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# ***The Transport Bill: Part I*** **National Air Traffic** **Services**

**Bill 8 of 1999-2000**

Part I of the *Transport Bill* contains measures to enable a public-private partnership to be established for National Air Traffic Services Ltd (NATS). This paper is concerned only with that part of the Bill. Other aspects of the *Transport Bill* are covered by Research Paper 99/103 on railways, Research Paper 99/104 on local transport plans and buses and Research Paper 99/105 on road pricing and workplace parking.

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## Summary of main points

Part I of the Transport Bill will enable the Government to establish a public-private partnership (PPP) with a strategic partner from the private sector to deliver air traffic services currently provided by NATS. This paper is concerned only with that part of the Bill.

- The Bill provides for the transfer of ownership of the company which now provides “en route” air traffic control services (NATS) from the Civil Aviation Authority (CAA). En route air traffic control services are the instructions provided to aircraft to guide them after they have left the control of the departure airport and prior to their coming under control of the destination airport. The regulation of safety will remain with the CAA thus providing a separation between the provision of air traffic services and the regulation of safety.
- The CAA will remain the single regulator for aviation with responsibility for safety regulation, economic regulation and air navigation.
- The Bill will give the Government the power to grant a licence for the provision of en route air traffic control services. The Bill will give the Government power to grant exemptions to providers of airport air traffic control services.
- The Bill will give powers to the Secretary of State to issue directions to a licence holder in the interests of national security or international relations. Provision is also made for a special administration regime in the event of a breach of one of the licence conditions by a licensed provider of air traffic services or in the event of its insolvency.



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## I Introduction

The Civil Aviation Authority (CAA) was set up in 1972 as a statutory public body to regulate the civil aviation industry, and to guarantee the safety of those who work in it, and those who use its services. It is now regulated under the *Civil Aviation Act 1982* (the 1982 Act), a consolidation Act, which sets out the Authority's constitution, functions and general objectives. Its main task is to provide an air traffic control service - this is by far the largest part of the Authority's work - and to regulate the UK airline and airport industries. Its regulatory role encompasses both safety and economic regulation.

The CAA's regulatory powers are underpinned by the 1982 Act, the *Air Navigation (No 2) Order 1995*<sup>1</sup>, and the *Rules of the Air Regulations 1996*.<sup>2</sup> Within the CAA the safety role is conducted within the Safety Regulation Group (SRG). The Group must satisfy itself that:

- aircraft are properly designed, manufactured, operated and maintained;
- airlines are competent;
- that flight crews air traffic controllers and aircraft maintenance engineers are fit and competent
- air traffic services and general aviation activities meet required safety standards.

The Economic Regulation Group (ERG) within the CAA regulates airlines, air travel organisers and airports. ERG's principal task is promoting air transport users' interests by encouraging a diverse and competitive industry and where appropriate, protecting passengers from the consequences of financial failure.

The Director of Airspace Policy (DAP) is the head of the Directorate of Airspace policy. The Directorate was created at the same time as the formation of NATS Ltd in order to keep what had been the regulatory function of NATS apart from its service provision functions. The Directorate includes both civil and military staff and is accountable jointly to the Board of the CAA and the Secretary of State for Defence.

The DAP provides advice to the CAA the Ministry of Defence (MOD) and the Department of Environment, Transport and the Regions (DETR) on airspace and related air traffic management matters and support to the UK representation on international bodies.

Air traffic services involving air traffic control (ATC) and radio and navigational aids are carried out through a subsidiary company, National Air Traffic Services Ltd (NATS).

A change in the institutional status of NATS has been under discussion since the early 1990s. A Transport Select Committee Report in 1989 recommended that the government consider splitting the Civil Aviation Authority (CAA) into two separate organisations,

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<sup>1</sup> SI No 1970

<sup>2</sup> SI No 1393

with the CAA remaining as a regulatory and advisory body and NATS established as a separate public sector body responsible to the Secretaries of State for Transport and Defence.<sup>3</sup>

The separation of the provision of air traffic services and the regulatory functions of the CAA was also recommended for consideration by the Monopolies and Mergers Commission in their 1990 Report on the CAA, although privatisation was not mentioned.<sup>4</sup> Some users felt that it was wrong in principle that the same body should both regulate the airline industry and act as supplier of services to it.

Privatisation of NATS was first considered by the previous Conservative government and the various models discussed are considered further on in this paper. Following the concerns about privatisation raised in responses to a consultation paper<sup>5</sup> and in the 1989 Transport Select Committee Report, no decision on privatisation was taken.

On 29 November 1995 in a written answer, Sir George Young, then Secretary of State for Transport, announced that he had approved in principle a proposal by the Board of the CAA that the air traffic control operation should be incorporated as a wholly owned subsidiary of the CAA<sup>6</sup>. He confirmed that this would pave the way for future privatisation, which still remained the government's longer term objective.

On 1 April 1996 the civil elements of NATS were incorporated as a wholly owned subsidiary of the CAA as NATS Ltd.

## **II Structure and Functions of NATS**

### **A. Functions**

Until its incorporation NATS was a joint civil/military organisation with 400 Ministry of Defence (MOD) personnel working alongside CAA/NATS staff to provide an integrated service. It is now a wholly civilian body, but an operating agreement between NATS and the MOD ensures that the joint and integrated provision of services continues.

NATS' role is to plan, provide, and operate an integrated air traffic service covering en-route (in which NATS has a monopoly throughout UK airspace), terminal area, approach and airport air traffic control operations in UK airspace. NATS also provides air traffic control services over the eastern part of the North Atlantic, as part of an agreement with

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<sup>3</sup> Transport Committee, *Air Traffic Control Safety*, 9 February 1989, HC 198-I 1988-89, xlviii, para 183

<sup>4</sup> MMC July 1990, *Civil Aviation Authority: A report of an inquiry into the supply of navigation and air traffic control services to civil aircraft*, Cm 1122, chapter 6

<sup>5</sup> Department of Transport May 1994, *Privatisation of the National Air Traffic Services [NATS]: A Consultation Paper by the Secretary of State for Transport*, Deposited Paper 10862

<sup>6</sup> PQ HC Deb 29 November 1995 c786W



the Irish Republic. These air traffic control, aeronautical information and other services to aviation are supported by a network of communications, surveillance and navigational aids, and by a computer based infrastructure which includes flight and radar data processing systems.

NATS is a wholly-owned subsidiary of the CAA, operating within the framework laid down in the *Civil Aviation Act 1982* and Directions to the Authority under section 72(2) of the Act. The current Directions, given to the CAA in March 1996, require the Authority, in collaboration with the Ministry of Defence (MOD) to discharge its air navigation service functions (with the exception of those relating to airspace policy) through NATS. The Directions set out the basic principles governing the conduct of air navigation services, placing NATS under a duty to provide a comprehensive service, balancing user demands, sharing airspace on a non-discriminatory basis, and taking account of the requirements of all airspace users. The company employs 5,200 staff, predominantly air traffic controllers, air traffic services assistants, and engineers, and has an annual turnover in excess of £500 million per year.

Some 85% of NATS' income derives from the provision of en route, terminal area and oceanic ATC services. These are currently provided from the London Area and Terminal Control Centre (LATCC) at RAF West Drayton, the Manchester Area Control Centre at Manchester Airport, and the Scottish and Oceanic Area Control Centre (SCOACC), at Prestwick. Under the Centre Development Plan, however, NATS proposes for the future to operate from only two, state of the art, centres: the New En Route Centre (NERC) at Swanwick, and a new Scottish Centre (NSC) at Prestwick, which is being developed under the Private Finance Initiative.

A further 15% of NATS' income is drawn from the provision of approach services and airport ATC services. Services are provided by contract on an open market basis. NATS is the market leader in the supply of airport ATC services in the UK, holding some 80% of the market by value and servicing about 20% of all licensed civil aerodromes (including the three main London airports). In addition, NATS provides ATC services to helicopters operating in the southern and northern North Sea, and performs a variety of miscellaneous functions including controller and other specialist ATC training, the provision of radar data to non-NATS airports, ATC consultancy, research and development, and statistical data and information provision. NATS also provides the Aeronautical Information Service, as required of the UK by international treaty, which forms an international interface between the UK and other countries for the provision and exchange of aeronautical information.

Services are provided by contract on an open-market basis and, depending on the relevant contract, may comprise a full range of aerodrome, approach and radar control services, or only some of them.

## **B. Structure of NATS and interface with MOD**

On 1 April 1996 the civil elements of NATS were incorporated as a wholly owned subsidiary of the CAA under the *Companies Act 1985*, as National Air Traffic Services Ltd<sup>7</sup>. The Directors of the Board of NATS now have the legal duties inherent in Companies Act status. The Board of NATS has eight directors comprising the Chairman, two other executive directors and five non-executive directors. The Chairman and Chief Executive are appointed by the Secretary of State for Environment, Transport and the Regions, in consultation with the Secretary of State for Defence. The remaining civil members of the Board are appointed by the CAA Board and one non-executive director is nominated by the Secretary of State for Defence. As a wholly owned subsidiary of the CAA, the NATS Board is accountable to the CAA Board for all aspects of the business.

Under the new arrangements, airspace policy and regulatory activities, previously undertaken by NATS were transferred to a new body, the Joint Air Navigation Services Council (JANSC). This was designed to ensure that effective collaboration between civil and military and regulatory elements was maintained. It is an umbrella organisation comprising representatives of NATS Ltd, Military Air Traffic Operations and the Director of Airspace Policy.

At present NATS is subject to regulation by the CAA's Safety Regulation Group (SRG), whose functions and powers are established in legislation (the *Civil Aviation Act 1982* and *Air Navigation (No 2) Order 1995*).

It is currently set down in secondary legislation, the 1996 Directions made under the 1982 Act, that access to airspace should be provided on an equitable basis without discriminating against any particular class of user. Airspace planning is currently discharged by the Director of Airspace Policy (DAP), whose directorate is jointly resourced by the CAA and the MOD. The 1996 Directions set out the working arrangements between the CAA and the MOD. These also establish the JANSC which is charged with instituting the framework within which the CAA and Defence air navigation services continue to be provided on a joint and integrated basis and overseeing the DAP's activities.

The current arrangements make it possible to reconcile changing military and civil requirements, in a way which permits commercial air users access to the maximum amount of airspace while retaining for the military and general aviation the freedom to operate safely and flexibly.

Military controllers are responsible for providing the greater part of en route (between airport) ATC services to aircraft - civil and military - outside controlled airspace. Importantly, the joint operation also provides a basis for accommodating national needs in times of crisis and war.

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<sup>7</sup> National Air Traffic Services Ltd news release 1 April 1996

During 1999 NATS began the process of preparing the company for the PPP. The changes maintained the separation between responsibility for safety management processes and responsibility for operations and also established an internal separation between the customer and supplier of the major projects.

### Key Figures for NATS 1997-1999

<b>Income</b> (£ million)	1999	1998	1997
UK airspace traffic services	449.0	439.3	419.3
Airport traffic services	73.6	71.1	70.9
North Atlantic traffic services	19.6	17.1	19.3
Miscellaneous services	9.8	7.5	8.2
<b>Total income</b>	<b>552.0</b>	<b>535.0</b>	<b>517.7</b>
<b>Profit after interest and taxation</b> (£ million)	30.9	14.9	13.7
<b>Capital and reserves</b> (£ million)	190.4	59.4	144.7
<b>Capital expenditure</b> (£ million)	35.7	42.7	56.5
<b>Staff in post at 31 March</b>	5,372	5,237	5,154
<b>Aircraft movements</b> (handled by controllers) 000s			
London Area and Terminal Control Centre	1,778	1,658	1,560
Manchester Area Control Centre	451	420	394
Scottish Area Control Centre	471	450	415
Oceanic Area Control Centre	312	286	265
Airports	1,688	1,612	1,542
<b>Total aircraft movements</b>	<b>4,700</b>	<b>4,426</b>	<b>4,176</b>

Source: NATS Annual Report and Accounts 1998,1999

## C. Economic Regulation

NATS is not currently subject to a formal economic regulatory regime. It sets its charges and recovers its costs in accordance with the Eurocontrol Charging Principles. Since NATS is a monopoly provider of en route air traffic services, the Secretary of State proposed in the 1998 consultation paper that this and any other monopoly parts of its business should be subject to statutory economic regulation when NATS was in the

private sector.<sup>8</sup> The consultation paper envisaged that regulatory control would be exercised through the licence issued to the provider with a regulator monitoring compliance.

For activities other than those covered by the Eurocontrol arrangements, HM Treasury requires the CAA to make an 8% return(pre-interest) on the average level of capital employed, expressed in current cost terms.

It is customary in the UK for price regulation to be effected by the RPI-X formula. However the membership of Eurocontrol requires a common regime for calculation and recovery of ATC charges. This regime makes explicit provision for the service provider to collect a rate of return, equal to the cost of capital, but requires an annual adjustment of charges, which appears incompatible with the periodic review element of RPI-X regulation.

The DETR and CAA have secured the agreement of Eurocontrol to an amendment to the charging system to allow a method of economic regulation which would permit NATS to be regulated by the RPI-X method. As part of this process, in which user representatives participated, guidelines have been drawn up to help ensure that states who wish to adopt the economic regulation method, do so in a proper fashion.

These guidelines require consultation at three stages:

- an initial consultation (in which Eurocontrol member states as well as users will be involved) before the new system is implemented, which will include details of the proposals for the regulatory process and timetable, and proposals for future consultation;
- at the beginning of each review period, where users will be given information on the current regulatory cost base, projected costs and revenues, traffic forecasts, investment plans and planned capital employed for the review period, and the principles the regulator intends to apply (e.g. appropriate cost of capital). It is envisaged that the regulator will also consult on his proposed charges before reaching a decision; and
- ongoing consultation, as required by the revised Eurocontrol Convention and consistent with the best practice guidance drawn up by the Eurocontrol Financial Information for Users Group, between the provider, users and the regulator on other aspects of the service.

At present the aviation regulator is the Economic Regulation Group of the CAA, which licences airports and airlines, and regulates the four largest UK airports. The CAA is unique as an economic regulator in having the duty conferred upon a statutory corporation: in the case of other private sector monopolies, the economic regulator is an individual person, the Director General.

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<sup>8</sup> DETR October 1998, *A Public Private Partnership for National Air Traffic Services Ltd (NATS)*

### III The history of privatisation proposals

#### A. The Conservative Government and NATS

At the time of the 1993 Budget, the then Secretary of State for Transport announced that he was setting up a working group of officials to examine the possibility of privatising the air traffic operations of the UK Civil Aviation Authority (CAA).<sup>9</sup>

The working group considered four methods of privatising NATS:

- establishing it as a statutory, non-profit making, trust or company, probably owned by airspace users;
- franchising its operations, with the CAA retaining ownership of its assets;
- setting up a regulated utility operating under licence (like gas and electricity);
- establishing NATS as a privatised contractor to the CAA.

In his White Paper on Competitiveness the then President of the Board of Trade, Michael Heseltine, announced that the government was proposing that NATS should be established as a private contractor to the CAA, following the work of the CAA and government departments.<sup>10</sup> On 24 May 1994 the then Secretary of State for Transport, John MacGregor, issued a consultation paper, to which responses from the aviation community and other interested parties were requested by 8 July.<sup>11</sup>

It was proposed that, subject to consultation, NATS' air traffic operations should be privatised - probably by flotation - and that NATS plc would contract with the CAA to provide air traffic control services. The consultation document made clear that the main reason for the proposed privatisation of NATS was financial:

2.1. For NATS, and for its customers, the prime benefit of privatisation would be the freeing of NATS' investment and other management decisions from the constraints imposed by public sector ownership.....As part of the public sector, NATS' investment is competing with other public spending, for example on health and education, and investment in air traffic control facilities cannot always be a priority within public expenditure programmes, even though it would generate commercial returns.

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<sup>9</sup> Department of Transport Press Notice 480/93, 30 November 1993

<sup>10</sup> Cabinet Office June 1996, *Competitiveness: Helping Business to Win: Consultation on a new approach to business support*, Cm 2563

<sup>11</sup> Department of Transport *Privatisation of National Air Traffic Services* Library Deposited Paper no 10862

On 22 November 1994 in response to a written question, as to whether the then government intended to proceed with the privatisation of NATS, Dr Mawhinney said that a number of concerns had been expressed by those who had responded to the public consultation and that he wished the concerns to be properly considered before proposals were put to Parliament.<sup>12</sup>

The Department of Transport published a report on the same day on the outcome of the consultation. This report was deposited in the Library and summarised the main points made by those who responded to the consultation followed by the Secretary of State's response<sup>13</sup>. According to this report, of the 188 respondents, 114 (primarily individuals) said that NATS should remain in the public sector, 54 gave no opinion on the principle but commented on specific aspects of the proposal, and 20 respondents (mainly airlines, airport operators, ATC providers and consultants) were in favour of privatisation, with 6 of these having major reservations.

A majority of individual respondents to the consultation paper and their union representatives expressed the fear that privatisation would threaten employment levels, existing staff conditions and working practices, and existing and future pension rights. They argued that the high level of commitment of NATS' professional and skilled grades would be undermined by privatisation, and that staff morale would be deeply affected by uncertainty over their future status. Some said that there should be legislative guarantees on the pension rights of existing and former employees. The Secretary of State responded as follows to these particular concerns:

27. The Secretary of State does not doubt the professionalism or commitment of NATS' staff and fully appreciates that any talk of any change is unsettling. The TUPE Regulations - which would almost certainly apply in the case of NATS being sold - provide that the new employer takes over responsibility for the employment contracts of the employees, who would transfer on their previous terms and conditions of service. The CAA Chairman has said that he and the Board are committed to ensuring that existing pension rights should be safeguarded, and has the Secretary of State's full support. If necessary the Secretary of State will consider whether legislative provisions may be required.

In February 1995 the Transport Select Committee published the report of its own inquiry into the privatisation of NATS<sup>14</sup>. The Committee was not satisfied that the Department of Transport had conducted its consultation exercise adequately, six weeks not being long enough to allow interested parties to give a fully considered view of a complex set of proposals. It reasoned that the Secretary of State had been keen to introduce legislation in Autumn 1994 and not to prolong uncertainty for NATS staff. In the event no Bill was

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<sup>12</sup> PQ HC Deb 22 November 1994 c130W

<sup>13</sup> Department of Transport November 1994, *Privatisation of the National Air Traffic Services [NATS]: A Report by the Secretary of State for Transport on the Outcome of the Public Consultation*, Deposited Paper no 3/ 649

<sup>14</sup> Transport Committee, *Privatisation of National Air Traffic Services] Second Report*, 1994-95 HC 36-I

presented. The Committee recommended that in the forthcoming consultation process the conversion of NATS into a profit-making public sector company should receive careful consideration.<sup>15</sup> Many witnesses questioned the assumption that NATS had to be privatised in order to be free to fund investment from the capital markets, and favoured "corporatisation" along the lines some other countries had followed with ATC in the hands of a publicly-owned company expected to act on a commercial basis and allowed to borrow privately. The Committee recommended that:<sup>16</sup>

Before the Government proceeds with its plans, we recommend that it publish detailed arguments as to why it does not favour the alternative put to us of converting NATS into a profit-making public sector company.

## **B. The Labour Government and NATS**

There was no reference to NATS in the 1997 Labour manifesto although the Labour party transport policy document of 1996 contained some discussion of public-private partnerships:<sup>17</sup>

Labour believe that it is the role of government to set the framework, then enabling much of the provision to be privately funded. We must construct genuine public-private partnerships in which clearly stated public policy aims have the central place. It would then be the role of the private sector to participate in projects to which they can bring the expertise and investment, within a stable and strategically planned environment.

Genuine public-private partnerships should involve a sharing of responsibility, rather than a shifting of what is rightly government's strategic responsibility wholly onto the private sector. They cannot simply be a substitute for public investment. And they should involve a fair sharing of risk, which creates a stable environment for private partners, while ensuring good value for money to taxpayers and the users of transport.

At its first meeting on 16 July 1997 the new Transport Sub-Committee of the Environment, Transport and Regional Affairs Select Committee decided to enquire into air traffic control. One of its terms of reference was to examine the new government's policy as to the ownership of NATS and the funding of its capital investment programme.<sup>18</sup>

NATS thought that it would need to invest more than £100 million per year over the next decade in order to maintain and improve service quality.<sup>19</sup> It considered that it was constrained by its External Financing Limit (EFL) and that by 1999/2000 it would have

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<sup>15</sup> Paragraph 98

<sup>16</sup> Paragraph 100

<sup>17</sup> 1996, *Consensus for change: Labour's transport strategy for the 21<sup>st</sup> century*

<sup>18</sup> Environment, Transport and Regional Affairs Committee, *Air Traffic Control*, HC 360-I 1997-98

<sup>19</sup> Paragraph 57

exceeded its available cash and would be unable to finance its investment programme other than through the PFI. NATS did not believe that the PFI was a desirable way to finance its investment because of the delays caused by its complexity and the risks of placing safety-critical work in the hands of a diverse group of contractors. It did not think that increases in its EFL or changes in the definition of the PSBR were likely and therefore recommended structural change to the company. It set out three options which would allow adequate investment funding to be secured:<sup>20</sup>

- A regulated utility: NATS would be established as a plc and floated, with at least 50% of the shares being sold so as to avoid problems with the company's classification by the Treasury.
- Trust status: a precedent was NAV CANADA, now responsible for Canadian ATC. It was sold by the government for \$CDN 1.5 billion, financed by a \$CDN 3 billion loan from a consortium of banks. It was required to recover its costs rather than make a profit.
- Corporatisation: precedents were found in New Zealand, Germany and the Netherlands. The air traffic service provider would be incorporated as a government company which could borrow privately and would be expected to behave as if it were in the private sector and to return a dividend to its shareholder. NATS believed that this could only work in the UK if the present PSBR rules were altered.

The CAA and NATS favoured the idea of privatising NATS as a regulated utility. In 1995 the then Transport Committee had recommended consideration of the option of corporatisation.

The Committee concluded:<sup>21</sup>

77. NATS will need significant capital investment in the near future. We doubt whether it can expect to receive any more money direct from government funds to finance this. In addition, the evidence suggests that there are serious problems about using the Private Finance Initiative as a mechanism for funding air traffic control investment where a unified system is of critical importance for safety, and that the PFI is a relatively expensive way of financing investment. Since the Eurocontrol charging structure ensures that NATS recovers its costs, we believe that the private sector would be likely to be willing to lend NATS money for capital investment. We have reservations about the privatisation as a profit-making company of such an important national organisation with vital defence implications. Other countries have solved this dilemma in a number of different ways. Their common feature has been to provide the air traffic control service with the ability to raise capital outside government spending limitations, and

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<sup>20</sup> Paragraph 58

<sup>21</sup> Paragraph 77



allow it more management freedom, while not turning it into a profit-making private sector company.

And recommended that:

The Government should examine the experience of other countries in restructuring their air traffic control organisations with a view to adopting one of these models or adapting one of them to UK conditions.

The Committee also found that the evidence they had received identified profound issues regarding the role of the CAA's Safety Regulation Group and the activities of the CAA in this and other areas of responsibility.<sup>22</sup>

On 11 June 1998, the then Transport Minister, Dr Gavin Strang, announced, in response to a parliamentary question, plans for a new public-private partnership for NATS<sup>23</sup>. Dr Strang said that the government would consult interested parties further on the implementation of its decision in principle and would then bring forward the necessary legislation.

The main elements of the government's preferred option were:<sup>24</sup>

- 51% of NATS would be sold to the private sector through flotation or a trade sale, with a proportion being made available to employees. The government would retain a 49% stake and a golden share. It intended to retain its ability to deal with matters of national security and the UK's international obligations;
- safety would be the first priority, with NATS being subject to tough safety regulation. The proposal would, for the first time, effect complete separation between service provision and regulation;
- there would be statutory economic regulation of the prices charged by NATS where necessary.

A consultation paper on the government's proposals for a public private partnership for NATS was published on 21 October 1998, with comments to be received by 31 January 1999.<sup>25</sup>

In the consultation paper the government confirmed that its preferred option for delivering the partnership was a part sale of NATS, resulting in a 51% holding in the private sector (including employees) and 49% remaining in public ownership. The government proposed to offer up to 10% of shares not retained by government to staff.

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<sup>22</sup> Paragraph 78

<sup>23</sup> PQ HC Deb 11 June 1998 c637W

<sup>24</sup> DETR Press Release 98/475 11 June 1998

<sup>25</sup> DETR October 1998, *A Public Private Partnership for National Air Traffic Services Ltd (NATS)*

In outline and subject to the passing of primary legislation, the Secretary of State proposed that NATS be separated from the CAA and established as a separate company, charged with the provision of air navigation services in UK airspace and any other airspace for which the UK has undertaken to provide these services. The Secretary of State proposed that the provision of these services by NATS would be subject to statutory safety, economic and airspace regulation. The company would operate under licence. The consultation paper requested comment in particular on the aspects of air traffic control relating to safety, economic and airspace regulation and national security.

The consultation paper acknowledged that the government's proposal was causing uncertainty among staff and concern about their terms and conditions of employment. However the paper says that "the Government wishes to see employees' existing contractual terms and conditions of employment maintained and welcomes CAA and NATS' management's commitment to full and proper consultation with the workforce and their representatives"<sup>26</sup>. It also states that "there will be full consultation with staff representatives on future employment, conditions of service, and pension rights."

On 27 July 1999, the then Minister of Transport, Helen Liddell, announced the government's intention to proceed with a public-private partnership (PPP) for NATS.<sup>27</sup> The main elements of the proposal were the following:

- The government would retain a 49% stake in NATS, while NATS staff would have a 5% share. There would be an equal element of gifted shares to all employees, with an opportunity to buy more. A private sector partner would take the remaining 46% of the company in a trade sale.
- Safety regulation would remain with the CAA.
- The government would appoint some of the company's non-executive directors and there would be a requirement for board unanimity on the specific matters necessary for protecting the taxpayer's financial interests such as the policy for dividends or reinvestment.
- The government would hold a golden share and would have statutory powers to direct NATS in case of war or national emergency.
- The joint and integrated military use of air traffic control systems would continue under the PPP.
- There would be a new stakeholder council, which would bring together government representatives, the strategic partner, NATS management, customers and staff representatives in a forum for consultation about the company's plans.

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<sup>26</sup> Paragraph 41

<sup>27</sup> PQ HC Deb 27 July 1999 cc121-133

## IV Responses to Labour government proposals

A report on the response to the public consultation on the government's proposals was also published on 27 July 1999.<sup>28</sup> The responses to the consultation in relation to the government's objectives for NATS from this report are reproduced below:

### **A. Freeing NATS from Government financial constraints and enabling private capital to be used in ways more appropriate to the business:**

1. There was general agreement that:

- NATS urgently needed access to additional sources of capital for investment purposes;
- freeing NATS from the government budgeting process and the PSBR was the best way of achieving this; and
- the PFI was an inappropriate way for NATS to raise capital due to its high funding cost and lack of flexibility. Airlines were particularly critical of the PFI and it was widely urged that the proposed PFI for the New Scottish Centre should be postponed until the PPP process was complete.

2. There was less consensus over the PPP proposal: some 25% of the corporate respondents supported it as a means of achieving access to greater capital and to inject private sector management expertise into NATS, but a further 10% preferred the corporatised models adopted by New Zealand, Canada, Germany and the US, as well as the Government's proposals for the Post Office. With very few exceptions, NATS staff were opposed to a private sector solution, and argued that:

- the PPP represented a privatisation of NATS and no government had yet privatised its ATC provider;
- the PPP as proposed was likely to be driven by a profit motive. Since charges were regulated, profits could only come from cost-cutting. This would inevitably lead to job losses which would compromise safety;
- NATS was required to provide certain services (such as the Aeronautical Information Service and Overseas Briefing) which were not commercially viable. A private enterprise driven by profits would be unwilling to provide these services and, unless some other provider could be found, safety would be jeopardised;
- currently, NATS provided services in an unbiased fashion without regard to the characteristics of the user. A commercial organisation would favour its biggest customers;
- a PPP was not needed in order to raise capital, as the German, New Zealand and Canadian ATC models, and the Government's proposals for the Post

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<sup>28</sup> *A Public Private Partnership for National Air Traffic Services Ltd (NATS): A Report of the Response to the Public Consultation Deposited Paper 99/1475*

Office, demonstrated. These were not driven by the profit motive, so safety was much less likely to be compromised.

**B. Effecting a complete separation between the service provider and the regulator:**

3. It was also generally agreed that clearer separation between NATS as service provider and the CAA as regulator was necessary to provide transparency and accountability and to avoid any conflict of interest between ATC service provision and regulation. Some employees argued that the current structure, with NATS as a wholly owned subsidiary of the CAA, achieved sufficient separation to meet these goals, although some non-employee respondents argued that the free interchange of staff between the CAA and NATS, meant that the separation was actually less than it appeared. It was suggested that the public perceived insufficient separation between the CAA and NATS.

**C. Establishing a structure of incentives and disciplines to maximise efficiency:**

4. Many non-employee and several employee respondents felt that private sector management and expertise were necessary to enhance NATS' efficiency. The employee shareholding incentive structure proposed in the paper generally found support, though a few respondents considered there was a need to investigate other performance based incentive schemes.

**D. Developing the business:**

5. There was general approval in principle for allowing NATS to develop its business internationally, especially given NATS' high standing abroad. However, employee respondents felt that commercial freedom was too high a price to pay for loss of public sector status. Corporate respondents urged the Government to build in safeguards to ensure that:

- NATS did not lose focus on its main business, and
- there would be no cross subsidy from the core monopoly business to contestable activities and any new business ventures.

**E. Managing NATS in accordance with best private sector practice:**

6. Many respondents felt that high costs and continued increases in delays pointed to the need for both investment and greater efficiency, and that private sector money and expertise could provide both. Many of the delays to the investment programme were attributed to poor management, and several respondents, including some employees, felt that the overall quality of management could be improved by the intake of people from the private sector. Several respondents who favoured a PPP pointed out that this could most easily be accomplished by having a strategic partner, who would be better placed than an institutional investor accurately to price the opportunities and synergies which resulted from the partnership.

**F. Safeguarding the public interest such as national security and international relationships:**

7. Most people agreed that the safeguards discussed in the consultation paper such as the Government's "golden share" and the Secretary of State's powers of direction would safeguard the public interest. These issues are discussed in greater detail below.

**G. Allowing the taxpayer to share in the success of the company:**

8. A few respondents felt that the timing for a sale was wrong and that uncertainties in the investment programme meant that the taxpayer would not realise a fair price. Certain potential buyers suggested the use of clawback provisions and an Initial Public Offering (IPO) at a later date to ensure that taxpayers could benefit further down the road.

**H. Use of proceeds:**

9. This point was made most commonly by the airlines. The consensus was that, since the value of NATS had been built up through user charges, it would be unfair and inappropriate for the proceeds to be used anywhere other than in building up NATS infrastructure. This would help to reduce user charges which were the highest in Europe.

**I. Financing structure:**

10. This issue was of most interest to non-employee respondents who argued that, to realise maximum value, the Government would have to offer a controlling interest to the strategic partner. This in turn suggested that the employee shareholding would have to come from the Government's stake. Respondents also pointed out that the Eurocontrol charging regime would constrain the returns to equity holders, thereby limiting the attractiveness of the investment. In contrast, the security of NATS' future cash flow owing to NATS' enjoyment for the immediate, foreseeable future, of a monopoly position, and the effectiveness of the Eurocontrol charging and cost recovery regime, made it a secure and attractive debt proposition. One recommendation was to make use of this characteristic to increase the proceeds from a strategic sale by developing a leveraged structure, making use of a high debt component borrowed at low rates to increase the returns to the equity holders, thereby making the investment more valuable. Other suggestions were:

clawback provisions should be introduced to enable the Government to realise maximum proceeds from the sale; and

"not for profit, non-share capital" and Independently Publicly Owned Corporation models should be reconsidered as they could provide the necessary financing and impose the efficiency incentives the Government was seeking for NATS.

11. Many users were concerned by the possibility of conflicts of interest if a single user or other industry interest were to acquire a large shareholding in the PPP or if the PPP invested in airlines or airports. Recreational and general

aviation users were worried that they might be squeezed out of the airspace if airlines become shareholders.

As the summary of responses indicates there is a general consensus about the need to separate safety regulation of ATC from the provision of the service and the need for funding from the private sector. Recent debate, therefore, has centred on the PPP model proposed for NATS.

The Transport sub-Committee is currently conducting an inquiry into the proposed public-private partnership for NATS. The committee has heard evidence from NATS, DETR, the unions representing NATS employees, IPMS and PCS, and the British Airline Pilots Union, BALPA.

### **IPMS and PCS**

The Institution of Professionals, Managers and Specialists (IPMS) and the Public and Commercial Services Union (PCS) have consistently opposed the current government proposals. In their submission to the committee they express the belief that introducing considerations of profit and shareholder interests into a safety organisation will, in time, undermine safety considerations.<sup>29</sup> They say that they have supported the increased commercial focus of NATS for over 10 years by:

- breaking the Civil Service link;
- agreeing new working practices for controllers, assistants and engineers;
- undertaking various reviews of NATS to improve the efficiency of the NATS service.

They advocate the alternative models of an IPOC, as in New Zealand, or the Canadian Trust model, which organisations are in the public sector but are allowed commercial freedom. They also suggest the issue of bonds. This argument for bonds has been rehearsed in the context of London Underground. They believe that the financial demands of a private company would have a detrimental effect on the existing safety culture. They have maintained this stance in spite of a financial incentive of the acquisition of shares in a new PPP company.

### **BALPA**

The British Airline Pilots Association (BALPA) feels that the privatisation of what is essentially a safety function raises important issues and that these issues have not been debated fully and frankly.<sup>30</sup> They take the view that the government has paid insufficient attention to viable and proven alternatives and seems intent on privatisation regardless of other solutions. They believe that the term public-private partnership is a misnomer: the

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<sup>29</sup> PPP 08

<sup>30</sup> PPP 10

state will retain a large but essentially nominal stake allowing a future strategic partner full operational and financial control. They believe that “a significant and even disproportionate amount of managerial time would be diverted into prospecting and exploiting additional revenue generating activities. The experience of the water industry privatisation shows that this would have a negative effect on core service provision. Diversification and lack of focus on core customer concerns were among the charges levelled at Yorkshire Water in 1996.”

On investment the union says that:

“NATS has suffered from a failure on the part of successive governments to allow it to channel the necessary investment into the upgrading and improvement of air traffic services. NATS is a net contributor to the Treasury and yet receives no hypothecated income. The fact that the service has not been allowed to retain the charge income, which it levies upon airlines in return for its service, is at the root of the problem. Government seeks to borrow on financial markets. We would suggest that were the service allowed to invest its own revenues and to borrow within PSBR limits, it could promote a virtuous circle of investment, delivering further improvements in safety and efficiency.”

BALPA also mention the bond finance model as has been implemented at the new Denver airport:

This approach termed “Non Recourse Debt “(NRD), has the benefit of assuring long-term investment in vital public infrastructure. It works by creating a financial instrument (bond/equity/hybrid) carrying a fixed rate of interest which can be purchased and traded on global markets as other financial instruments. However although regarded as a debt, investors have not rights against the company assets and cannot foreclose or liquidate. Properly managed, after the initial payback period, the scheme delivers a stable income stream to investors dependent on the performance of the asset.

BALPA also mentions the IPOC model, but governed and managed by a stakeholder charter. The service would remain a Companies Act company with shares retained by the government, with NATS being given the freedom to borrow in the financial markets to deliver the necessary investment. The principal stakeholders would include the treasury, civil and military authorities, airlines and customers managers and employees. All of these parties would have input into the efficient running of the service on the basis of a quinquennial strategic plan. BALPA claims that the German ATC service DFS operates on such a basis as do many undertakings in the USA. It claims that the charter basis would ensure accountability and scrutiny of a vital civil and military public resource and would obviate the need for a golden share, complex statutory powers and micro-regulation, which would be made necessary by the proposed PPP.

## NATS

NATS in its submission welcomes the government's proposals for the PPP. It expresses the view that the alternative options would not deliver the benefits of the PPP for the following reasons.<sup>31</sup> They do not:

- free NATS from the government borrowing rules or Treasury controls;
- give employees a direct stake in the business;
- provided structural incentives to improve efficiency and performance; or
- allow NATS to have access to the investment it needs in a steady and sustained way to tackle the threat of growing delays.

## DETR

The DETR also takes the view that the alternative models would not necessarily allow NATS to borrow outside the PSBR rules.<sup>32</sup> The DETR's submission claims that the government considered the IPOC model and other options but preferred the PPP model referred to as the New Partnership Company. The DETR also explains that it did not consider the Post Office model a suitable model for NATS because NATS' investment needs are much more complex:

26. The Government considered the Independent Publicly Owned Company (IPOC) model, and a range of other options, both in deciding on its preferred option in the first place and in analysing the responses to the public consultation. There are many similarities between the IPOC model and the New Partnership Company, and the Government believes that the New Partnership Company approach offers all the benefits claimed for the (untried) IPOC model, plus some additional benefits.

27. The New Partnership Company secures access to private capital separates regulation from operation; introduces economic regulation; involves all stakeholders in the company's future; provides for Government to appoint Partnership Directors; gives Government – and the taxpayer – annual dividends; and provides on-going assurance that the company is operating properly in the national interest. The IPOC model also claims to deliver these ends, but the New Partnership Company also:

- removes any future risk of investment counting in the public accounts and therefore becoming subject to Government controls;
- enables private sector investment, project and commercial management expertise to be introduced;
- establishes genuine private sector efficiency drivers at the outset;

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<sup>31</sup> PPP 05

<sup>32</sup> PPP 03



- gives the company commercial freedom to extend its operations world-side, while minimising the risk to the taxpayer of possible financial failure; provides proceeds for use in other transport projects.

28. The Government does not agree that it is valid to compare NATS with the Post Office. The scale and complexity of their investment needs are quite different, as is the nature of the markets in which they operate. NATS' investment involves large, complex, state of the art systems, and its successful delivery requires project management skills and expertise which are not easily found in the public sector. The scale of these projects, in relations to the size of NATS business, is quite different from the situation in the Post Office. NATS does not have a good track record in delivering these large investment projects within budget and within a timetable. On the other hand, the Post Office's investment has been generally less complex, and it has had a good track record in delivering it.

29. The Post Office is exposed to competitive pressures from the market, since a significant part of its business operates in an increasingly competitive environment. This is not the case with NATS - a large part of its business (en route ATC) is a natural monopoly and it is not exposed to the competitive disciplines of the private sector. By bringing the private sector into a partnership, together with effective regulation, the PPP can bring greater efficiency to NATS monopoly operations.

## **V Private Finance Initiative and the New Scottish Centre**

On Budget Day 1993, John MacGregor announced that a £200 million air traffic control centre in Scotland was to be built by the CAA under the government's Private Finance Initiative (PFI)<sup>33</sup>. There is already an air traffic control centre at Prestwick, which deals with Scottish and Oceanic (transatlantic) air traffic. The new ATC centre would be built at Prestwick where the CAA already owns land. This would be the counterpart in Scotland of the new ATC centre for England being built at Swanwick near Southampton which will replace the ATC centre at West Drayton.

In its Memorandum to the 1994-95 Transport Select Committee, the CAA expressed scepticism about the role of the PFI in funding programmes for ATC services. It had accepted the PFI for the funding of the New Scottish Centre as there was no other source of funding. NATS would have a bigger role in managing the Prestwick project than is normal with a PFI project because of its safety responsibilities. This had delayed the project for a year while discussions with the Treasury took place on the management of the project. The CAA's conclusions on the PFI in relation to ATC and on privatising NATS were as follows:

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<sup>33</sup> Department of Transport Press Notice 93/480 20 November 1993

24. Given the safety critical nature of NATS' operations, the Authority believes that the PFI route for funding NATS' investment programme does not offer the best solution for meeting customer requirements, though in the case of a few projects it may be acceptable as an interim measure. The Authority is committed to proceeding by this route for the New Scottish Centre since no alternative source of funds is available. The interaction between the PFI and privatisation remains unclear but potential problems should have been circumvented by the agreed "buy-back" arrangement if privatisation proceeds.<sup>34</sup>

On 8 September 1995 the Secretary of State for Transport<sup>35</sup> announced that the CAA had invited bidders to take part in the competition to design, build, maintain and finance the New Scottish Air Traffic Control Centre. He said that several consortia had expressed an interest in bidding for the concession, which would last for 25 years.

Doubts were subsequently raised about the building of the new centre at Prestwick by the decision of the CAA to review its strategy of having two air traffic control centres for the UK. However the then Secretary of State for Transport announced in January 1997 that the CAA had reported that its review had validated the strategy of providing air traffic control through two centres based respectively at Swanwick in Hampshire and Prestwick in Scotland and that the government were inclined to accept this recommendation<sup>36</sup>. He had asked the CAA to initiate consultation with the airlines and other interested parties and hoped to announce the outcome of the consultation in March.

In December 1996 the Transport Select Committee heard oral evidence sessions on NATS and in particular its current review of its air traffic control centre strategy. The Committee decided to hear further oral evidence from NATS on 29 January 1997.

In its memorandum of evidence to the Select Committee NATS Ltd summarised its attitude to the PFI as follows:

10.7 The PFI route for funding NATS' investment programme does not offer the best solution for meeting customer requirements, though in the case of a few projects it may be acceptable as an interim measure. An alternative funding mechanism needs to be found.

The Transport sub-Committee had also as one of its terms of reference for its 1997 inquiry; when NATS expected to begin operations at the new Swanwick air traffic control centre and the causes of the delay in its opening; the terms under which the new Prestwick en route air traffic control centre would be constructed; and whether delays at Swanwick would postpone its opening beyond 2001/2.<sup>37</sup>

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<sup>34</sup> *Air Traffic Control*, HC 36-II 1994-95 page 14

<sup>35</sup> Department of Transport Press Notice 95/279 8 September 1995

<sup>36</sup> PQ HC Deb 16 January 1997, c317W

<sup>37</sup> Environment, Transport and Regional Affairs Committee, *Air Traffic Control*, HC 360-I 1997-98

The CAA's preferred bidder for the New Scottish Centre is Sky Solutions, a consortium of Bovis and Lockheed Martin. 85% of the systems at Swanwick and Prestwick will be common to both. NATS told the Committee that it planned to sign a letter of intent with Sky Solutions very soon after it gave evidence and would pay the company an initial sum of about £5 million. It intended to sign a binding memorandum in April 1998 and the final contract in August, once Sky Solutions had organised its financing. NATS assured the Committee that it would not sign any binding agreement with Sky Solutions until it was sure that the software at Swanwick could be made to work. The Committee recommended that the National Audit Office should in the near future examine in detail the costs of the New En Route Centre, the placing of the contract for the New Scottish Centre, and the implications, financial and otherwise of having a single supplier of air traffic control systems. It recommended that "the contract for the New Scottish Centre must not be signed unless the independent audit of the software system which we have recommended shows that the software at NERC is capable of working properly."<sup>38</sup>

Dr John Reid announced on 9 April 1999 that the Government had authorised NATS and the CAA to sign a letter of intent with Sky Solutions for the new Scottish air traffic control centre at Prestwick.<sup>39</sup> He said that NATS had been given the authority to finalise negotiations on an initial design and development contract as the first phase in delivering the two-centre strategy and the New Scottish Centre (NSC).

The press release continued that NATS and the government had concluded that a first phase design and development contract was "the best way to allow NATS the opportunity to modernise its operational infrastructure so as to best meet growing demand, as well as ensuring that the NSC fits within the Government's wider plans for the public private partnership (PPP) for NATS."

In a written answer in March 1999, Dr John Reid, admitted that NATS had been negotiating with Sky Solutions as preferred bidder since February 1997.<sup>40</sup> He estimated that the lead time for the NSC was about 5-6 years. At the time the original tender documents were issued NATS estimated that the centre would be needed in around 2000. This date had now been subject to revision and the current estimate is that it will be needed in 2005-06.

A privatised NATS would want to buy out any PFI contracts. It would want the freedom to update the equipment during the life of the contract and not be locked into a contract for outdated equipment.

In 1988 it was decided to that a New En Route Centre (NERC) would be constructed to replace the present facility at London Area and Terminal Control Centre (LATTC) at West

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<sup>38</sup> Paragraph 76

<sup>39</sup> DETR Press Release 1999/389, *Prestwick air traffic control cleared for take-off*, 9 April 1999

<sup>40</sup> PQ HC Deb 22 March 1999, c48-50W

Drayton. It was then envisaged that NERC would become operational by 1996. A succession of delays have dogged Swanwick mainly as a result of problems with installing the software. The contract for the definition of the software for the centre was awarded to IBM and Thomson CSF in 1991. In 1992 the implementation contract was let to IBM, with a delivery date of late 1995. During 1993 the system was designed and developed by IBM. In 1994 IBM International Air Traffic Corporation was acquired by LORAL Corporation, which was in turn acquired by Lockheed Martin in March 1996.

Since NERC has been repeatedly delayed, LATCC has been asked to continue to operate. For that reason the Environment, Transport and Regional Affairs Committee recommended that an independent audit of the project be carried out. An independent report, carried out by the Defence Evaluation and Research Agency (DERA) and published in November 1998, found that the Swanwick centre is viable and West Drayton will be able to handle the predicted levels of air traffic until Swanwick opens in the spring of 2002.<sup>41</sup> The report also comments that NATS can safely use the same software for the NSC as is being used at Swanwick.

Although the development of the NERC is not a PFI project, it has been suggested in the press that the sale of NATS could be jeopardised by doubts on the part of potential investors over its future.<sup>42</sup>

## **VI Organisation of air traffic control in other countries**

In the context of the government's proposals for NATS there has been considerable interest in how ATC services are organised in other countries. The transport sub-committee of the Department of Environment, Transport and the Regions took evidence on ATC in New Zealand and Canada.<sup>43</sup> This information and some about other countries is outlined below.

### **Switzerland**

In answer to a parliamentary question in 1994, the then Transport Minister, Steven Norris, said that he knew of no country whose air traffic control system had been fully privatised, in the sense that it was wholly or predominantly owned by shareholders or organisations outside of government.<sup>44</sup> He understood that Switzerland's air traffic control service, Swisscontrol was only partly owned by the Swiss Government. In a press article

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<sup>41</sup> DETR Press Release 1018/98, *Independent experts give Swanwick safety thumbs up*, 30 November 1998

<sup>42</sup> "Solve the problems, air traffic chiefs told", *Times* 24 September 1999

<sup>43</sup> Environment, Transport and Regional Affairs Committee, *Air Traffic Control*, HC 360-I 1997-98

<sup>44</sup> PQ HC Deb 21 June 1994 c125W

Swisscontrol was described as "a quasi-governmental provider of air navigation services for the Swiss Confederation."<sup>45</sup>

More detail about Swisscontrol was given in an earlier press article, which is reproduced in full below:<sup>46</sup>

"Swisscontrol, Schweizerische Aktiengesellschaft fuer Flugsicherung, is to become independent of the Treasury budget from January 1 1996. The Swiss Parliament announced yesterday that Swisscontrol would be able to act with improved flexibility and become more customer-oriented as an independent company. Financial independence will be carried out under several conditions: Swisscontrol will continue as a non-profit-making, part publicly-owned joint stock company providing air traffic control services to the state. The fees for air traffic control services will in future be determined and collected by Swisscontrol directly. The state will provide Swisscontrol with the necessary installations and buildings. The state will take a stake in the company's share capital. The Swiss Parliament has thus approved in principle the organisational structure of the company which was put into place in 1987. Swisscontrol currently employs 1,070 staff. In the first half of 1995, the company oversaw 407,417 flights in accordance with instrument flying rules."

In recent evidence to the Transport sub-Committee of the Environment, Transport and Regional Affairs Committee, representatives of NATS said that Fiji was the only country in the world to have privatised its ATC: it had been sold to an Australian company.<sup>47</sup>

## Netherlands

The following information on the Dutch ATC system was obtained from a visit made by members of the transport sub-committee:

63. Until 1993, Dutch air traffic control was managed by and responsible to the Dutch Ministry of Transport. It is now a free-standing corporation which reports to government. Its budget is still approved by relevant minister, but any expenditure by the air traffic control organisation is not now considered to be part of government expenditure. This is very close to privatisation but because the organisation does not have shareholders or make a profit, its incorporation is different. The minister appoints the board of management and the advisors. They include representatives from the Ministry of Transport, Schiphol Airport, the Dutch military, and the airlines KLM and Transavia. Foreign airlines are not represented.

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<sup>45</sup> *Asia Intelligence Wire* March 1998

<sup>46</sup> "Swisscontrol becomes independent of treasury", *Reuter Textline*, 26 September 1995

<sup>47</sup> sub-Committee hearing 8 December 1999

## Germany

Germany was cited in Steven Norris's written answer mentioned above as one of the countries where ATC had been removed from the machinery of government and established in some form of corporate body. A little more detail about the German system is contained in the website of the IPMS Union which is campaigning against the privatisation of NATS:

If (NATS) could be given more commercial freedoms like DFS, the German Air Traffic Control organisation. This is a publicly owned company which is allowed to borrow money from the markets and act commercially but it is still firmly under public control and is not driven by profit. The Dutch air traffic control system is similar. The Transport Committee said the government should look at these different models before making a decision - why has it not done so?

Why not follow the German model?

The government argues that if NATS were like DFS, any loans would still be counted against the Public Sector Borrowing Requirement (PSBR), since the government ultimately bears the risks of NATS borrowings. But the PSBR is a peculiarly British definition of public borrowing that no one else in Europe uses. They use the GGFD (the Gross Government Financial Deficit) which is used in the European Union to measure government borrowing against the Maastricht entry criteria for monetary union. The GGDF excludes the borrowings of public corporations like NATS and DFS. Why does the Treasury insist in sticking to a more restrictive measure?<sup>48</sup>

In another article DFS (Deutsche Flugsicherung) is described as a privatised organisation.<sup>49</sup> This article also states that air safety in Germany is under the authority of the Ministry of Internal Affairs.

## New Zealand

The Environment, Transport and Regional Affairs Committee in its March 1998 report summarised the operation of New Zealand Air Traffic Control after taking evidence from a former New Zealand Treasury Official:<sup>50</sup>

62. New Zealand Air Traffic Control was established as a State-owned Enterprise (SOE). Known as the Airways Corporation in 1987. The New Zealand government developed an SOE policy in the mid-1980s in order to address the problems of a number of state-owned businesses that were loss-making and providing poor services. Legislation required that SOE to be operated as if it were privately-owned and its borrowing was no longer counted as public sector

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<sup>48</sup> <http://www.ipms.org.uk>

<sup>49</sup> "Germany: airport development & expansion projects" *Asia Intelligence Wire* 16 July 1998

<sup>50</sup> *Air Traffic Control*, HC 360-I 1997-98

borrowing. Many of the original SOEs in New Zealand have in fact been privatised, although the Airways Corporation remains entirely government-owned. This is probably because of concerns on the part of airlines about it being a natural monopoly. One special feature of the new structure is the official recognition of the policy tension involved in trying to implement the objective of commercial autonomy and accountability when the government is the owner of the company. The requirement to prepare a 'Statement of Corporate Intent' was included in the SOE legislation in order to enable a compromise to be reached between conflicting demands in the event that a minister wished to pressurise an SOE into pursuing uncommercial objectives.

## Canada

The Select Committee also took evidence from the Director of Air Navigation Services and Aerospace Regulation in Canada and included a paragraph about the restructuring of air traffic services in Canada:<sup>51</sup>

61. The Canadian Air Navigation System was sold to NAV CANADA in 1996 for \$CDN1.5 billion. It is a not-for profit corporation with a Board comprising representatives of users, government, unions and others. It has borrowed \$CDN 3 billion privately (which was 3 times oversubscribed) and the corporation is allowed to collect user charges on the basis of cost recovery rather than profit. Any profits made must be used to pay debt or be spent on the air traffic service. The restructuring was driven by the need for an efficient and responsive service and by the realisation that because of budgetary constraints the former air traffic control service was likely to be underfunded and unable to afford the latest technologies. It was "widely considered to have been a success for all concerned": for the taxpayer through \$CND1.5 billion in receipts, for the industry, in allowing the system to modernise, for users, who benefited from more efficient operations, and for employees, NAV CANADA itself and the government of Canada.

## VII The Bill

The air traffic provisions of the Bill are divided into six chapters.

### 1. Chapter 1: Air traffic services

This part of the Bill defines air traffic services as currently provided by NATS and sets out the duties of the CAA and the Secretary of State under the new regime. It provides for en route services to be provided under a licence issued by the Secretary of State or the CAA and provides for economic regulation by the CAA. Any new company will continue to provide the services currently provided by NATS. En route services will be provided

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<sup>51</sup> Ibid

under a licence issued by the Secretary of State, and will be subject to statutory economic regulation by the CAA. All air traffic services, whether provided by NATS or other providers will remain subject to safety regulation by the CAA, who will also have responsibility for airspace policy.

**Clauses 5 to 7** make provision for the grant of a licence to provide air traffic services. The purpose of a licence will be to enable the CAA to carry out economic regulation of the licensed activities.

The method of economic regulation is not spelt out in the Bill. The Government's thoughts on a regulatory regime for NATS were set out in the consultation paper:<sup>52</sup>

27. The Secretary of State proposes that the following duties should be placed on the economic regulator:

- Secure reasonable demands for supply are met. This duty would require the regulator to ensure the supply of en route ATC and associated air navigation services, and would allow him actively to encourage investment in new facilities in time to satisfy anticipated demands by users.
- Regulate the licensee in a manner which would not make it unduly difficult for the licensee to finance its activities. This duty would require the regulator to have regard to the financial position of the provider. In conjunction with the other duties, it prevents the regulator from pursuing a course of action that would bankrupt the provider. It would also ensure that the regulator did not oblige, or permit, the provider to set charges at an unsustainably low level.
- Protect users' interests in terms of the cost and quality of service provided. This duty is self-explanatory and would require the regulator to have regard to the interests of users in carrying out his functions.
- Promote efficiency and economy in the provision of air traffic services. This duty requires the regulator to regulate the provider in a way which promoted efficiency in their day to day operations. It is normally discharged by the regulator's setting an upper limit on the charges which the provider could levy. In doing so, the regulator would take account of a wide variety of factors, including the financial position of the provider, what scope existed for savings through more efficient working practices, investment needs, and the views of the provider and users.
- Impose minimum necessary restrictions to undertake the preceding duties, thereby minimising the direct and indirect costs of regulation, and
- Have regard to the UK's international obligations, which would require the regulator, in determining pricing caps and in encouraging investment in new facilities, to take into account the UK's international obligations.

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<sup>52</sup> DETR October 1998, *A Public-Private Partnership for National Air Traffic Services Ltd: A Consultation Paper by the Secretary of State for the Environment, Transport and the Regions* Dep 98/1068



The Bill does not specify the duration of the licence. In the consultation the government said that it “recognises the constraints and conflicts pointed out by respondents to the consultation and will seek out the optimum balance between incentivising the licence holder and allowing for flexibility in the future structure of the industry.”<sup>53</sup>

There was widespread concern in the response to the consultation that the framework should include safeguards to ensure that commercial interests did not compromise the public interest. The range of measures proposed in the consultation paper (the “golden share “, statutory powers of direction, provisions to take control over NATS in times of war, emergency or crisis as well as economic and safety regulation) was seen as sufficient to protect the public interest.

**Clause 38** gives the Secretary of State powers to issue directions to licence holders (either individually or generally) of a general character in the interests of national security in the interests of encouraging or maintaining the UK's relations with another country or territory. The Secretary of State may also give a licence holder specific direction in the interests of national security or a direction in connection with fulfilling an international obligation laid on the United Kingdom. Failure to comply with a direction is an offence. The penalties for committing an offence under this clause range from a fine not exceeding the statutory maximum on summary conviction, to up to two years imprisonment on conviction on indictment.

This part of the Bill also provides for an administration regime. The consultation paper had said that powers would be needed for the issue of statutory enforcement orders where it is considered that the company was in serious breach of the licence, and existing remedies under commercial law would prove inadequate. These statutory enforcement orders are to be called air traffic administration orders and are contained in **Clauses 29 and 30 and Schedule 1**. Details of the contents of the other clauses in this part of the Bill are set out in the Explanatory Notes to the Bill.<sup>54</sup>

## 2. Chapter II : Transfer Schemes

Transfer schemes are the means by which shares in the current air traffic services provider will be transferred out of the CAA's ownership and into Crown ownership, in readiness for partial sale. The transfer of ownership is the means by which the objective of separating the CAA's regulatory functions from the provision of services is achieved. The transfer scheme provisions also allow the corporate structure of the air traffic service provider's business to be reorganised in light of the new licensing regime and the proposed public-private partnership.

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<sup>53</sup> Ibid Paragraph 47

<sup>54</sup> Transport Bill Explanatory Notes Bill 8-EN December 1999

The Bill contains no detail of the proposed sale of NATS. **Clauses 40-48** contain the provisions for transfer schemes either by the CAA or the Secretary of State as set out in the Explanatory Notes.

### Special share

As envisaged by the government's consultation paper the Bill contains the requirement for a special ("golden") share in NATS if it is sold. **Clause 49** requires the Secretary of State to ensure that the Crown continues to hold any special share provided for under the company's articles of association, and must not consent to any alteration of the special share arrangements without the approval of Parliament. The provisions of this clause can only be amended or repealed with the approval of Parliament (see *clause 89(4)*).

**Clause 89(4)** provides that the power to make an order under section 49 is exercisable by statutory instrument; but no order can be made unless a draft has been laid before and approved by resolution of each House of Parliament.

It has been reported that the European Commission is considering a challenge to the government's special share in the British Airports Authority.<sup>55</sup> The Transport Minister, Lord Macdonald, in evidence to the Transport sub-Committee, said that the government was confident that a special share in NATS would be justified on the grounds of national security.<sup>56</sup>

The government's consultation paper stated that the special share might be used to protect NATS from dominance by a controlling interest.<sup>57</sup>

Other clauses related to transfer schemes in this part of the Bill are outlined in the Explanatory Notes.

**Clause 55** enables the Secretary of State, with the Treasury's consent to extinguish the debts to the CAA of a company wholly owned by the CAA. The Secretary of State may direct the CAA to release such a company from its debt to the CAA. He may also, by order, extinguish the CAA's corresponding liability to him in respect of this debt, and the assets of the National Loan Fund would be reduced accordingly by a corresponding amount. The Explanatory Notes to the Bill reveal that NATS has outstanding loans of around £300 million, which will need to be settled either by refinancing from the private sector, repayment, or writing off.

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<sup>55</sup> "EU ready to sue Britain over BAA golden share", *Times* 29 July 1999

<sup>56</sup> sub-Committee hearing 8 December 1999

<sup>57</sup> DETR October 1998, *A Public-Private Partnership for National Air Traffic Services Ltd: A Consultation Paper by the Secretary of State for the Environment, Transport and the Regions* Paragraph 22

### 3. Chapter III: Air Navigation

The Government's consultation paper acknowledges that access to airspace is likely to be a major consideration for aircraft operators following any change to the status of NATS. It is currently set down in the 1996 Directions to the CAA that access to airspace should be provided on an equitable basis without discriminating against any particular class of user. Airspace planning is currently discharged by the Director of Airspace Policy (DAP) whose directorate is jointly resourced by the CAA and the MOD. The existence of the DAP, the role of the MOD in his appointment, and the working arrangements between the CAA are set out in the 1996 Directions. These establish the Joint Air Navigation Services Council (JANSC) which is charged with constituting the framework within which the CAA and Defence air navigation services continue to be provided on a joint and integrated basis, and with providing general policy oversight over the DAP's activities.

Users who responded to the consultation felt that airspace regulation should remain in the public sector, under the DAP. Many airlines felt that there was a need to recognise that as air traffic increased, civil users would require more airspace. They felt that closer consultation between NATS, the DAP and the users would assist airspace regulation and that the DAP should be required to consult them in the formation of airspace policy. The government's response was as follows:

The Government is content that airspace regulation should become wholly a function of the CAA, discharged through the DAP, and it is envisaged that the Director will be a member of the Authority. The Director will be appointed jointly by the Secretary of State for Defence and the Secretary of State for the Environment, Transport and the Regions, and the appointment will follow open competition in accordance with the guidance in the Code of Procedure for Public Appointments. The main objective of airspace regulation will continue to be the reconciliation of military and civil needs without according preferential treatment to either. Safeguards will be put in place to ensure that the CAA has a responsibility to the Secretary of State for Defence in matters of national security.

The future operation of the JANSC, or a successor body, is still for detailed consideration. The current arrangements will require revision to avoid the clearly undesirable position of the airspace regulator being placed under the oversight of the main service provider, but the need for a body to bring together civil and military provision of air traffic services will not change. Allied to this, there is a need to re-examine the mechanisms for consultation on airspace policy, where it is recognised that existing consultation fora are less effective than they might be. Neither subject is a matter for legislation, and will be dealt with in directions to the CAA.

**Clause 64** allows the Secretary of State to give responsibility for air navigation functions to the CAA. The CAA may be given functions now exercised by the DAP."). The DAP is appointed by the Secretary of State for Defence and is subject to the direction of that Secretary and the Secretary of State for the Environment, Transport and the Regions. This clause also permits the Secretary of State to nominate a member of the CAA to perform,

on behalf of the CAA, specified air navigation functions. **Clause 65** deals with supplementary provisions relating to directions.

#### **4. Chapter IV: Charges for Air Traffic Services**

Charges are currently levied in the UK for the provision of en route air navigation services pursuant to the Multilateral Agreement relating to route charges signed at Brussels on 12th February 1981 (Cm 8662) for services provided in the Shanwick Oceanic Control Area; and for certain services provided by the governments of Canada, Denmark and Ireland. The 1982 Act authorises the Secretary of State to make regulations requiring the payment to him, to the CAA, or to Eurocontrol of charges for air navigation services provided by them or any other person. The 1982 Act also provides a statutory basis for the CAA to detain and sell aircraft owned or operated by any person in default in respect of such charges, in order to effect payment of the debt. A similar basis of charging and charge recovery exists in relation to airport air traffic control services at a limited number of airports, and for North Sea helicopters.

The system in this Bill retains a broadly similar system of charging and charge recovery. The costs of providing the air traffic services mentioned above will continue to be met by the owners and operators of aircraft. However, the duty to pay such charges will no longer be set out in regulations made by the Secretary of State, but rather the CAA will specify the charges which will be set out in a published notice. The CAA will continue to have statutory powers to detain and sell aircraft in respect of unpaid charges. These provisions are set out in **clauses 66 to 74** of the bill and details are contained in the explanatory notes.

#### **5. Chapter 5: Competition**

**Clauses 75 to 77** give the CAA, as economic regulator, concurrent powers with the Director General of Fair Trading ("the DGFT") under competition legislation in relation to the supply of air traffic services. This is consistent with the powers granted to other utility regulators (telecommunications, gas, electricity, water and railway services). These provisions are explained in the Explanatory Notes.

#### **6. Chapter VI: Miscellaneous and General**

**Clauses 78 to 83** deal with the collection and publication of information by the CAA under these provisions, the Secretary of State's general powers to issue directions to the CAA, and control in time of hostilities, as set out in the explanatory notes.

In its response to the consultation the government expressed its intention to take powers of direction in the event of crisis, war or national emergency. The powers are broadly similar to the powers contained in the 1982 Act but it felt that the circumstances in which these powers could be invoked were too limited, depending as they do on a formal declaration of war. Hence the provision for the government to take powers of direction in **Clause 81** over NATS, the CAA and other listed persons concerned with aviation

generally “in time of actual or imminent hostilities or of severe international tension or of great national emergency.”

**Clauses 86 to 91** contain other general provisions as set out in the Explanatory Notes.

The Explanatory Notes to the Bill suggest that the partial sale of NATS to a strategic partner could raise in the region of £350 million, against which NATS has outstanding loans of £300 million. In evidence to the transport sub-committee, officials of NATS said that they could not put any value on NATS Ltd.<sup>58</sup>

The government estimates that the cost of establishing a public-private partnership for the provision of air traffic services will be approximately £35 million.

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<sup>58</sup> Committee Hearing 8 December 1999.

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