policies and procedures are in place to achieve this outcome.
- 3.2 The CAA's review of the existing governance and ring-fencing arrangements found that there are a number of areas in which the ring-fence and associated conditions in NERL's licence do not give the CAA the level of oversight and comfort that it requires in order to ensure that stakeholders and consumers are adequately protected.
- 3.3 In addition, it is clear that the current licence conditions are significantly less robust than those prevailing in other regulated sectors and are, in many respects, an 'outlier' of regulatory practice. For example, requirements for regulated company boards to contain independent directors (sometimes as the largest group) are common to the gas, electricity, water, rail, health and financial services sectors, each of which undertakes activities of national importance, are of comparable significance to consumers and, in some cases, also affect their safety. NERL does not, at present, have an obligation to have independent directors on its board of directors.
- 3.4 The CAA considers that any new obligations need to be designed in a manner that ensures that they work in conjunction with one another and with other licence conditions, such as those in respect of regulatory accounts. In practice, this is likely to require the regulatory regime to ensure and deliver the following outcomes:

- appropriate mitigation of any risks and conflicts of interest faced by the boards of NERL and NATS Holdings, the parent company of the group;
- a management of NERL that is sufficiently focussed on that business rather than the broader interests of the NATS group so that risks are not traded off between NSL and NERL;
- that the apparent culture of regulatory compliance within NERL can be easily observed by the CAA and maintained in the future;
- protection for the funds provided (indirectly) by consumers through NERL's regulated revenues for the benefit of the regulated business;
- sufficient transparency for the CAA as to the ongoing financial and operational robustness of NERL; and
- clarity and lack of ambiguity in NERL's licence obligations, so that the licence can apply with as little as possible need for consents or comfort letters.

3.5 In order to deliver these outcomes, the CAA has identified a range of potential changes to the governance and ring-fence arrangements of NERL that could address these problems and bring the regulation of NERL more into line with best practice observed elsewhere. These options are considered further in the following chapters.

Objectives of any proposed licence amendments

3.6 The CAA considers that any proposed amendments to NERL's licence should be assessed in the context of an overall objective of ensuring that the regulatory arrangements for NERL remain effective and appropriate. Regulatory obligations should be viewed as an interlocking set, which complement and support one another in the interests of consumers. The appropriateness of these rules also needs to be assessed in the context of:

- the changes to the economic and regulatory landscape that have happened in the period since the financial crisis began in 2008 and referred to in The Executive Summary and Chapter 2;
- the commercial activities of the wider NATS group and the impact on the risks affecting NERL that those activities may have;

- developments in regulatory best practice as evidenced by the arrangements used by other regulators, while being mindful of the differences between regulatory sectors;
- the need to ensure the efficacy and clarity/lack of ambiguity of the existing obligations which NERL is required to comply with (and associated compliance costs through the need to make difficult judgment calls on compliance); and
- the need to impose obligations that are “necessary or expedient” to allow the CAA to fulfil its statutory duties while imposing on licence holders the minimum restrictions or burden consistent with the exercise of those functions.

The role of consents

- 3.7 In this context, the CAA’s aim is that the relationship between NERL and the CAA should be governed, as far as possible, directly by the obligations set out in NERL’s licence and that, other than in exceptional circumstances, the licence should operate without the need for consents or comfort letters.
- 3.8 As such, we consider that, while there is a place for consents to be given to allow NERL to gain derogation from some licence conditions (in whole or part), where possible the licence should be simplified so that less regulatory intervention is needed. The issue of consents should be restricted to those circumstances in which it is truly needed, rather than to provide general comfort to NERL or its financiers.

Areas identified for strengthening the licence obligations

- 3.9 The CAA’s analysis has identified potential to amend NERL’s licence in a number of respects which would better achieve the objectives set out in paragraph 2.19 above.
- 3.10 The CAA considers that these changes fall into four broad categories:
- corporate governance (what governance will ensure that the interests of safety and consumers are adequately protected?);
 - information (what additional information/certification could NERL provide to support the objectives set out above?);