

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

CAP 1261 – non-confidential



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CHAPTER 1

Introduction

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

Reason for conducting the study

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

Legal Framework for the analysis

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

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

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

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

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

Timetable and how to respond

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

Process to date

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

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

Timetable

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

How to respond

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

Structure of this document

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

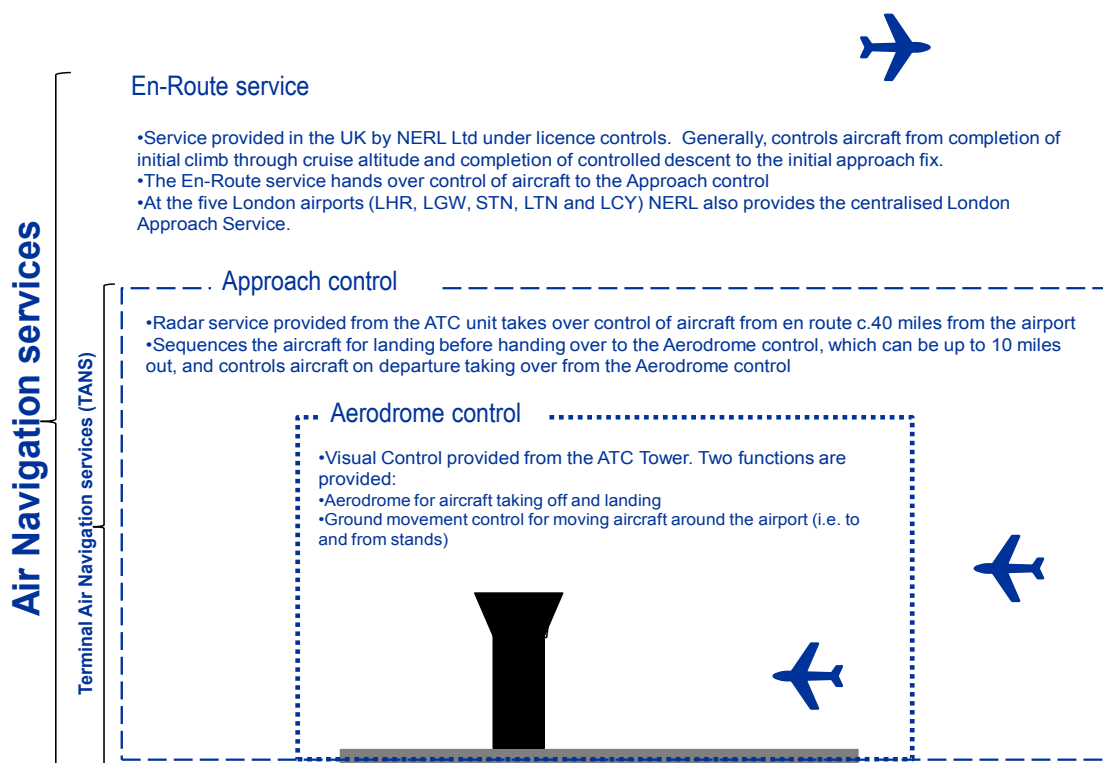
Chapter 2

Background

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

Definition of TANS

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

Figure 1: Illustrative definition of TANS

History of UK TANS provision

1972 to 2003

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

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

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

2004 to 2013

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

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

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

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

⁶ This was prior to the BAL and GAL decisions.

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

which started on 1 January 2015.

2013 to present day

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

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

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

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

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

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

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

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

Chapter 3

Summary of the relevant findings from CAP 1004

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

Criterion one

- 3.2 Criterion one is:

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

a) The existence or otherwise of any significant legal or economic barriers that would prevent a service provider from offering to provide or withdrawing the provision of these services;

b) The contract duration; and

c) The existence of a procedure allowing assets and staff to be transferred from one air navigation service provider to another."

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

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

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

NSL interface with NERL

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

NATS ToaP and the transfer risk of ATCOs

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

Criterion two

3.12 Criterion two is:

The extent to which there is a free choice in respect to service provider, including, in the case of airports, the option to self-supply;

a) the existence or otherwise of legal, contractual or practical barriers to change service provider or in the case of terminal air navigation service to move towards self-supply of air navigation by airports;

b) the role of airspace users' representatives in selecting the service provider.

3.13 CAP 1004 considered that five issues were relevant to the assessment of this Criterion. These were:

1. tolerance for transition risk of service provision;
2. complexity of operation;
3. NSL cost transparency;
4. self-supply; and
5. the role of airspace user representatives.

3.14 CAP 1004 did not find that any of the relevant issues on their own raised particular barriers in the meaning of the Criterion. Although some of them posed practical difficulties, it was only where these issues are combined with the issues raised in Criterion one, that they together pose a barrier within the meaning of Criterion 2.

Criterion three

3.15 Criterion three is:

The extent to which it can be chosen from a range of service providers:

a) the existence of a public tendering process (not applicable in the case of self-supply);

b) if applicable, evidence of alternative service providers participating in the tendering process and having provided services in the past, including the option of self supply for the airport.

- 3.16 At the time of CAP 1004, the Luton tender was the only open process in the UK since privatisation. The Birmingham tender had opened but had yet to conclude. The majority of contracts were yet to come to market but would do so over the course of RP2 (2015-2019).
- 3.17 A number of airport operators raised concerns over the credibility of ANSPs' in relation to ability to provide TANS in the UK during the course of RP2. This was particularly the case at the larger airports. However, a list of potential competitors was put forward consisting of other European states' incumbent providers and smaller UK operators.
- 3.18 Attention was drawn to the liberalisation activities in Europe and further afield. However, the CAA considered these liberalisations had little in common with the UK context, given that UK airports tender individually and contracts for TANS had not been let on a group basis.
- 3.19 On balance, the advice considered that the current lack of credible alternatives limited the extent to which airport operators could freely choose supplier. However, this was expected to change over time as contracts came to tender and suppliers came forward to bid.

Criteria four and five

- 3.20 Criterion four is:

For terminal air navigation service, the extent to which airports are subject to commercial cost pressures or incentive based regulation:

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

- 3.21 Criterion five is:

Where the provider of terminal air navigation services or CNS, MET and AIS services also provides en route air navigation services, these activities shall be subject to separate accounting and reporting.

- 3.22 CAP1004 did not conduct a formal assessment of the competitive landscape of airports in the UK. It set out that, without prejudice to any further decision taken by the CAA, or any action other competition authorities may wish to take concerning the level of competition at UK airports, the CAA broadly considers that airport operators in the UK face cost pressures which mean that they would seek to minimise the cost of TANS provision at the airport as a result of either economic regulation or competitive pressures.
- 3.23 The advice found that airport operators bear the cost of TANS to a greater or lesser extent across the airports reviewed. There was no evidence presented at the time to suggest that the airport operators did not bear the cost of TANS provision.
- 3.24 With regards to the requirement for separation between the providers of TANS and the providers of en route services, in the UK this is only applicable to the NATS group which owns NERL, the en route service provider, and NSL, a provider of TANS. The advice set out that these are separate legal entities and are required by law to lodge separate accounts with Companies House. NERL is also required by regulation to produce separate regulatory accounts. As such there activities are subject to separate accounting and reporting.
- 3.25 In summary, CAP 1004 found that there were no issues of concern in relation to criteria four and five.

Conclusion of CAP 1004

- 3.26 In summary CAP 1004 found that:
- there were some barriers under Criterion 1;
 - barriers with Criterion 2 arose only in combination with those found under Criterion 1;
 - under Criterion 3, alternative providers would likely develop over time;
 - there were no barriers under Criterion 4; and
 - there were no barriers under Criterion 5.

Chapter 4

Evidence collection

4.1 This section describes the collection of evidence undertaken by the CAA as part of this assessment.

Scope

4.2 This assessment has considered the operation of TANS in the UK. In particular, the CAA has focussed its assessment on airports with over 70,000 instrument flight rules air traffic movements (IFRS) annually. These are the airports that are currently covered by the SES II Performance Scheme and are those within the scope of the DfT's request to the CAA set out in its letter of 10 August 2014. These include the following airports (ranked by IFRS):

- London Heathrow;
- London Gatwick;
- Manchester;
- London Stansted;
- London Luton;
- Birmingham;
- Edinburgh;
- London City; and
- Glasgow.

4.3 Additionally, to assist its analysis, the CAA has considered the recent renegotiations that took place at Belfast International and Cardiff Airports. The CAA has also welcomed representations made by the wider industry in its call for evidence.

Evidence collection

4.4 As part of this study, the CAA has conducted three main stages of evidence gathering and analysis:

- an industry wide call for evidence;
- a review of open tender processes; and
- a review of closed procurement processes.

Industry wide call for evidence

4.5 On 26 September 2014, the CAA published a notice to industry calling for evidence on the changes that had taken place in the provision of TANS since the publication of CAP 1004.¹³

4.6 CAP 1226 set out the high level conclusions from CAP 1004 and the events, set out in paragraph 2.17, which had happened since its publication. It requested views and evidence around these events. In particular, four areas of focus were identified:

- how the events, as set out, affect the presence (or otherwise) of market conditions in the UK;
- any additional evidence that affects the findings of CAP 1004, including in relation to barriers to entry;
- how the CAA should deal with the remaining issues identified in CAP 1004;¹⁴ and
- any other representations that interested parties may wish to make relating to the competitiveness of TANS provision in the UK.

Review of open tender process

4.7 The CAA engaged directly with the operators of Luton, Birmingham and Gatwick airports, as well as ANSPs that had taken part in those airport operators' open tender processes. The aim of this review was to understand the open tender process, the issues that may have arisen during these processes and how these were dealt with. The review was conducted on the basis of structured interview with the parties, written responses and supporting documentary evidence.

¹³ This notice was published on the CAA's website as 'Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence (CAP1226)' and accompanied with a press release. The call for evidence ran until 7 November 2014. See www.caa.co.uk/cap1226

¹⁴ These are set out in chapter 3.

- 4.8 The CAA has assessed whether the tenders followed best practice.
- 4.9 The CAA conducted meetings with and/or sent targeted information requests to the following companies:¹⁵
- Birmingham Airport Ltd;
 - Cyrrus Ltd;
 - Deutsche Flugsicherung GmbH;
 - Gatwick Airport Ltd;
 - London Luton Airport Operations Ltd;
 - NATS Services Ltd; and
 - VantageANS Ltd.

Review of closed processes

- 4.10 The CAA engaged directly with airport operators, as well as the incumbent ANSP at airports that had recently conducted a contract renegotiation rather than an open tender. The CAA was keen to understand the motivation behind the choice of a closed procurement process over an open process and what process was undertaken. The review was conducted on the basis of a structured interview with the parties, written responses and supporting documentary evidence.
- 4.11 The CAA conducted meetings with, and/or sent targeted information requests to, the following companies:
- Belfast International Airport Ltd;
 - Cardiff Airport Ltd;
 - Manchester Airports Group; and
 - NATS Services Ltd.

¹⁵ Not all parties provided a response. The questionnaires around which the discussions were structured is provided in Annex A for both the open and closed procurement processes.

Chapter 5

Analysis

- 5.1 This chapter sets out the CAAs analysis. It is difficult to disentangle each issue individually given the various linkages between them. This section therefore sets out the main areas where issues were raised in the CAP1004 assessment as follows:
- general comments;
 - alternative providers;
 - tender processes and contract length;
 - TANS / NERL interface; and
 - ToaP.

General Comments

- 5.2 IATA did not consider that the recent developments supported the presence of market conditions. IATA referred to its more substantive response to CAP 1132 on the CAA's approach to TANS regulation.

“IATA notes that CAP 1004 recognised that there was some uncertainty about the likely timing for market changes, noting that while greater competition was in theory possible, very little change had so far occurred in practice.

Recognising that the uncertainty could also affect the RP2 period, the CAA stated that it would keep developments under review. It would seem that the renewal of contract with NATS at five airport, the challenging developments at Gatwick and the cautious transition at Birmingham, all serve to underline and confirm the CAA's careful approach about the scope for further change.[sic]”¹⁶

- 5.3 IATA also questions the DfT's ability to seek derogation from the SES II Performance Scheme during the reference period, should DfT choose to do so.

¹⁶ IATA, Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence, 6 November 2014

- 5.4 On the other hand GAL considered that its experience demonstrates that market conditions exist within the provision of TANS and further considered that its experience will encourage other airports to take such steps. The issues previously considered by the CAA did not form insurmountable barriers to switching from the incumbent, when tested in a live situation.¹⁷
- 5.5 NATS also supported this view of market conditions, that given the recent market developments all the elements of the test are now met. NATS considered that increased competitive pressures in the market, alongside recent changes in airport ownership and regulation, have resulted in commercial deals consistent with a fully functioning contestable market place.¹⁸
- 5.6 Heathrow Airport Ltd (HAL) welcomed the developments but was more cautious as it considers it is too early to conclude that an airport can make a seamless transition between suppliers.
- 5.7 HAL commented that has been exploring its options but
*'until [it has] a commercial deal that is in the interests of our airlines and passengers [it] cannot say it is a contestable market. However, if [it is] able to secure a commercial deal that is in the interests of both [its] airlines and passengers [it] does not see a need for additional regulation of the TANS market.'*¹⁹
- 5.8 Although generally supportive of market conditions DFS set out a number of factors for the CAA to address to ensure the continued development of the market. DFS also criticised the CAA over its lack of action following the previous review. Noting that *"the CAA had committed to work with NATS after the last call for evidence to provide this clarity but seems content to allow NATS to determine unilaterally what they are prepared to offer.[sic]"*²⁰

¹⁷ GAL, TANS call for evidence, 14 January 2014

¹⁸ NATS, NSL's response to CAP1226: Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence, 7 November 2014

¹⁹ HAL, Provision of TANS in the UK: Call for evidence - Heathrow Response, 6 November 2014

²⁰ DFS, Amended ANS response cap 1226, 12 January 2015

Alternative providers

- 5.9 Since CAP 1004, there have been a number of open tender processes. For these tenders there has been more than one credible supplier. In the most recent tender run by GAL it had 14 providers interested in the contract, five submitted pre-qualifying questionnaires, from which GAL selected four, three of which eventually submitted compliant bids. Following the process a subsidiary of DFS won the contract.²¹
- 5.10 DFS is one of the largest ANSPs in Europe. It is responsible for en route airspace and the operation of the majority of TANS in Germany. Its TANS operations include large airports such as Frankfurt and Munich. Additionally there has been interest shown from other European ANSPs and other new entrant services such as VantageANS (who entered a bid at Luton).
- 5.11 DFS and VantageANS represent different two very different forms of provision. One is developing its offering from the base of an extensive operation in its home country while the other is commercialising in-house provision.
- 5.12 Additionally, at Birmingham, BAL has taken the decision to bring TANS in-house.
- 5.13 NATS has set out that it considers there are commercial pressures stemming from alternative providers. NATS note that DFS has entered the market at Gatwick, a major airport has taken the service in-house, and it considers that other airport operators have credibly threatened to take service in-house as part of negotiations.²²
- 5.14 Although, MAG did not tender it states that its ability to assess an in-house solution and consider third party alternatives allowed it to apply commercial pressure on NSL during its recent negotiations.²³
- 5.15 [redacted].²⁴
- 5.16 Meanwhile, Cardiff Airport Ltd (CAL) considered that there were no suitable alternatives for it at the time of its tender.²⁵ Belfast International Airport Ltd (BFS) was in a similar position although had also considered in-house

²¹ GAL, TANS call for evidence, 14 January 2014

²² NATS, NSL's response to CAP1226: Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence, 7 November 2014

²³ MAG, Provision of Terminal Air Navigation Services in the UK: Call for Evidence, 19 January 2015.

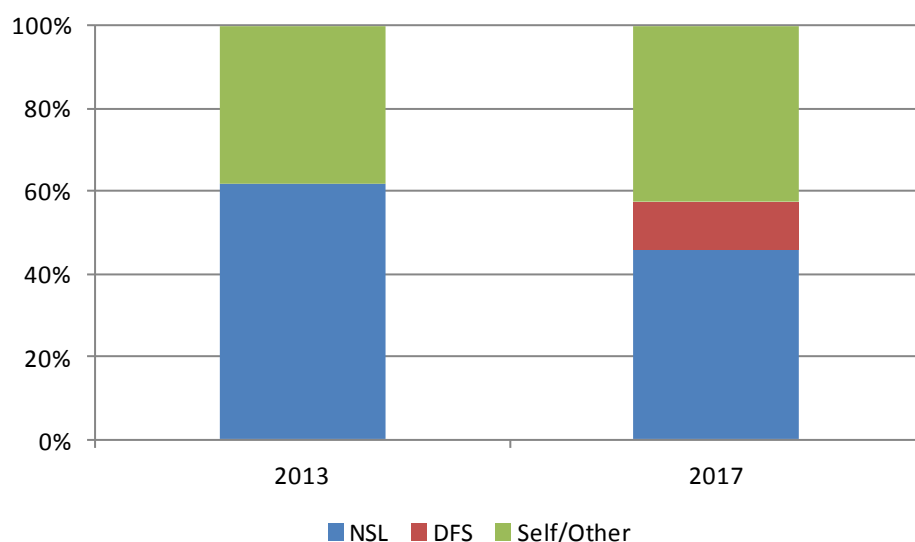
²⁴ [redacted]

²⁵ CAL, Provision of terminal air navigation services (TANS) in the UK - Call for Evidence, 29 Oct 2014

provision.²⁶

- 5.17 As for new entry, DFS considered that transition and set up costs, such as safety regulatory certification and designation, remain the biggest barrier. They argue that these costs disadvantage new entrants, making scale of entry important. DFS has requested that the CAA seek practical measure to ensure there is a level playing field for new entrants.²⁷
- 5.18 As a result of these changes, by 2017 the make-up of the industry may be expected to look quite different to that observed today. Figure 3 shows a forward look to 2017 for market shares based on 2013 movement data and the current known changes in operator.

Figure 3: Share of ATMs by operator in 2013 and 2017



Source: CAA Statistics, NOTE: 2017 estimated on 2013 data with ownership change

- 5.19 DFS and self-supply (as illustrated by BAL) pose credible alternatives for airport operators. The transitions of Gatwick to DFS and Birmingham to self-supply should be completed by the time other airport operators are considering their contracting options. The credibility of these providers should, therefore, become clearer during this period.
- 5.20 By 2017, the CAA would like to see the contracts at London City, London Luton, Edinburgh and Glasgow (each of them airports covered by the regulation) being tendered. Additionally, the operators of Aberdeen, Belfast International, Cardiff and Southampton airports will be seeking new

²⁶ CAA, Conference call on Belfast International's renegotiation with NATS (Services) Ltd, 18 Nov 201

²⁷ DFS, Amended ANS response cap 1226, 12 January 2015

contracts in the period to 2018. This represents a significant proportion of contracts operated by NSL and has the potential to instigate further change in the industry.

- 5.21 The CAA accepts DFS's point on setup costs. However, for DFS, these costs will now be sunk and its future barriers to expansion will be lower. Other potential entrants will face setup costs the magnitude of which will vary depending on the operation and development of the ANSP. These do not appear to have formed a barrier that has prevented DFS from a successful bid at GAL, or for BAL to develop an in-house option from the ground up.
- 5.22 The CAA considers that, given the nature of the market, a competitive dynamic can persist and develop even if there are only a few active parties, in addition to the option to self-supply. It appears to the CAA that those credible alternatives are now present and the successful transition of the Gatwick and Birmingham towers will only strengthen this position. The CAA considers that Criteria 3 is now met.
- 5.23 That said, with a significant feature of the market is that NSL still holds the majority of the major TANS contracts. The self supply operators who represent the other 40 per cent of the market are a group of 50 or so providers at airports with low numbers of movements. In 2017 BAL will form a large part of the self-supply grouping.

Tender process and contract length

Contracts let

- 5.24 The CAA is aware that, since CAP 1004, there have been seven contracting processes with respect to TANS provision at UK airports. Four new contracts for TANS have been awarded following renegotiations with the existing provider and three awards have been made following an open tender process. The details of these are set out in the Figure 2 below.

Figure 2: Recent renegotiations and tenders for TANS in the UK

airport operator / Airport	Services tendered	Date(s) of tender	Compliant bids	Outcome
London Luton Airport Operations Limited (LLAOL)	Aerodrome and Engineering	2011/12	2 Bids	- NATS (Services) Ltd - 3 year contract with 2 and 1 year extension options - live Oct 2013
Birmingham Airport Limited (BAL)	Approach, Aerodrome and Engineering	2012/13	1 Bid and the development of a self supply alternative	- Self-supply - goes live March 2015
Belfast International Airport Ltd (BFS)	Approach, Aerodrome and Engineering	N/A	Renegotiated	- NATS (Services) Ltd - 5 year contract - live April 2013
Cardiff Airport Ltd (CAL)	Approach, Aerodrome and Engineering	N/A	Renegotiated	- NATS (Services) Ltd - 5 year contract - live Jan 2014
Gatwick Airport Limited (GAL)	Aerodrome and Engineering	2013/14	3 Bids	- Deutsche Flugsicherung - 10 year contract - transition planed winter 2015/16
Manchester Airports Group (MAG)	Group Contract for Manchester (MAN) and Stansted (STN) airports Approach (MAN only), Aerodrome and Engineering	N/A	Renegotiated	- NATS (Services) Ltd - 10 year contract - live March 2015
[REDACTED] ²⁸	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Source: Press releases and evidential submissions

²⁸ [REDACTED]

Tender process

- 5.25 CAP 1004 set out the limited tender activity since 2001. The test asks whether there is a public tender mechanism in place.
- 5.26 In the UK, there is a public process in place. The OJEU process is available and has been used by some airport operators. The CAA is aware that, with recent changes in airport regulation, there has been a shift in the legal framework which may result in some lack of clarity on this issue and the applicability of the requirement to tender.
- 5.27 Previously, Part O of Category 7 of Schedule 1 of the Utilities Contracts Regulations 2006 (UCRs) set out that the regulations applied to airports as a utility, as:
- 'An airport operator within the meaning of the Airports Act 1986(10) who has the management of an airport subject to economic regulation under Part IV of that Act.'*
- 5.28 However, this condition was removed on 6 April 2013 by Section 5 of Schedule 1 of the Civil Aviation Act 2012 (Regulation of Operators of Dominant Airports) (Consequential Amendments) Regulations 2013. The 2012 Act replaced the framework of Part IV of the 1986 Act with a licensing regime. The combined consequences of this and the 2013 Regulations, are that the test of whether the UCRs apply is now on the basis of whether "special or exclusive rights exist". These are defined under section 3(2) of the UCRs as:
- "special or exclusive rights" means rights granted by a competent authority by way of any legislative, regulatory or administrative provision, the effect of which is to limit the exercise of activities specified in the second column of Schedule 1 to one or more entities, and which substantially affects the ability of other entities to carry out such activities'*
- 5.29 The relevant activities in Schedule 1 are:
- 'The exploitation of a geographical area for the purpose of providing airport or other terminal facilities to carriers by air'*
- 5.30 It is the CAA's understanding that the position appears to have moved from one of blanket application to all airports with revenue of greater than £1 million per annum to application on a case by case basis determined by whether the airport operator has "special or exclusive rights".
- 5.31 Airport operators have taken different views on whether or not they are obliged to tender or whether it is in the best interests of their business to do so.

- 5.32 It is not appropriate for the CAA to provide guidance to airport operators on whether the UCRs apply to individual airports. Rather it is for airport operators to consider their own compliance with the relevant procurement law.
- 5.33 The CAA is aware that both GAL's tender process and MAG's decision not to tender were both the subject of legal challenges. However, both of these actions were settled out of court and so no additional clarity on where the UCRs apply has, as yet, been forthcoming.
- 5.34 The CAA understands IATA's criticism that a number of contracts have not gone to market and that GAL came under challenge for its decision to do so. It shares the view that there must be scope for contracts to come to market to allow the development of market conditions. However, as discussed above, the CAA considers that both the GAL and BAL decisions to put TANS services to tender represent significant changes to the state of the market and evidence of what can happen (in terms of the interest generated from potential suppliers by the tender) when contracts at larger airports do come to be opened up to competition. The situation under Criterion 2 has therefore significantly improved.
- 5.35 NSL's challenge to GAL's decision was an exercise of its legal rights. The CAA has considered whether this may have a cooling effect on the market but has been unable to fully assess the issue at this time. Private legal action is expensive and smaller airport operators may not be able to devote resources to defend such action in the event that a tender process they have run is challenged. Such behaviour may influence their decision making as to whether or not to tender TANS, and as to how to conduct any tender process they choose to operate. However, as no clear evidence is available at this time on which to make this assessment, the CAA will keep developments in this area under review.

Operation of Open tender processes²⁹

- 5.36 As set out in Figure 2 above, there have been three open tender processes held recently in the UK. These have been held in respect of Luton, Birmingham and Gatwick Airports.
- 5.37 The LLAOL tender was the first major open tender of TANS in the UK. To assist the running of the tender process, LLOAL employed a consultancy firm, Cyrrus. The CAA is aware that Cyrrus went on to support the other tender rounds.

²⁹ This section covering the shape of the tending process has been developed from using submissions from BAL, GAL, LLAOL and NATS.

- 5.38 The LLAOL tender was conducted following an OJEU tender process. LLAOL reported receiving significant interest in the opportunity to tender for its contract but only received two compliant bids.
- 5.39 The BAL tender also took place using an OJEU tender process. BAL received some interest in its tender. Ultimately, however, it received only one compliant bid. In contrast to the LLAOL tender BAL, from the outset, considered a self-supply option as an alternative to bids from third parties. BAL also sought interest in a managed solution as an alternative to either a fully in-sourced or out-sourced solution.
- 5.40 The GAL tender took place in 2013 and, again, was initiated with an OJEU notification. GAL initially received in excess of 14 expressions of interest. This resulted in five pre-qualifying questionnaire submissions followed by three compliant bids.³⁰
- 5.41 All tenders were conducted on the basis of three lots. These were for the air traffic service, for the engineering support services and one for a combination of both services. Each tender followed a similar process.
- 5.42 Tenders were scheduled to take place over a 6 to 10 month time period. The key steps were as follows, with the number of potential bidders being reduced at each stage:
- notice of tender;
 - prequalifying questionnaire (PQQ);
 - invitations to tender (ITT);
 - on-site briefing;
 - data room;
 - submission of bids; and
 - best and final offer (BAFO) (where appropriate).

Evidence provided by airport operators

- 5.43 As set out in Figure 2 LLAOL, BAL and GAL held open tenders.
- 5.44 LLAOL considers that it benefited from the open tender process through obtaining:³¹
- transparency surrounding the cost base;

³⁰ CAA, Gatwick Airport Ltd TANS Open Tender, 22 Dec 2014

³¹ LLAOL, London Luton Airport Response to the Call for Evidence on Provision of Terminal Air Navigation Services in the UK, 5 November 2014

- a more productive relationship with the supplier; and
- a clear set of responsibilities in the contract.

- 5.45 BAL ultimately opted for an in-sourced solution as it did not consider that the market could provide an adequate service at a suitable price. BAL has stated that it considers that, had it been in a position to delay its tender by a year, there may have been more interest from other European providers. It considers that, at the time, many such providers were gearing up to compete but were not then in a position to do so.³²
- 5.46 GAL awarded its contract to DFS. However, prior to the tender process GAL considered that there was scepticism amongst ANSPs of airport operators' seriousness in tendering. GAL undertook specific steps to engage with potential bidders prior to the ITT. It also took steps to ensure that the tender process did not provide unwarranted advantage to the incumbent.³³
- 5.47 GAL considered that offering the service as two lots may have encouraged more competition for the tender. However, GAL considered that there was little appetite from bidders to provide either ATC or engineering services in isolation.³⁴
- 5.48 GAL considers that it has benefited from conducting an open tender. It noted that, for CAP 1004, it had raised potential issues of a lack of commercial experience with ANSPs. In practice, GAL did not consider that this was an issue as all parties were able to provide robust and coherent bids.³⁵
- 5.49 On the other hand MAG, BFS and CAL did not hold an open tender.
- 5.50 MAG states that they took a staged approach to their decision on contracting for TANS. This involved a consideration of both in-house and alternative providers. MAG utilised the information it held from its own provision at East Midlands International Airport as well as the differing contracts for MAN and STN within its negotiation. MAG states that it held open the option to move to tender or an in-house solution until it was sure that it could get a suitable price and quality offer from NSL. MAG argued that this allowed them to avoid the costs of tendering and the risks involved

³² BAL, Open Tender response, 17 October 2014

³³ CAA, Gatwick Airport Ltd TANS Open Tender, 22 Dec 2014

³⁴ CAA, Gatwick Airport Ltd TANS Open Tender, 22 Dec 2014

³⁵ CAA, Gatwick Airport Ltd TANS Open Tender, 22 Dec 2014

in seeking to switch service provider.³⁶

- 5.51 The operators of both BFS and CAL were in a similar position when considering whether to tender TANS. At the time of the Luton Airport tender, both airports and Luton were jointly owned by Abertis. Both Airports Operators have set out that, at that time, consideration was given to a joint contract. However, given the complexities of differing contract termination dates and differing service requirements, this was not taken forward. The decision was taken to tender the Luton service only. Having conducted the Luton tender, the market information thereby gained was then available across the group for application at both BFS and CAL.³⁷
- 5.52 BFS used the experience gained from the Luton tender as part of its decision to renegotiate with NSL for the provision of TANS. BFS had particular concerns over the impact of ToaP given the relatively small size of its operation and the cost that this may impose on any bidder.
- 5.53 Unlike BFS, CAL had transitioned to new ownership during the renegotiation of its contract with NSL that had started under Abertis. As the result of transition, CAL contracted for a further year with NSL to allow the new owners to consider the appropriate approach. CAL has provided a write up on its motivation for undertaking a renegotiation instead of an open tender.
- 5.54 CAL's approach to negotiation was based on its view of the future. That future view is set out in a 10 year strategy it has for the development of TANS at the airport. Its decision to conduct a closed process was based on its view of recent procurement activity, discussions with consultants and the legal implications of its decision (i.e. whether it was under a duty to tender). As noted in the prior section CAL did not consider suitable alternatives to NSL were available. Its stated aim was as follows:

*"[to secure] a cost-effective, integrated system of ATS provision that will as well as [support the operations of] CAL, supports operations at other government-owned and possibly privately-owned aviation establishments across [Wales]"*³⁸

³⁶ MAG, Provision of Terminal Air Navigation Services in the UK: Call for Evidence, 19 January 2015.

³⁷ CAA, Conference call on Belfast International's renegotiation with NATS (Services) Ltd, 18 Nov 2014 and CAL, Provision of terminal air navigation services (TANS) in the UK - Call for Evidence, 29 Oct 2014.

³⁸ CAL, Contract to supply air traffic services / air traffic engineering for Cardiff airport - procurement strategy, supplied 29 Oct 2014

- 5.55 As to whether both BFS and CAL would consider and open tender in the future, the airport operators noted the following:
- the benefits of a tender would need to outweigh the costs;
 - the need for evidence of credible competition from third party service providers; and
 - the need for evidence of innovation of third party suppliers.

Evidence from Air Navigation Service Providers

- 5.56 NSL was the incumbent provider for all three of the open tenders. As the incumbent, NSL was required to facilitate the provision of a data room for each of the tender rounds. The data rooms were controlled by non-disclosure agreements with the bidding parties and access to the data room was controlled by recording equipment. NSL consider that the operation of three tenders by different airport operators demonstrates the airport operators' ability to run successful tender processes.³⁹
- 5.57 VantageANS was a bidder in the LLAOL tender and considered bidding for the BAL contract but decided not to progress to a formal bid. It did not participate in the GAL tender. VantageANS identified a number of risks within the bidding process. With the LLAOL tender, as the first significant commercial tender, VantageANS identified particular risks as it was a new initiative i.e. those around developing their competence to commercially tender. It considered that these risks would be mitigated with repeat tenders. Indeed VantageANS noted that there was clear learning in the process that it was involved with in the BAL tender.⁴⁰
- 5.58 DFS consider that the GAL's tender was a step change with the airport really looking for a market solution rather than just a better deal from the incumbent provider. DFS argue that it is evidence that some airports are willing to understand the provision of TANS and to challenge the status quo.⁴¹
- 5.59 DFS also contend that the renewal of contracts, in some cases well in advance of expiry of the current contract, without recourse to the market, is not appropriate behaviour in the market in its current state of development. DFS notes this may be acceptable in a mature market but not one in the early stages of development. DFS question whether this is evidence of NSL

³⁹ NATS, NSL's response to CAP1226: Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence, 7 November 2014

⁴⁰ CAA, VantageANS Open Tender discussion, 22 Oct 2014

⁴¹ DFS, Amended ANS response cap 1226, 12 January 2015

using its dominant position within the market place by offering new contract terms in advance of contract expiry dates – effectively locking out competition. DFS notes that such behaviour contradicts public statements made by NATS.⁴²

- 5.60 DFS conclude that this behaviour, if it persists, threatens to undermine plans not only of DFS but also those of others to enter the market since it will lead to contracts not coming to market as expected. A lack of clarity over the requirement of airport operators to tender also hinders any planned entry. As part of its submission, DFS believe that clarity on a requirement to tender is needed. It has a preference that all airports with more than 50,000 air traffic movements have an obligation to tender for services.⁴³
- 5.61 The CAA considers that it is through contracts coming to market that airport operators will be able to reap the full benefits of the developing competitive dynamics. The CAA expects to see continued development of market conditions for the provision of TANS over the coming years as contracts approach their renewal dates. By the end of 2016, the CAA expects to see at least half of the airport operators whose contracts are nearing termination to have begun some form of open tender for TANS provision. In the absence of this the CAA, will conduct a further review of the market.
- 5.62 The CAA also recommends that the Government reviews the position on whether there should be duty on airport operators to publically tender TANS services.
- 5.63 Short of launching a statutory investigation under competition law, the CAA does not have powers of regulatory oversight to review recent contracting behaviour. The CAA recommends that the Government review the CAA's powers for effective oversight of this sector particularly to strengthen the CAA's ability to gather information.
- 5.64 That said, the CAA considers that it is evident from the above that a number of tender processes have taken place. The CAA has a preference for airport operators to hold open tenders, but without a clear requirement for them to do so, it does not seem appropriate for the purposes of this test that the CAA should hold the airport operators to a requirement to tender. Where airport operators have not tendered, they appear to have at least undertaken some form of informal market testing and have benefited from this action and from the open actions of other parties. The CAA considers

⁴² DFS, Amended ANS response cap 1226, 12 January 2015

⁴³ DFS, Amended ANS response cap 1226, 12 January 2015

that there is evidence of public tender process being available and used. As such, this is an improvement observed against the criteria set out in the test.

Contract duration

5.65 Figure 4 below sets out the contract durations of the current contracts in operation at airports covered by the study. The Birmingham and Gatwick contracts have already been awarded to a different ANSP. The Manchester and Stansted contract dates reflect the recent renegotiation between MAG and NSL.

Figure 4: Current contract duration

Airport	ANSP	Contract duration (years)	Contract expiry date
Heathrow	NSL	5 + 5yr extension	Mar-18
Gatwick	NSL	5 + 2 + 0.5 yr extension	Sep-15
Manchester	NSL	10	Mar-24
Stansted	NSL	10	Mar-24
Edinburgh	NSL	3 + 7yr extension	Mar-18
Birmingham	NSL	9 + 1yr extension	Mar-15
Luton	NSL	3 + 2yr extension	Oct-17
Glasgow	NSL	3 + 7yr extension	Mar-18
London City	NSL	15	Mar-17

Source: NATS

- 5.66 The CAA commented on contract duration in its earlier assessment and raised no concerns with contracts of around 5 to 7 years in duration. In particular, the CAA noted the need for contracts to recover bid costs and to be sufficiently long to provide a return to the ANSP, especially where investment is needed. The lengthy transition process (and associated costs) is also a factor pointing to relatively long contracts.
- 5.67 In relation to recent contracting activity, the CAA notes the 10 year contract awarded by GAL. In this case the CAA expects significant set up costs for DFS as a wholly new entrant to the UK. The duration of the contract appears to provide scope for DFS to amortise these cost over a longer period and make a reasonable return. The CAA expects it would be normal to observe longer contract lengths for new entrants.
- 5.68 However, the CAA does have some concerns with the contracting behaviour at MAG [X]. In particular, the early renegotiation of a 10 year contract for a mature operation and its renegotiation, without conducting an open tender, appears questionable. From the CAA's review of the tenders,

it seems that these practices are not necessary to drive efficiencies in mature operations. Indeed, such a contract length has not been needed at Belfast International, Cardiff or Luton. The CAA does not consider that such contracting behaviour, without recourse to the market, assists the development of effective competition.

- 5.69 Overall, the evidence suggests a slight increase in duration of contract compared with the contracts outstanding at the time of CAP1004. However, where this is the result of new entrants gaining market share, the CAA does not consider this as indicating a deterioration in market conditions. Longer contracts between airport and existing ANSPs do, however, potentially raise concerns. Long term contracts may constitute a barrier to effective competition even if it does not necessarily mean that market conditions do not exist.

TANS/NERL interface

- 5.70 Issues, perceived or otherwise, may arise in the TANS / NERL interface due to the joint ownership of NSL and NERL, such that the incentives on NATS are to favour NSL over other TANS operators. As set out in CAP 1004, there are, however, some protections within the NERL licence to mitigate this risk.
- 5.71 Additional issues may arise where, as with both BFS and CAL, NSL provides some of the local en route services as a delegated function under contract from NERL. The CAA has sought to explore as far as possible how this affects the airport operators' ability to contract for TANS.⁴⁴ There are similarities in both cases in that the airport operators appear to receive a discount on their TANS charge for hosting the delegated service at their tower. CAL has not made detailed representations on the delegated functions, but did consider that it provided increased resilience and fitted with its overall strategy. Similarly, BFS saw benefits to hosting a delegated function.
- 5.72 DFS considers that this is a potential issue with the TANS/NERL interface and considers that clarity should be brought to the issue, potentially through the NERL licence, to ensure equal non-discriminatory treatment of all TANS providers.⁴⁵
- 5.73 NATS, however, points out that it has taken steps to clarify the relationship between NERL and TANS providers. It also considers that the actions of

⁴⁴ Given the scope of the study focussing on the larger airport the CAA has not been able to carry out a detailed review of delegated functions as part of this assessment.

⁴⁵ DFS, Amended ANS response cap 1226, 12 January 2015

BAL and GAL demonstrate that it has not been a material barrier.⁴⁶

- 5.74 As set out in CAP 1004, it was suggested that this may fall away as a barrier should (a) a successful transfer of a TANS service be observed and/or (b) standardised and transparent terms and conditions of service be provided by NERL to airport operators and all TANS providers.
- 5.75 Since CAP 1004 NATS has taken steps in relation to standard terms with the skeleton agreements published. The CAA will need to be convinced that these agreements are sufficient to provide the required information and comfort to airports and ANSPs of the scope of the services provided by NERL to airports.
- 5.76 The CAA considers that airport operators should be signatories to these agreements on the scope of the services delivered by NERL to the Airports Operators' chosen TANS provider. The CAA considers the primary customers of NERL in this context to be the airport operators, regardless of whether it has decided to outsource the provision of TANS.
- 5.77 Following the transition of the Birmingham TANS operation to self supply, the CAA shall carry out a detailed review of the transition process to draw out lessons for best practice in TANS transition. The CAA shall also review progress on the GAL transition and other tender process as they arise. Following this review, the CAA will consider whether further action is needed on the TANS / NERL interface.
- 5.78 In the meantime the CAA will closely monitor NSL's compliance with its obligations and the spirit of those obligations, as set out in CAP 670, during the GAL transition.
- 5.79 Overall, if these improvements continue, these developments indicate an improvement against criteria 1.

Trust of a Promise (ToaP)

- 5.80 ToaP provides certain employment protections to NATS staff employed prior to the PPP. In the event of a transfer of service, such as the loss of a tower following competitive tender, NATS staff covered by ToaP have the right to remain with NATS rather than transfer to the new operator. The individual employee may remain if they do not consider that the pension arrangements with the new employer are equivalent to its current provision.

Figure 5: ATCO covered by ToaP

⁴⁶ NATS, NSL's response to CAP1226: Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence, 7 November 2014

Airport	Number of ATCOs 2013/14	% ATCOs covered by ToaP 2011/12	% ATCOs covered by ToaP 2013/14
Heathrow	77	56	53
Gatwick	36	64	64
Manchester	50	91	82
Stansted	29	50	52
Edinburgh	34	76	68
Birmingham	30	63	50
Luton	22	52	50
Glasgow	31	68	65
London City	17	41	41

Source: NATS

Note: The ATCO numbers quoted refer to the number of ATCOs based at each airport operational unit and include a number of trained ATCOs who are in managerial or other non-operational roles.

Figure 6: Number of NSL staff moving between airports

Year	Actual	% NSL headcount
2008	39	3.8
2009	28	2.8
2010	30	3.0
2011	18	1.9
2012	15	1.6
2013	30	3.1

Source: NATS

- 5.81 Figure 5 shows the ToaP coverage at the towers covered by the study. This ranges from 41 to 82 per cent with an average coverage of 60 per cent. This is a fall on the prior assessment which had an average coverage at the nine airports of 65 per cent. This illustrates, as expected, a fall in the coverage of ToaP over time. However, it still covers a very significant proportion of staff within the NSL operation.
- 5.82 Figure 6 shows NSL staff movement between airports. This is a relatively low figure. This indicates that staff do not, as a rule, move between towers to a great degree. This may act to limit the effect of ToaP as staff may be unwilling, even in the event of a transfer of service, to move to a different airport. This would make them more inclined to accept a transfer to a new

provider.

- 5.83 Despite this, the CAA considers that ToaP remains a barrier to airport operators seeking to tender. This affects the bidding process and transition in a number of ways, which would not occur under a standard TUPE transfer. As such, it distorts the competitive process by forcing new entrants and airport operators to incur additional costs and uncertainty associated with an agreement to which they are not a party if they seek to move away from provision of TANS by NSL.
- 5.84 ToaP forces new entrants to price in additional costs to cover the risk of staff not transferring (i.e. to train and replace staff that do not transfer). This has an effect:
- at the bidding stage where a potential entrant will have to build in this cost to its bid;
 - following the bid, where a portion of this cost has to be incurred regardless of whether ToaP comes into play. Given that staff are not required to decide whether to transfer until late stage in the transfer process, the new entrant will have to train some staff to cover the risk to ensure a smooth transition in the service;
 - in the event that insufficient staff transfer or train in time, ToaP forces third parties to request secondments from NSL on whatever terms it sets. This is because only current staff can conduct training for any new employees required. This has the potential to allow NSL to benefit, even if it loses a contract. In the extreme, incentives could be such that any value is extracted from the new entrant's contract; and
 - airport operators that are aware of this provision may consider the risk to transition through lack of suitable trained staff is too great to move to a formal tender.
- 5.85 Despite this, each of the processes conducted by BAL and GAL to date demonstrate that this issue may be overcome as a barrier to entry in transition and bidding. Both NSL and GAL are supportive of this view.⁴⁷
- 5.86 DFS, on the other hand, considers that ToaP does cause some issues given the need for bidders to build in these costs from an agreement to which they were not a party. It considers that this skews the normal TUPE process. However, DFS considers that ATS could act by setting out clearly the terms on which secondments would be made in the event of a loss of

⁴⁷ See NATS, NSL's response to CAP1226: Provision of Terminal Air Navigation Services (TANS) in the UK: Call for evidence, 7 November 2014 and GAL, TANS call for evidence, 14 January 2014

contract so that the costs are known at the time of bidding.⁴⁸

- 5.87 As part of its assessment for the Birmingham bid, VantageANS identified risks that were unique to that particular bid. The most significant of these risks was the potential pensions impact of ToaP. The CAA understands that VantageANS identified increased risks around ToaP, the need to supply both approach and aerodrome designated ATCOs. This was an increased magnitude of risk that it faced in bidding for Luton where it only needed to provide aerodrome ATCOs. This factored into its decision not to bid.⁴⁹ Similarly to VantageANS, BFS considered the risk of ToaP and the costs that may involve in its decision not to run an open tender.⁵⁰
- 5.88 Overall, the entry of new providers does suggest that the barrier posed by ToaP may not be as high as previously considered and so indicates an improvement in performance under the criteria. As noted previously, ToaP will be less of a barrier as time progresses. However, as Figure 5 demonstrates, it will still likely be relevant for the upcoming tenders in 2017.
- 5.89 The CAA expects the BAL transition to be completed in April 2015. The CAA intends to carry out a full review of this process to draw out lessons for both the CAA in facilitating transition and the wider industry in understanding the issues involved. It will focus, in part, on whether (and how) ToaP has affected the transition.
- 5.90 It has also been suggested, as part of the evidence collection, that NSL could be proactive and publish a price list for ATCO secondments in the event of a transfer. The CAA considers that NSL should do so, in order to provide greater clarity to the market and facilitate competition.

⁴⁸ DFS, Amended ANS response cap 1226, 12 January 2015

⁴⁹ CAA, VantageANS Open Tender discussion, 22 Oct 2014

⁵⁰ CAA, Conference call on Belfast International's renegotiation with NATS (Services) Ltd, 18 Nov 2014

Chapter 6

Market conditions test

6.1 This Chapter sets out the CAA's conclusion against each limb of the test.

Criterion 1. The Extent to which service providers can freely offer to provide or withdraw the provision of these services:

(a) the existence or otherwise of any significant legal or economic barriers that would prevent a service provider from offering to provide or withdrawing the provision of these services;

(b) the contract durations; and

(c) the existence of a procedure allowing assets and staff to be transferred from one air navigation service provider to another.

6.2 The CAA has not found any significant legal or economic barriers that prevent a service provider from offering to provide or withdraw from the provision of TANS.

6.3 Barriers previously identified in CAP 1004 have been overcome by alternative ANSPs. This is evidenced by the forthcoming transfer of the TANS service at BAL and in the outcome of the more recent tender by GAL. The LLAOL tender, which was won by the incumbent, shows the ability of a range of competitor ANSPs actively to participate in tenders.

6.4 The CAA considers that any concerns that may arise over contracting behaviour, particularly duration, can be dealt with, as appropriate, under its competition powers.

6.5 To the extent that there remain some barriers from ToaP, the CAA considers these to be lower than previously thought and it seems they can be overcome during the tender process.

Criterion 2. The extent to which there is a free choice in respect to service provider, including, in the case of airport, the option to self-supply:

(a) the existence or otherwise of legal, contractual, or practical barriers to change service provider or in the case of terminal air navigation services to move towards self-supply of air navigation services by airports;

(b) the role of airspace users' representatives in selecting the service provider.

6.6 The CAA has not found any significant legal or economic barriers that

prevent airport operators from exercising choice in service provider or to self supply.

- 6.7 With respect to practical barriers, Gatwick airport is the busiest single runway in the world and Birmingham is a large regional airport. The CAA considers that the ability of these two airports to market and find a solution to their respective TANS requirements is indicative of the availability of choice at the full range of airports covered by this report.

Criterion 3. The extent to which it can be chosen from a range of service providers:

(a) the existence of a public tendering process (not applicable in the case of self-supply);

(b) if applicable, evidence of alternative service providers participating in the tendering process and having provided services in the past, including the option of self-supply for the airport.

- 6.8 In CAP 1004, the CAA found that there was a lack of credible alternatives for the provision of TANS and that self supply may be difficult for the larger airport operators to consider.
- 6.9 The evidence presented to the CAA in relation to recent events changes this view. BAL's move to an in-house solution indicates that self supply is a possibility for larger airports. GAL's decision to appoint DFS and other airport operators' engagement in open tenders has shown that there is at least one credible alternative to the current provider in addition to self-supply.
- 6.10 The CAA's conclusion is that there are now sufficient alternative providers for market conditions to exist.

Criterion 4. For terminal air navigation services, the extent to which airports are subject to commercial cost pressures or incentive based regulation:

(a) whether airports actively compete for airline business;

(b) the extent to which airports bear the air navigation service charge;

(c) whether airports operate in a competitive environment or under economic incentives designed to cap prices or otherwise incentivise cost reductions.

- 6.11 As was the case in CAP 1004, the CAA does not see any issue with this Criterion in the UK.

- 6.12 The CAA currently regulates both Heathrow and Gatwick airports.⁵¹ The CAA has deregulated Stansted Airport recognising that it faced sufficient competition such that it no longer had significant market power and therefore is subject active competition for airline business.⁵²
- 6.13 Accordingly, all airports in the UK (event those with significant market power) compete for airline business and bear the air navigation service charge, and operate in a competitive environment or under economic incentives. This view is without prejudice to any future decision that the CAA or other competition authorities may take in relation to the level of competition at any UK airports.

Criterion 5. Where the provider of terminal air navigation services [...] also provides en route air navigation services, these activities shall be subject to separate accounting and reporting.

- 6.14 As stated in CAP 1004, Criterion 5 is only an issue where NSL is the incumbent ANSP. NSL is a wholly owned subsidiary of NATS Ltd which also owns NERL, the monopoly en route provider. NERL and NSL are however separate legal entities and are, therefore, required by law to lodge separate accounts with Companies House. Additionally, NERL is required by its licence to produce separate regulatory accounts and to report on its en route activities.
- 6.15 Given the legal requirements for separate accounting for NERL and NSL, the CAA is satisfied that this Criterion is met for the TANS provided airports included within the study.

Criterion 6. For TANS, the assessment in Annex 1 of EC Regulation 391/2013 shall be carried out at each individual airport, as appropriate.

⁵¹ For more detail please see: *Licence granted to HEATHROW AIRPORT LIMITED by the Civil Aviation Authority under section 15 of the Civil Aviation Act 2012 on 13 February 2014* url: www.caa.co.uk/docs/5/heathrow%20licence_1%20august%202014.pdf and *Licence granted to GATWICK AIRPORT LIMITED by the Civil Aviation Authority under section 15 of the Civil Aviation Act 2012 on 13 February 2014* url: www.caa.co.uk/docs/5/gatwick%20licence%20consolidated%20version_1%20May%202014.pdf

⁵² For more detail please see: *CAP 1135: Market power determination for passenger airlines in relation to Stansted Airport – statement of reasons* url: www.caa.co.uk/cap1135 and *CAP1153: Market power determination for cargo services in relation to Stansted – statement of reasons* url: www.caa.co.uk/cap1153

- 6.16 The CAA has not carried out an individual assessment by airport. The CAA does not consider that it is appropriate to consider TANS in the UK on an individualised basis. Specifically, our finding of market conditions is that all airports have a realistic possibility of choosing from a reasonable range of different TANS providers. For the purposes of this review, therefore, (and for the avoidance of doubt without prejudice to the approach the CAA may take in the future in relation to any of its other powers) the geographic scope of TANS should be viewed on a national level.
- 6.17 We have taken this approach since it is unhelpful to consider individual towers since this pre-supposes that each tower forms a market on its own. This would imply that, once a contract is signed, there would be no possibility of market conditions for that particular tower. This approach would ignore any potential wider market or competitive dynamics that may be present due to contestability in the wider industry.
- 6.18 In the renegotiations observed, it is clear that changes in supplier have at least in part been motivated by the actions of BAL, GAL and LLAOL in seeking a market based solution.
- 6.19 The above assessment against the five criteria is, however, qualified. In particular, the CAA considers that there is a distinction to be drawn between the existence of market conditions on the one hand, and of the market being subject to fully effective competition on the other. As such, for the purposes of the Regulation, the test is whether market conditions exist. The CAA is satisfied that this test is met. The CAA does not consider at this stage it is required to assess whether the market is effectively competitive.

Chapter 7

Next Steps

Actions

- 7.1 The CAA proposes the following actions to support the competitive development of the TANS market:
- following the transition of the Birmingham TANS operation to self supply, the CAA will carry out a detailed review of the process to draw out lessons for best practice in TANS transition. The CAA will also review progress on the GAL transition;
 - following the review of the Birmingham transition, and based on its findings, the CAA will consider whether further action is required on the TANS / NERL interface;
 - the CAA will review the impact of long-term contracting on the development of the market and take action using its competition powers where appropriate;
 - the CAA considers that NSL should publish the terms and conditions on which it will second staff in the event of transfer where ToaP will be relevant. The CAA will take this forward with NSL bilaterally in the first instance;
 - the CAA recommends that the Government reviews the position on whether there should be duty on airport operators to go to a public tender for TANS services; and
 - the CAA recommends that the Government reviews the CAA's powers for effective oversight of this sector, and in particular, considers strengthening the CAA's ability to gather information.
- 7.2 It should also be note that, in CAP 1004 the CAA expressed the view that competition law applies to the providers of TANS. We continue to hold this view.
- 7.3 In the meantime the CAA will closely monitor NSL's compliance with its obligations, and the spirit of those obligations, as set out in of CAP 670, during the GAL transition.
- 7.4 The CAA expects to see continued development of market conditions for the provision of TANS over the coming years as contracts near renewal. By the end of 2016, the CAA expect to see most of the airport operators,

whose contracts are nearing termination, to have notified some form of open tender for TANS provision. In the absence of this the CAA will conduct a formal review of the market.

- 7.5 A number of requests were made to the CAA during the call of evidence. The CAA has discussed some of those issues at a high level with the relevant parties. Otherwise, these are considered within this paper or will be addressed as part of the wider work of the CAA. A number of the requests made were, however, beyond the scope of the CAA's powers.

Appendix A

CAA questions to parties

Open tender

Airport operators

1. What was the process that you employed when seeking to tender for this service?
 - a) Did you undertake any market engagement prior to opening the tender process?
 - b) What were you proposed the stages of the assessment?
 - c) What information if any did you provide to the bidders prior to them bidding?
 - d) How was the tender structured to take account of the need for both technical competence and to deal with the commercial issues?
2. Barriers within the process
 - a) Did you seek to understand the potential barriers for bidders prior to tender?
 - b) What, if any, barrier were identified and what steps did you take to mitigate these?
 - c) Were there any issues or barriers that arose during the process that made the tender more difficult to enact?
 - d) How did you present issues such as trust of a promise and the interaction with London Approach? How were they overcome or not?
3. Who were the bidders?
 - a) Which companies showed an interest in bidding?
 - b) Did you approach particular companies to encourage bids?
 - c) Which companies submitted bids?
 - d) Which companies provided suitable bids?

4. How were the bids evaluated?
 - a) Did you set out an overall aim and objectives for the tender? Were bidders aware of this?
 - b) What was the overall evaluation framework?
 - c) Was the framework staged such that technical competence had to be proved early in the process with commercial issues taken later?
 - d) What was the range in terms of service and price offered by bidders?
 - e) Where bidders able to modify their initial bid following feedback? If so and what stages?
5. Do you consider that you have benefited from holding an open tender?
 - a) What was the estimated cost of the tender to the airport operator? Will this be less in future tender rounds?
 - b) What does the airport operator consider would prevent it from holding an open tender in the future?
6. Any further comments?

ANSPs

1. How did you find out about the opportunity to tender?
2. What information were you provided with prior to submitting a bid?
 - a) Did you, as the bidder, understand the aims and objectives of the airport operator in holding an open tender?
 - b) What was your understanding of the process prior to bidding?
 - c) What was your understanding of the scope of service requirements prior to bidding?
 - d) Do you consider that you had sufficient information on which to make a sensible bid?
3. Following expressions of interest were you invited to formally bid?
 - a) If the bid did not progress can you explain why this was the case?
 - b) How was information provided to you? Was it easy to access the relevant information?
 - c) After submitting a bid were you provided with feedback on potential improvements to your offer?

4. What challenges, if any, did you face in bidding?
5. Overall how do you consider competitive tendering will develop in the UK?
 - a) Do you consider the process you entered was fair? If not why?
 - b) Do you consider you will bid for other contracts?
 - c) What was the estimated cost of the bid?
 - d) What is the smallest contract that is likely to be of interest to you, in terms of revenue and movements?
6. Further Comments?

Closed procurement - airport operators only

Motivation behind the choice of a closed process

1. Please describe your motivation for re-contacting rather than holding an open tender?
 - a) Did you have specific aims that you were hoping to achieve?
 - b) What were the key issues identified that factored in your decision not to hold an open tender?
 - c) To what extent did you involve the airline community with your decision making?

Whether and to what extent market testing took place prior to or during the bid.

1. Please describe the process that you have undertaken to i) assess your options and ii) re-negotiate?
2. Did you undertake any form of market testing activities? This may have included the following:
 - a) Discussion with the incumbent ANSP
 - b) Discussion with alternative ANSPs – please list the ANSPs that you had discussions with and provide their contact details.
 - c) Desk-based research into alternative ANSPs – please provide an overview of the approach taken to desk research and summary results of the process.

3. Did you undertake any cost challenge activities with the incumbent?
Particularly activities any activities undertaken to i) understand cost of provision and ii) understand the level of service

Negotiation process with the incumbent ANSP

1. Please describe the nature of negotiation with the incumbent.
2. How did you form the request for the renegotiation?
3. What criteria were used for assessing the proposal?
4. Did you have criteria under which your approach may have changed following an unsatisfactory negotiation?

Future

1. Please outline the key terms of your contract including but not limited to overall cost, end date, break point arrangements, treatment of operational assets not owned by the airport and treatment of key safety documentation such as MATS Pt2.
2. Based on your experience of re-negotiation and the other market developments that are taking place what do you consider are likely to be your action at i) the break point ii) end of the contract.
3. How likely are you to tender in the future? What change(s) in the market would make you more likely to tender?