

# **AIRPORT AIR TRAFFIC SERVICES: CONSULTATION ON PROPOSED CHARGING METHODS**

## **Introduction**

The Department for Transport has asked the CAA to review the way in which airport air traffic services are charged and to advise whether direct charging of airlines should be an option at all airports or should be discontinued. There are currently direct charging schemes at Heathrow, Gatwick, Stansted, Glasgow, Edinburgh and Aberdeen. As part of that review the CAA is publishing this consultation paper to seek the views of interested parties.

There are important linkages to the current reviews of Heathrow, Gatwick, Stansted and Manchester airports under the Airports Act. Any change to the status quo would imply a revision to the airports' price caps. The CAA has therefore brought this review forward so that these issues can be resolved, or at least be nearing resolution, before the CAA makes its final decision on the airports' price caps.

## **Responses**

Comments on the issues raised in this paper and any other issues which respondents believe should be considered by this review should be sent in writing by 20<sup>th</sup> September 2002 to:

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All responses will be treated as public information unless otherwise specified. If a response is made in confidence it should indicate that.

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## Background

1. During the process leading to the establishment of the PPP certain issues were identified concerning the mechanism for payment of airport air traffic services and while the Government set up a legal framework allowing continuation of the status quo, it indicated that it expected to return to these issues in due course. The Government has asked the CAA to review the way in which airport air traffic services are charged and to advise whether direct charging of airlines should be an option at all airports or should be discontinued.
2. NATS recovers direct charges from aircraft operators for the airport element of air traffic services at six BAA-owned airports: Heathrow, Gatwick, Stansted, Glasgow, Edinburgh and Aberdeen. As there is no contractual relationship between NATS and aircraft operators for the provision of these services and the right to collect charges from foreign airlines is derived through international treaty, a statutory charging scheme is necessary to give NATS a right to these charges. Prior to the Transport Act, charges were approved by Government and set by annual statutory instruments. However, the powers to specify and promulgate charges now reside with the CAA under section 73 of the Transport Act. Payment of these charges is enforceable by powers of detention and sale for which the Secretary of State may make regulations. The CAA (but not NATS) is currently authorised to detain and, subject to the leave of the court, sell aircraft for the recovery of unpaid charges.
3. It is the airport operator that either provides the airport air traffic service itself or appoints a service provider under contract. At airports other than those above (and including various other airports where NATS provides the service) such contracts are based on the airport paying the service provider for the service which then forms part of the airport's own cost base. At the BAA airports there are contracts with NATS but these contracts have some of the characteristics of licences as, although they require NATS to provide a service, the charges are made on third parties (i.e. the operators of aircraft). These two situations present very different incentives to efficiency as discussed in paragraphs 20 and 21 below.
4. For the three BAA London area airports there are further issues raised by the London Terminal Approach charge. NATS operates these services as part of the core services under the NERL licence rather than under the contracts with the three airports. They are however "associated" with the three airport contracts in as much as the current contracts effectively place a limit on what can be charged to airlines for the aerodrome service and the London Terminal Approach charge combined. The London Terminal Approach Charge is not levied on aircraft terminating at other airports in the London area.
5. This general charging situation presents some anomalies. There is uneven treatment between air traffic services at the six BAA airports and others. The absence of a normal contractual relationship between the service provider and aircraft operators means that the regulator is required to specify charges and act as debt collector for charges relating to airport air traffic services that do not fall within the ambit of the licensed business. The BAA airports appoint the service provider but do not derive a direct benefit if the cost of the service is low, although they do have considerable interest in how NATS performs given the implication for airport capacity and service quality. The apparent discretion of the CAA in specifying charges under the Transport Act introduces an unusual element of potential regulatory risk to NATS, extending to areas outside formal regulation through the licence. Although it is

perhaps arguable that this discretion is likely to be more apparent than real, the risk nevertheless remains.

6. There are important linkages to the current reviews of Heathrow, Gatwick, Stansted and Manchester airports under the Airports Act. The legal definition of what is included in "airport charges" depends on whether or not airports have a direct charging scheme under the Transport Act for airport air traffic services. Thus at Manchester this element forms part of the regulated charges while at the three BAA London airports it does not. It follows that any change to the status quo would imply a revision to the airports' price caps. It is therefore desirable that these issues are resolved, or at least nearing resolution, before the CAA makes a final decision on the airports' price caps for the next five years. The CAA is also aware that the BAA London airports and NATS are currently negotiating new contracts that could be in effect from 2003. The contract at Manchester Airport also comes up for negotiation in 2003. It would clearly benefit the parties and users if they were aware at an early stage of what charging basis will be required for these new contracts.

### **Basis of Advice**

7. This review is expected to form the basis of advice to the Secretary of State under section 16 of the Civil Aviation Act "to provide such assistance and advice as the Secretary of State may require ... in connection with the Secretary of State's functions relating to Civil Aviation". The Secretary of State has no relevant duties under Chapter IV of the Transport Act 2000. The CAA therefore proposes that his Chapter I duties would be the most appropriate framework against which to test the options for change. These are:

- a) a high standard of safety (taking priority over the duties below);

- b) to exercise functions in a manner best calculated:

to further the interests of those using the service;<sup>1</sup>

to promote economy and efficiency on the part of the licence holder;

to secure that licence holders will not find it unduly difficult to finance activities authorised by their licences; and

- c) minimum restrictions consistent with its functions.

It should however be noted that, except for the provision of London Terminal Approach Services, the services in question are not provided under a licence granted under the Transport Act 2000. The CAA however proposes in this context to consider the economy and efficiency in the provision of air traffic services at airports generally as a relevant consideration.

8. The CAA has additional duties under Chapter I of the Transport Act to take account of the UK's international obligations and guidance on environmental objectives given by the Secretary of State.
9. In the event of a conflict in the application of the three objectives in b) above, the Secretary of State (and the CAA) must apply the provisions in the manner he thinks

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<sup>1</sup> The operators and owners of aircraft, owners and managers of aerodromes, persons travelling in aircraft and persons with rights in property carried in them..

reasonable having regard to them as a whole. The CAA would therefore propose a test of recommending outcomes that are most likely to maximise the net benefits combined to all the parties (i.e. the ultimate passengers and freight shippers, the operators of aircraft, airport operators and air navigation service providers.)

10. The PPP has created an ownership structure with The Airline Group as NATS' strategic partner and where some but not all of the participants in the downstream market have an equity interest in NATS. The CAA will need to have regard to its concurrent powers under the Competition Act 1998, to make sure that its recommendation are consistent with this role.

### **Options for Change**

11. The Department for Transport has identified two options for change:

- a) to extend the option of direct charging of airlines to all airports.
- b) to discontinue the direct charging of airlines at the six BAA airports.

The CAA believes that this review should consider a further option:

- c) to discontinue direct charging in respect of the unlicensed portion of air traffic services at airports i.e. charging the BAA airports for the airport service as at Manchester, but to retain it for that part which forms part of the core services of the NERL licence (i.e. the London Terminal Approach charge).

### **Preliminary Analysis**

12. The following considerations arise from the proposed framework.

#### *Safety*

13. The Secretary of State and the CAA both have a duty to maintain a high standard of safety and that duty takes priority. Safety is assured by the setting of standards by the CAA's Safety Regulation Group (SRG) and the monitoring and enforcement of those standards. The CAA sees no reason to believe that any of the options for charging would have any material effect on the level of safety.

#### *Interests of users*

14. The duty to further the interests of users raises two key issues: first, the protection of users from any monopolistic behaviour and secondly the transparency of cost and other information so that users can judge for themselves whether the amounts that they pay are too high, or the quality, continuity or range of services are inappropriate.
15. Through the process leading up to the PPP, the Government and the CAA took the view that aerodrome air traffic services at airports are contestable: there is the potential for competition for the market either through alternative third party suppliers or by the airport itself providing the service. However, the airport itself has the sole right to appoint an air traffic services provider and any market power that the airport has extends to the provision and pricing of this service. It should be possible to deal with any potential abuse of a dominant position through the Competition Act 1998. If it were to be demonstrated that an airport was abusing a dominant position, the Competition Act gives powers to fine the offending company up to 10% of turnover for up to three years. The CAA also has powers under section 41 of the Airports Act to impose conditions on airports that unfairly exploit their bargaining power in setting

charges. More importantly, if an airport is both subject to price cap regulation and the air traffic services provider is paid by the airport rather than directly by aircraft operators, then the payment for air traffic services is directly regulated by a price cap under the Airports Act, as with Manchester.

16. A concern which has previously been expressed by users, particularly airlines, has been the transparency of what they pay directly or indirectly to the air traffic service provider. Where there are direct charges these are transparent to the airlines. Where the air traffic service has been paid for by the airport and then recovered through its own airport charges this has not been so. Air traffic service providers have treated this information as commercially sensitive and have made it a condition of the contract that the airport does not disclose the payments made.
17. An argument that has been put forward in favour of direct charging is that users are likely to have a greater influence with the service provider than where charges are incorporated within airports' costs. However, it might be argued that such influence is more notional than real as there is little scope for users to change their supplier (other than transferring services to another airport) or to withhold charges.
18. In addition it may also be possible to separate the issue of the transparency of air traffic service cost from who pays whom. It would be open to NATS, with the airports' agreement, to make the terms of airport contracts public. If NATS did not choose to do so however it would be difficult for the CAA to require them to as the provision of airport air traffic services does not fall within the NERL licence. An alternative approach might be to make disclosure mandatory for each airport under its permission to levy charges but this would require a finding under section 41 of the Airports Act – and would probably require a test that if the airport did not do so it would be unfairly exploiting its bargaining position relative to airports generally. Finally, in practice there might be an opportunity to require the three BAA London airports to publish this information as part of the enhanced information disclosure proposals if this were made part of the revision of the airport price caps to allow the recovery of the additional costs of airport air traffic control services.
19. NATS has taken the view in the past that the publication of the contractual fee paid by an airport would prejudice its future negotiations at other airports and has treated this as commercially confidential information. The CAA seeks views on whether this is reasonable in the circumstances. While the CAA regards the market for ATS provision at airports as being contestable, NATS nevertheless often has some market power in this area. Moreover, it might be argued that where airports have substantial market power, and are subject to economic regulation, it would not be unreasonable to require them to disclose their costs for the provision of ATS which their users consider to be of considerable importance. It should also be noted that in the case of the six BAA airports the current charges levied on airlines are public and it is possible for potential competitors to make good estimates of the total revenues to NATS. A shift away from direct charging accompanied by the publication of payments under a contract would not reveal an appreciable level of additional information compared to the status quo.

### *Economy and efficiency*

20. There is a different alignment of incentives where the airport contract is based upon airlines being charged directly compared to where the airport pays the service provider. In the former the airport chooses the service provider but does not have a direct financial interest in the cost effectiveness of the service provider. In the latter, the airport has a direct financial interest in keenly negotiating the contractual charges

for air traffic services as these go into its own cost base in the same way as costs from any other outside supplier and the service provider is subject to the normal commercial disciplines to control costs.

21. The CAA believes that there are likely to be important issues in terms of the best use of resources in dealing with the dividing lines between en route navigation charges, the London Terminal Approach Charge, and aerodrome air traffic services. The approach charge is part of NATS' core licensed activities and the operational organisation of London Terminal Approach charges are such that they are highly integrated into the wider services provided by London Terminal Control currently situated at West Drayton. The cost effectiveness argument for requiring these services to be part of a contract remunerated by the airport does not apply, as the licence does not allow any competition for this market at least for the first 10 years. Further, the ATS cost structures for the congested terminal airspace around the London airports are quite different from the cost structures for en route airspace. Although it is difficult to be definitive, the incremental cost of handling more flights in London terminal airspace are likely to be much higher than elsewhere in UK airspace. If the existing London Terminal Approach Charge were to be absorbed into the Eurocontrol en route charge this would move further away from a pricing structure which promoted net benefits to the market in aggregate. Based upon these considerations there might be merit in retaining a direct charging scheme limited to the London Terminal Approach charge alone.

#### *Ability to finance*

22. While the nature of payment does not have an immediate bearing on the ability of NATS to finance its licensed activities, it does have some bearing indirectly through the incidence of regulatory risk. The Transport Act gives the CAA the function of specifying NATS' charges. This appears to give the CAA a wide potential discretion. While the CAA does not plan to exercise that discretion in any currently foreseeable circumstance, NATS nevertheless depends on the CAA to specify charges and to enforce the collection of debts even in respect of the charging scheme for airport air traffic services that is not formally subject to economic regulation. This is an unusual role for the regulator and one that could be supposed to imply some degree of regulatory risk for NATS and its investors and lenders.
23. Given that the rights and obligations to provide air traffic services flow from international treaties, some form of endorsement by a public body seems inevitable to justify charges that are given effect by statutory schemes. It could be argued that the extent of these schemes should be limited to a minimum and where possible recovery of charges and the enforcement of payment should be achieved by more commercial relationships, particularly where those statutory charging schemes would not themselves be subject to economic regulation. Where the air traffic services contract is based on contractual payments from the airport to the air traffic service provider that relationship is within the UK jurisdiction of normal contract law.

#### *Minimum Restrictions*

24. Where there are direct charging schemes the regulator is clearly drawn into areas that would otherwise be outside the ambit of regulation. Direct charging schemes extend the potential for the regulator to restrict the business.

#### *International obligations and environmental issues*

25. These options do not appear to raise issues in respect of these areas.

## The CAA's Preliminary View

26. On the basis of the analysis above the CAA's preliminary view is that there would be significant net benefits in discontinuing separate charging schemes for airports ATS but that there does appear to be a prima facie case for retaining direct charges for the London Terminal Approach service which is part of the core services provided through the NERL licence. However, before coming to its decision as to the recommendation it will make to the Secretary of State, the CAA wishes to understand and take into account the views of consultees.

## Implementation

27. Section 77 of the Transport Act gives the Secretary of State discretion to designate or de-designate the airports which have direct charging schemes, by order. The Secretary of State also has the power by order to amend the definition of chargeable air services. There does not, therefore, appear to be any impediment to implementing any of the options under the existing legislation.

## Next Steps

28. The CAA proposes the following timetable for this review:

Issue consultation paper	18 July
Responses by	20 September
Advice to Secretary of State	By end October

This is designed to allow the prospect of either knowing the outcome of the Secretary of State's review or for it to be sufficiently advanced to take a contingent view, if necessary, of the outcome when the price caps for Heathrow, Gatwick, Stansted and Manchester are set.

## The Views of Parties

29. The CAA invites comments on any of the issues raised in this paper and any other issues that respondents believe are material to this review.

Revised  
5 August 2002