Assessment of Contestability under Annex 1 of the Air Navigation Services Charging Regulation (EC) No 1794/2006

Contents

Executive Summary

Background

1. This Assessment analyses whether provision of air navigation services (ANS) at UK airports is *contestable*. The Assessment considers a range of criteria, set out in the Charging Regulation under the Single European Sky[1], before reaching an overall view on whether a framework exists which enables ANS provision to be contested.

2. The Economic Regulation Group (ERG) in the Civil Aviation Authority (CAA) was asked to undertake this Assessment by the Department for Transport (DfT), and to report back by the end of January 2008[2]. This Assessment has been undertaken with significant stakeholder input informing the findings. DfT will now consult formally on this, and related issues under the Charging Regulation. We set out our approach to this Assessment in the Introduction to this document.

Key Findings

3. We found that in broad terms the conditions and framework for contestability, as defined in the Charging Regulation[3], exist in the UK. There have also been a number of changes in ANS provision at airports in the last 10 years, confirming that a framework exists to enable changes in ANS provision to occur where airport operators decide this makes commercial sense. The majority of airports we gathered evidence from also told us that, even where they had not changed air navigation service provider (ANSP), they had actively considered different options, while many also highlighted recent regulatory changes in Europe and the fact this creates a framework to facilitate the entry of providers from across the EU. While the Assessment found that NSL[4] has a strong presence in the provision of ANS at UK airports, particularly at the largest airports, a framework is in place to support contestability. Six airports in the top 20 (by Air Traffic Movements) currently self-supply their ANS, and further down the scale most airports self-supply, while a few have an alternative third party supplier.

The Overall Framework Supports Contestability

4. In broad terms, the Assessment found key aspects of the framework are in place to support contestability. Key points are:

(i) Significant competitive pressures exist in the UK which incentivise airports to focus on costs and levels of service, including ANS provision. These pressures ensure that airports regularly review their ANS provision and consider the different options open to them.

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[1] Commission Regulation (EC) No 1794/2006 of 6 December 2006 laying down a common charging scheme for air navigation services. The Contestability Assessment criteria are set out in Annex I.
[2] Some minor revisions have been made to this document prior to publication to reflect developments in related policy areas. However, the substance of the Assessment of Contestability is unchanged from the document presented to DfT in January 2008.
[3] In assessing contestability, we are obliged to assess whether the framework in place to enable provision of ANS at airports is *capable of being contested.* This is distinct from an assessment of the *level of competition* currently in evidence.
[4] NATS Services Ltd.

(ii) The costs for an ANSP of either offering to provide (or withdraw) services are broadly proportionate to the value of the contract on offer. We found no evidence of significant cost barriers to ANSPs offering or withdrawing from service provision, and contract duration (generally at least five years) should ensure the contract value is sufficient to justify any up front costs associated with offering to provide services.

(iii) ANS assets tend to be held either by airports or leasing companies, with provisions generally in place to transfer use of assets if the ANSP were to change. TUPE (Transfer of Undertakings Protection of Employment) legislation creates a clear framework for staff transfer.

(iv) Airports are free to change ANS provider, including moving from outsourcing to self-supply. Evidence also suggests that, even where an airport has had the same supplier for a significant period of time, they are likely to consider different options periodically.

(v) Contracts are generally for periods of five to ten years (sometimes longer) but usually contain clear break points and review processes, enabling change in the event of unsatisfactory performance.

(vi) Recent changes to the EU regulatory framework should facilitate provision across EU boundaries in future. The EC Common Requirements Regulation (2096/2005) should aid the potential entry of ANSPs from other Member States seeking to win ANS contracts at UK airports in future. There is already evidence from Germany of Austro Control moving into a number of German regional airports.

Other Factors to Consider

5. Overall, we judge that the provision of ANS at UK airports meets the Contestability criteria set out in the Charging Regulation. However, in gathering evidence from stakeholders, a number of areas and issues where possible obstacles – either real or potential – may exist were brought to our attention, and we summarise these below. While we do not judge that these issues materially affect contestability overall, we set out a number of observations and suggestions for consideration by industry, which we believe could help address those issues, and potentially deliver benefits for the industry as a whole.

MATS Part 2

6. Many stakeholders have raised with us the importance of the Manual of Air Traffic Services ('MATS') Part 2 document. This document sets out unit specific operating instructions and procedures, which safety regulations require ANSPs to prepare prior to providing services at a particular aerodrome site. Although it would be possible for a new provider to draw up this document from scratch (hence there is no absolute barrier to entry), it could be resource intensive. It would clearly be easier if the new provider could get access to the previous incumbent's MATS Part 2 in order to draw on its contents. In response, we would draw attention to the advice the CAA Safety Regulation Group give[5] that airports should take appropriate steps to ensure that MATS 2 and other important assets are available to a new entrant at a change of contract. This is something an airport operator could seek to address during the contract negotiation with the ANSP.

[5] CAP 670, Air Traffic Services Safety Requirements (Part A, Section 6.1. Part A, page 11) (www.caa.co.uk/application.aspx?catid=33&pagetype=65&appid=11&mode=detail&id=200)

Tendering Issues

7. While there are no barriers to contestability associated with tendering regulations, we are aware that, at present, airports do not typically tender when contracts with incumbent ANSPs come up for renewal. In many cases, airports will conduct their own in-house assessments, and in some cases may use external consultants to advise them on potential alternative providers, before coming to the view that they wish to renew the contract with the incumbent supplier. The absence of open tendering may make it more difficult for ANSPs, especially those from outside of the UK, to gain access to commercial opportunities. More use of open tendering could therefore be a useful support to contestability.

Supply of ATCOs

8. Stakeholders have also raised with us the issue of a perceived shortage of Air Traffic Control Officers (ATCOs). Such a shortage has been argued to run the risk of entrenching incumbent suppliers by increasing the cost to a new entrant of either moving existing staff across under TUPE, or bringing in new staff. We do not consider that ATCO costs are a barrier to contestability, as these cost pressures are faced equally by all ANSPs. We also note that the ATCO Directive[6] is due to be implemented in the UK in July 2008 and this will represent an important step towards facilitating the movement of ATCOs across EU borders. Over time, one might expect the Directive to help in mitigating any perceived shortfalls, or industry to take the necessary steps to ensure increased supply of ATCOs.

Vertical Integration

9. We have also considered the issue of vertical integration within the ANSP sector, and how that might impact on contestability of ANS at airports. The sole en-route service provider in the UK is NERL[7]. The company operates under licence in regard to the bulk of its air traffic control operations[8] and is price-controlled by the CAA in respect of its Eurocontrol, London Approach and Oceanic businesses. Where NSL is the airport service provider, service provision is vertically integrated (under the NATS umbrella) and as part of the Assessment we have explored the protections in place to ensure that other airport ANSPs (whether the airport themselves where self-supplying, or an alternative third party supplier) are assured of fair access to the en-route airspace controlled by NERL. We consider that the existing regulatory framework provides adequate protections to ensure this, though not all stakeholders may be fully aware of them.

10. Should concerns arise there are safeguards for stakeholders in the form of the NERL Licence conditions and obligations, the protections in the Transport Act 2000[9](TA2000), and the CAA's Directorate of Airspace Policy's (DAP) statutory duties to secure the most efficient use of airspace and satisfy the requirements of

[6] http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_114/l_11420060427en00220037.pdf
[7] NERL or NATS En-Route plc is a subsidiary of NATS Holdings Ltd, as is NATS Services Limited (NSL).
[8] The NERL Licence granted by the Government in 2001 gives NERL a 10 year monopoly in regard to its Eurocontrol, Oceanic and 'London Approach' services. *Non*-'London Approach' radar control, provided by NERL at airports other than Heathrow, Gatwick and Stansted, is not a monopoly service under the licence, although this activity is permitted by the licence. There is more on this on page 35.
[9] http://www.opsi.gov.uk/Acts/acts2000/pdf/ukpga_20000038_en.pdf Section 70(2)(a)

operators and owners of all classes of aircraft. The existence of UK and EU competition law also acts as a restraint on NATS' behaviour.[10]

Configuration of Infrastructure in London

11. We have also considered the nature of ANS provision at airports in the London area, which differs from the rest of the country. NERL is the monopoly provider of the Approach Control radar service to major London airports. This service is provided from a central site at Swanwick in Hampshire. The specific Approach Control service NERL provides in relation to Heathrow, Gatwick and Stansted is known as the 'London Approach', and is a core service within the overall NERL price controls and NERL licence. Only the visual (tower) control (i.e. the Aerodrome Control service) is delivered directly at airports by the relevant airport ANSP.

12. For the purposes of this Assessment, we consider only the Aerodrome Control service to be within scope, as the Approach Control service is not delivered 'at airports', but rather from a remote location as part of the London arrangements. However, we have focussed on whether the centralisation of the Approach Control, delivered as a monopoly service by NERL, materially impacts the contestability of the Aerodrome Control service at London airports. We conclude that the provision of the Aerodrome Control service remains contestable, and note that where an ANSP offers to provide services at an airport in the London area, it would provide the Aerodrome Control service itself, and, in all likelihood, obtain the Approach Control service from NERL.

Summary

13. In summary, this Assessment finds that the conditions for contestability, set out in the Charging Regulation Annex 1, have been met and **the conditions and framework for contestability exist**. Our Assessment also explores a number of issues raised with us and we set out a number of observations and suggestions for consideration by the industry, which we believe would deliver benefits for the industry as a whole.

14. We recommend that, subject to the outcome of formal consultation on Charging Zones by the Department for Transport, the reduced regulatory requirements permitted in the Charging Regulation in respect of terminal charges at airports between the thresholds of 50,000 ATMs per year and 150,000 per year can be applied.

[10] In order for European competition law, and the Competition Act, to apply the enterprise concerned has to be an "undertaking". It was drawn to the CAA's attention that it might not be the case that providers of aerodrome air traffic services are undertakings that are subject to competition law. The CAA is not, however, in a position to come to a definitive view on this question which can only be determined by the courts. For more information see http://www.caa.co.uk/docs/5/ATSCompetitionLaw040406.pdf

Introduction and Policy Background

Introduction

1. The Charging Regulation[11] sets out regulatory requirements for the disclosure of costs, the calculation of charges and the setting of unit rates for the provision of air navigation services (ANS). The Regulation includes provision for a Contestability Assessment, which Member States can carry out in regard to the provision of ANS at airports. If contestability is demonstrated, the Member State can apply a reduced set of regulatory requirements in respect of ANS provision at airports between 50,000 and 150,000 air traffic movements (ATMs) per year. The UK has decided to conduct an Assessment as the UK's view is that where contestability exists, a lower level of regulatory oversight is more appropriate. In 2006 the UK had four airports above the 150,000 ATM threshold, and a further nine airports between 50,000 and 150,000 ATMs.

2. The Department for Transport (DfT) asked the Civil Aviation Authority (CAA) to take forward the Assessment for the UK. The CAA is the UK's aviation regulator and exercises functions in Safety, Airspace, Consumer Protection and Economic Regulation, and acts as an expert adviser to Government on aviation. The CAA also has concurrent competition powers under the Transport Act 2000 and the Enterprise Act 2002, along with the Office of Fair Trading (OfT), to address anti-competitive conduct of providers of services and to recommend aspects of that market to the Competition Commission for investigation. Consequently, the CAA has powers both to enforce the prohibitions on the abuse by an undertaking of a dominant position and to refer aspects of the air traffic services market to the Competition Commission if it has reasonable grounds for suspecting that a feature of the market prevents, restricts or distorts competition.[12] During the Assessment the CAA did not find any evidence that would lead it to consider exercising the CAA's competition powers. Should such evidence come to light in future the CAA would consider it.

3. The Economic Regulation Group (ERG) in the CAA has undertaken the Assessment. ERG exercises functions in a number of areas, including setting the periodic price controls for both designated airports and NATS En-Route (NERL), while also advising the Secretary of State on a number of other economic issues.

Policy Background

Development of the UK Civil Aviation Industry

4. UK civil aviation began to develop significantly from the 1960s, with the growth of leisure traffic and charter flights for holidays. Until that time, the Ministry of Defence had had a significant interest in all airports. However, commercial operations grew and, while airport ownership remained with central Government or was passed to local Government authorities, the ownership role became increasingly complex, which led to new solutions being sought. In 1965 the Airports Authority Act led to the creation of the British Airports Authority, which assumed control of Heathrow, Gatwick, Stansted and Prestwick in 1966 and then Edinburgh, Aberdeen

[11] Commission Regulation (EC) No 1794/2006 of 6 December 2006 laying down a common charging scheme for air navigation services

[12] See footnote 10 concerning whether providers of aerodrome air traffic services are undertakings that are subject to competition law.

and Glasgow during the period 1971-75. In 1986, the Airports Act enabled the assets of the British Airports Authority to be transferred to a new company BAA, which was floated the following year. Subsequently, BAA purchased Southampton in 1990 and sold Prestwick in 1992. BAA was acquired in 2006 by a consortium in which Grupo Ferrovial hold the major stake. Airports outside of the BAA group have also increasingly moved into private hands, though the Manchester Airports Group (owning Manchester, Nottingham East Midlands, Bournemouth and Humberside airports) remains owned by a group of local authorities.

5. Air Traffic Control (ATC) was historically the responsibility of the Ministry of Civil Aviation but National Air Traffic Control Services (NATCS) was established in 1962 as a unified body, covering civil ATC while also liasing with the MoD where military traffic needed to cross civilian routes. NATCS became National Air Traffic Services (NATS) when it was made part of the CAA when that was established in 1972, before being reorganised as a wholly owned subsidiary of CAA in 1996. The Transport Act 2000 then provided the basis for NATS to be taken out of public control through a Public-Private Partnership (PPP) arrangement in 2001, with 46% of the shares going to the Airlines Group, a consortium of UK airlines, and 5% to staff, the Government retaining the balance of 49%. NATS was also divided into two distinct operating entities – NATS En-Route Ltd (NERL), which principally provides en-route services, and NATS Services Limited (NSL), which provides terminal (i.e. airport) ANS. Following September 11 and its impact on demand for air services, and therefore revenue to ATS, the Government invested further in the company and BAA took a 4% shareholding in 2003[13].

Provision of Air Navigation Services (ANS) at UK Airports

6. Historically, air navigation service provision at airports was conducted on a self-supply basis at each airport (i.e. the airport supplied ANS itself). However, after NATS was established, it built up a strong presence in the market, developing particular expertise at larger airports, operating in congested airspace and perfecting the interfaces between en-route and terminal services. Since 2001, NSL has expanded its portfolio, taking on a number of airports that had been self-supplying, such as Bristol and Luton. Serco also provides services at a number of sites, albeit typically at smaller civil and military aerodromes in the UK, although it does provide ANS at a number of larger overseas sites, such as at 54 air traffic control towers in the US, and at Abu Dhabi and Dubai airports in the Middle East. The industry also has a significant number of self-supplying operations. Manchester Airports Group (MAG) self-supplies at East Midlands, Bournemouth and Humberside, while Liverpool airport is now a self-supply operation with Peel Holdings (the airport owner) providing airport ANS, while Peel also self-supply at Durham Tees Valley and Doncaster Sheffield. Meanwhile, Infratil own and self-supply ANS at Glasgow Prestwick and Kent International, with Highland and Islands Airports Ltd (HIAL) self-supplying at 10 sites in Scotland[14].

[13]There is more detail on the NATS website history page at: http://www.nats.co.uk/text/129/our_history.html

[14] HIAL has recently acquired Dundee Airport, but the ANS at that airport is currently supplied by Dundee Airport Ltd.

ANSP at Airports – the Basics

7. Air navigation service provision at UK airports typically consists of an Approach Control service, either based on radar or on procedural control techniques (which rely on aircraft reporting their position in relation to ground-based navigation aids and approved procedures), together with an Aerodrome Control service. The Approach Control radar service involves air traffic controllers directing pilots descending from the en-route (cruise) controlled phase, typically from a distance of around 40 miles from the airport. Once aircraft come within around 10 miles of the airport they will be passed to the aerodrome controllers for their final descent to the runway. At the busier airports, aerodrome controllers are split into air control and ground control, the latter of which guide the aircraft to its parking stand once it has landed. The precise point at which the transfer to the Approach and the Aerodrome Control occur will vary from one airport to another and from time to time depending on specific conditions on the day e.g. weather. The same division between the radar and visual service will apply for aircraft taking off from the airport concerned.

8. The situation in the London area is distinct from the rest of the country as NERL supplies a centralised London Terminal Control (radar) service, provided out of Swanwick covering lower airspace in South East England. This centralised service includes services that at airports outside of London would be supplied by air traffic controllers in the ATC unit. These services are provided within a smaller area around the London Airports known as the London Terminal Manoeuvring Area (TMA). Given the complexity of airspace in and around the London area, and the number and nature of aircraft movements within it, such a centralised and co-ordinated service is considered to be the safest, most efficient and most economic means of providing approach control. This area would typically control planes from around 80-100 miles from their airport of destination, further out than Approach Control elsewhere in the country, to within around 10 miles, before handing them over to the Aerodrome Control service at the specific airport in question. Included within the London TMA is the London Approach service for Heathrow, Gatwick and Stansted.

The London Terminal Control Service and Regulation of the London Approach

9. The London Approach service is conducted by NERL under a licence from Government initially granted for a minimum period of 30 years (i.e. until 2031) with NERL exclusivity until 2011. Since 2006 the cost base for the London Approach Service for Heathrow, Gatwick and Stansted has been included within the assessment of the CAA's Price Control of NERL[15]. The provision by NERL of the Approach Control service for the other London airports within the TMA is authorised under NERL's Licence but is not directly regulated. For example, it is not price controlled.

How the London Terminal Control Service is Considered in the Contestability Assessment

10. Any services provided by London Terminal Control are considered, for the purposes of this Assessment, to be out of scope, as this radar service is not

[15] Under the Licence the CAA sets price controls in five yearly periods. The London Approach charge levied by NERL for Approach Control for flights in and out of Heathrow, Gatwick and Stansted is part of the CAA price control.

delivered 'at airports', but rather from the London Area Control Centre at Swanwick. However, we have focussed on the issue of whether the centralisation of radar provision, delivered as a monopoly service by NERL, materially impacts the contestability of the Aerodrome Control service at London airports. We conclude that the provision of this service remains contestable. These issues are covered in detail at section 3(i).

Issues Around 'Unbundling' of ANS

11. In analysing the provision of ANS it is clear that there is a range of distinct services, from the en-route service provided almost exclusively[16] for the UK by NERL, to radar or a procedural approach to Aerodrome Control, which are provided by a range of providers. Whereas in many EU and non-EU countries these services are provided by a single, vertically integrated company, in the UK such services have been 'unbundled' into separate services. So while there is a single en-route provider, there is a range of providers of radar and tower services, though in London, as set out above, the radar approach provision has been centralised, and NATS (NERL and NSL) currently provide all the services – en-route, approach radar and Aerodrome Control - for flights into major London airports.

12. The High Level Group report on the future of aviation regulation[17] recommended that greater competition and unbundling could offer efficiencies and improved performance. In a UK context, there may be scope in future for changes. Depending on specific circumstances, this could take the form, for example, of consolidation of radar provision as has happened in London (e.g. to gain efficiencies in increasingly complex areas of airspace within which a number of different airports operate), or for Approach and Aerodrome Control contracts to be let to different providers. This is something that happened in respect of Liverpool airport (where there was a LIVRAD position at the Manchester Area Control Centre (ACC) to provide the radar approach service, while Serco provided the tower service at Liverpool Airport) but we are not conscious of it happening anywhere else. We are not aware of barriers in the regulatory or legal framework which would prevent such innovations. Other potential forms of unbundling include separation of the ATS provision from the technical infrastructure which supports it.

The Contestability Assessment

Coverage of the Charging Regulation

13. For terminal ATC services, the regulation stipulates that ANSPs at airports with more than 150,000 commercial air transport movements (ATMs) per year must comply with the full provisions of the Regulation and set unit rates and disclose information accordingly. ANSP services provided at airports below 50,000 ATMs per year can be exempted from the Regulation and the UK has already confirmed in writing to the Commission its intention to do this. The UK has also notified the Commission of its intention to defer the application of the regulations to terminal charges for all airports (including those above 150,000 ATMs) until 1 January 2010.

[16] MoD provide some services on behalf of NATS in the en-route phase of flight.
[17] http://ec.europa.eu/transport/air_portal/hlg/doc/2007_07_03_hlg_final_report_en.pdf

This approach has been taken to enable the Assessment and the establishment of Charging Zones[18], which are interlinked, to be taken forward together.

14. As set out above, Member States have the option of conducting a Contestability Assessment, and where it can be demonstrated that provision of ANS at airports is contestable, a reduced regulatory requirement is placed on ANSPs at airports between 50,000 and 150,000 ATMs per year. More limited, higher-level, information about the cost base must be provided along with limited information on the charging mechanism.

15. In addition to consulting on the CAA's advice on contestability, the DfT will also consult on the establishment of Charging Zones[19].

CAA Methodology for Approaching the Contestability Assessment

16. Annex 1 of the Charging Regulation provides a clear framework, with four high-level questions, and sub-questions below each. The four high-level questions focus on the extent to which:

- ANSPs can freely offer to provide or withdraw from ANS provision at airports
- Airports can freely determine the provider of their ANS, including the option to self-supply
- There is a range of ANS providers from which airports can choose
- Airports are subject to commercial cost pressures or incentive-based regulation.

17. The main body of the Assessment (from page 12 onwards) goes through each question in turn.

18. We have conducted an Assessment of the provision of ANS at UK airports which is broad-based and industry wide. This allows consideration of issues in the round, and also makes the Assessment more robust to future developments (e.g. airports moving above the 50,000 ATM threshold). We do not consider it would have been feasible or appropriate (in terms of the requirements of the Test) to seek specifically to assess contestability at each of the nine airports between the 50,000 ATM and 150,000 ATM thresholds in 2006, and we judge it is not the intention of the Regulation that Member States consider contestability airport by airport. We have therefore adopted a methodology that looks at whether a contestable framework is in place at the broad industry level.

19. The Assessment does not seek to define a 'market' or assess dominance[20] (in a way that might be relevant for a Competition Act case). Instead, it follows the approach stipulated in Annex 1 of the Charging Regulation, and looks at the provision of ANS, and the key aspects of the 'framework' that impacts on it, across the UK as a whole, without reference to the possible existence of distinct sub-markets (i.e. groups of airports). We judge that this is consistent with the requirements of the Regulation, though where issues of particular relevance to

[18] For more information on charging zones see Article 4 of the Regulation: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_341/l_34120061207en00030016.pdf
[19] A charging zone is an airport or group of airports for which a single cost base and a single unit rate are established.
[20] 'Dominance' in this sense has a particular meaning – see 'Assessment of Market Power', Office of Fair Trading, December 2003

service provision at airports from 50,000 to 150,000 ATMs per year arise, these are considered in more detail.

20. In judging contestability, it is also important to consider the nature of the industry itself. Clearly, some sectors of the economy (e.g. provision of take away food) are by their nature likely to be more contestable than others (e.g. aircraft manufacture). This will be due to factors such as level of entry costs, economies of scale from large-scale production, and the level of expertise, experience and reputation required to deliver the service. In assessing contestability of ANS provision at airports the specialised nature of the industry should also be taken into account.

21. Finally, we have included, at Annex A, a one page grid which sets out an illustrative framework of indicators of contestable ANS provision against non-contestable provision. This seeks to serve as an aid to understanding, and to our work on this Assessment.

Issues Around Confidentiality

22. In conducting the Assessment, we needed to gather information of a confidential nature from stakeholders. We made clear to the parties concerned that this information would be treated in strict confidence and would be anonymised before being publicly presented. Stakeholders were given the opportunity to view specific, commercially sensitive areas of the document prior to the completion of the final version.

Key Milestones for the Assessment

23. We conducted the Assessment through a mix of desk-based research, and gathering evidence from stakeholders. Key milestones in 2007 were:

- a briefing seminar at CAA House on 17 May.
- a written questionnaire sent out on 2 July, for response by 17 September.
- a series of bilateral meetings held over the summer; and
- a workshop to discuss emerging evidence on 26 October.

24. Further details of the consultation process are set out on the CAA website[21]. We would like to thank all those who have given their time in support of this work.

25. The remaining sections of this paper will now consider the specific questions set out in Annex 1 of the Charging Regulation in turn.

[21] http://www.caa.co.uk/default.aspx?catid=589&pagetype=90&pageid=7963

1. Extent ANSPs can freely offer to provide or withdraw from provision of ANSs at airports.

Summary

Section 1 of the Assessment considers four specific questions which impact on the extent to which ANSPs can freely offer to provide or withdraw from provision of ANS at airports. Key conclusions are:

- There are a number of costs associated with offering to provide services, but these are proportionate to the contract value. 'Phase-in' costs are typically recoverable as part of the contract. We found no evidence that the economic factors involved in an ANSP offering to provide service or withdrawing from service at an airport are a material barrier to contestability.
- There are a number of legal and regulatory requirements which an ANSP has to meet in providing ANS. However, these requirements are the same for all providers and therefore this Assessment does not judge that any of the requirements act as a barrier to contestability.
- The recent development of an EU wide certification process for ANSPs has also created a framework which should facilitate the potential movement of ANSPs across national boundaries in future.
- There is no barrier to contestability associated with tendering regulations. However, airports do not typically tender ANS contracts at present, and more open tendering in future could be a useful support to contestability.
- Contracts between ANSPs and airports are typically between five and ten years, though some may be longer. Such duration can act to aid contestability by ensuring the value of a contract to an ANSP makes any costs associated with offering to provide service worthwhile.
- Contracts typically have break points and review clauses, and this both puts pressure on performance and ensures that provision could be opened up to other parties in the event of failing performance by the incumbent provider.
- Where airports self-supply ANS, there is typically no contract in place. Instead, the ANS provision functions like a department of the airport. In these circumstances airports are free to contract with a third party ANS provider if they decide to, and there are recent cases of such a change.
- ANS assets are typically owned by the airport or the leasing company, rather than ANSP. These arrangements aid contestability as they make it easier to change supplier. This Assessment found that contractual stipulations are typically in place allowing ANSPs access to assets.
- The MATS Part 2 and associated safety documents are important assets to take into account when there is a change of ANSP at an airport. In our view it would be in the interest of airports to consider treating MATS Part 2 and related safety documents in line with the guidelines published in CAP 670 (to ensure that appropriate arrangements for a transfer of ANSP have been made and ownership of the MATS Pt 2 is addressed), as this would help them to safeguard airport-specific assets and ease any future change of ANS provider.
- The UK legislation on the Transfer of Undertakings (Protection of Employment) (TUPE) creates a clear framework for staff transfer, and this has been used successfully to transfer ANS staff on a number of occasions.

Costs Associated with Offering Services

1.1 In offering to provide air navigation services at a specific aerodrome, the evidence we have gathered suggests there are a number of specific steps which are likely to be needed, all of which will imply costs. Typically these include:

- A site visit by relevant staff members, including inspection of equipment in situ.
- Review and analysis of operations.
- Preparation and costing of a bid document.
- Negotiation of the contract.

1.2 These costs, which would not be recouped in the contract, will be variable and depend on the method of tendering and the size and complexity of the task. However, the evidence we have suggests the process might take up somewhere between 100 and 200 person days, and the monetised costs would be likely to be no more than 1% of the total contract value, and perhaps as little as 0.5%.

Phase-in Costs

1.3 Once an agreement has been reached to provide services then a number of other 'phase-in' costs are likely to be triggered. If existing staff are being retained but transferred across to the new provider then arrangements are likely to be more straightforward. But there would still be costs, which are likely to include:

- The development of requisite safety management systems (SMS) (e.g. any costs associated with acquiring/developing the 'MATS Part 2' – see section 1(iv)).
- Hiring or relocation of an experienced ATS manager.
- Any costs associated with the transfer of assets (e.g. taking over use of assets leased from third party where such arrangements are in place with the exiting ANSP).
- Any costs associated with the transfer of staff under the Transfer of Undertakings, Protection of Employment (TUPE) provisions, from the previous incumbent ANS provider.
- Any capital costs associated with infrastructure, which fall to the ANSP itself.
- Possible costs associated with running a reduced service for an initial phase until all staff are fully site-trained.
- Costs associated with establishing a phase-in team on site.

1.4 These phase-in costs would be likely to be as much or more than the bidding costs above, and payment for the incumbent's MATS Part 2 (if required) could push that cost up. However, we understand all these costs would be likely to be paid by the contracting airport as part of the contract, either up front or over the contract life. As such, we would not expect them to act as a barrier to offering provision and entry.

Staff Costs

1.5 Where an ANSP is taking over provision at an aerodrome which is active, existing staff would normally transfer across under the auspices of the Transfer of Undertakings (Protection of Employment) (TUPE) legislation – see section 1(iv) below. Costs associated with the TUPE process would not be significant in the overall context of the contract, and again, such costs would be expected to be

factored into the price of the contract. If the incumbent ANSP were moving out and taking its staff, the costs (and risks) would be greater for the entrant ANSP, especially in regard to the recruitment and training of new staff. Costs would include:

- Hiring or relocation of ATCOs
- Analysis of staff training needs
- ATC training costs, including site-specific validation
- Possible lower revenues (to both airport and ANSP) associated with running a reduced service for an initial phase until all staff are fully site-trained.

1.6 Transferring staff across from another site elsewhere in the company's portfolio could be cheaper than recruiting new staff from the open market, as the ANSP would avoid some of the recruitment and training costs. However, the ANSP would still potentially face relocation costs, and would presumably need to recruit replacement staff at the other site, unless that site was no longer requiring as many personnel. **The most likely approach in practice is for staff to transfer across to the new provider when the ANSP changes. There are established practices for facilitating this, and costs would be incorporated in the contract. In working on this Assessment, we did not come across any examples of a new provider bringing in a whole new set of ATC staff on taking over provision.**

Costs Associated with Withdrawing Services

1.7 Costs an ANSP would face in withdrawing from service provision would depend on the specific circumstances:

- If the ANSP owned some or all of the assets, then it may incur some costs in negotiating terms and conditions for the sale or release of those assets. At the extreme, if the incoming ANSP did not purchase those assets they may need to be written off.
- The ANSP may incur costs in negotiating the sale to the entrant ANSP of some or all of the SMS documentation (e.g. MATS Part 2). These costs would be likely to be outweighed though by the fee that the ANSP could be expected to charge.
- If the ANSP was exiting with its own staff, then it would incur costs in relocating or making redundant those staff. These costs would not arise if staff were passing across to the new ANSP under TUPE, which we judge as by far the most likely scenario.
- There may be costs associated with closing down IT systems.
- If termination and exit were occurring ahead of the end of the contract then early termination costs may apply.

1.8 We understand these costs could vary depending on the circumstances of the exit of the ANSP, and could be higher if the ANSP were exiting due to breach of contract conditions. Overall, though, **we did not find any evidence that the costs of potential future withdrawing of service acted as a barrier to contestability of ANS provision. We are also aware that on exiting from provision, an ANSP may be able to gain a fee for passing across specific safety systems material (e.g. MATS Part 2).**

How Significant are the Costs Associated with Offering and Withdrawing From Service Provision?

1.9 Based on the evidence presented to us by stakeholders, and the views they have expressed, we do not consider that the costs associated with offering to provide or withdrawing service provision are disproportionate to the value of the contracts on offer. Where we have been presented with monetised costs, they have either been proportionate to the value of contracts (e.g. costs associated with the bidding process), or have been chargeable against the contract (e.g. phase-in costs). Contracts in this industry are typically of at least five years, and this ensures that the cost of offering to provide, and the possible risk of costs associated with exiting, can be recouped and an acceptable return made. There is more detail on contracts in section 1 (iii).

Have these Costs Changed Over Time?

1.10 We encountered differing views on whether the costs associated with offering to provide or withdrawing from service provision have changed over time. Overall there was no clear majority view. A number of stakeholders have highlighted what they view as increased regulatory costs related to increased requirements around corporate governance and safety regulation (e.g. linked to safety management systems). These costs, some of which are one-off, would apply to all ANSPs, though conceivably could have less of an impact on larger providers which could achieve economies of scale.

1.11 However, many stakeholders stated that either costs have not increased or they have only increased in line with contract values. A number also highlighted the increased willingness of airports to consider changes to supplier (due to competitive pressures on them), and the fact that this willingness should lead to mechanisms to facilitate such changes of supplier being progressively introduced in contracts, which should itself reduce costs and complexity associated with changing supplier in future. Implementation of the Common Requirements could also be a future source of reduced costs for ANSPs certificated elsewhere in the EU, as they would not need certification in the UK (though would still need site-specific designation).

1.12 All stakeholders agreed that staff costs have increased in recent years, and the particular issues arising from this are discussed further in Section 3(i). With the likely use of TUPE to transfer staff in the event of a change of provider, costs associated with entry or exit (as opposed to ongoing salaries) may not have changed significantly.

Summary

1.13 The Assessment did not find evidence of significant economic barriers to an ANSP offering to provide service or withdrawing from service at an airport. There are some costs to be borne, but evidence and information we have gathered suggest these costs are proportionate to the value of contract on offer, and do not act as a barrier to contestability.

1. (ii) existence of significant legal barriers preventing an ANSP from offering or withdrawing from provision of ANSs.

1.14 In this section, the Assessment considers potential legal and regulatory barriers together.

Potential Barriers to ANSPs Offering to Provide Service

Tendering Issues

1.15 There are no legal barriers in regard to tendering which could prevent an ANSP from offering or withdrawing from provision of ANS. ANSPs are free to offer to provide or to withdraw from provision as they see fit on commercial grounds.

1.16 We are aware from discussions with stakeholders that airports do not typically tender when contracts with incumbent ANSPs come up for renewal. In many cases, airports will do their own in-house assessments, sometimes using external consultants to advise them on alternatives, before coming to a view on whether or not it would be worthwhile to tender or instead renew the contract with the incumbent supplier. While this does not represent a structural barrier to contestability, the absence of open tendering may make it more difficult for ANSPs, especially those from outside of the UK, to gain access to commercial opportunities and as such, greater use of open tendering could be a useful support to contestability.

Certification and Designation

1.17 The second issue to consider is possible barriers relating to the regulatory requirements around certification and designation. These are the European legal requirements for ANSPs stemming from the Service Provision Regulation (certification and designation) and the Common Requirements Regulation (with its detailed certification requirements).

Certification

1.18 Certification is a set of generic requirements designed to create a level playing field for ANSPs, enabling them to offer their services throughout Europe on the basis of a mutually recognised certificate. These requirements cover areas such as safety systems, insurance, and financial and economic tests. Once an ANSP is certified under the Common Requirements, the UK is obliged, under the terms of the Service Provision Regulation[22], to recognise Certificates issued by other Member States. This new framework should make it easier in future for an ANSP from one Member State to offer to provide services at an airport in another Member State. However, a certificated ATS provider can only provide such services at a specified unit or centre if it is also designated by the Member State concerned for provision at that specific site – a function which in the UK has been delegated to the CAA as the UK's National Supervisory Authority.

[22] See Article 7, paragraph 8 of Commission Regulation (EC) No 550/2004 of 10 March 2004 on the provision of air navigation services in the single European sky (http://eur-lex.europa.eu/LexUriServ/site/en/oj/2004/l_096/l_09620040331en00100019.pdf).

Designation

1.19 Unlike certification, designation is a matter of national discretion in order to achieve high safety standards. This inevitably means that while there is now mutual recognition in regard to certification, there remain specific national safety requirements that must be met before site-specific designation is achieved. These are essential, however, to deal with national and local specifics of service provision, in airspace of varying complexity, and to maintain consistently high safety standards. As long as service providers are able to meet these standards the choice of ANSP at airports is a commercial matter for the airport.

1.20 Previously, all providers of air traffic control at UK airports were required to hold a safety approval under Article 100 of the Air Navigation Order 2005. Article 100 covered *all* aspects of their safety, most of which are now covered by certification requirements. Pending a change in UK legislation, the CAA's approach has been to use site-specific designation to address those elements of Article 100 which are not addressed by certification, but which we consider essential to maintain the UK's safety standards. There are just two elements of the Article 100 requirements which currently need to be reflected in designation: the UK schemes regulating air traffic controllers' hours (SRATCOH) and ATCO training for emergency and unusual circumstances (TRUCE). These specific UK requirements seek to maintain high safety standards, are transparent, and we do not judge they constitute a barrier to entry. As such the choice of ANSP is open for the airport to make on commercial grounds.

1.21 UK aviation legislation will in due course be updated in order to capture the above mentioned designation elements not covered by certification.

Are UK Safety Standards Higher than in Other Member States?

1.22 The UK has a strong safety record and regulatory requirements are designed to maintain and enhance that record. While the precise basis for designation is likely to vary from State to State, one might expect that operational demands will lead to an equivalence of sorts over time, with Member States with less mature safety systems developing models more closely aligned to those in the UK and other larger, more developed states.

1.23 In order to obtain designation in the UK, a non-UK ANSP would, as with a UK-based provider, need to demonstrate that it matched or exceeded UK safety requirements. This may make it more likely, at least in the near term, that any entrant ANSP from the EU may be from a Member State with a similar degree of airspace complexity and track record in safety. Overall, though, we consider these high standards in safety as necessary, reasonable, and no barrier to contestability.

Other EU Requirements

1.24 We have also considered whether any other Single European Sky (SES) requirements create barriers to the offering of services. It is certainly the case that certain SES provisions create new challenges for ANSPs, perhaps especially smaller ANSPs for which new regulation is likely to have a greater proportionate cost impact.

MATS Part 2

1.25 The requirement for a provider to have an operations manual (Manual of Air Traffic Services (MATS) Part 2) in place as part of certification under the Common Requirements Regulation[23] is an important issue to consider. A new provider may find it challenging and to develop both MATS Part 2 and the other safety documentation required, prior to taking over provision. This will be considered further under section 1(iv).

Summary

1.26 Overall, there do not appear to be any features of the legal and regulatory framework that constitute a barrier to an ANSP offering to provide or withdrawing from the provision of services. Certain features of the framework are actually designed to promote this, such as the Common Requirements and the ATCO Directive (which, though primarily aimed at ATCOs, should have future benefits for ANSPs). While growth in regulatory requirements always runs the risk of disproportionate impacts on smaller players and new entrants, the experience in the UK of going through the process of certification in the first half of 2007 was broadly positive. Although there is some evidence that the new requirements created significant burdens for the smallest players, the UK has 66 ANSPs currently certificated (the majority of which are self-supplying airports), believed to be the highest number of any EU country.

Future Single European Sky Issues

1.27 There have been an increasing number of new regulations, many concerned with standardisation, but it is difficult to speculate on where specific new regulatory requirements might arise. Interoperability is one area which poses a number of future challenges, not least the burden in 2011 of legacy systems having to comply with interoperability requirements. However, again, this is unlikely to create a barrier to entry or exit in itself, although the increase in Interoperability Implementing Rules associated with SESAR may increase the complexities of operating as an ANSP. A second legislative package for SES “SES II”, proposing (among other things) amendments to the four high-level SES regulations, is expected to be announced in a Commission Communication before the end of June 2008. This will form the basis of a legislative programme to be developed over the next few years.

Potential Barriers to ANSPs Withdrawing from Provision of ANS

1.28 The Assessment criteria set out in the Charging Regulation also require consideration of whether there are any barriers to ANSPs withdrawing from the provision of services. We have considered this issue and conclude that any such ‘barriers’ are likely to derive from the contract itself, and in particular from provisions that may be in place to facilitate the possible changing of supplier at a future point. Potential issues we are aware of include:

[23] See, Annex 1, paragraph 3.3 of Commission Regulation (EC) No 2096/2005 of 20 December 2005 laying down common requirements for the provision of air navigation services (http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/l_335/l_33520051221en00130030.pdf).

- Notice periods in contracts – in order to withdraw from provision of service, an ANSP would normally expect to give a notice period to the airport operator. Although this does create a restriction on exit, notice periods for both parties are a normal pre-requisite in complex service provision contracts such as airport ANS.
- Asset transfer provisions in contracts – contracts may contain provision for both physical assets and other assets (such as MATS Part 2 and related safety documentation) to be transferred to the new supplier on a change of ownership. Such transfers may require resource commitments by the exiting supplier and act as a disincentive, but again such provisions equally protect safety and in many regards facilitate potential entry of a new supplier. MATS Part 2, and similar assets, may also command a fee payable to the exiting ANSP, lessening any overall costs associated with withdrawing from provision.
- Staff transfer provisions under TUPE – the possibility of staff transfer under TUPE could possibly act as a disincentive to an exiting ANSP, if it is concerned about losing trained staff from its business. In reality, though, an exiting ANSP may be exiting because the airport has chosen another provider, rather than voluntarily. Also, such provisions facilitate entry by a new provider, creating a clear and transparent framework for staff to be transferred and expertise at a specific site to be retained.

Summary

1.29 In summary, we do not judge that there are significant barriers to the withdrawal of provision by an ANSP. On the contrary, where 'barriers' exist in the current framework, they tend to stem directly from provisions which are in place to support either safety or contestability objectives (or both), and on balance, we believe that such provisions are likely to do more good than harm to contestability overall.

1. (iii) length of contract duration

Introduction

1.30 In this Assessment the CAA has looked not just at contract duration but also whether contracts are drawn up in ways that indicate a level of competitive pressure, such as the ease of early exit, presence of break points, review periods and delivery targets, and we asked stakeholders for a range of contractual details in our questionnaire. We also asked whether providers and airports would, with a guarantee of confidentiality, be prepared to let us see the contracts themselves, and a number of stakeholders responded positively. Although this information has been invaluable in conducting this Assessment, to ensure we respect commercial confidentiality we have generalised and anonymised information where necessary.

1.31 In considering contract duration it is important to make the links to the costs of offering to provide services and the potential 'phase-in' costs. Ensuring contracts are of a certain length (e.g. at least five years) can ensure that the one-off costs of bidding by the ANSP are worth incurring, and in such cases relatively long contracts can actually be pro-competitive. They may also represent the most efficient outcome by allowing for longer-term investment (such as in staff training) and some degree of staff security. On the other hand, where contracts are over-long, and do not have

break and review clauses, then they risk acting as a barrier to contestability. These issues are considered in more detail below.

1.32 As explained in the introduction to this paper, in respect of its ANS provision an airport has two options: it can provide the service, or some of the service, itself ("self-supply"), or it can contract-in provision from a third party.

Airports that self-supply ANS

1.33 We found that those airports that self-supply their air navigation services do not typically have anything in place comparable to a contract. For the self-supply airport, ANS is generally considered to be a division of the airport, no different in many respects from the fire service or HR department. Airports will typically use measures such as on-time performance to judge the efficiency of the service. Many are also developing service levels and key performance indicators as a result of the reporting requirements in the Common Requirements[24]. A number of airports told us that their ATC Managers attend regular meetings with other managers at the airport to discuss operational matters, such as the reasons for any delays. We were also told that many airports "benchmarked" themselves against airports of similar size and considered alternatives to self-supply on a regular basis.

Airports that contract-in ANS

1.34 There are currently two third-party suppliers of civilian ANS certificated and designated in the UK and at least one other military supplier. Contractual arrangements between suppliers and airports tend to be very detailed, and there is more on this in the section below.

Contracts – an overview

1.35 There is no "typical" contract to supply air navigation services, and individual terms will vary from contract to contract. Each contract will be for a fixed period and may include provisions for early voluntary or involuntary termination. Contracts may be subject to review, or several reviews, after set periods of time. Penalty-based service quality indicators and/or some other kind of performance monitoring may be included.

1.36 The manner in which an ANSP generates revenues will either be through a regular set charge (such as a monthly or yearly fixed sum) or on a per-movement basis. The charge the airport makes to the aircraft operator will either be as a separate ANS charge or be included in its landing fee. However, ANS at the BAA airports at Glasgow, Edinburgh and Aberdeen is currently charged directly by the ANSP to operators of aircraft at these airports. Direct charging ended at Heathrow, Gatwick and Stansted on 31 March 2008. The UK Government has recently decided to end the ANSP's authority to levy charges on aircraft. More detail on direct charging is in Section 4.

[24] Under Annex 1 of Commission Regulation (EC) No 2096/2005 of 20 December 2005 laying down common requirements for the provision of air navigation services. (http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/l_335/l_33520051221en00130030.pdf)

Contract arrangements in more detail

1.37 In all we received specific contract details involving 12 UK civil airports, plus more general information applicable to another five. The information below is an amalgamation of what we received, broken down in as much detail as possible while maintaining commercial anonymity.

Contract duration

1.38 The majority of contracts were for between five to ten years, although some were shorter and some longer than this. The shortest was for three years and the longest 20.

Break points and/or termination clauses

1.39 All contracts include a right to terminate following a breach of contract, and also the right to terminate voluntarily, either at a break point, or to be triggered at any time. Notice periods of voluntary termination varied from between six months and two years.

Review periods

1.40 All the contracts that were longer than seven years had at least one review period. Review periods varied from annual to five yearly, generally (although not always) varying in length in relation to the duration of the contract itself.

Service quality and performance indicators

1.41 Most of the contracts had some form of agreed service quality indicators. Examples of such indicators include: feedback from customer satisfaction surveys; delays attributable to the ANS; and safety indicators such as runway incursions. We found evidence of financial penalties being specified in more than one contract if these indicators were not met. These service indicators were brought to the airport's attention by means of regular reports and meetings.

1.42 It is worth noting that Commission Regulation 2096/2005 – the "Common Requirements" – has a requirement for an ANSP to specify in its Annual Plan indicators of performance against which the level and quality of service may be reasonably assessed. This should address concerns over the lack of appropriate performance measures, and a number of ANSPs have indicated that they are in the process of developing such indicators.

Asset transfer procedures

1.43 Further details of the asset transfer procedures in contracts, including important safety documentation, such as the Manual of Air Traffic Services (MATS) Part 2, are in section 1(iv).

Conclusion

1.44 Contract length is not in itself a barrier to contestability and, as noted earlier, contracts of a certain length can aid contestability by ensuring the contract value makes bidding worthwhile. We found that contracts longer than five years always contain at least one break point. Governance of contracts involves regular review periods and most have some form of service quality measures. In some cases these

are linked to financial penalties and even to breach of contract. In summary, we have not discovered provisions in contracts we would expect to impact negatively on contestability.

1. (iv) existence of procedure allowing assets and staff to be transferred from one ANSP to another

Introduction

1.45 The issue of asset ownership, as well as any procedures for the transfer of assets, clearly makes a difference to how straightforward and predictable it is to change supplier, given the heavy reliance on certain assets in the provision of ANS. This question is therefore important to the Assessment and we sought as much detail as we could from ANSPs and airports.

1.46 From an airport perspective, it is important to ensure arrangements for the ownership or leasing of equipment do not entrench the incumbent ATS provider. At the same time the airport needs to enable appropriate input into procurement processes by that provider who will ultimately be operating and managing the systems in order to provide the service. The provider may assume a number of legal responsibilities with regard to the equipment, in terms of certification, interoperability, or specific equipment approvals, such as Air Navigation Order (ANO) Article 124[25], which requires ATS equipment to have an approval granted by the CAA.

1.47 For the purposes of this Assessment we include in the definition of "assets" navigational equipment, computer software and any documentation fundamental to the operation of the airport. A brief list of some of the assets relevant to this Assessment is at Annex B. Staff, although also an "asset", will be treated separately. In each section we will look first at the nature of assets and staff before dealing with the transfer procedures.

Asset ownership

1.48 Where an ANSP is contracted to an airport, one of the following scenarios currently exist:

i) The ANSP owns the ground-based navigation equipment itself;
ii) A third party (such as a finance company) owns this equipment, which is then leased to the ANSP;
iii) The airport owns this equipment, which is then operated and managed by the ANSP.

1.49 We found scenario iii) to be the most prevalent. In many cases airports own this equipment for historic reasons – as a hangover from the days when the airport provided its ANS service in-house, and subsequently have taken a conscious decision to maintain control of the assets. Some airports do, however, take advantage of their contracted ANSP's expertise and knowledge of the equipment purchasing market to acquire and install infrastructure that the airport will own. We only found a few instances of i), while there were more instances of ii), and where the

[25] Statutory Instrument (SI) 2005 No. 1970, The Air Navigation Order 2005 http://www.opsi.gov.uk/SI/si2005/20051970.htm#124.

airport does not own the navigation equipment itself, it is nearly always the case that it is leased by the ANSP from a third party.

1.50 We discovered that where airports do not own the equipment themselves, they have taken steps to ensure that the use of any capital equipment that is essential to the provision of the ANS is not put at risk in the event of early termination or expiry of the contract. For instance, there may be agreements that are triggered if the ANSP defaults on its lease payments, becomes insolvent, or if the airport terminates or does not renew the contract. There are further details of these in the discussion on asset transfer procedures.

Issues around particular assets

Ownership of ANS safety documentation essential to the operation of the airport (such as the MATS Part 2)

1.51 The UK MATS document contains procedures, instructions and information that are intended to form the basis of air traffic services within the United Kingdom. It is arranged in two parts:

a) The MATS Part 1, which applies to all United Kingdom air traffic services units and which is published by the CAA[26]
b) The MATS Part 2, which applies to a particular air traffic services unit at a specific location: it is produced by the ANSP for use at a specific unit and is approved by the CAA. It is not a public document.

1.52 The MATS Part 2 is a key safety document that has detailed information on the procedures applicable at the ATS unit in question and requires considerable resources to produce. In order to be designated at an airport in the UK it is a requirement for an ANSP to have an approved MATS Part 2 and related safety documentation in place. It is therefore an important asset that will need to be taken into account when there is a change of ANSP at an airport. If there were a change of provider and the incoming provider were unable to have access to this documentation, then it would need to create this from scratch. This would require substantial resources, perhaps including employing external consultants, take time and require the approval of CAA's Safety Regulation Group (SRG).

1.53 The new documentation would not be expected to be exactly equivalent to the incumbent's manual though, and indeed SRG officials have told us they might expect some variations based on different operating practices.

Has the MATS Pt 2 been passed to an incoming provider?

1.54 As can be seen from Table 1 in Section 3(ii) there have been various changes of supplier in the last ten years. We are aware that this document has been passed to a new provider in a number of these cases.

Is the MATS Pt 2 and related documentation intellectual property?

[26] CAP 493 Manual of Air Traffic Services Part 1 (www.caa.co.uk/docs/33/CAP493Part1adv.pdf)

1.55 Although there may be elements of an individual organisation's practices in the document (such as best practice guidance on how to get the best out of a particular runway configuration), the MATS Part 2 is almost entirely site specific and, we judge, has little value to an ANSP once it has withdrawn from providing a service at the airport concerned. However, ANSPs have mentioned to us that the MATS Part 2 and related documentation can, depending on circumstances, represent years of work, and can be in effect their intellectual property. As such they may be reluctant simply to hand over the documentation to an incoming provider. However, there could of course be a fee attached to the transfer.

Taking Steps to Ensure the Transfer of MATS Pt 2 and Related Documentation

1.56 The ownership status and handover procedures for the MATS Part 2 and any related safety documents is clearly important to an airport operator at a specific site. As such, it will be in an airport's interest to ensure this ownership (or transfer) issue is considered, perhaps in contract negotiations. We would draw attention to the guidance in CAP 670 Air Traffic Services Safety Requirements[27]: "Licensees may wish to assure themselves that appropriate arrangements are in place to cover the transfer of ATC services to an alternative provider and that ownership of the Manual of Air Traffic Services Part 2 is addressed."

1.57 In our view it would be in the interest of airports, where they have not already done so, to consider the treatment of the MATS Part 2 and related safety documents in line with these guidelines, as this would help them to safeguard airport-specific assets over time and would ease any future change of ANS provider.

Ownership of IT software

1.58 In our discussions with ANSPs and airports we have not discovered any serious concerns about the ownership of IT software. However, it is worth noting that the issue of software is assuming greater importance now that the European Commission has published the regulation transposing Eurocontrol's Safety Regulatory Requirement (ESARR) 6 on software safety assurance systems into European law[28]. Aside from what would appear to be the ANSP's evolving responsibility to provide safety assurance, an ATS contract may in future need to address the issue of transferring provider-developed software even where the hardware is largely owned elsewhere.

Are there procedures to allow transfer of assets from one ANSP to another?

1.59 The following section provides some example scenarios of procedures around the transfer of physical assets, such as navigational aids.

[27] CAP 670 Air Traffic Services Safety Requirements (Part A, Section 6. Section 1 (iv), pages 26-34) (www.caa.co.uk/application.aspx?catid=33&pagetype=65&appid=11&mode=detail&id=200)
[28] Commission Regulation (EC) No 482/2008 establishing a software safety assurance system to be implemented by air navigation service providers and amending Annex II to Regulation (EC) No 2096/2005. This will apply from 1 January 2009.

Example 1: The airport owns the equipment, which is then operated and managed by the ANSP.

1.60 In those cases where assets are owned by the airport then the transfer to a new contracted provider may be easier and there have been a number of successful examples of this happening in the UK (such as in the cases of Bristol, Liverpool and Luton listed in Table 1 in Section 3(ii)). We have discovered that many airports have no procedures in place, but there do not seem to be any barriers to these being set up, and the airports concerned have told us they do not foresee difficulties of this nature arising on change of supplier.

Example 2: The ANSP is providing a service to an airport under contract and leases the equipment from a third party

1.61 As explained above we have discovered there are often legally-binding step-in arrangements or other agreements that are triggered if the ANSP defaults on its payments, becomes insolvent, or if the airport terminates or does not renew the contract. We also discovered arrangements that are essentially a guarantee by the airport owner of the ANSP's payment obligations should the ANSP default. Arguably, this means that the airport is protected in the event of the ANSP's insolvency because it can "access" the assets and take on the lease payments for the assets. There may also be a provision that allows a further lease of an item of equipment to a new provider at the end of the lease term in the event that the ANS contract with the existing provider has not been renewed.

Example 3: The ANSP is providing a service to an airport under contract and owns the equipment itself

1.62 We have discovered that where assets are owned by the ANSP there is typically in place some form of legal agreement that any non-leased equipment is, on termination, to be available to the new provider, either by being sold by the ANSP to the airport at a market rate or through establishing a rental agreement with a third party.

Example 4: The airport self-supplies its ANS

1.63 As we have established above, where an airport self-supplies its ANS, it owns its assets. It is not usual for transfer procedures to exist in these circumstances, and we have not discovered any, but again there is no reason why these could not be put in place in the event of a third party being contracted to provide ANS.

Staff transfer issues

1.64 This section begins by setting out the staff roles and numbers involved in airport ANS. Requirements in this area are clearly set out in CAP 670 Air Traffic Safety Requirements[29]. Further details of staff roles and hierarchy are in Annex B.

[29] CAP 670 Air Traffic Services Safety Requirements (www.caa.co.uk/application.aspx?catid=33&pagetype=65&appid=11&mode=detail&id=200).

1.65 As far as staff numbers are concerned, the CAA must be satisfied that a unit maintains sufficient qualified controllers to provide safe air traffic control services. This will be dependent on the nature of the service provided, together with the airport's opening days and times.

1.66 In practice, a typical medium-sized airport might have around 30 controllers plus around 5 engineers and a manager. There may also be a small number of administrative support staff. Staff are usually employed by the ANSP where it operates a contracted service for the airport, and by the airport in the case of self-suppliers.

Procedures to allow the transfer of staff from one ANSP to another

1.67 There is legislation in place in the UK concerned with preserving employees' terms and conditions in the event of transfer of a business or undertaking. This is known as the Transfer of Undertakings (Protection of Employment) Regulations 2006 (the "TUPE Regulations") and ensures no diminution of the contractual terms of staff on change of employer. Broadly speaking, the effect of the Regulations is to preserve the continuity of employment and terms and conditions of those employees who are transferred to a new employer when a relevant transfer takes place. This facilitates smooth transition of staff on a change of provider. There are more details of the TUPE regulations in Annex B.

Experience of using TUPE in recent years

1.68 These regulations have been used on a number of occasions, depending on circumstances. When Durham Tees Valley airport moved from local authority control to Peel Airports, staff moved across on local authority terms and conditions under TUPE, and the same more recently when Dundee Airport moved from local authority control to Highlands and Islands Airports. In both these cases the airports technically continued to self-supply their ANS throughout. TUPE was also used when Luton Airport went from self-supply to NSL in 2000. On the other hand TUPE was not used when Bristol Airport moved from self-supply to contracting-in NSL in 2005. In this case staff contracts with Bristol Airport were terminated and replaced with new contracts with NSL.

Summary

1.69 Key ANS assets are typically owned by the airport or by a leasing company, rather than the ANSP. These arrangements aid contestability. This Assessment found contractual stipulations are typically in place to allow ANSPs access to assets. Where an airport owns its equipment there are not always asset transfer procedures in place, but for the reasons discussed above we do not see this as a concern for this assessment. There are also legal agreements to ensure that assets not owned by airports will be available to an incoming provider. Difficulties could arise if a potential entrant had problems obtaining access to a previous incumbent's MATS Part 2, and associated documentation. We would draw airports' attention to the guidance in CAP 670 and the suggestions made above. The UK legislation on the Transfer of Undertakings (Protection of Employment) (TUPE) creates a clear framework for staff transfer, and this has been used successfully to transfer ANS staff on a number of occasions.

2. Extent airports can freely determine who will provide their ANS, including the options to self-supply

Summary

Section 2 of the Assessment considers three specific questions which impact on the extent to which airports can freely determine their ANSP, including moving to self-supply. Key conclusions are:

- There is the scope and the framework in place for airports to change ANSP. The Assessment found no barriers to an airport moving to self-supply of ANS. Airports would need to consider a range of issues including cost, regulatory requirements, staffing and strategic business issues, but the framework exists to make such a change and it has been done, for example at Liverpool airport.
- Any ANSP, including the airport itself if it were to self-supply, must be certified and gain designation under the Common Requirements for the aerodrome in question, and the airport would have to consider key questions of the kind set out above around staffing, costs and the ANSP's level of experience, but we have not encountered any aspects of the legal and regulatory framework which would prevent an airport from changing supplier.
- A key practical issue will be the range of ANS supplier options. The framework is there to enable contestability, through provisions such as the Common Requirements and TUPE. Evidence suggests self-supply of ANS is a credible option, but specific airports may consider they have limited practical options currently in terms of third-party suppliers.
- There is on-going engagement by airports with users, and a legal framework that mandates and supports this engagement. While there is not direct engagement with airspace user representatives in the selection process of an ANSP, we judge that users bring relevant influence to bear on airports through other fora and competitive pressures.

2. (i) ability of airports to move towards self-supply of ANS.

Do Airports Consider Changing ANS Provision?

2.1 The evidence we have gathered and discussions we have had suggest that airports consider alternative options for ANS provision and that this is a consequence of competitive pressures to reduce costs. Airport operators we talked to cited processes they had gone through, including periodic benchmarking of ANS costs against provision at similar aerodromes, independent studies commissioned to consider the scope for change at certain sites, and there were some examples of tenders being launched to invite bids for provision, though these were limited.

2.2 Even where operators may expect to continue with existing ANS arrangements (e.g. because they want to continue to self-supply for strategic reasons, or because they may feel only the incumbent has the necessary experience), operators stressed to us that they would have a commercial duty seriously to consider other options periodically.

ANS Provision Options: Broad Considerations for an Airport

2.3 Evidence we have gathered suggests that airports will look at a range of factors when considering potential changes to ANS provision, including:

- Fit with the overall company strategy (e.g. a specific airport operator may not want to self-supply for strategic business reasons);
- Cost of provision;
- Staffing issues (e.g. recruitment, training, or general staff unrest) that might be raised by a change;
- Quality of service and track record of potential replacement ANSPs, including whether they have experience of the type of airspace involved at a specific site;
- Quality of management team;
- ANSP corporate infrastructure (e.g. SMSs and documentation);
- The regulatory environment and whether an outside provider is better equipped to address the regulatory requirements than the self-supplying option.

2.4 Overall, respondents stressed to us that in considering changing provider there would be the need to balance the risks of change with the potential benefits on offer. For an airport to go ahead and make the change, there would need to be a clear sense that these benefits outweighed the risks.

Are Airports Able to Move to Self-Supply of ANS?

2.5 The evidence we have gathered suggests there are no insurmountable barriers to an airport operator moving to self-supply of ANS. Recent examples of this happening were at Liverpool (where NATS and then Serco provided the service until 1999, and it then became self-supply under Peel Airports) and at Glasgow Prestwick (where NATS was the provider until 2001, when the airport became self-supply on change of ownership to Infratil).

2.6 Key issues an airport operator may examine when considering whether to move to self-supply are:

- Cost issues – whether costs could be reduced (while maintaining service levels);
- Staffing issues – whether it would be practicable and affordable for the existing staff to transfer across to the airport operator or for a new team to be brought in, relative to the size of any efficiency gains;
- Regulatory Issues - whether the airport operator can meet the regulatory requirements for certification and designation under the Common Requirements;
- Fit with strategic company objectives – for example, a move to self-supply might suit a wider strategy of company-wide self-supply operations.

2.7 In especially complex airspace, such as the London TMA, an ANSP's relative experience will be relevant, though were an airport to retain existing staff (transferring them under TUPE), this experience could be maintained.

Summary

2.8 The Assessment found no barriers to an airport moving to self-supply. A range of business factors would need to be considered, but a framework exists to support the change (e.g. TUPE).

2. (ii) existence of legal, contractual or practical barriers to an airport's ability to change ANSP.

2.9 Section 1(ii) deals with legal and other barriers from the point of view of an ANSP. This section considers the issues from an airport's perspective. In many cases the same issues apply, but we have sought here to draw out the differences.

Regulatory Costs

2.10 There are no barriers related to procurement. However, where an airport wants to self-supply ANS, then it will have to meet the certification and designation requirements of the SES Common Requirements regulations (designation including State requirements such as SRATCOH and TRUCE). The evidence from the UK suggests it is not a barrier as a number of self-supplying airports have gone through this process[30].

MATS Part 2 and related Safety Systems Documentation

2.11 An airport wishing to switch to self-supply having previously outsourced provision would face similar challenges around the MATS Part 2 and other operational assets as an incoming third-party ANSP – see section 1(iv). However, the airport has the means to address these issues contractually with the supplier, to ensure that a smooth future handover could take place. As detailed in section 1(iv), we would draw attention to the advice that SRG give[31] that airports should take appropriate steps to ensure that MATS 2 and other important assets are available to transfer to an alternative supplier at a change of contract. If no such contractual arrangements exist, an airport could consider negotiating a fee with the outgoing ANSP for the MATS Part 2 and related documentation.

Staff Issues

2.12 Staff issues may also create a practical barrier for an airport seeking to change ANSP. Where an airport has an incumbent ANSP and wished to change either to another provider or to self-supply there would be two possible scenarios in regard to staff. The existing staff would normally transfer across to the new ANSP (or the airport in the case of self-supply) under the TUPE provisions. Recent examples of this include Durham Tees Valley and Dundee airports moving from local authority control to Peel Airports and Highlands and Islands Airports respectively. Alternatively, but less likely in practice, the existing staff could move out with the exiting provider to be replaced by a new team.

2.13 A key issue could be persuading some or all of the staff to move across to a new employer. While the transfer would be on the same general terms and conditions (under TUPE), it would be important for the new entrant to assure employees that their terms and conditions will evolve favourably with the new

[30] For example, Exeter, Leeds, Bradford and Newcastle. In total of the 67 certificated providers in the UK the majority are self-supply – see section 3(ii)

[31] CAP 670, Air Traffic Services Safety Requirements (Part A, Section 6.1. Part A, page 11) (www.caa.co.uk/application.aspx?catid=33&pagetype=65&appid=11&mode=detail&id=200)

employer. The alternative option of moving an entire new team into an airport would be likely to be complex, requiring recruitment of new staff in what is a tight ATCO market, and also sufficient site training to ensure the requisite validation. Co-operation from the outgoing ANSP could make this process easier, but even with full co-operation there would still be a possible need to reduce service levels for a period, though this could be timed to take place out of high season.

Practical Issues

2.14 A key practical issue will be the range of ANS supplier options. While evidence suggests self-supply of ANS is a credible option, there may not be a large choice of third-party suppliers able or willing to provide service, which have sufficient experience and expertise. Although specific airports may consider they currently have limited practical options, the framework is there to enable contestability, through provisions such as the Common Requirements and TUPE. Section 3(ii) considers evidence of alternative ANSPs, including the option of self-supply.

Summary

2.15 The evidence we have gathered suggests that in broad terms there is the scope and the framework in place for airports to change ANSP. Any ANSP, including the airport itself if it were to self-supply, must be certified and gain designation for the aerodrome in question, and the airport would have to consider key questions of the kind set out above around staffing, costs and capability of the ANSP. However, we have not encountered any aspects of the legal and regulatory framework which would prevent an airport from changing supplier. The availability of a range of credible third-party suppliers is also a factor at specific sites, particularly at airports above the 150,000 ATM threshold, but even there there is no structural barrier to contestability.

2. (iii) role of airspace users' representatives in the selection process of the ANSP.

Introduction

2.16 There are a number of ways that airspace users can have a relationship with airports, and the direct engagement of airspace users' representatives in the ANSP selection process is one of these. In our view the key question is whether airspace users have influence over airports and the quality of service on offer, in ANS as with other areas, and ANS is only one aspect of the overall airport "package" which airspace users will want to influence. The CAA fully recognises the value of stakeholder engagement, and has developed this in the context of its own regulatory processes such as the Constructive Engagement process as part of the Airports Price Control[32]. However, we judge that the exact forum is less relevant than the effectiveness of whatever process is used.

Legal requirements

2.17 Aerodromes to which section 35 of the Civil Aviation Act 1982 applies have a responsibility to provide facilities for consultation with users and local interests on matters concerning the management or administration of the aerodrome. Where an

[32] http://www.caa.co.uk/docs/5/ergdocs/erg_ercp_airportregulation_may05.pdf.

aerodrome is designated[33] under section 35, the Department for Transport recommends the operator establish an airport consultative committee according to Guidelines published by the Department for such Committees.[34]

Evidence gained from airports and airspace users

2.18 It is clear that all airports have some kind of regular engagement with their users on operational issues. For most larger airports these are in the form of regular formal meetings with users. These meetings allow a range of issues to be discussed, and provide the opportunity for issues of concern, whether in regard to ATC or other aspects of service provision, to be addressed. As we make clear in Section 4, UK airports operate in a commercial environment and actively compete for airline business. Their relationship with users is therefore likely to be of great importance, as would any issues raised regarding ANSPs, and there are fora in place to give users the opportunities to raise such issues.

2.19 We found that airspace users did not appear to have a direct role in the selection process of an ANSP, although some airports said that they would seek a mandate from their users for any change. A number of airports said that any change of ANS provision was a private decision for the airport, based on its best interests, both commercially and in terms of maintaining service provision standards. As above, however, this commercial focus would be expected to lead to a desire to satisfy their users. The input we received from users suggested that there could be more specific engagement in this area, but overall it is our view that, as the previous paragraph makes clear, a number of processes exist for users to engage with airports and input their views.

Conclusions

2.20 While we did not find that there was direct engagement with airspace user representatives in the selection process of an ANSP, we did find significant levels of on-going engagement with users and a legal framework that mandates and supports this engagement. Our view (as discussed in Section 4) is that airports compete for airline business. They need to retain and win that business and processes that exist to give airspace users an opportunity to influence these airports and the quality of service on offer should be seen in that competitive context.

[33] 51 aerodromes are designated. They are listed in The Aerodromes (Designation) (Facilities for Consultation) Order 1996 (SI 1996/1392) as amended (SI 2002/2421). The list covers the airports relevant to the assessment. http://www.opsi.gov.uk/si/si1996/Uksi_19961392_en_1.htm.
[34] http://www.dft.gov.uk/pgr/aviation/environmentalissues/guidelinesforairportconsulta2880?page=1.

3. Extent to which there is a range of ANSPs from which airports can choose

Summary

Section 3 of the Assessment considers two specific questions which bear on the extent to which there is a choice of ANSPs available to airports, including the option of self-supply. Key conclusions are:

- In complex airspace we have considered the proposition that alignment of provision at the airport with the en-route provider is necessary to facilitate efficient service. We judge this is not the case and in the Scottish and Manchester TMAs, ANSPs other than NSL are providing service at airports.
- We also considered whether monopoly provision of radar approach service in London by NERL impacts on contestability of Aerodrome Control at London airports. We judge that provision of ANS at London airports remains contestable, and that a framework exists, including restraints on NERL, which would enable changes of ANSP at London airports.
- The ATCO shortage affects all ANSPs, although some may be better placed (having resources to recruit, train and retain staff) to deal with the resulting rising staff costs than others. The ATCO Licensing Directive will have the effect of increasing the pool of available controllers.
- ANSPs operating in complex airspace in Europe may offer a suitable alternative in similar UK airspace in time, and the Common Requirements framework assists in widening the pool of experienced providers. Additionally, provided an incoming ANSP can retain experienced staff, then expertise can be maintained.

3. (i) existence of structural rigidity which restricts the effective choice of the ANSP for airports

Introduction

3.1 In this Assessment we have considered a "structural rigidity" as a technical or cost limitation outside the immediate control of airports/providers. We have excluded economies of scale, or other economic reasons why an ANSP may pay more to staff, as these can change over time and are a feature of a competitive environment.

3.2 In this section we consider three propositions which have been raised with us which could imply possible structural rigidities:

1.) The complexity of airspace in certain areas of the UK may have a bearing on an airport's choice of ANSP because the airport perceives:
    a) the need for a provider that is sufficiently experienced in operating in complex airspace;
    b) the relationship between radar and tower provider needs to be particularly strong, and may help with the allocation of capacity on a day to day basis.

2.) The monopoly provision (by NERL) of radar Approach Control in the London Terminal Manoeuvring Area (TMA) could impact on the contestability of Aerodrome Control.

3.) The perceived worldwide shortage of trained controllers has led to rising staff costs and smaller providers may be less able to meet growing pay and pension demands than larger providers. It could be more difficult for smaller self-supply airports to absorb these costs.

3.3 We will explore each of these propositions raised with us in more detail, assessing the extent to which they may represent a barrier to contestability.

1.) The complexity of airspace

3.4 Airspace in the UK can broadly be divided into upper and lower en-route airspace, and terminal control airspace in which the provision of ATS is in the form of Approach Control and Aerodrome Control services, which outside the London area are generally both located in an airport control tower.

3.5 The relationship between these services is obviously of great importance, particularly when the airport is situated in an area of lower airspace shared by a number of other airports and designated a Terminal Manoeuvring Area (TMA) to reflect the complexity of the airspace. The TMA ensures that aircraft arriving and departing from a number of airports that are comparatively close together are directed to their destinations in the most safe and efficient manner. In the UK there are TMAs covering the areas around London, Manchester, Belfast and the lowland Scottish airports. Aircraft within the TMA are normally under control from an area control centre unless they are close enough to the airports to be under Approach or Aerodrome Control. In London, as discussed earlier, the Approach Control for the major airports is centralised and delivered by NERL. A number of issues have been raised with us in relation to these areas of airspace, as detailed below.

a) The need for a provider that is sufficiently experienced at operating in complex airspace

3.6 Some stakeholders suggested that only NSL may currently have sufficient breadth of experience to be able to operate terminal services in the complex airspace within a TMA. They indicated that at the present time, there is a shortage of credible alternatives. We note, though, that there are self-supplying airports within the Manchester and Scottish TMAs (Liverpool and Prestwick respectively), although only NSL operates at major airports in the London TMA (LTMA). Any issue would seem therefore to be principally related to airports in the LTMA.

3.7 However, it was also suggested by several stakeholders that some ANSPs operating in complex airspace in Europe may offer a suitable alternative in time, and the Common Requirements framework assists in widening the pool of experienced providers. Additionally, we have noted the argument that experience rests with the staff, rather than the ANSP, and provided an incoming ANSP can retain experienced staff then expertise can be maintained.

3.8 As discussed in the following section on specific arrangements in place in the LTMA, we do not judge there are structural barriers to contestability in the LTMA. We also note that three of the airports within the LTMA have over 150,000 ATMs and are therefore subject to the full scope of the Charging Regulation's transparency

provisions. It would be these airports where complexity is likely to be more of an issue.

b) The need for a strong relationship between the Approach Control and Aerodrome Control provider

3.9 As explained earlier, the en-route service provider in the UK is NERL, a company that operates a monopoly service under licence and is price-controlled by the CAA. NERL is responsible for controlling the aircraft within the TMAs and its relationship with the controllers at the aerodromes in these areas is perceived by some stakeholders to be of great importance. An airport has to ensure that both arriving and departing aircraft are not delayed by constraints in the surrounding airspace, and also, as far as possible, that its plans for future growth are not impeded by its inability to find capacity in that airspace.

3.10 Some stakeholders pointed out that airports operating within complex airspace would place importance on the need for a strong relationship with the en-route provider, and that this may influence their choice of terminal provider. In a UK context this might suggest a perceived preference for NSL given its links with NERL. Clearly, if there were differentiated levels of service this would raise concerns about fair treatment. However, we have no substantiated evidence of this happening. We have explored the protections in place to ensure fair access to the NERL-controlled airspace and note that:

- The Air Traffic Services Licence for NATS (En-route) PLC[35] contains general obligations to make its services available to any user and broadly not to discriminate between classes of user or against particular users in the operation of the systems by which it provides services.

- The CAA's general duty as set out in the Civil Aviation Authority (Air Navigation) Directions 2001[36] is to develop, promulgate, monitor and enforce a policy for the sustainable use of UK airspace and for the provision of necessary supporting structure for air navigation. The CAA's Directorate of Airspace Policy (DAP) is responsible for the regulation of UK airspace, the development of appropriate policies and the planning of airspace arrangements for the benefit of all users. It has statutory duties to secure the most efficient use of airspace and to satisfy the requirements of operators and owners of all classes of aircraft[37];

- DAP is able to deal with complaints from all airspace users concerning the activities of ANSPs, including any perceived unfairness in the allocation of airspace capacity on a day-to-day basis. Matters that are raised are investigated and resolved through dialogue with the service provider concerned.

3.11 With reference to the third point above, DAP has only received one complaint from an airport within complex airspace concerning their relationship with en-route. This was investigated but no issues of concern found.

[35] http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=585.
[36] The Directions are at http://www.caa.co.uk/docs/7/DfT%20CAA%20Directions.pdf, where there can be found the more particular duties concerning the use of UK airspace.
[37] Transport Act 2000 Section 70(2)(a) http://www.opsi.gov.uk/Acts/acts2000/pdf/ukpga_20000038_en.pdf.

3.12 In summary, we consider that an appropriate framework exists to protect users in their dealings with en-route service providers and to give comfort where an airport may consider changing their third-party ANSP. It is possible, however, that not all stakeholders may be aware of some of these provisions and we hope that the publication of this document will make them more widely known.

2.) The specific arrangements in place in the London Terminal Manouvering Area (LTMA)

3.13 A particular feature of the London TMA is that the radar Approach Control service is provided by NERL controllers, based at the London Terminal Control Centre, at Swanwick. In specific regard to flights in and out of Heathrow, Gatwick and Stansted (i.e. the 'London Approach'), it is a price-controlled service delivered under exclusive licence. Only Aerodrome Control services are provided at the airports themselves.

3.14 For the purposes of this Assessment we consider only the Aerodrome Control service within the LTMA to be within the scope of the Assessment, as the radar Approach Control service (including the 'London Approach') is not delivered "at airports" (which is the definition in Annex 1 of the Regulation) but from a remote location.

3.15 We have considered whether the centralisation of the approach radar service, delivered as a monopoly service by NERL, materially impacts the contestability of the Aerodrome Control at the London airports. We have concluded that the framework is there to support contestability as we see no structural barrier to a new entrant ANSP taking over provision at an airport in the London area. A new entrant (or airport self-supplying) could deliver the Aerodrome Control, while sub-contracting the approach service to NERL as at present, or conceivably reaching agreement with NERL to receive onward-routed radar data directly to the airport where an approach radar service could be provided[38]. Of these two possibilities, we think the former (sub-contracting with NERL) would be more likely in practice.

3. 16 Were any new entrant ANSP concerned that they would not receive equal treatment in any sub-contract, they should note the concurrent powers with the Office of Fair Trading given to the CAA to enforce the provisions in the Competition Act 1998, as they relate to the supply of air traffic services[39].

3.17 In considering the issues around arrangements in the LTMA, we have also considered the possibility of DfT judging that Approach Control in London was in fact a 'terminal service' for the purposes of the Charging Regulation, and the impact that would have on whether or not ANS provision at London airports (which in these circumstances would refer to both Aerodrome and Approach Control) would remain 'contestable'. The dividing line between 'terminal' and 'en-route' services differs across Europe, and while the CAA has followed the wording of the Charging Regulation Annex 1 in considering Approach Control in the LTMA as out of scope (because it is not delivered 'at' an airport), we recognise that DfT may deem this approach service as a 'terminal' service for the purposes of the operation of Charging Zones.

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[38] This would not be possible in regard to the Approach Control service for Heathrow, Gatwick and Stansted, as this service (i.e. the 'London Approach') is operated exclusively under licence by NERL.
[39] See footnote 10 concerning whether providers of aerodrome air traffic services are undertakings that are subject to competition law.

3.18 The evidence we have suggests that the majority of the service value for an airport ANSP in London relates to the provision of Aerodrome Control, with a lesser share relating to the provision (i.e. obtaining the service by the sub-contracting) of the approach service. Therefore, while recognising it would be highly unlikely for a new entrant to provide its own approach service (and not possible at present at Heathrow, Gatwick and Stansted due to NERL's exclusive licence), we consider it reasonable to judge that ANS provision, in relation to the majority of service value, would remain 'contestable' at London airports, even if DfT were to deem that both Aerodrome and Approach Control were part of ANS provision at London airports.

3.19 In summary, we conclude that the provision of the Aerodrome Control service is contestable in that we see no structural barriers to changes in provision happening. The airports where practical difficulties may be greatest are already subject to the full scope of the Charging Regulation requirements.

3.) The worldwide shortage of trained controllers has led to rising staff costs.

3.20 There are three ATC training establishments in the UK[40] that are approved to provide training towards the UK Air Traffic Controller Licence. Such training requires significant financial investment (and, in terms of time, a minimum of six months for initial training, plus a further period of validation training at an ATC unit, which can vary according to the complexity of the unit) and failure rates can be high.

3.21 It is generally accepted by the industry that rising staff costs are a result of a shortage of controllers, which we understand to be a worldwide problem. Reasons given to us for the shortage include:

(i) the high cost of training weighed against failure rates.
(ii) many controllers being prepared to travel to secure the most attractive pay and conditions (for instance to North America and the Middle East).
(iii) the fact that controllers are often highly trained university graduates; we have been told that whereas in the past they may have thought of air traffic control as a lifetime career, this is not always the case now.

3.22 This is clearly an issue that affects all ANSPs although it has been argued that some may have the resources to recruit, train and retain staff that will make them better placed to deal with the shortage than others. Further, reluctance to invest in training can lead to ANSPs endeavouring to attract controllers from another unit by being able to offer benefits in pay and conditions. Some smaller providers have mentioned that they are experiencing a shortage of controllers to the extent that the airport for which they provide may be unable to grow as it wishes. We were told by one airport that it moved from self-supply to contracting-in its ANS in order to meet its expansion plans.

3.23 Concerns would arise if there was evidence that one ANSP had any unfair advantage over any other in terms of being able to hire and remunerate staff. In this respect it should be noted, for example, that there is a prohibition in NERL's Licence preventing cross-subsidy between different parts of the NATS group, so it would not be permissable for NSL to receive cross-subsidy from NERL that could be used for

[40] These are: Aviation Services Training and Consultancy Ltd (ASTAC) at Gloucestershire Airport and at Rudloe College, Shoreham Airport; BAE Systems Training College at Cwmbran Training College in South Wales; National Air Traffic Services Ltd at its College of Air Traffic Control in Bournemouth.

NSL staffing[41]. The CAA commisioned consultants in 2005 to consider whether NATS allocated costs appropriately between the regulated and non-regulated business. They concluded that NATS' operating cost allocation methods are suitable, adequate and applied consistently.[42]

The ATCO Directive

3.24 One development that we would expect to have the effect of increasing the pool of available controllers is EU Directive 2006/23/EC of 5 April 2006 on a Community air traffic controller licence – the "ATCO Licensing Directive". This is intended to establish Community competence standards for ATCOs with 'mutual recognition' being a key concept. From 18 July 2008 (the expected UK implementation date) Community ATCOs can come to the UK, exchange their licence for a UK one, and as long as they have sufficient verification from the other Member State, they will be free to work at a unit, subject to completing the relevant validation training at the airfield concerned. This Directive will increase the available pool of ATCOs, when it takes effect. It could, however, be argued that this may not necessarily reduce costs as the problem of controller shortage is not just confined to the UK; pay in other countries could simply increase as competition for the pool of European controllers takes effect. This will depend on a range of future market conditions.

3.25 In summary, increases to the cost of provision resulting from the shortage of controllers clearly present some challenges to ANSPs, particularly those with fewer resources. However, we do not think that this is a barrier to contestability for the following reasons:

- The ATCO shortage affects all ANSPs, although some may be better placed (having resources to recruit, train and retain staff) to deal with the issue than others;
- The ATCO Licensing Directive will have the effect of increasing the pool of available controllers.

[41] NATS (En Route) plc (NERL) Licence Condition 9 (www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=7866).
[42] "Civil Aviation Authority**,** NATS – Cost allocation review – Phase 2, Final report in summary format" KPMG IIP 24th May 2005 (www.caa.co.uk/docs/5/ergdocs/erg_ercp_sp1_costallocation.pdf).

3. (ii) evidence of alternative ANSPs, including the option of self-supply, that provides choice in the selection of ANSP by airports

Current industry situation and recent history

3.26 In considering evidence of the range of ANS supply options for airports, we have looked at the current industry position and recent history of changes in provision. It is clear from this analysis that NSL has a strong presence in the provision of air navigation services (ANS) at UK airports, particularly in terms of providing services at the largest airports in the country. Of the top 20 airports by ATMs, NSL is clearly the main provider. However, six airports in the top 20 currently self-supply, and further down the scale most airports self-supply, while a few have an alternative third party supplier. The diversity of the UK in this regard is highly unusual, compared to other EU countries. Overall, of the 67 providers certificated under the Common Requirements in the UK, the majority are self-supply[43].

3.27 There have also been a number of changes in ANS provision at airports in the last 10 years, confirming that a framework exists for this to occur where airport operators decide it makes commercial sense. Table 1 below shows significant changes of provider over the last ten years.

Table 1 Changes of provider at major UK airports since 1997

Airport	Date of transfer	Previous ANSP	In-coming ANSP	Notes
Liverpool	July 1999	NATS until 1982, then Serco	Peel Airports (self-supply)	Switched to self-supply following acquisition by Peel Airports.
Southampton	April 2000	Self-supply	NSL	
Luton	November 2000	Self-supply	NSL	
Glasgow Prestwick	January 2001	NATS	Infratil (self-supply)	Switched to self-supply on change of ownership
Bristol	November 2005	Self-supply	NSL	

3.28 There has also been dynamism in the UK airports market in terms of ownership in recent years. In addition to BAA there are other significant airport groups such as MAG, Peel and Infratil. This has helped to contribute to diversity in the provision of ATS, with changes of airport ownership at times leading to changes in provider. The top 30 airports in terms of ATMs are listed in the table below, with the nine airports within the 50,000 to 150,000 bracket in 2006 highlighted.

[43] The providers that are not self-supply are NSL, NERL, Serco, the UK Met Office and the CAA's Aeronautical Charts and Data Section.

Table 2 ANS Provision at the Top 30 UK Airports

Airport	ATMs in 2006 (000s)	Ownership	ANSP
1. Heathrow	473	BAA Ltd[44]	NSL
2. Gatwick	256	BAA Ltd	NSL
3. Manchester	213	MAG	NSL
4. Stansted	192	BAA Ltd	NSL
5. Edinburgh	119	BAA Ltd	NSL
6. Birmingham	109	LAs/AGI/Employees	NSL
7. Aberdeen	102	BAA Ltd	NSL
8. Glasgow	99	BAA Ltd	NSL
9. Luton	83	Luton Council	NSL
10. London City	74	Global Infr. Partners	NSL
11. Bristol	66	MacQuarie	NSL
12. Newcastle	59	Local Auths & Copenhagen Apt	Self-supply
13. East Midlands	57	MAG	Self-supply
14. Belfast Intl	49	ACDL / Abertis	NSL
15. Liverpool	48	Peel Group	Self-supply
16. Southampton	46	BAA Ltd	NSL
17. Belfast City	38	Ferrovial	Self-supply
18. Leeds Bradford	38	Bridgepoint	Self-supply
19. Norwich	24	Omniport	Self- supply
20. Cardiff	22	ACDL / Abertis	NSL
21. Inverness	21	HIAL	Self-supply
22. Prestwick	19	Infratil	Self-supply
23. Exeter	16	Regional & City Airports (Balfour Beatty)	Self-supply
24. Humberside	14	MAG	Self-supply
25. Blackpool	14	City Hopper Airports Ltd	Self-supply
26. Kirkwall	13	HIAL	Self-supply
27. Durham Tees Valley	13	Peel Group and local authorities	Self-supply
28. Bournemouth	12	MAG	Self-supply
29. Scatsta	11	Consortium with Bristow Helicopters, Shell, BP and others	Serco
30. Coventry	11	CAFCO (Coventry) Limited	Self-supply

Possible Future Entry of non-UK ANSPs

3.29 As explained earlier in this Assessment the Common Requirements increase the choice of ANS providers available to UK airports. With this framework now in place, the UK, due to its traditional open market approach, may be well positioned to benefit – as it has in other areas of the economy. Whether UK third party suppliers are equally able to move into EU markets outside of the UK will depend on the openness of other countries and their airport operators, and the European Commission may want to consider this issue in its response to the High Level Group Report, and prospective "Single European Sky II" package of legislation.

3.30 Airports have told us that in future if they were to tender for ANS, they might expect expressions of interest from a number of EU providers, in particular those

[44] BAA Ltd is owned by a consortium in which Grupo Ferrovial hold the major stake.

which have experience of larger, more complex airspace. This could include the ANSPs listed below:

Table 3 Selection of EU ANSPs[45]

ANSP	Nationality	Ownership	Number of airfields where it offers a service
DFS Deutsche Flugsicherung	Germany	State	17
Austro Control	Austria	State	6 in Austria 10 in Germany
AENA	Spain	State	48 (including one heliport)
Aeroports de Paris	France	State	14 (including one heliport)

The Common Requirements in Action

3.31 An early example of the Common Requirements facilitating a change in provision can be found in Germany. As a result of the Common Requirements, ten German regional airports are using the Austrian air navigation service provider Austro Control, nine airports the DFS subsidiary, the Tower Company, and three airports have undergone certification to provide air navigation services themselves. One of the airports using Austro Control is Lubeck, which is owned by Infratil, the airport owner and ANS self-provider at Prestwick and Kent International airports in the UK. At a press briefing on 6 July 2007 DFS welcomed proposals by the German Federal Government for its privatisation as it will “consolidate the company's position in a liberalised European air navigation services market”[46].

Summary

3.32 While NSL currently has a strong position in providing ANS at UK airports, there are choices open to airports, particularly that of self-supply. In addition, the framework now exists to facilitate the entry of ANSPs from other EU Member States.

[45] Sources: ANSP websites
[46] Source: press release dated 6 July 2007 available from the DFS website http://www.dfs.de/dfs/internet/english/index.html.

4. Extent to which airports are subject to commercial cost pressures or incentive-based regulation

Summary

Section 4 considers the extent to which airports are subject to commercial cost pressures or incentive-based regulation, and covers three specific sub-questions:

- whether airports actively compete for airlines' business;
- the extent to which airports bear the air navigation service charge; and
- whether airports operate in a competitive environment or under economic incentives designed to cap prices or otherwise incentivise cost reductions.

The key findings are:

- The recent rapid growth in services and traffic at regional airports has resulted in the UK airport sector being characterised by a relatively large number of airports, offering a range of services. Virtually all are operated as commercial ventures with a mix of ownership structures.
- In general, UK airports operate in a commercial environment, including all the airports currently or prospectively falling within the 50,000–150,000 ATMs per year range; evidence suggests that airports actively compete for airline business and for passenger and freight traffic.
- This commercial approach provides considerable confidence that airports will put downward pressure on ATS costs, and this view is supported by the discussions we had with airports during the Assessment.
- In addition to competitive pressures, the UK has a regulatory framework that includes clear criteria to assess whether airports should be subject to incentive-based price controls. Three airports are currently subject to the regime, all of which are above the 150,000 ATMs per year threshold in the Regulation. This framework is backed up by a strong independent competition regime.
- The Government ended direct charging at Heathrow, Gatwick and Stansted after 31 March 2008. Direct charging is expected to cease at Edinburgh, Glasgow and Aberdeen in due course. Ensuring that airports that negotiate ANS contracts also bear the costs directly should further ensure that appropriate cost pressure is placed on these charges, to the benefit of airport users.
- Overall, the UK airport sector combines competitive pressures with a framework of regulation that ensures that airports face incentives to reduce costs and which should put downward pressure on ANS charges.

4.1 Section 4 of the Assessment is structured in four main sections:

- Background on the UK airports sector;
- The overarching competition policy framework and the role of incentive-based economic regulation;
- A high-level analysis of the impact of the commercial outlook of airports, and the impact of that on competition and pressure on costs, including ANS costs;
- The effect of the ending of direct charging by the ANSP at six BAA airports.

4.2 This section of the assessment focuses on the broad context of competition between airports. Much of the material cited is based on existing CAA analysis of the UK airports markets. [47] The CAA has not sought to undertake further detailed analysis of airport competition as this was not considered to be either necessary or a proportionate response to addressing the requirements in Annex 1 of the Charging Regulation.

4.3 The Competition Commission is currently undertaking a review of both BAA airports, under a Market Inquiry, and Stansted Airport, under a price control inquiry. The CAA notes that the majority of the new analysis presented by the CC relates to BAA's London airports. The competitive position of these airports is not directly relevant to the issue considered in this paper, not least because BAA's London airports are price controlled and, as they have more than 150,000 commercial ATMs per year, they will be subject to the full scope of the Regulation.

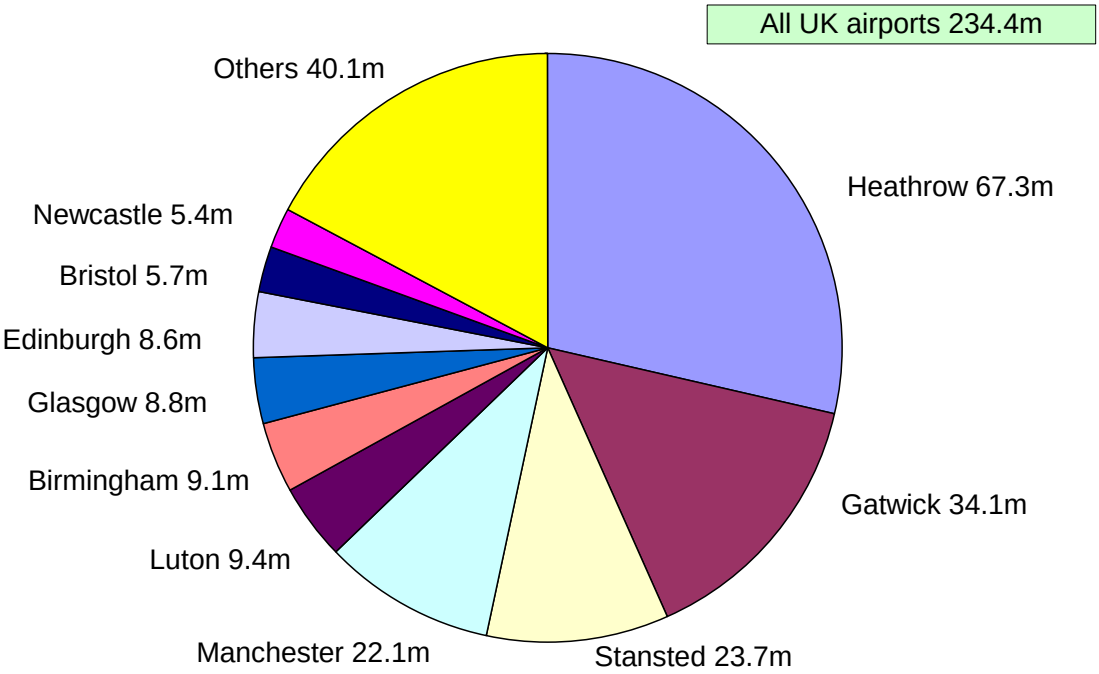
Background to the UK airports sector

Diversity of Airports in the UK

4.4 The UK airports sector has a relatively large number of airports with significant levels of commercial passenger traffic. For example, in 2006, 29 UK airports[48] attracted more than 500,000 passengers, more than any other EU Member State[49]. Figure 1 shows the 10 biggest UK airports in terms of the proportion of total passengers handled by UK airports in 2006.

[47] For example, the CAA's study Air Services at UK Regional Airports (CAP 775) at: http://www.caa.co.uk/cap775 and CAA advice to Government on Stansted/Manchester de-designation at: http://www.caa.co.uk/docs/5/ergdocs/de-designation_advice.pdf
[48] Excluding the Isle of Man, Jersey and Guernsey, all of which exceeded 500,000 passengers in 2006.
[49] According to data accumulated for Air Services at UK Regional Airports (CAP 775) at: http://www.caa.co.uk/cap775, Spain had 27, France 23, Germany 21, and Italy 18, for example.

Figure 1 Total passengers at UK airports, 2006



Source: CAA airport statistics, excluding Isle of Man and Channel Islands airports.

4.5 It is also notable that a number of major UK conurbations are served by multiple airports situated within a reasonably short distance that offer a range of regular scheduled and charter flights. This can be seen from Figure 2 below which plots the location of UK airports handling more than 500,000 passengers in 2006.

Figure 2 Selection of UK airports with more than 500,000 passengers in 2006

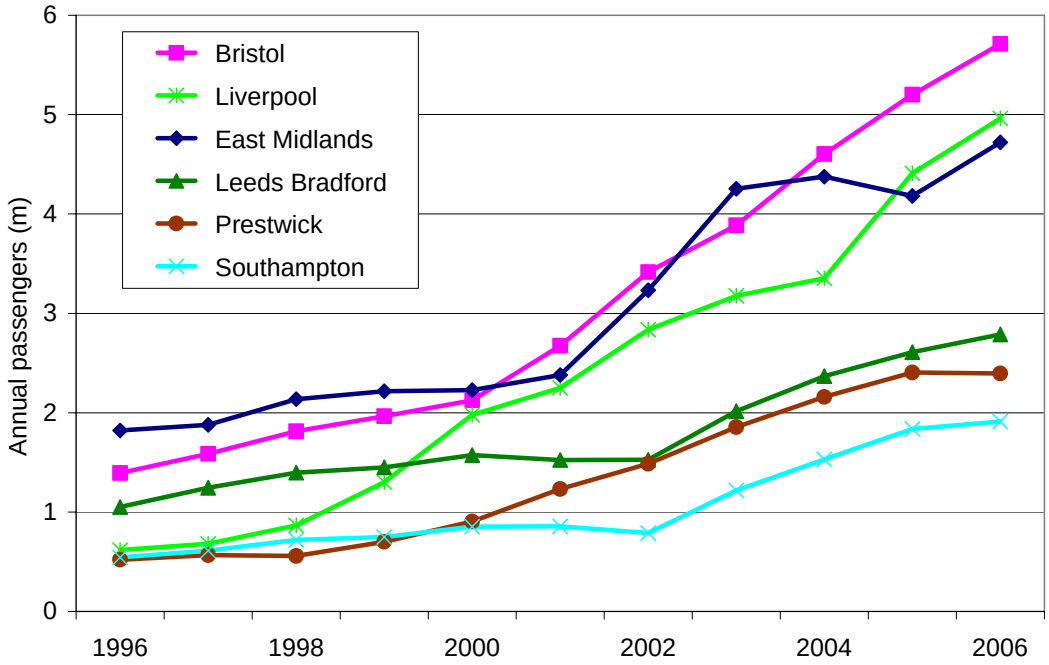
Growth of Regional Airports in the UK

4.6 In November 2007 the CAA published *CAP 775 Air Services at UK Regional Airports*[50]. This detailed study included analysis of recent trends in the UK airports sector. The study noted that:

- regional airports have continued to grow at a faster rate than London airports, and in 2006 handled 42 per cent of passengers at UK airports;
- the strongest growth continues to be in international scheduled services, where passenger numbers have doubled between 2002 and 2006;
- eight regional airports now offer daily scheduled flights to 12 or more international destinations, whereas only Birmingham and Manchester did in 1990;
- as well as a range of services from regional airports to European hubs, six regional airports now offer regular direct scheduled flights to a US hub and four offer regular direct scheduled flights to a Middle East hub, allowing a wide range of connections to points beyond;
- there is a noticeable reduction in the proportion of passengers travelling from or to UK points outside London who are travelling to London by air, road or rail to catch a flight – from around 60 per cent in 2000 to around 50 percent in 2005.

4.7 The particularly rapid growth at some regional airports is illustrated in Figure 3 below. All of these airports except Prestwick are within, or close to, the 50,000 to 150,000 ATMs thresholds relevant for the Charging Regulation.

Figure 3 Top six fastest-growing regional airports 1996–2006



Source: CAA airport statistics, excluding airports with fewer than 1m passengers in 2006.

[50] http://www.caa.co.uk/cap775. CAP 775 document defines 'Regional' as outside the London area (including Northern Ireland, Scotland and Wales) and this chapter uses the same definition.

Recent Changes in Airport Ownership

4.8 The current structure of the UK airports sector reflects the continuing trend towards private ownership and commercial operation of UK airports. In the last 20 years, substantial parts of the sector have been transferred from public to private ownership and/or operation, most notably through the privatisation of the British Airports Authority (now BAA Ltd). Many local authorities have decided to transfer their airports into the private sector, such as Bristol and, more recently, Exeter and Leeds Bradford airports. A number of airports are jointly owned by local authorities and private shareholders, including Birmingham and Newcastle, or are operated by private companies under long-term leases, such as London Luton.

4.9 The commercial nature of the UK airports sector is also demonstrated by the fact that there has been new entry by fully commercial airports, including the development of London City and the conversion of Doncaster Sheffield from a former military base. Further, the vast majority of UK airports do not rely upon subsidy from public funds to cover their costs[51].

Why Commercialisation Matters

4.10 Increasing commercialisation increases the likelihood of budgetary constraints and a focus on costs, including ANS costs. Where an airport is in private ownership, one might expect this focus to be most acute, with the additional pressure of shareholders seeking to maximise the return on their investment.

4.11 This process of growing commercialisation of the UK airports sector has coincided with the emergence of a number of airport groups. The largest of these is BAA, privatised in 1986; others include the Manchester Airports Group, Peel Holdings, and Abertis. These airport groups are illustrated in the table below. Manchester Airport Group (MAG) is the only major airport group that is wholly owned by public bodies. However, it should be noted that MAG is owned by local[52], and not national government, and that the group operates its airports in a commercial way, without public subsidy.

4.12 There have also been a number of instances in recent years where the ownership of private airports has changed. For example, in the last few years there have been changes in the ownership of all five London airports as well as at Bristol and Birmingham airports. This illustrates that the capital markets can act as an effective discipline on these airports, with changes of ownership occurring when commercial performance determines this to be profitable e.g. new ownership putting pressure on costs to seek greater profit.

[51] The exception being some airports in peripheral regions, such as the Scottish Highlands and Islands.
[52] Manchester Airport Group operates as a limited liability company, owned by a consortium of local government bodies.

Table 3 Ownership of UK airports

Owner	Airport	Terminal passengers in 2006 (millions)	% of UK terminal passengers
BAA Ltd	Heathrow*	67.3	29%
	Gatwick*	34.1	15%
	Stansted*	23.7	10%
	Glasgow	8.8	4%
	Edinburgh	8.6	4%
	Aberdeen	3.2	1%
	Southampton	1.9	1%
Manchester Airports Group (MAG)	Manchester*	22.1	9%
	East Midlands	4.7	2%
	Bournemouth	1	0%
	Humberside	0.5	0%
Abertis	Belfast International	5	2%
	Cardiff	2	1%
	Luton[53]	9.4	4%
Peel	Durham Tees Valley	0.9	0%
	Doncaster Sheffield	0.9	0%
	Liverpool	5	2%
Other	**Birmingham**	9.1	4%
	Bristol	5.7	2%
	Newcastle	5.4	2%
	Leeds Bradford	2.8	1%
	Prestwick	2.4	1%
	London City	2.4	1%
	Belfast City[54]	2.1	1%
	Others	6.1	3%
	Grand Total	235.1	100%

Source: *CAA Airport Statistics, 2006*. The nine airports in bold text fell within the 50,000 – 150,000 ATM range in 2006 for the purposes of SES Charging Regulation. The asterisked airports are designated for price control, though the Government announced in January 2008 its intention to de-designate Manchester airport.

The Extent to which Airports are Subject to Commercial Cost Pressures or Incentive Based Regulation

4.13 The following sections will set out the conclusions of this assessment on the extent to which airports are subject to commercial cost pressures or incentive based regulation. It is the view of this Assessment that the UK airports sector is broadly competitive. In relation to the UK airports within or just below the 50,000 ATM to 150,000 ATM range set out in the Charging Regulation, the vast majority of these

[53] Luton airport is operated under a long-term concession from London Luton Airport Limited, a company wholly owned by Luton Borough Council.
[54] Belfast City is owned by Ferrovial, which is the major shareholder in the BAA consortium.

airports do face competition from local independent competitors, and/or face other competitive constraints. This is backed up by a strong independent competition regime, and, where it is deemed necessary, price regulation is in place at designated airports to protect the interests of the airport user. These factors combine to ensure that airports face cost pressure on ANS charges or are subject to incentive based regulation where these do not apply.

The Overarching Competition Framework and the Role of Incentive-Based Economic Regulation

The Overarching Competition Framework

4.14 In addition to competitive pressures, it is important to note that the UK has a strong, active framework of competition law and incentive-based regulation at designated airports. The Office of Fair Trading (OFT), along with the CAA[55], has competition powers, under the Transport Act 2000 and the Enterprise Act 2002, to address anti-competitive conduct of providers of services and to recommend aspects of that market to the Competition Commission (CC) for investigation if it has reasonable grounds for suspecting that a feature of the market prevents, restricts or distorts competition. Airlines can also take action directly through UK and European courts where they believe that they are being affected by anti-competitive conduct or agreements.

4.15 This framework provides significant comfort that where competition may not be functioning properly, an active competition regime will be brought to bear, and recent evidence supports this view.

4.16 In November 2005 an offer to purchase Exeter by the owners of Bristol airport was withdrawn after the OFT referred the case to the CC, saying that the merger raised concerns about a loss of competition between the two airports that might ultimately adversely affect the choice of low-cost and charter flights for air passengers in the South-West.

4.17 More recently, following a reference by the OFT, the CC has launched an inquiry into whether there are any features of a market in which BAA operates that prevent, restrict or distort competition. The OFT's initial market study[56] had concluded that the current market structure did not deliver best value for air travellers in the UK and that competition between independently owned airports led to improved value for air travellers.

4.18 It is important to note in the context of this Assessment that while the outcome of the CC's inquiry might have significant implications for the future structure of the UK airports market, the OFT received no submission concerning a lack of competition between airports other than those owned by BAA. It should also be noted that the CAA has received no recent complaints from airlines in relation to any of the 9 airports currently falling in the 50-150k ATM range.

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[55] Airlines can also raise complaints with the CAA under s41 of the Airports Act.

[56] OfT published its findings in December 2006. The Press Release is at: www.oft.gov.uk/news/press/2006/175-06. The decision to make a reference to the CC was confirmed in March 2007 and more information about the CC's Market Investigation, including the precise issues being considered, and the CC's "Emerging Thinking" document, published on 22 April 2008, can be found at www.competition-commission.org.uk.

4.19 The UK also has a framework to enable *designation* of specific airports, in certain circumstances, in order that they are subject to incentive-based economic regulation, if deemed necessary where competitive pressures do not apply adequately – see the section on 'designation criteria' below.[57]

Airport Designation for the Purposes of Incentive-Based Economic Regulation

4.20 The UK Government's view is that the relationship between airport operators and airport users should normally be governed by commercial considerations. Where the market power of the airport is such that these mechanisms are insufficient, there is a framework of economic regulation which is applied.

4.21 Airports can be designated by the Secretary of State under the Airports Act, 1986[58]. The CAA must, after a reference to the Competition Commission, set a price cap on the airport charges levied by designated airports, covering a period of five years.[59] The price caps applied must be set in a way that is best calculated to achieve a number of objectives, including the promotion of the economic, efficient and profitable operation of airports. This duty ensures that the CAA's price caps will be set in a way that provides appropriate incentives to the airport to reduce costs, including those relating to the provision of ANS. The CAA announced its final decision on the price caps for Heathrow and Gatwick airports on 11 March 2008. These were applicable from 1 April 2008.

4.22 All of the UK airports currently price-controlled by CAA are above the 150,000 ATM threshold and as such ANS provision at these airports will be liable to the full scope of the transparency and unit rate setting requirements in the Charging Regulation.

Designation Criteria

4.23 In May 2007 the Government set criteria for designation, adopting an approach that takes as its starting point that where airports are subject to competitive pressures, they should not be subject to unnecessary intervention through regulation of their prices. The criteria are used to assess whether an airport should be designated and/ or whether a designated airport should have this status removed. The criteria relate to whether[60]:

- the airport has, or is likely to acquire, substantial market power; and
- UK and EC competition law provide an effective response to any risk of abuse; and
- the application of price caps would deliver incremental benefits, over and above the incremental costs associated with such regulation.

[57] On 28 April 2008 the Government announced a review of the economic regulation of the UK airports system. Further details on the review are at http://www.dft.gov.uk/pgr/aviation/airports/reviewregulatioukairports/.

[58] In 1986, the Secretary of State designated Heathrow, Gatwick, Stansted and Manchester Airports. No additional airports have been designated since 1986, though the Government announced in January 2008 its intention to de-designate Manchester airport.

[59] The CAA must also impose conditions to remedy any public interest findings made by the Competition Commission at each five-yearly review.

[60]http://www.dft.gov.uk/consultations/archive/2007/designationdedesignationairports/consuldecisionairports.

4.24 The Secretary of State announced on 15 January that Manchester airport would be de-designated, but that Stansted would remain subject to price controls.

Development of Competition and Pressure on Costs – a High-level View

The Increasing Commercial Focus of Airports

4.25 The UK's airports sector is now characterised by a significant degree of competition between airports for airline business and for passenger and freight traffic. In the course of research for CAP 775, UK regional airports explained that competition between airports – both with neighbouring airports in serving the local catchment and more widely with any airport where airlines might choose to deploy capacity – is now a "given" and is seen as positive in terms of delivering benefits to consumers. This concept of competition between airports, which might once under widespread local-authority ownership have seemed more difficult to accept, is described more fully in Chapter 6 of CAP 775.

Pressure on Costs

4.26 The increasingly competitive nature of the European airline sector has intensified the pressure on airports to compete through driving down costs and delivering service quality that meets the needs of airlines and passengers. As noted above it is, for example, widely reported that no-frills airlines, in addition to airlines with other business models, actively compare the prospects for profitable operation across a broad range of routes and airports, within the UK and across Europe.

4.27 The competitive impact of airlines' ability to consider a broad range of alternatives for their growth plans is compounded by the ability of some airlines to switch existing services between airports, and the potential for competing new services to attract passengers away from other airports. In addition, for some market segments, airlines face pressure from competing travel modes, such as rail, seeking to attract passengers away.

4.28 Many airports are aiming to develop a full range of services to leisure and business destinations, with a mix of short and long-haul services, scheduled and charter, and encouraging inbound as well as outbound passengers.

4.29 There are a number of examples of the competitive pressure faced by airports. For example, the rapid expansion of services at Liverpool has eroded Manchester Airport's share of local passenger numbers, whilst new entry by Doncaster Sheffield Airport has also increased the competitive pressure in that region. Discussions with stakeholders in the course of the Contestability Assessment have also supported the conclusion that airports in general operate in a commercial environment.

Drivers of Competition

4.30 In general, growing competition between a number of neighbouring airports under diverse ownership, and the capital-intensity of airport operations, meaning that they are relatively sensitive to losses of airline business, will provide airports with a strong incentive to reduce their charges to airlines and, therefore, to reduce ANS costs.

4.31 Where these circumstances do not apply, there are other features relating to an airport's operations that may indicate the potential level of competitive constraints it faces. These features include:

- *The proportion of no-frills carriers*: a fairly high proportion of no-frills carriers is likely to indicate that there will be active downward competitive pressures on prices.

- *The level of airline concentration:* The percentage of terminal passengers accounted for by the biggest airlines will indicate buyer power. Where there is concentration this is likely to allow those carriers to put more pressure on airport costs.

- *The proportion of domestic traffic, and where the proportion is high, whether there are credible alternative modes, e.g. rail:* The nature of passengers is important in assessing the competition faced by airports and airlines and the extent of pressure to reduce costs. Where passengers are able to readily switch between different airports, or take alternative routes, this will provide pressure for cost reductions.

- *The proportion of long-haul with high proportions of interconnecting passengers:* Lower levels indicate fewer barriers to individual airlines moving services away from an individual airport.

4.32 In relation to the UK airports within or just below the 50,000 ATM to 150,000 ATM thresholds set out in the Charging Regulation, the vast majority of these airports do face competition from local independent competitors, as set out earlier. In addition, all face additional competitive constraints in regard to some or all of the additional factors listed above. This supports the other evidence we have gathered, and indicates the level of competition faced by UK airports is high, including those at or around the relevant ATM thresholds of 50,000 to 150,000 for the purposes of the Charging Regulation.

4.33 There are some specific factors in the South East, such as the high proportion of traffic accounted for by BAA's London airports, that might limit the degree of competitive pressure faced by some airports. However, a system of economic regulation, supported by a robust competition law framework, is in place to protect the interests of airport users where these specific factors apply. This is touched on at paragraphs 4.20 to 4.24 above.

Pressure on ANS Costs

4.34 One consequence of the emergence of commercial airports is that these commercial companies are more likely to exert cost pressure over ANS providers, as these airports are subject to pressures from shareholders (as well as their competitors). In addition, the emergence of airport groups is also likely to increase the degree to which smaller airports in that group are able to effectively negotiate ANS cost reductions, as the total cost of ANS provision to these groups is larger than for each individual airport[61] and their business is more significant to each of the competing ANS providers. This section considers how ANS is procured and looks at the pressure on ANS costs.

[61] Allowing the costs of contract negotiation to be spread across multiple airports.

Magnitude of ANS Costs to an Airport

4.35 As discussed earlier in this paper, airports have the choice of either providing Air Navigation Services (ANS) in-house (i.e. self-supplying), or outsourcing the function to a third-party provider. In either case, the extent to which the airport seeks to bear down on ANS costs will be linked to the relative magnitude of ANS costs as a share of operating costs for the airport.

4.36 Evidence on this issue is subject to commercial confidentiality considerations but in the CAA's Price Control proposals the CAA's estimates of ANS costs were around 5.9% of forecast operating costs at Heathrow and about 5.8% of forecast operating costs at Gatwick[62], while at the last Manchester Price Control, the Competition Commission's 2002 report showed ANS costs at about 4.6% of operating costs at Manchester.

4.37 This suggests that ATS charges are a material cost item for airports. However, these figures may understate the potential focus on ANS costs as the capital-intensive nature of airports will tend to increase the impact of any operating cost reduction on overall profitability. This effect will be further magnified where the airport has adopted a 'geared' (i.e. heavily debt financed) financial structure (as is common for capital intensive businesses).

Direct Charging

4.38 The arrangements for recovering ANS costs currently vary between UK airports. At the majority of UK airports, the airport operator recovers the costs it incurs in supplying ANS services (whether directly or via a third party contractor) from airlines either though general landing fees or via a separate ANS charge. This is known as 'indirect charging'.

4.39 The extent of downward pressure on ANS charges might be expected to be greater still where airports both negotiate for, and bear the cost of, the provision of ANS services. The main reason for this is that a single party (the airport) will be negotiating for ANS services, and will be directly exposed to the costs resulting from the contract. In contrast, where airports negotiate with the ANS providers but airlines are charged direct ('direct charging'), there may be some risk that a disconnect between the contracting party and the liability for payment could reduce the incentive for airports to exert downward pressure on these costs (although the nature of airport competition may limit this risk).

Ending of Direct Charging

4.40 There are three UK BAA airports where the airport operator currently contracts with a third party supplier and the supplier recovers ANS costs directly from airlines (known as "direct charging"). The airports are Glasgow, Edinburgh and Aberdeen. Direct charging is established through a process of Government designation. **Following a consultation in 2007, the Government decided to end direct charging at Heathrow, Gatwick and Stansted after 31 March 2008. Direct**

[62] See paragraphs 5.52 and 5.53 of CAA decision of 11 March 2008 on Economic Regulation of Heathrow and Gatwick Airports
http://www.caa.co.uk/docs/5/ergdocs/heathrowgatwickdecision_mar08.pdf

charging is expected to cease at Edinburgh, Glasgow and Aberdeen in due course. With the end of direct charging, all airports will bear the ANS costs[63].

Summary

4.41 In summary, it is the view of this Assessment that the UK airports sector is broadly competitive, while price regulation is in place at designated airports to protect the interests of the airport user where this is deemed necessary. This is backed up by a strong independent competition regime. The commercial UK airports market, where airports compete for airline business, and a regulatory regime that, where appropriate, applies additional incentives to airports that face less competitive pressure, combine to ensure that airports face the cost pressure on ANS charges.

[63] The 'London Approach' service – the Approach Control service delivered by NERL for aircraft flying in and out of Heathrow, Gatwick and Stansted – will continue to be directly charged to airlines. CAA is regarding Approach Control services as out of the scope of this Assessment as they are not delivered 'at airports', as is drafted in Annex 1 of the Charging Regulation.

ANNEX A: AN ILLUSTRATIVE COMPARISON: INDICATORS OF CONTESTABLE ANS PROVISION AS AGAINST NON-CONTESTABLE PROVISION

Conditions to be assessed under Annex 1	**A contestable industry**	**Non-contestable industry**
Existence or otherwise of significant economic barriers	Costs (e.g. of offering service) proportionate to value of ANS contract on offer.	Unable to recover costs (and make profit) of starting and /or running a service through ANS charges.
Existence or otherwise of significant legal barriers	Legal and regulatory framework that supports contestability.	Insurmountable/expensive legal/regulatory barriers to providing or withdrawing from ANS provision.
Length of contract duration	Contract of sufficient length to justify one-off bidding costs (e.g. 5-10 years), but not over long. Contract also drawn up in ways that indicate competitive pressure, e.g, presence of break points, review periods and delivery targets	Long contract (e.g. 20 years) with no provisions for early termination, break points, review periods or delivery targets.
The existence of a procedure allowing assets and staff to be transferred	Essential assets/staff either owned/employed by airport or, where not, a procedure in place to ensure smooth transition of these to an incoming provider.	Assets owned and staff employed by ANSP and no process in place for transfer on change of provider.
The ability or otherwise of airports to move towards self-supply	No barriers in cost, staffing or safety requirements. Tested frameworks like TUPE to allow transfers.	Costs of switching provision prohibitive, unable to meet safety requirements, unable to acquire/switch staff.
The existence or otherwise of legal, contractual or practical barriers to an airport's ability to change provider	No barriers in cost, staffing or safety requirements.	Costs of switching provision prohibitive, unable to meet safety requirements, unable to acquire/switch staff.
The role of airspace users representatives in the ANSP selection process	Fully engaged in the process, but with due regard given to the ultimate commercial needs of the airport.	No relevant engagement or consultation with users on ANS.
The existence or otherwise of structural rigidities which restrict the effective choice	No such barriers to any ANSP providing a service at any aerodrome and surrounding airspace.	Insurmountable technical or cost barriers to an ANSP offering to provide at an aerodrome. Only one ANSP who could do the job.
Evidence of alternative ANSPs, including the option of self-supply, that provides choice in the selection of ANSP by airports	Different options for ANS provision, from which an airport can choose.	Few, if any, alternatives to a state-owned sole provider.
Whether airports compete for airline business	Range of airports, with commercial pressures a key driver and focus on costs. Competitive airlines focussed on costs and with options to switch services.	Limited number of airports, with market power over carriers.

ANNEX B

Additional Information Relevant To Sections 1 And 3 of the Assessment

(The headings refer to the relevant sections in the main document)

1. (iv) existence of procedure allowing assets and staff to be transferred from one ANSP to another

What Are Assets?

For the purposes of this assessment we define assets as including:

- All ground-based equipment utilised in the provision of air traffic services, including approach and landing aids. Such assets include Secondary Surveillance Radar (SSR), which is a radar system that also requests additional information from the aircraft, and the Instrument Landing System (ILS), which provides guidance to landing aircraft using radio signals and high intensity lights.

- Documentation essential to the operation of the airport, such as:
  - Safety Management System (SMS), including the MATS Part 2
  - Quality Management System (QMS)
  - Security Plan
  - Contingency Plan

- Computer software (although service provision software systems are generally regarded as part of the ground-based equipment utilised in the provision of air traffic services)

Staff transfer issues

ATC staff engaged in aerodrome ATS.

Approach Controllers

Broadly speaking, approach controllers take over contact with aircraft from the en-route controllers as the aircraft approach within a certain distance towards the airports. They guide and sequence aircraft into the most efficient order for landing. For departures they provide an initial radar service prior to transferring the aircraft to an en-route controller. At airports in the London Terminal Manoeuvering Area this function is performed by NATS (En Route) controllers based at London Terminal Control at Swanwick in Hampshire.

Aerodrome Controllers

Aerodrome controllers take over to monitor the aircraft through final approach, landing and parking. At the very busy airports, the aerodrome control function is split into air control and ground control, the latter of which integrates the movement of aircraft and vehicles on the ground and directs the aircraft to its parking area.

Staff hierarchy

Senior Air Traffic Control Officer (SATCO) or Air Traffic Services Manager
Air Traffic Control Officer (ATCO)
Air Traffic Control Assistant (ATSA)

1. (iv) existence of procedure allowing assets and staff to be transferred from one ANSP to another (continued)

Transfer of Undertakings (Protection of Employment) Regulations 2006 (the TUPE Regulations).

These Regulations are concerned with preserving employees' terms and conditions when their employer changes as a result of a transfer of a business or undertaking. They implement the European Community Acquired Rights Directive (77/187/EEC, as amended by Directive 98/50 EC and consolidated in 2001/23/EC).

Broadly speaking, the effect of the Regulations is to preserve the continuity of employment and terms and conditions of those employees who are transferred to a new employer when a relevant transfer takes place.

This means that employees employed by the previous employer when the transfer takes effect automatically become employees of the new employer on the same terms and conditions (except for certain occupational pensions rights). If for any reason an individual does not accept being transferred his or her contract is terminated, and he or she is deemed to have resigned (and not be entitled to redundancy payment). The Regulations also provide some limited opportunity for the companies concerned to vary, with the agreement of the employees concerned, the terms and conditions of employment contracts for a range of stipulated reasons connected with the transfer.

The Regulations contain specific provisions to protect employees from dismissal before or after a relevant transfer. Representatives of affected employees have a right to be informed about a prospective transfer. They must also be consulted about any measures which the transferor or transferee employer envisages taking concerning the affected employees.

In addition, the previous employer cannot retain the staff of the economic entity (the ATC unit) who would otherwise be transferred to the new employer. In theory the previous employer could reassign staff out of the ATC unit prior to the transfer, but in practice this would be difficult to do bearing in mind the need to maintain continuity of service throughout.

The Regulations also place a duty on the transferor employer to provide information about the transferring workforce to the new employer before the transfer occurs.

The Regulations can apply regardless of the size of the transferred business.

Source: Employment Rights on the Transfer of an Undertaking: a guide to the 2006 TUPE Regulations for employees, employers and representatives (http://www.berr.gov.uk/files/file20761.pdf).

3. (i) existence of structural rigidity which restricts the effective choice of the ANSP for airports

The London Terminal Control Area

NERL Controllers at Swanwick handle traffic below 24,500 feet flying to or from London's airports in what is known as the London Terminal Control Area. This area, which is one of the busiest in Europe, extends south and east towards the coast, west towards Bristol and north to near Birmingham. Controllers provide an approach service to inbound aircraft ensuring they descend in a safe and orderly stream ready to land. At busy times, aircraft are directed to holding stacks. Here they descend, under the controller's guidance, before being sequenced and released for their final approach. Aircraft flying from London's airports are handed over to Terminal Control shortly after take-off. The controllers then guide the aircraft into the airways where they are passed on to staff in the London Area Control operations room at Swanwick[64].

[64] Source: NATS website (http://www.nats.co.uk/text/81/london_terminal_control_centre.html).