Aviation: National Air Traffic Services (NATS)

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Section Business and Transport

This note gives information about the structure of National Air Traffic Services (NATS).

NATS provides air traffic navigation services to aircraft flying through UK controlled airspace and at several UK and international airports, moving over 6,000 flights daily.

UK airspace contains a network of corridors, or airways. These are usually ten miles wide and reach up to a height of 24,000 feet from a base of between 5,000 and 7,000 feet. They mainly link busy areas of airspace known as terminal control areas, which are normally above major airports. At a lower level, control zones are established around each airport. The area above 24,500 feet is known as upper airspace. All of these airways are designated "controlled airspace". Aircraft fly in them under the supervision of air traffic controllers and pilots are required to file a flight plan for each journey, containing details such as destination, route, timing and height.

NATS was part-privatised in 2001 by the Labour Government. NATS is a public private partnership between the Airline Group, a consortium of seven airlines, which holds 42%, NATS staff who hold 5%, UK airport operator BAA Limited with 4%, and the government which holds 49%, and a golden share.

The successes of NATS under this structure led the Labour Government to look at whether to sell the government's remaining shareholding in the company. These proposals were taken up by the Coalition Government after May 2010. However, after lengthy consideration the government announced on 10 July 2012 that it would not proceed with a sale of its shares at this time.

Information on other aviation issues can be found on the Aviation Topical Page of the Parliament website.

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1 An overview: NATS then and now

The most recently lodged accounts for NATS Holdings ltd are for the year ending 31 March 2012; the first set of accounts were for the period ending 31 March 2002.

Employees

Typically the accounts are not entirely consistent with their definitions over the years. One example is the material supplied on the number of employees. In the first set of accounts it states both the actual number of employees on a particular date and also the average during the year including the directors. The latest accounts give the average figure including the directors. The average number of employees in the period ending 31 March 2002 was 5,652; the average number of employees in the year ending 31 March 2012 was 4,533.

Performance

Average delays per flight attributable to NATS were 109 seconds in 2000-02 and just under 8 seconds in 2011.

Finance

In 2000-02 turnover was £553m, with a loss of £80m before tax and net assets of £81m; in 2011-12 turnover was £653m, with a profit of £194.4m before tax and net assets of £526m. NATS was making a modest profit (for the government) prior to the PPP (£31 million in 1999).[1] Since the PPP NATS' profits have increased and it is consequently paying more tax (e.g. £38.1 million on £194.4 million profit in 2011-12).

Investment

As indicated above, almost the entirety of NATS' income comes from its charges to customers; it has not required public funding since the PPP with the exception of the one-off payment that followed the downturn in air travel following September 11 (£65 million from the

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1 Environment, Transport and Regional Affairs Committee, *The Proposed Public-Private Partnership for National Air Traffic Services Limited* (third Report of session 1999-2000), HC 35, February 2000, ev. PPP05A

government matched by £65 million from BAA). NATS has not required further public funds and has made profits for the past eight years.

Share capital

As stated above, the overall ownership of NATS is as follows:

- Government – 49 per cent;
- NATS staff – five per cent; and
- private sector partners (the Airline Group and BAA) – 46 per cent

There are three different types of shares: Ordinary, Ordinary A and Special Rights Redeemable Preference. As of March 2012:

Ordinary shares 131,000,007, of which:

- 59,994,056 held by The Airline Group ltd;
- 64,190,004 by the government; and
- 6,815,947 by NATS Employee Sharetrust ltd.

Ordinary A shares 12,048,193, of which:

- 5,997511 held by BAA plc;
- 5,714,219 held by the government; and
- 336,463 by NATS Employee Sharetrust ltd.

Special Rights Redeemable Preference Share 1: held by the government.

The NATS Employee Sharetrust ltd is fully owned by NATS Holdings ltd and is in fact dormant (i.e. non trading). The 2011-12 accounts of NATS Holdings ltd give the following information:

> There are no share option schemes in place for executive directors.
>
> The NATS All-Employee Share Ownership Plan is designed to give every member of staff (including executive directors but not non-executive directors) an equal opportunity to acquire a stake in the future success of the company. The share plan holds 5% of the shares in NATS and is administered by a special trustee company with three directors – one each appointed by HM Government, AG and the Trades Unions (collectively known as the Trustee). Baroness Brenda Dean chairs the Trustee meetings.
>
> Richard Deakin currently holds 400 shares, Nigel Fotherby holds 2,377 shares and Paul Reid holds 2,377 shares.
>
> The current HM Revenue and Customs approved valuation, for the period 1 January 2012 to 30 June 2012, values the shares at 395p each.[2]

[2] *NATS holdings ltd annual report and accounts 2012*, p62

2 Proposals to extend private ownership, 2009-12

In light of the economic downturn, in December 2009 the Labour Government published an Operational Efficiency Programme Asset Portfolio which set out those state-owned assets that the government might seek to commercialise over the medium term. One of these was NATS. However, the document did not propose selling the government's shareholding, it merely pointed out that from mid-2010 it would be possible for the government and the companies currently invested in NATS as part of the PPP to begin selling their shares in the company:

> Policy Objectives
>
> **Shareholding objectives**
>
> Maintaining (and where appropriate enhancing), NATS' safety performance and culture, to provide over the long term a risk-adjusted commercial return to NATS' shareholders through:
>
> - efficiently and cost effectively providing air traffic services that meet the reasonable requirements of customers in terms of reliability, capacity and delay;
> - investing efficiently and cost effectively in appropriate air traffic control (ATC) infrastructure to be able to deliver those services; and
> - pursuing strategic commercial growth opportunities in the UK and overseas ATC markets, including European.
>
> **Policy considerations**
>
> Safety – to maintain, and where practicable improve standards to achieve the highest level of safety performance and to ensure a reasonable level of resilience.
>
> Department for Transport overall objective – to support national economic competitiveness and growth, by delivering reliable and efficient transport networks. NATS has a key role to play in delivering this objective, in particular by providing greater capacity and helping to reduce delays, in particular in the congested south east of England.
>
> Single European Sky – NATS is an active participant in this pan-European initiative aimed at improving and integrating air traffic control across Europe. As part of the Single European Sky, NATS will be subject to new performance targets established at EU level in the areas of cost efficiency, safety, capacity, and environment from 2012. NATS is the main UK participant in SESAR, the public-private programme to develop the next generation of air traffic management technology, and UK involvement depends on its commitment.
>
> Environment – NATS has set a target to reduce the ATC-related CO_2 impacts from air travel by 2020 by on average 10 per cent per plane. Environmental targets will also be established at EU level as noted above. This is an important part of reducing aviation's impact on climate change.
>
> Any reduction of the Secretary of State's shareholding below 25 per cent would need an order to be laid before, and approved by a resolution of each House of Parliament, in accordance with the Transport Act 2000.
>
> **Alternative Asset Options**

> In light of the impending expiry of the restrictions on transfer of shares, it is likely that other shareholders may wish to consider the options available to them regarding their shareholding in NATS.
>
> It is therefore appropriate to work with existing shareholders to look at future ownership options and structures, to best meet the needs of the company and shareholders.
>
> **Other Considerations**
>
> NATS remains a profitable and cash generating business despite the downturn in air travel business.
>
> The CAA-led NATS en route price control review for Control Period 3, 2011-15 will report in late 2010.
>
> Any changes in ownership would need to consider the potential constraints of current legislation.
>
> **Private Sector Opportunity**
>
> The expiry of the restrictions on the transfer of shares in NATS may present an opportunity for a private sector party to invest in the company.[3]

There were no further developments before the 2010 General Election.

The Conservative-Liberal Democrat Coalition Government's first Budget, in June 2010, indicated the government's intention over the following 12 months to "explore with other shareholders the options for a potential sale process in NATS".[4] In his statement, the Chancellor, George Osborne, was more specific, he stated that this would mean the government selling its share in NATS: "We will look at how to dispose of our shareholding of NATS, the air traffic control services".[5] In Budget 2011 the government confirmed that it "intends to realise value from its shareholding in NATS, subject to considering the views of key interested parties".[6]

On 8 June 2011 the Secretary of State for Transport, Philip Hammond, made a statement to the House announcing that his Department was publishing 'a call for evidence'

> ... to support my decision making in whether to sell all, part or none of the Government's 49% shareholding in NATS—formerly National Air Traffic Services.
>
> [...]
>
> [In light of] the Government's policy that assets held in the public sector, where there is no policy requirement to do so, tie up state resources that could deliver better value for money for the public if used elsewhere. We are seeking evidence through this process from key interested parties including the regulator, employees of NATS and the wider aviation industry, to establish whether or not there is a policy requirement to retain a shareholding in NATS.
>
> NATS provides strategically important services to the UK and as such, I want to ensure that the overall aviation policy objectives of safety, security, economic regulation, civil/military co-operation, environment and supporting the Single European Sky

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3 HMT, *Operational Efficiency Programme: Asset Portfolio*, December 2009, pp33-34
4 HMT, *Budget 2010*, HC 61, 22 June 2010, para 2.10
5 HC Deb 22 June 2010, c170
6 HMT, *Budget 2011*, HC 836, March 2011, para 2.16

programme are not compromised by any decisions we take over future share ownership. The call for evidence document outlines the controls and protections that exist in NATS' operating environment independent of the Government's shareholding and seeks evidence from consultees on what, if any, protections would be required on top of these to allow the delivery of these objectives.

The call for evidence will be open from today until 6 July and we aim to publish the results shortly after the closing date. The evidence collected will support my final decision about whether to sell Government shares in NATS.[7]

In December 2010 *The Times* reported that Serco, Global Infrastructure Partners and Lockheed martin had 'emerged' as potential buyers for the government share of NATS. It speculated however that bidders would be looking to secure a controlling stake in the company rather than just the government's 49 per cent share.[8]

Richard Deakin, Chief Executive of NATS, was reportedly not in favour of a 'full privatisation' of the company.[9] The proposal was also criticised by some airlines (for example easyJet) and unions.[10] The Labour Party called the proposals "ideologically driven".[11]

A summary of responses to the Call for Evidence was published in September 2011[12] and in July 2012 the Secretary of State for Transport, Justine Greening, announced that, upon consideration, the government had decided not to go ahead with the sale of any government shares at the present time:

My Department ran a call for evidence last year to explore the options for the future of the Government's 49% shareholding in the UK's air traffic control provider, NATS Holdings plc (NATS).

The responses, along with work done by my officials in conjunction with other stakeholders, highlighted the strategic importance of NATS to the UK and the far-reaching implications of a sale at this time. These include the continued development of the single European sky agenda and the ongoing work on the single European sky air traffic management research programme (SESAR).

In parallel, I have considered the potential value that could be realised through a sale of the shares alongside the benefits from receiving dividends from a retained shareholding.

After considering these factors, I have concluded that it is in the best interests of the British taxpayer, the travelling public and the company itself to retain the Government's shares in NATS at this time.[13]

3 Public-private partnership, 1997-2004

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 Part III of the *Civil Aviation Act 1982*, as amended,

7 HC Deb 8 June 2011, cc30-31WS; the document is available on the DfT website: DfT, *Call for Evidence: NATS Government share ownership*, 8 June 2011
8 "Buyers form orderly queue for stake in air traffic control", *The Times*, 20 December 2010
9 "Air traffic chief voices sale concerns", *Financial Times*, 5 July 2010
10 "Proposed sale of air traffic controller angers airlines", *Financial Times*, 23 June 2010
11 "Air traffic sell-off plans attacked", *Financial Times*, 9 June 2011
12 DfT, *Summary of responses to the call for evidence "NATS Government Share Ownership"*, September 2011
13 HC Deb 10 July 2012, c22WS

which sets out the Authority's constitution, functions and general objectives. Its main task was to provide an air traffic control service before 2001 (this was by far the largest part of the Authority's work) it also regulates the UK airline and airport industries. Its regulatory role encompasses both safety and economic regulation, although these areas are gradually being moved across to the European Aviation Safety Agency (EASA).

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 National Air Traffic Services (NATS) in order to keep what had been the regulatory function of NATS apart from its service provision functions. NATS carries out air traffic services involving air traffic control (ATC) and radio and navigational aids.

A change in the institutional status of NATS was talked about as far back as the late 1980s. For example, a Transport Select Committee Report in 1989 recommended that the then Conservative Government consider splitting the CAA into two separate organisations, 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.[14] 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.[15] Some users felt that it was wrong in principle that the same body should both regulate the airline industry an act as supplier of services to it.

Privatisation of NATS was first considered by the Conservative Government in a consultation paper published in May 1994 but no decision on privatisation was taken.[16] In November 1995 the then Secretary of State for Transport, Sir George Young, 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. He confirmed that this would pave the way for future privatisation, which remained the government's longer term objective.[17] Consequently, on 1 April 1996 the civil elements of NATS were incorporated as a wholly owned subsidiary of the CAA as NATS Ltd.

3.1 Proposals by the Labour Government, 1997-99

There was no reference to NATS in the Labour Party's Manifesto for the 1997 General Election, however there was some discussion of public private partnerships in a 1996 transport policy document:

> 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

[14] Transport Committee, *Air Traffic Control Safety: minutes of evidence* (session 1988-89), HC 198, 9 February 1989, para 183

[15] MMC, *Civil Aviation Authority: A report of an inquiry into the supply of navigation and air traffic control services to civil aircraft*, Cm 1122, July 1990, chapter 6

[16] Department of Transport, *Privatisation of the National Air Traffic Services [NATS]: A Consultation Paper by the Secretary of State for Transport,* May 1994 [DEP 10862]

[17] HL Deb 29 November 1995, c64WA

> 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.[18]

In July 1997 NATS submitted a paper to the new Labour Government putting the case for an alternative funding mechanism together with an analysis of the various options available.[19]

On 11 June 1998, the then Transport Minister, Dr Gavin Strang, announced plans for a new public private partnership (PPP) for NATS.[20] Dr Strang said that the government would consult on the implementation of its 'decision in principle' and would then bring forward the necessary legislation.[21]

A consultation paper was published on 21 October 1998, in which the government confirmed that its preferred option for delivering the PPP was a part sale of NATS, resulting in a 51 per cent holding in the private sector (including employees) and 49 per cent remaining in public ownership. The paper proposed to offer up to ten per cent of shares not retained by government to staff. The consultation 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 had undertaken to provide these services. The provision of these services by NATS would be subject to statutory safety, economic and airspace regulation. The company would operate under licence.[22]

The consultation paper acknowledged that the government's proposal had caused uncertainty among staff and raised concerns about their terms and conditions of employment. The paper stated that the government wished to see employees' existing contractual terms and conditions of employment maintained and welcomed the commitment by CAA and NATS' management to full and proper consultation with the workforce and their representatives. It also stated that there would be 'full consultation' with staff representatives on future employment, conditions of service, and pension rights. [23]

In July 1999 the government announced its intention to proceed with a PPP for NATS. The main elements of the proposal were as follows:

- The government would retain a 49 per cent stake in NATS, while NATS staff would have a five per cent 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 per cent 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

[18] Labour Party, *Consensus for Change: Labour's transport strategy for the 21st Century*, 1996
[19] NATS, *NATS and commercial freedom: a review of the options*, July 1997
[20] the terminology can be confusing: the Treasury refers to PFI as a type of public private partnership (PPP); but the term PPP is also used to refer to specific arrangements for the financing and operation of NATS and parts of the London Underground; further information on PFI generally can be found in HC Library Research Paper RP 03/79
[21] HC Deb 11 June 1998, c637W
[22] DETR, *A Public Private Partnership for National Air Traffic Services Ltd (NATS)*, 21 October 1998, paras 5-6; the joint response to the consultation from NATS and the CAA is available on the NATS archive website
[23] ibid., para 41

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; and

- The joint and integrated military use of air traffic control systems would continue. [24]

There would also be a new stakeholder council, which would bring together government representatives, the private strategic partner, NATS management, customers and staff representatives in a forum for consultation about the company's plans.

3.2 Transport Act 2000 and the PPP

A detailed overview of the NATS provisions in the Transport Act 2000 is given in HC Library research paper RP 99/102.

The *Transport Act 2000* gained Royal Assent on 30 November 2000. Under section 43 of the 2000 Act the Secretary of State was empowered to give the CAA a direction requiring it to make a transfer scheme. Transfer schemes are the means by which shares in NATS were transferred out of the CAA's ownership and into Crown ownership, in readiness for partial sale. Following an amendment to the Bill at Lords Report Stage, which would have delayed such a direction until the Parliament after the one in which the Act was passed,[25] the Commons proposed a compromise whereby the transfer scheme could be delayed until three months after the Act was passed. This amendment was subsequently accepted by the Lords.[26]

Three consortia were taken forward to the final stage of the bidding process for the NATS PPP:

- **Nimbus:** comprised of SERCO and PPM Ventures (equity participants) and ARINC and Cranfield University (technical assistance);

- **Novares:** comprised of Lockheed Martin, Apax Partners and Airways International Ltd (equity participants) and AEA Technology and DERA (technical assistance); and

- **Airline Group:** comprised of British Airways, British Midland, Virgin Atlantic, Airtours, Britannia, JMC, Monarch and easyJet (equity participants) and BT and several European air traffic service providers (technical assistance).[27]

The House of Commons approved the draft Order on 12 February 2001 and the House of Lords debated and approved the same on 27 February.[28] The *Transport Act 2000 (Designation of Transferees) Order 2001* (SI 2001/1292) came into force on 31 March 2001 and transferred the shares in NATS from the CAA to the then Secretary of State for the Environment, Transport and the Regions (now the Secretary of State for Transport).

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[24] HC Deb 27 July 1999, cc121-123
[25] HL Deb 26 October 2000, cc525-530
[26] HL Deb 29 November 2000, c1323
[27] DETR press notice, "NATS PPP – three consortia move to next round of bidding", 3 November 2000
[28] DL Committee Deb 12 February 2001 and HL Deb 27 February 2001, cc1124-1131

On 27 March 2001 it was announced that the Airline Group had been chosen to be the government's strategic partner in the PPP and would sign contracts later in the year.[29] Each of the seven airlines making up the Airline Group (British Airways, bmi British Midland, Virgin Atlantic, Thomsonfly, Monarch, easyJet and My Travel) would hold equal stakes of 14.29 per cent. The deal was subject to EC merger clearance, which it subsequently obtained in May 2001.[30] The government expected to receive around £800 million from the deal after the payment of outstanding public debt of some £330 million, the repayment of new debt and a further cash payment. The final sum would depend on technical adjustment on matters such as the level of working capital and movements in interest rates between then and completion. The Airline Group was financed by Barclays and Abbey National. The air traffic controllers' union, the Institution of Professionals, Managers and Specialists (IPMS), welcomed the decision to award the contract to the Airline Group because it was a 'not for commercial return bid' but stressed in its press notice that it still did not welcome the PPP.[31]

On 2 April 2001 the government laid before Parliament a report of its use of the three-month delay in the implementation of the PPP provided for in the 2000 Act. This report gave more information about the future structure of NATS and the CAA:

> Transfer schemes will be used to separate NATS from the CAA in readiness for the PPP, and will transfer NATS to the ownership of the Secretary of State.
>
> Although day to day management of the PPP will rest with the strategic partner, the Government is appointing up to 3 non-executive directors. They will contribute to the organisation's commercial success, exercising independent commercial judgement on issues of strategy, performance, resources and standards of conduct, and ensure that the Board functions effectively and transparently. But they will also protect the Crown's financial interests in the Company and ensure that the company retains an independent identity. The Partnership Directors will meet periodically with representatives of the Crown Shareholder to review developments within the Company.
>
> The posts have been advertised in the national press and applicants are being considered. The partnership directors will be able to report direct to the Government, and Ministers are looking for people with experience in safety, employee share issues, pensions, finance and trades union matters.
>
> The strategic partner will appoint an executive director who will have specific responsibility for all safety related matters. This appointment - as with all executive director appointments - will require the unanimous approval of the Government appointed Partnership Directors. The Director of Safety will sit on a Board-level Safety Review Committee which will be chaired by a Partnership Director and will oversee all safety matters.
>
> In the CAA, an internal committee has been established to exercise oversight of the air traffic services licence, which the Government will issue shortly. The CAA has consulted interested parties on how this committee proposes to conduct itself and has posted a consultation paper on its website. The committee comprises representatives of all three main regulatory arms: the Safety Regulation Group, Economic Regulation Group, and the Directorate of Airspace Policy. The Government can give a categorical assurance that the CAA's watchword will be "joined-up regulation" within the terms of

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29 DETR press notice, "NATS PPP: Deal agreed", 27 March 2001

30 SG(2001) D/288530, 14 May 2001

31 IPMS press notice, "Staff welcome air traffic control decision", 27 March 2001 (IPMS merged with EMA on 1 November 2001 to form the new union, Prospect)

Section 2 of the Transport Act 2000 and that safety will be placed ahead of all other regulatory considerations.

The CAA is being further strengthened by two appointments to its Board: the Director of Airspace Policy (DAP) and the Assistant Chief of the Air Staff both joined the Board on 1 March.

The appointment of the DAP is also germane to empowering the CAA in relation to airspace policy. This is a vital function as it is the process by which airspace is shared among users of all classes so as to ensure, as far as possible, that the needs of all users can be met.

The Transport Act 2000 places the CAA's duties in respect of airspace policy into primary legislation for the first time. It brings airspace policy wholly within the CAA by providing for the nomination of a member of the Board to discharge that function. The DAP will take on that role. Since the airspace policy function requires the DAP to "hold the ring" between the needs of commercial, leisure and military users, the present DAP is standing down as a serving RAF Officer.

The Government has been consulting on, and will shortly issue air navigation policy directions to the CAA under Section 66 (1) of the Act. These directions set out the CAA's air navigation functions, such as the determination and procurement of a Lower Airspace Radar Service (LARS) and the responsibility for ensuring that an Aeronautical Information Service (AIS) is provided in accordance with the UK's international obligations. They also lay down:

- how the Directorate of Airspace Policy is to be organised;
- the consultation and liaison arrangements to be followed;
- the circumstances under which the Secretary of State for Defence must be consulted and his approval sought;
- how the environmental impact of air operations is to be considered, and
- the role of the CAA in international relations.

The Government will also issue directions to NATS setting out how they are to ensure that they take full account of the environmental implications of their operations.

The Government has also strengthened the CAA's ability to enforce its airspace policy decisions through an amendment to the Air Navigation Order 2000 which empowers the CAA to direct any person in charge of the provision of air traffic services to provide such services as the CAA considers appropriate. This will ensure the efficient use of airspace in requiring that the air traffic services provided are appropriate for the airspace classification. [32]

The Airline Group took control of NATS on 26 July 2001.[33] Richard Everitt, formerly BAA Director of Strategy, was the first Chief Executive of NATS. He announced that the 5,700 NATS employees would be awarded a first tranche of shares worth £500. This allocation was completed on 21 September 2001.[34] A second tranche of shares worth between £400 and £500 was awarded in financial year 2003-04 and a third allocation of 400 free shares in the

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[32] DETR, *Transport Act 2000: Public/Private Partnership for National Air Traffic Services Ltd (Report to Parliament, March 2001),* 2 April 2001, paras 27-37

[33] NATS press notice, "Safety and investment key to NATS' future says Airline Group", 27 July 2001

[34] HC Deb 25 February 2002, c809W

company was offered to all employees who were in NATS employment on the qualifying date of 30 July 2004, and who continued in employment until the award date of 10 September 2004.[35]

On 7 August 2001 the government announced the appointment its first partnership directors. The primary function of the partnership directors is to safeguard the government's financial interests in the company. They also have a government reporting function.

In July 2002 the National Audit Office (NAO) issued a report on the NATS PPP. It found that the PPP contained many positive elements, but that the financial position of the company needed strengthening to enable it to make further vital investment to expand the capacity of air traffic control. In particular, NATS' indebtedness to banks, and comparatively little equity from investors, made the organisation vulnerable to severe downturns in traffic, such as that which followed the terrorist attacks on the United States on September 11 2001.[36]

3.3 Pensions

The 2000 Act also introduced safeguards for NATS employees' pension rights. In its response to the public consultation on the proposed PPP the government gave an assurance that existing NATS employees would be entitled to remain in the Civil Aviation Authority Pension Scheme (CAAPS).[37] NATS would continue to participate in the scheme as a non-associated employer (much like Highland and Islands Airports Ltd). It was explained that as part of the Cabinet Office's *Staff Transfers in the Public Sector: Statement of Practice January 2000* the Treasury had issued new guidance to improve the protection of staff pensions in PPP deals, including a definition of the protection offered by the term 'broad comparability'.

At Committee stage of the *Transport Bill* in the House of Lords both Baroness Thomas of Walliswood (Liberal Democrat) and Lord Brett (Labour) moved amendments on CAAPS. Lord Brett explained that many of the obligations to finance the scheme would pass to the strategic partner (i.e. the Airline Group) under the PPP and that the Lords did not believe that the government's assurances, however well meant, offered sufficient protection. Lord Brett argued that his amendment would ensure that sufficient funds were segregated within the CAAPS to reflect liabilities and he pointed out that the trustees of the new pension scheme would test the position at law if that particular provision were not included in the Bill.[38]

The government did not disagree with the amendment but maintained that it was not necessary in order to guarantee protection.[39] Lord Brett went on to say that unless the issue was resolved a similar amendment would be put to a Division at Report Stage, which is what happened.[40] The amendment was subsequently approved by 78 votes to 77.[41] On 15 October 2000 the Bill returned to the House of Commons for consideration of Lords Amendments. The Commons voted to omit the Lords Amendment on pensions by 337 votes to 203.[42] When the Bill returned to the Upper House the Lords insisted on the pensions

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35 NATS, *Financial statements for the year ended 31 March 2005*, p10

36 NAO, *The public private partnership for National Air Traffic Services Ltd* (session 2001-02), HC 1096, 24 July 2002

37 DETR, *A Public Private Partnership for National Air Traffic Services Ltd (NATS): A Report on the Response to the Public Consultation*, 26 July 1999, para 65

38 HL Deb 6 July 2000, c1688

39 HL Deb 6 July 2000, cc1692-94

40 HL Deb 26 October 2000, cc546-548

41 HL Deb 26 October 2000, c557

42 HC Deb 15 November 2000, cc954-1042

amendment staying in the Bill. They got their way. The pension provisions are contained in section 96 and Schedule 8 to the 2000 Act. The *Transport Act 2000 (Civil Aviation Authority Pension Scheme) Order 2001* (SI 2001/853) was laid before Parliament on 9 March 2001 to implement the restructuring of CAAPS.

4 NATS' finances

In early 2002 the government announced that the downturn in air traffic that followed September 11 had had a serious impact on NATS' revenues.[43] The banks and the government were asked to make a contribution through the provision of short-term financial support, likely to be in the form of commercial loans. Some 44 per cent of NATS' income at the time came from transatlantic flights which were particularly affected. It was reported that Sir Roy McNulty, then Chairman of NATS, had warned the government that the planned financial structure of NATS was inadequate. He reportedly told the government that NATS would be too highly geared, with an unacceptable level of debt-to-equity financing, which would leave it exposed and make it difficult to cope with large external shocks.[44]

On 18 June 2002 the government confirmed that it had matched a short term loan facility of £30 million to NATS in March of that year[45] and that a private bid for an additional contribution had been received from BAA plc., reported to be between £50 and £65 million.[46] On 16 September the government confirmed a new investment of £65 million subject to it being matched by BAA.[47]

In January 2004 the NAO published a second report on the NATS PPP which concluded that the company's finances were now on a more stable footing:

> NATS' finances are more robust than before. The robustness of the new financial structure has been tested by modelling a wider range of exacting scenarios than those used when setting up the PPP. For the refinancing the extent and nature of scenario testing was agreed between all the parties, including NATS' management and the Company's economic regulators in the Civil Aviation Authority, as well as independent credit rating agencies. NATS regards the combination tests, which combined possible traffic shocks with adverse trends on costs, as particularly severe scenarios which provide strong assurance of robustness. Compared to before the Composite Solution, the PPP now has a much stronger buffer of cash reserves with which to cope with possible future crises.
>
> (…) Assembling the Composite Solution required consistent progress to be made on five parallel fronts, each of which were major projects in their own right. The projects were:
>
> - A cost reduction initiative within NATS;
> - Implementation of the interim solution, a temporary working capital facility;
> - Identification and selection of a new corporate shareholder;

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43 HC Deb 25 February 2002, c809W

44 "Plan for public-private air traffic rescue", *Financial Times*, 2 May 2002

45 HL Deb 18 June 2002, c620; previously reported earlier in the year in the media, see for example: "Byers offers £30m loan to bail out air traffic services", *Financial Times*, 20 February 2002

46 "BAA ready to invest up to £65m in NATS", *Financial Times*, 11 June 2002

47 NAO, *Refinancing the public private partnership for National Air Traffic Services* (session 2003-04), HC 157, 7 January 2004, appendix 3

- Extensive revisions to NATS' three major bank facilities for the Company's acquisition, working capital and capital investment; and
- Negotiations between NATS and the Civil Aviation Authority following NATS' request for the relaxation of the caps on its prices and other changes in the regulatory framework.[48]

The NAO gave more information on the five aspects of the revised financial deal that were critical to the company's recovery:

NATS is making cost reductions

As its own contribution to the Composite Solution, NATS plans to reduce costs by some £170 million (just over ten per cent of total costs) over the four years ending 2005/06. The main sources of these reductions are savings in support costs, a pensions contributions holiday and fewer air traffic controllers than was assumed in the Airline Group's original bid for NATS. NATS has also deferred capital expenditure (in part reflecting slower projections of growth in traffic) to conserve cash. NATS still expects its investment programme to cope with the possibility of higher than expected growth in traffic over the next ten years. Because NATS expects its high case demand forecasts to be revised down, the apparent risk of a shortfall of capacity until 2009 should not be as significant as it appears.

Government and a new investor put in new money

Following September 11th it quickly became clear that the Airline Group were unwilling or unable to invest more money in NATS. Given the difficult and uncertain conditions facing the Aviation Industry, the Group's inability or unwillingness to pay was taken as read and not subject to detailed examination. The Airline Group's preference was for a proposal where they retained their controlling majority on the NATS Board and supported the overall solution. The Department, backed by the Treasury, resisted proposals from other participants that the Government should provide the entire investment that was required, as this would have resulted in an effective end to the PPP and a loss of the benefits associated with it. Therefore a new investor was sought. The selection process that followed identified BAA plc, the largest operator of airports in the UK and a customer for NATS' services, as the most suitable investor. Steps were taken to identify and address any perceived conflicts of interest from having this customer as a shareholder. Many participants in the refinancing expressed their approval to us that BAA plc has become a shareholder in NATS. Its business has natural synergies with NATS'.

After internal savings and an expected relaxation of the price caps by the regulator, NATS submitted a formal business case for a total new investment of £130 million, £65 million each on equal terms from the Department and BAA plc, thus satisfying the Government's condition that it would commit new shareholder funds only on the basis that the funds were matched by private sector shareholder capital. The Department concluded, on advice from its advisers Credit Suisse First Boston, that this investment in NATS would be commercially justifiable.

The Department obtained equal terms to BAA plc. This was important because:

- Matching private sector investment, pound for pound, broadly reflected the existing split between public and private sector share capital;

[48] ibid., paras 4 and 6

- Most of the new investment is ranked earlier for interest and capital repayment than is the Airline Group's investment and in some circumstances, it is as well protected as Bank debt;

- Equal terms gives added assurance that the terms are robust and strictly commercial; and

- Demonstration of the investment being on commercial terms protects the deal against challenges on grounds of state aid.

NATS' bank facilities are revised

The four banks which had provided the £730 million acquisition facility when the Airline Group bought a controlling stake in NATS were reluctant to relax the structure of the original PPP, and also needed to be sure that the terms of any new finance package would not prevent them from later syndicating their loans to other financial institutions. They made some concessions, particularly in relation to the key ratios, but successfully resisted substantial reductions to their margins and fees. In order to retain access to these facilities NATS now has to meet less onerous financial covenants, which are more akin to those found in corporate transactions than the previous project finance structure.

NATS' charges to Airlines were revised

The Civil Aviation Authority has made two main contributions to giving NATS more robust finances. Firstly, following consultation with the industry, it agreed that the Company's prices should fall less in real terms than the price cuts originally planned for the first five years of the PPP. Though these concessions will cost airlines some £100 million over the period 2003-2010, NATS' prices should still improve relative to prices elsewhere in Europe, where operators raised their charges by 12 per cent on average in 2002. Indeed, on the basis of the amounts actually paid by air users NATS has improved to become the fourth most expensive service provider in Europe. Secondly, the Authority has introduced an automatic risk sharing mechanism for the first control period for reducing the impact of future traffic fluctuations on NATS, by allowing it to raise its prices automatically to recover half of lost revenue attributable to traffic falls below the level forecast by the Company in November 2001, rising to 80 per cent of lost revenue in extreme circumstances.

Following the good credit ratings that NATS received from major ratings agencies, and armed with the £130 million of additional shareholders' funds, in August 2003 NATS successfully completed the refinancing of its debt. It replaced with the proceeds of a bond issue the remaining £600 million of debt that it took on when the Airline Group bought a controlling stake in the Company. The practical advantage of this refinancing is that bonds are a cheaper source of very long term finance, without more onerous conditions, and reduce the company's dependence on bank finance.[49]

The so-called 'composite solution' described above helped turn NATS' fortunes around and in 2010 it reported its seventh successive year of profit.[50]

5 Charge cap

The monopoly services provided by the NATS PPP are subject to price regulation by the 'RPI-X' method, which is the standard model for monopoly regulation in the UK. The charge

[49] ibid., paras 7-13
[50] NATS press notice, "Delays at all-time low as NATS posts profit", 2 July 2010

cap or 'X factor' is set for a five-year period and for the first five-year period only, was set by the government. The CAA provided advice in August 2000 setting out how they proposed to approach the economic regulation of NATS and recommended that the 'X' factor for NATS monopoly en route services (NATS En Route Ltd) should be set at five per cent per annum for the first five years.[51] The government announced on 23 January 2001 that they had decided to set a charge cap less than that recommended by the CAA for the first three years, implying a real-terms reduction in UK route charges for the first five years. The charge cap was set at 2.2 per cent for 2001, three per cent for 2002, four per cent for 2003 and five per cent for 2004 and 2005. The then Transport Minister said that he hoped the price control in the early years would help the 'smooth transition' to the PPP.[52]

The charge cap includes a 'delay term' so that the 'X factor' will automatically tighten, and thereby reducing NATS' revenues, if delays increase beyond the 2001 level. The maximum delay term was set at £2 million per year for 2001-02 and £5.7 million per year for 2003-05. For NATS' Oceanic services the CAA recommended that the 'X factor' be set at ten per cent for the first year and two per cent for the following four years. The government announced on 15 February 2002 that it had decided to set a cap of two per cent for each of the first five years and that there should be no delay penalty term for that period.

NATS announced on 8 January 2002 that it intended to apply for a review of the regulatory price formula to be applied to its NATS En Route Ltd business from January 2003.[53] It wanted to achieve cost savings of over £200 million in the period to 2006 in order to mitigate the revenue loss. On 21 May the CAA published a consultation paper on NATS' application to raise its charges to airlines for air traffic control services in the UK. Its preliminary view was that having assessed the application against the statutory objectives of the *Transport Act 2000* and standard regulatory policy it was not convinced that this justified allowing NATS to increase its charges to airlines through the requested increase in its price cap as submitted.[54] Agreement followed and the revised package was put in place from 1 January 2003, this was part of the 'composite solution' mentioned above.

In December 2005 the CAA published its decision on the price controls for 2006-10.[55] The effects on the NATS En Route Ltd licence were as follows:

> The changes in the composite unit allowance (expressed in terms of pence per km of chargeable distance flown) equate to an average annual reduction in the p/km allowance of 3.4 per cent each year;
>
> Financial incentives on service quality are strengthened with an expected maximum penalty of £24 million a year in the event that average annual delay exceeds 45 seconds per flight. The actual maximum will depend on the outturn level of traffic. A mechanism is also introduced that provides a greater financial incentive in relation to delays early in the morning and longer delays; and
>
> New price controls for NERL's Oceanic business for the five years starting on 1 April 2006 provide for an annual four per cent reduction in prices in real terms. No changes are proposed to the structure of price controls for the Oceanic business.[56]

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[51] CAA, *NATS PPP: Setting the charge control for UK en route services for the first five years,* August 2000

[52] HC Deb 23 January 2001, c532W

[53] NATS press notice, "NATS statement on regulatory price formula", 8 January 2002

[54] CAA press notice, "CAA publishes consultation paper on NATS' application to raise prices", 21 May 2002

[55] following two years of consultation; all documentation available on the CAA website (scroll down to 'Air Traffic Services: Price Control Review (2006-2010) and follow-up work')

Following preliminary work and consultations in 2008-09, the CAA published its main consultation paper on price controls for the NATS En Route Ltd licence in the period 2011-15 in February 2010. This gave the CAA's view that it was sensible to review whether the current level of the cap (three per cent) remained appropriate. Before deciding on any change to the existing arrangements, the CAA would need to be satisfied that this would be in the interests of users of NATS En Route Ltd's services. Consequently, the consultation paper asked for views on the level of the cap which it would take into account in formulating draft licence conditions for consultation in May 2010.[57] The CAA's formal proposal for 2011-14 was published in October 2010[58] and the final conditions were published in December 2010. The effects on the NATS En Route Ltd licence were as follows:

> to establish new price controls for NERL's Eurocontrol business for the four years starting on 1 January 2011 as set out in the CAA's formal proposal published in October 2010. The per SU price (real, deflated for CPI inflation) increases between the final year of CP2 (2010) and the first year of CP3 (2011) by £3.94 or 8.0 percent and subsequently by 0.1 percent per annum for the remainder of CP3. This reflects the spreading of the traffic correction (K) factor and the service quality (delay) bonus due to NERL in 2011 over the subsequent three years to smooth the profile of charges;
>
> a new charging condition for London Approach with effect from 1 April 2011 that will set a separate annual revenue allowance (condition 21a) and extend the London Approach Service to include London City and Luton airports;
>
> service quality par values for T1 (average delay per flight) of 11.5 seconds in 2011 and 2012, rising to 12.5 seconds in 2013 and 2014, with a dead band of +/-2.5 seconds;
>
> an increase in the par values during the Olympic and Paralympic games period applicable to the payment of penalties; and
>
> a two-tier direct control on NERL's gearing through a gearing target of 60 percent and cap of 65 percent.[59]

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56 CAA, *NATS price control review 2006-2010: CAA decision*, December 2005, para 4

57 CAA, *NATS (En Route) plc price control review for control period 3: CAA Consultation*, February 2010, para 4.14

58 CAA, *NATS (En Route) plc price control: CAA formal proposals for control period 3 (2011-2014)*, October 2010; all supporting documentation available on the CAA website (scroll down to 'Air Traffic Services: Price Control Review (from 2011)')

59 CAA, *NATS (En Route) plc CP3 Price Control Review 2011-2014: CAA Decision*, December 2010, para 4