

CIVIL AVIATION AUTHORITY

DECISION UNDER SECTION 11 OF THE TRANSPORT ACT 2000: NATS (EN ROUTE) LIMITED EUROCONTROL CHARGES CONTROL

Before: Sir Roy McNulty) Members of the Authority
Mr J Keohane)

INTRODUCTION

1. On 17 October 2002 the CAA issued for consultation a Notice under Section 11(2) of the Transport Act 2000 ("the Notice") and a document entitled "NATS Application to Re-open the Eurocontrol Charge Control: Consultation on CAA Proposals – October 2002" ("the Consultation Document"). Paragraph 7 of the Notice stated that, subject to the responses to the consultation and to publication of a decision document on the issue, certain modifications to the licence held by NATS (En Route) Ltd ("NERL") as specified in the Notice would take effect after the end of the consultation process.

PROPOSED CONDITIONAL LICENCE MODIFICATIONS

2. This decision concerns only the proposed conditional licence modifications set out in summary in sub-paragraphs 6(a) and (b) of the Notice. These were set out in full in that part of the attachment to the Notice which refers to Licence Conditions 20 and 21. The reasons for and the effects of these proposed modifications were set out fully in the Consultation Document. In summary their effects would be as follows:
 - (a) To amend the price cap for Eurocontrol Charges for the three year period from 2003 to 2005 so that charges would be subject to an RPI-2 limit in each year compared to the current limits of RPI-4 in 2003 and RPI-5 in 2004 and 2005.
 - (b) To introduce a symmetrical volume term into the specification of the price cap so that, above a floor, NERL would face 50%/50% sharing of both downside volume risks and upside volume opportunities with users. That is, if chargeable service units (CSUs) were to fall (or rise) by a certain amount compared to a benchmark level, prices would rise (or fall) sufficiently for NERL to lose (or gain) only 50% of the revenue that would have been lost (or gained) if no modification were made. In addition, a "trigger floor" would be established at around 80% of NATS' current base case forecasts. If CSUs fell below this level, NERL's exposure would be reduced from 50% to 20%.
3. In the Consultation Document the CAA also said that it was considering allowing price adjustments to compensate NATS for variations in its CSUs resulting from variations in aircraft weight. Although not part of its formal proposals, the CAA sought the views of users as to whether the elimination of aircraft weight as a determinant of NATS' revenues would be a desirable development to apply over 2003-2005 and beyond.

4. In the Consultation Document the CAA noted NATS' request for an increase in the regulatory asset base of 12% of its starting level. This decision does not deal with such additional user contribution as it is intended that it be addressed following a detailed review of NATS' Interim Composite Solution.

PURPOSE AND SCOPE OF PRESENT DECISION

5. This decision addresses only the proposals for conditional modifications to the NATS charges caps for the remaining three years of the current control period and the conditional introduction of a volume term for the same period. A decision on these is required at this stage as NATS wishes to implement an increase in its charges from 1 January 2003 while remaining within the charges cap specified within its licence. Implementation of these conditional changes to the charges conditions is seen as being important in facilitating the process of agreeing a solution to NATS' financial restructuring between NATS and its investors and shareholders. Under the proposals, these modifications would come into effect immediately. However, if because a solution acceptable to the CAA was not in the event realised and the CAA had not published a statement on or before 30 September 2003 confirming that NATS had met certain requirements, then the charges cap would revert to RPI-5 for 2004 and 2005. Moreover, the additional revenues accrued as a result of a charges cap of RPI-2 in 2003 together with any additional revenues which had resulted from the introduction of the volume term would subsequently be returned to users through compensatory price adjustments (including interest) in 2004 and 2005.
6. The CAA's requirements for an unconditional user contribution, as set out in the Consultation Document, were that NATS had:
 - provided for a robust financial structure to be in place;
 - placed control of NATS with management and shareholders;
 - demonstrated that equitable contributions have been made by NATS' investors and shareholders.
7. Thus the present limited decision concerning the conditional modification of the charges cap and the conditional introduction of a volume term will depend on the CAA's assessment of the responses to the Notice and the Consultation Document and whether or not these give it grounds to divert from the process laid down in the Consultation Document. Whether the final composite solution to be agreed and implemented by NATS, its shareholders and investors, will meet the CAA's requirements for confirming the charges caps and volume term, and whether the CAA will accept any justification put forward by NATS for a further exceptional user contribution relating to subsequent control periods will depend on an analysis of the Interim Composite Solution and will be the subject of a further decision to be issued in due course.

DEVELOPMENT OF THE CAA'S POSITION ON THE CASE FOR AN EXCEPTIONAL USER CONTRIBUTION

The CAA's Preliminary Position in the May 2002 Consultation Paper

8. The CAA published a consultation paper on NATS' original proposals in May 2002¹. The CAA accepted that NATS was expecting significantly lower demand over 2001/05 than was projected at the time of establishment of the PPP and under the CAA's advice to the Government on the initial price cap in August 2000². Nevertheless, for the reasons set out in the May consultation paper, when weighing the proposals against its statutory duties under the Transport Act 2000 the CAA reached the preliminary view that its statutory objectives would not best be met by accepting NATS' proposal as submitted.
9. However, the CAA recognised that on the basis of NATS' financial projections the demand shock did appear to have a major impact on key financing ratios after the first control period. This led to potential concern in four areas:
 - the current financial structure might not be robust;
 - the banks financing NATS might be reluctant to make available NATS' loan facility for capital expenditure if they believed that NATS' financial performance would be inadequate in the next control period;
 - an extended period of a "hard" financing constraint could lead to uncertainty over the leadership and management of NATS;
 - ongoing financial difficulties could have detriments for users.
10. Against this background, the CAA said that were the representative responses of users (particularly those that were not members of the Airline Group) to indicate that they would be prepared to contemplate a cash flow injection contingent upon a financial strengthening, and/or to contemplate some form of volume floor to mitigate against further substantial downside demand shocks, the CAA would consider this.
11. In this context the CAA set out a number of broad options for users' comments. It made clear that they would need to be developed by NATS, including an assessment of their costs and benefits in terms of the statute and regulatory policy. The nub of the argument in favour of permitting a moderate price cap increase conditional upon a satisfactory financial restructuring was that this might reduce the risk of a "muddling through" outcome where no such restructuring occurred independently of the regulator.
12. However, the CAA made clear in the May consultation paper its view that there were significant potential drawbacks to its encouraging NATS to develop such an approach. The idea would need considerable development by NATS, including the assessment of net benefits compared with the status quo. It would also be necessary to address broader regulatory issues. The CAA, as with other regulators,

¹ NATS' Application to Re-open the Eurocontrol Charge Control: Consultation on CAA's Preliminary Conclusions (May 2002)

² Setting the Charge Control for UK En Route Services for the First Five Years: Advice to DETR (August 2000)

was not well placed to decide what the company's financial structure should be, and intervention of this type might involve the regulator in undesirable negotiation and ongoing and potentially intrusive oversight. There would be significant practical hurdles to be overcome. Moreover, while it would not provide full compensation for NATS' investors for the demand shock alone, it might still give a signal that the regulator would contribute to the solution of financial difficulties resulting from previous financing decisions, thereby weakening NATS investors' future incentives to adopt a prudent approach to financing. This would be a departure from regulatory best practice.

The October Consultation Document

Conclusions on user responses to the May consultation

13. Fifteen airlines – four Airline Group members and eleven non-Airline Group airlines – and five bodies representing airlines responded to the May consultation paper or wrote subsequently setting out their views.
14. The CAA's conclusions on these user responses was set out in Annex 1 of the October Consultation Document as follows:

“Airlines which responded that are members of the Airline Group, and consequently are shareholders of NATS, were in favour of a user contribution to assist a financial restructuring. Several airlines that are not members of the Airline Group also supported a contribution. ERA, ATA and some other airlines did not support a charge increase. IATA, whose views reflect the interests of both Airline Group and non-Airline Group users, gave a cautious endorsement to the possibility of a user contribution. On balance the CAA considers that user views give support to an appropriate user contribution in order to enable a sustainable financial position to be reached, to allow NATS to resume implementation of its investment programme, and to ensure the continuation of the PPP.”

Conclusions on the case for an exceptional user contribution in principle

15. The CAA made clear in the Consultation Document that its consideration and effort to date had been driven by a desire for NATS as a public-private partnership to have a sustainable future, based on a robust financial structure and complemented by an equitable distribution of the cost burden, an ability for NATS' management to do its job without external interference and an incentive regime for it to meet the growing demand from users for cost effective services. The CAA believed that this held out the best prospect of meeting user interests and the CAA's duties under the Act.
16. The CAA believed that, in the unusual circumstances faced by NATS, the CAA's best means of meeting its statutory objectives and meeting the balance of user opinion, would be to allow an exceptional user contribution in order to facilitate a return to financial stability, and to assist in the creation of a financial structure that would be consistent with the risks faced under the regulatory framework. As part of this solution the CAA recommended that NATS' exposure to volume volatility should be reduced, but envisaged that a significant element of volume risk, and all other normal commercial risks would remain with NATS, giving the appropriate incentives to deliver benefits to users. The CAA had also obtained NATS' broad agreement to licence amendments that would go some way to preventing NATS from adopting inappropriate funding structures in the future, to ensuring that NATS retained and

could attract sufficient capital, and to meeting its ongoing investment programme and ring fencing value in NATS. The CAA considered the exceptional user contribution to be very much a one-off reflecting the unique circumstances of the regulatory and financing arrangements established under the PPP, together with the volume downturn and increased risk profile following the terrorist attacks of 11 September 2001.

17. The CAA had encouraged NATS to identify a solution that delivered as many of the desired measures as were reasonably achievable within a timescale (recognizing that continued financial distress is undesirable) that would allow a speedy return by NATS to a focus on operational service delivery and investment. The CAA made clear that, on balance, it was reluctant to operate with, or contribute to, the uncertainties inherent in not allowing for an exceptional user contribution, and this had been a key issue in coming to its decision.

RESPONSES TO THE SECTION 11(2) NOTICE AND THE OCTOBER CONSULTATION DOCUMENT

18. There were fifteen responses to the Section 11(2) Notice and the Consultation Document – ten from airlines, four from bodies representing airlines and one from the Trade Union, Prospect.

Airline Group Members

19. The Airline Group responded on behalf of its members generally and British Airways and bmi also responded individually. All three responses supported the proposed relaxation of the existing charges condition. British Airways argued also for a review of the charging mechanism with respect to weight at the earliest opportunity; for a symmetrical volume ceiling to mirror the proposed volume floor; and for the introduction of stronger incentives with respect to NATS' performance in future price cap reviews.

Other Airlines

20. JMC, KLM, KLMuk/buzz, Qantas, Regional, Ryanair, SAS and SWISS provided responses.
21. SAS and Qantas fully endorsed the CAA's proposals set out in the Consultation Document. Qantas agreed with British Airways' arguments with respect to a more symmetrical volume term and a review of aircraft weight within the charging mechanism.
22. SWISS supported the CAA's proposals subject to similar provisos to those described below for IATA. JMC welcomed the proposals in general, believing them both to strike a more equitable balance between NATS' shareholders, lending banks and users than NATS' original proposals. JMC considered the proposals to be particularly helpful in reaching an effective compromise. It did not oppose the specific changes to the charges cap and volume risk which are the subject of this decision and thought also that removal of the weight element from the charging mechanism had some attraction. JMC did however believe that there should be a shift of volume risk back towards NATS after the present control period and a greater emphasis on improved operational performance.

23. Regional supported the proposed licence change with respect to volume risk but was strongly opposed to the removal of the weight element from the charging mechanism. As regards the proposed change to the charges cap, Regional recognised that RPI-2 for 2003-2005 would be a significant improvement over NATS' original proposals and that NATS' was in urgent need of financial restructuring to ensure its continued operation and the success of the PPP. However, it argued that users should only be the providers of funding to restructure NATS through an increase in charges if all NATS' investors had provided equal and substantial funding.
24. In its initial response to the Consultation Document, Ryanair alleged that the proposals were anti-consumer, anti-competitive and infringed EU competition law. It put forward specific proposals of its own. These included an increase in the charges cap to RPI-2, but only if NATS were required to compensate airlines and passengers for failure to meet pre-defined standards with respect to flight delays and cancellations and if it were also obliged to bring its charges into line with the European average within five years.
25. Subsequently Ryanair and buzz objected jointly to the proposed licence changes and requested a hearing with the CAA to expand upon their reasons. The hearing took place on 11 December 2002. The two airlines' objections revolved mainly around issues relating to the CAA's process, NATS' current poor operational performance and the apparent inequity of the Interim Composite Solution being developed by NATS, its investors and shareholders. Specifically, the main grounds of objection were:
- The manner of addressing the solution was unacceptable: the CAA was being asked to sanction an exceptional user contribution before the details of the contributions being made by the investors had been worked out.
 - NATS' charges were among the highest in Europe for an increasingly sub-standard service and the proposals set out in the Consultation document contained no means of incentivising NATS to improve the quality of service to customers or of compensating airlines for damage suffered.
 - It was unfair and inequitable that, unlike the Airline Group, the Government and BAA, non-Airline Group airlines should be offered nothing in return for the exceptional user contribution and that NATS' customers should also be expected to shoulder increased volume risk.
26. Ryanair and buzz considered that much progress had been made in negotiations since NATS' first application in February 2002. However, they believed that further work was needed to find an equitable solution meeting the objectives of the Section 2 of the Transport Act 2000. They also believed that, if further submissions from NATS led the CAA to change its proposals as set out in the Consultation Document in a way that would materially affect the position of non-Airline Group airlines, then the CAA should consult such airlines again before reaching a final decision.
27. KLM was also opposed to the proposed licence changes. Like Ryanair and buzz, it considered that users should not be required to pay increased charges as a consequence of financial decisions taken at the establishment of the PPP. It

believed that an increase in NATS' charges should only be contemplated if it were to be linked in practice to substantial improvements in capacity and service quality.

Airline Bodies

IATA

28. IATA stated that it represented over 270 scheduled airline members worldwide with some 135 of these using airspace in which NATS provided air traffic services. It indicated that some of its members did not consider that the revised proposals reflected an equitable user contribution and that the CAA's requirements as set out in the Consultation Document could be achieved without any additional contribution from NATS' users. It also indicated that a number of its members considered that there should be no increase in NATS' charges unless and until there were significant improvements to the service performance.
29. Nevertheless, IATA said that consultation with NATS over its business plan and service standards and performance had been good. It recognised that the financial restructuring was necessary to enable both achievement of the business plan objectives and the performance standards to be met. It recognised also that NATS' management attention had been distracted by involvement in the financial restructuring and that its resolution would help to achieve proper attention and control by management and shareholders.
30. Representing its members as a whole, IATA concluded that it supported the revised package, subject to clarification of the user contribution and against the indication that charges would not be more than RPI-2 for each of the three remaining years of the present control period and the next. This support was also on the basis, first, that in practice other parties would only contribute to a solution if users made an exceptional contribution and, second, that it viewed the likely outcome of the proposals being adopted as preferable to either Air Transport Administration or to a return to full cost recovery without effective incentive-based economic regulation.
31. IATA accepted the dilution of volume risk if this was a necessary part of the refinancing package, provided that it would be symmetrical, that the triggers and limits were realistic and that these would be reviewed for the next control period. However, it did not support implementation at this stage of the idea put forward by the CAA with respect to derisking NATS by removing the weight element from the charging mechanism.

ERA

32. ERA recognised both that NATS was in urgent need of financial restructuring to ensure its continued operation as a PPP and that it was in users best interests that the PPP succeeds and that the current crisis was resolved without delay. It also believed that the proposed price cap of RPI-2 was a significant improvement over NATS' original proposal. However, it believed that users should only be the final providers of funding to restructure NATS' finances after all other avenues had been explored. In this context ERA commented that non-Airline Group users were being asked to bear the same burden as Airline Group users but without receiving the long term benefits that an investor would expect by way of dividends etc.
33. ERA supported the CAA's proposals regarding the dilution of NATS' volume risk. However, it was strongly opposed to the ideas for derisking NATS by removing the

weight element from the charging mechanism.

ATA

34. ATA expressed disappointment that the CAA had moved from its original position in the May consultation paper against any change in the charges cap, seeing this as a seriously negative development for its member airlines who faced the threat of reorganisation or bankruptcy. It was particularly concerned that the problem was one of replacing funds which had been extracted from the business at the time of implementation of the PPP.
35. Nevertheless, ATA supported the concept of a strong, independent regulatory authority able to deploy proper incentives to control the provider's costs and meet performance standards. It viewed NATS' management as adopting a pragmatic approach to implementing a composite solution. Within a framework of political reality, ATA described the CAA's proposals as being the least objectionable of several poor options.
36. ATA questioned the "one-off" nature of the proposals and how gains or benefits resulting from financial restructuring might in practice accrue to users. It also expressed concern with indications that an increase in the regulatory asset base and reduction in volume risk might continue indefinitely.

Trade Union: Prospect

37. Prospect's response focused on the proposed relaxation of the charges cap in the first control period. Prospect believed that this would be insufficient to address the fundamental weaknesses in NATS' finances. NATS would still be left in negative equity; it would not have the funds needed to carry out the one billion pounds capital investment programme; it would remain vulnerable financially to further traffic shocks with further negative implications for capital investment; and the cost cutting pressures within NATS, which had resulted in the predicted £200 million of cost savings in NATS current Business Plan would ultimately undermine the effectiveness of air traffic management and impact on the safety regime. The CAA should extend its remit to look at the wider impact of the current financial structure within NATS on the NATS employees providing air traffic services and on passenger confidence in the system.

THE CAA'S ANALYSIS OF RESPONSES

38. As is clear from the preceding section, the reactions to the generality of the proposals in the Consultation Document was mixed.
39. The Airline Group, responding collectively on behalf of its members gave its full support to the proposals. British Airways and bmi, both Airline Group members, also responded individually and similarly expressed their support.
40. IATA, whose response reflected both Airline Group and a wide range of non-Airline Group users of NATS' services, gave its conditional support to the generality of the proposals which it considered preferable to what it saw as the likely outcomes of alternative options. It also supported the proposed dilution of NATS' volume risk subject, *inter alia*, to its review for the next control period. ERA also supported the proposed reduction in NATS' volume risk. ERA considered the proposed change to

NATS' charges cap to be a significant improvement over NATS' earlier proposal, but remained concerned as to its equitability between Airline Group and non-Airline Group airlines. ATA was against the proposals in principle, but expressed reluctant recognition of them in practice.

41. Eight non-Airline Group airlines responded individually. Four – JMC, Qantas, SAS and SWISS – lent general support to the proposals. Three others – KLM, KLMuk/buzz and Ryanair – opposed them. Regional supported the proposed dilution of NATS' volume risk. Like ERA, Regional's potential concern was with the equitability or otherwise of the proposed change in the charges cap.
42. The weight of opinion was against the idea canvassed in the Consultation Document that price adjustments should be allowed to compensate NATS for variations in its CSUs resulting from variations in aircraft weight. Two airlines – British Airways and JMC – favoured the approach, but three airlines – KLMuk/buzz, Regional and SWISS – and two airline bodies – ERA and IATA – opposed it, at least at this stage and in the narrow context of the present NATS application.

NATS' PROGRESS ON INTERIM COMPOSITE SOLUTION

43. In its Consultation Document, the CAA said that NATS would be required to produce an Interim Composite Solution that met the criteria referred to in paragraph 6 above. In doing so the CAA made clear that it would be for NATS, in discussion with its shareholders, lenders and prospective investors, to finalise a solution that meets these criteria and then to demonstrate that the criteria had been met.
44. Since the CAA issued its October Consultation Document, NATS has made significant progress towards agreeing an Interim Composite Solution with its investors and shareholders along the lines described in the Consultation Document. As well as a reduction in and a restructuring of NATS' existing senior debt, this would also involve a move away from the project finance style debt structure established at the time of the PPP to a more appropriate corporate style debt structure designed to enhance significantly NATS' management control and flexibility. The CAA understands that such a high level commercial agreement is likely to be signed by the parties by 20 December.
45. Once this high level agreement is finalised, the CAA expects that the parties will translate this into formal, legally binding, contractual agreements. NATS' current target date for completion and signature of such contracts is 20 January 2003. However, before reaching this point NATS will need to satisfy the CAA that the CAA's criteria with respect to financial robustness, return of management control and equity as between users, shareholders and lenders would be met by the agreed solution. As part of this process, the CAA will also be carrying out its own independent evaluations of the Interim Composite Solution as it crystalises.

CONCLUSIONS

46. In reaching its present decision, the CAA recognises that it involves only conditional modifications to Licence Conditions 20 and 21 on charges in the first control period and that these will be clawed back if NATS failed subsequently to satisfy the CAA that it had met the CAA's requirements as set out in the Consultation Document. In these circumstances, the CAA is satisfied that it has sufficient grounds to implement these conditional changes as proposed. Without them NATS would be unable, within

the conditions of its Licence, to implement the charges from 1 January 2003 which have been approved through the Eurocontrol machinery. As indicated in paragraph 5 above, implementation of these conditional changes is seen as being important in facilitating the process of agreeing a solution to NATS' financial restructuring.

47. In reaching its conclusion, the CAA has had particular regard to the views of non-Airline Group airlines and airline representative bodies with substantial non-Airline Group membership. The CAA recognises the concerns expressed by some airlines regarding the development of a wider Interim Composite Solution, including those with respect to equity in the contributions of the various parties. It takes very seriously the concerns expressed regarding NATS' current poor operational performance. The CAA will have these firmly in mind as NATS and its investors and shareholders move forward towards an agreed Interim Composite Solution and will address these in its further substantive decision.
48. As regards the issue relating to aircraft weight, on balance the CAA concludes in the light of responses that it should not address this as part of the present NATS' application, although it continues to believe that better reflection of ATC cost drivers in charges is a key area for future consideration.

DECISION

49. In accordance with Section 11 of the Transport Act 2000, the CAA hereby modifies, with effect from 1 January 2003, Conditions 20 and 21 of the air traffic services licence held by NATS (En Route) Limited. The modified conditions are attached.

PK Taylor
For the Civil Aviation Authority

20 December 2002

PART III CONDITIONS RELATING TO CHARGE CONTROL

Condition 20: Charge Control Conditions: explanatory provisions and definitions

A Introduction

1. This Part provides a descriptive summary of the provisions which follow in Part B of this Condition and Conditions 21 to 25. This Part is not intended to add to the provisions which follow, and for the purposes of interpretation it is the detailed provisions which should prevail.
2. The Charge Control Conditions relate to the following sets of revenue:-
 - a) subject to certain exclusions, that part of the charges paid to Eurocontrol by users which is reimbursed to the United Kingdom and relates to services provided by the Licensee;
 - b) charges levied by the Licensee in respect of the Shanwick Oceanic Control Area (as described in Schedule 2);
 - c) charges for North Sea Helicopter Advisory Services and Terminal Approach Services.
3. The purpose of Condition 21 is to limit increases in average Controlled Eurocontrol Revenue in years three, four and five of the first five years of the Licence period as follows:-
 - a) the maximum permitted Controlled Eurocontrol Revenue for any year is the maximum permitted Average Charge Per Service Unit multiplied by the number of Service Units attracting a Eurocontrol Charge in that year.
 - b) For the year starting on 1 January 2003; and if the CAA has published a statement in particular terms on or before 30 September 2003, for the years starting on 1 January 2004 and 1 January 2005; the maximum permitted Average Charge Per Service Unit for each year is:-
 - (i) a variable revenue element of the base charge per charged Service Unit which is fixed for 2003 and adjusted for subsequent years by the movement in the Retail Price Index less a factor (X); plus
 - (ii) a fixed revenue element of the base charge per charged Service Unit which is fixed in 2003 prices for each relevant year and then converted to the appropriate price level for subsequent years by the movement in the retail price index; plus
 - (iii) an additional element to the base charge where traffic is below a defined threshold;
 - (iv) a correction factor (K) per charged Service Unit, to adjust the charge control to reflect the extent to which charges actually levied one year previously exceeded or fell short of the maximum permitted Average Charge Per Service Unit for that year (by reason, for example, of variances in the level of service units compared to what was forecast at the time when charges were set or charges being structured in that

period otherwise than in the form of a single tariff, resulting in the average of the charges levied exceeding the maximum permitted); less

- (v) a service factor (S) per charged Service Unit, reflecting the extent of achievement by the Licensee of specified service levels which will be based on a measure of delay calculated in accordance with the formula set out in paragraph 5 of Condition 21.

The purpose of considering the base charge per charged service unit as set out in (i), (ii) and (iii) above is to provide for a sharing of the traffic volume risk between the licensee and users generally and to allow for a higher allocation of that risk to users at very low traffic volumes.

- c) If the CAA has not published a statement in particular terms on or before 30 September 2003, the maximum permitted Average Charge Per Service Unit for the years starting on 1 January 2004 and 1 January 2005 is calculated on a basis which:-
 - (i) does not provide for a sharing of the traffic volume risk between the Licensee and users;
 - (ii) calculates the base charge for those years as if Condition 21 in effect on 30 September 2002 had been in effect throughout the two years;
 - (iii) adjusts the maximum permitted Controlled Eurocontrol Revenue in the years starting on 1 January 2004 and 1 January 2005 based on the difference (whether positive or negative) between the actual Eurocontrol revenue in the year starting on 1 January 2003 and what the revenue in that year would have been if Condition 21 in effect on 30 September 2002 had been in effect in 2003;
 - (iv) applies a service factor (S) as in subparagraph b(v) above.

4. The purpose of Condition 22 is to limit increases in average charges in the En route (Oceanic) Area as follows:

- a) the maximum permitted Oceanic Revenue for any Oceanic Relevant Year is the maximum permitted Average Charge Per Oceanic Flight multiplied by the number of Oceanic Flights attracting an Oceanic Charge in that year;
- b) the maximum permitted Average Charge Per Oceanic Flight for any Oceanic Relevant Year is:
 - (i) a base charge per Oceanic Flight which is the figure for the previous year multiplied by the movement in the Retail Price Index less a factor (Z); plus
 - (ii) a correction factor (L) per charged Oceanic Flight, to apply after the completion of the first three Relevant Years, to adjust the charge control to reflect the extent to which charges actually levied two years previously exceeded or fell short of the maximum permitted Average Charge Per Oceanic Flight for that year

calculated in accordance with the formula set out in paragraph 1 of Condition 22.

5. The purpose of Condition 23 is to limit increases in charges for North Sea Helicopter Advisory Services and Terminal Approach Services by requiring the Licensee in each case to demonstrate to the reasonable satisfaction of the CAA that the charges proposed, whether or not set by reference to a particular Relevant Year, have been set following appropriate consultation with users and other interested parties.
6. The Charge Control Conditions will be reviewed with effect from the end of the first five year period under the provisions of sections 11 to 19 of the Act.
7. The purposes of Conditions 24 and 25 are:
 - a) to require the Licensee to give information to the CAA annually, or where any change in the Eurocontrol Charges or Oceanic Charges is proposed, as to its forecasts for the Average Charge Per Service Unit or Average Charge Per Oceanic Flight (as appropriate), together with specified information demonstrating the basis on which these forecasts were calculated;
 - b) to require the Licensee to submit an annual statement to the CAA containing specified historical information to enable the CAA to monitor the Licensee's compliance with the Charge Control Conditions;
 - c) to make provision for the suspension or modification of all or part of the Charge Control Conditions in circumstances governed by national security directions or in certain other limited circumstances;
 - d) to make provision for the suspension or modification of the Charge Control Conditions relating to Oceanic Charges where this is demonstrated to the satisfaction of the CAA to be in the overall interests of users; and
 - e) to make provision for the adjustment of the Charge Control Conditions if necessary following a National Security Period.

B Definitions

8. In this Condition and in Conditions 21 to 25:

“Average Charge Per Service Unit” means the Controlled Eurocontrol Revenue in the Relevant Year divided by the quantity of Service Units attracting a Eurocontrol Charge in that year.

“Average Charge Per Oceanic Flight” means the Oceanic Revenue in the Oceanic Relevant Year divided by the number of Oceanic Flights attracting an Oceanic Charge in that year.

“Charge Control Conditions” means Conditions 20 to 25 inclusive, as from time to time replaced in accordance therewith or pursuant to sections 11 to 19 of the Act.

“Controlled Eurocontrol Revenue”	means the revenue (measured on an accruals basis) derived beneficially by the Licensee from the Eurocontrol Charge.
“Eurocontrol”	means the European Organisation for the Safety of Air Navigation, founded by the 1960 Brussels Convention relating to Co-operation for the Safety of Air Navigation, or any successor body.
“Eurocontrol Business”	means the business of the Licensee consisting in the provision of services for which Eurocontrol Charges are paid.
“Eurocontrol Charge”	means a charge collected by the Central Route Charges Office of Eurocontrol on behalf of the United Kingdom and reimbursed to the UK Government or its nominees.
“Exceptional Circumstances”	means circumstances which are outside the Licensee’s control and which: (a) have had or will have a negative effect on its financial position; and (b) that effect is such that the Licensee’s ability to meet its current or future obligations under the Act or this Licence is, or is threatened to be, materially impaired.
“National Security Period”	means a period commencing on the date on which any direction issued by the Secretary of State under section 94 of the Act enters into effect and terminating on the date such direction, as varied, is revoked or expires.
“Oceanic Charge”	means a charge paid to the Licensee from the provision of services in the En Route (Oceanic) Area.
“Oceanic Flight”	means a flight in the En Route (Oceanic) Area in an Oceanic Relevant Year.
“Oceanic Relevant Year”	means a period of 12 months commencing on or after 1st April 2001. The first Oceanic Relevant Year (referred to in paragraph 2 of Condition 22) shall be the period commencing 1st April 2001.
“Oceanic Relevant Year t”	means that Oceanic Relevant Year for the purposes of which any calculation falls to be made; “Oceanic Relevant Year t-1” means the Oceanic Relevant Year preceding Oceanic Relevant Year t or, in respect of the period prior to 1st April 2001, the period of 12 months commencing on 1st April 2000; and similar

expressions shall be construed accordingly.

“Oceanic Revenue”

means the revenue (measured on an accruals basis) derived beneficially by the Licensee from Oceanic Charges.

“Relevant Year”

means a calendar year commencing on or after 1st January 2001. The first Relevant Year (referred to in paragraph 2 of Condition 21) will be the calendar year commencing 1st January, 2001.

“Relevant Year t”

means that Relevant Year for the purposes of which any calculation falls to be made; “Relevant Year t-1” means the Relevant Year preceding Relevant Year t or, in respect of the period prior to 1st January 2001, the calendar year commencing on 1st January 2000; and similar expressions shall be construed accordingly.

“Service Unit”

means one unit for the purposes of the UK unit rate of charge as specified in accordance with the Eurocontrol Conditions of Application of the Route Charges System and Conditions of Payment version effective January 2000.

Condition 21: Control of Eurocontrol Charges

1. Without prejudice to Condition 25 (Suspension and Modification of Charge Control Conditions) the Licensee shall use its best endeavours to ensure that in the period from 1 January 2003 until 31st December 2005 the Average Charge Per Service Unit shall not exceed the Maximum Permitted Average Charge Per Service Unit calculated in accordance with paragraphs 2 to 5 of this condition it being recognised that:
 - (a) in respect of any Relevant Year such calculation can only be made after such Relevant Year, and
 - (b) the charge per service unit set for any Relevant Year will be based only on an estimate of Q_t for the Relevant Year, and
 - (c) the Licensee shall not be in breach of this condition if it makes the estimate in (b) on the basis of its best endeavours forecasts of Q_t for such Relevant Year.

Relevant Year 3

2. The Maximum Permitted Average Charge Per Service Unit shall be calculated as follows:

$$M_3 = VSC_3 + \frac{FSC_3}{Q_3} + LSC_3 - S_3$$

where:

M_3	means the Maximum Permitted Average Charge Per Service Unit in Relevant Year 3.
Q_3	means the quantity of Service Units attracting a Eurocontrol Charge in Relevant Year 3
VSC_3	is the variable revenue element of the base Charge per Service Unit in Relevant Year 3 which will have the following value: $VSC_3 = \text{£}22.77$
FSC_3	is the fixed revenue element of the base Charge per Service Unit in relevant year 3 which will have the following value: $FSC_3 = \text{£}217.2 \text{ million}$

LSC ₃	<p>means the additional element to the base Charge per Service Unit where the quantity of Service Units attracting a Eurocontrol Charge in Relevant Year 3 is below a defined trigger.</p> <p>Where $Q_3 \geq Q_{trigger_3}$ $LSC_3 = 0$</p> <p>Where $Q_3 < Q_{trigger_3}$</p> $LSC_3 = \frac{(Q_{trigger_3} - Q_3)VSC_3[0.6]}{Q_3}$
S ₃	means the service factor (whether of a positive or negative value), as calculated in accordance with the formula at paragraph 5 of this Condition.
Qtrigger ₃	<p>means the trigger value of the quantity of Service Units attracting a Eurocontrol Charge below which there is an additional element to the base Charge per Service Unit in Relevant Year 3 which will have the following value</p> <p>Qtrigger₃=7.629 million</p>

Relevant Years 4 and 5

3. If the CAA has published a statement on or before 30 September 2003 in the following terms:

“The CAA considers that the licensee has achieved the following objectives:

- (a) to provide a robust financial structure for NERL;
- (b) to place control of NERL with management and shareholders; and
- (c) to demonstrate that equitable contributions have been made by NATS’ investors and shareholder.”

Then the Maximum Permitted Average Charge Per Service Unit shall be calculated as follows:

$$M_t = VSC_t + \frac{FSC_t}{Q_t} + LSC_t + K_t - S_t$$

where:

M _t	means the Maximum Permitted Average Charge Per Service Unit in Relevant Year t.
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Q _t	means the quantity of Service Units attracting a Eurocontrol Charge in Relevant Year t.	
VSC _t	<p>is the variable revenue element of the base Charge per Service Unit in Relevant Year t calculated in accordance with the following formulae:</p> <p>For Relevant Years four and five:</p> $VSC_t = VSC_{t-1} \left[1 + \frac{RPI_t - X_t}{100} \right]$ <p>and for the purposes of the calculation of VSC_{t-1} in relevant year four:</p> $VSC_3 = £22.77$	
FSC _t	<p>is the fixed revenue element of the base Charge per Service Unit in relevant year t calculated in accordance with the following formulae:</p> $FSC_4 = £225.8million \left(1 + \frac{RPI_4}{100} \right)$ $FSC_5 = £229.9million \left(1 + \frac{RPI_4}{100} \right) \left(1 + \frac{RPI_5}{100} \right)$	
LSC _t	<p>means the additional element to the base Charge per Service Unit where the quantity of Service Units attracting a Eurocontrol Charge in Relevant Year t is below a defined trigger.</p> <p>Where Q_t ≥ Q_{trigger,t} LSC_t = 0 Where Q_t < Q_{trigger,t}</p> $LSC_t = \frac{(Q_{trigger,t} - Q_t)VSC_t[0.6]}{Q_t}$	
RPI _t	means the percentage change (whether of a positive or a negative value) in the Retail Price Index between the index published or determined with respect to August in Relevant Year t-1 and the index published or determined with respect to August in Relevant Year t-2.	
X _t	means a value to be set by the CAA in respect of each Relevant Year, which for the fourth and fifth year will have the following values:	
	Relevant Year 4:	2.0

	Relevant Year 5:	2.0
K_t	<p>means the correction factor (whether of a positive or negative value) which is zero for relevant year 3 and which in subsequent years is calculated in accordance with the following formula:</p> $K_t = \frac{(Q_{t-1}M_{t-1}) - TR_{t-1}}{Q_t} \left[1 + \frac{I_t}{100} \right]$ <p>where:</p>	
	M_{t-1}	means the Maximum Permitted Average Charge Per Service Unit in Relevant Year t-1 under this charge condition or the charge condition which applied in relevant year t-1.
	TR_{t-1}	means the total Controlled Eurocontrol Revenue in Relevant Year t-1.
	Q_t	means the quantity of Service Units attracting a Eurocontrol Charge in Relevant Year t.
	I_t	means the average of the Treasury Bill Discount Rate (expressed as an annual percentage interest rate) published weekly by the Bank of England, during the 12 months from the 1st September in Relevant Year t-1 where the value of $(Q_{t-1}M_{t-1}) - TR_{t-1}$ is positive, or 3 per cent per annum above this average rate where the value is negative.
S_t	means the service factor (whether of a positive or negative value), as calculated in accordance with the formula at paragraph 5 of this Condition.	
$Q_{trigger,t}$	means the trigger value of the quantity of Service Units attracting a Eurocontrol Charge below which there is an additional element to the base Charge per Service Unit. Which for the fourth and fifth Relevant Years shall have the following values:	
	Relevant Year 4	8.090 million
	Relevant Year 5	8.400 million

4. Where the CAA has not published a statement in the terms set out in paragraph 3 of this condition then the Maximum Permitted Average Charge Per Service Unit shall be calculated as follows:

$$M_t = SC_t + K_t - S_t$$

where:

M _t	means the Maximum Permitted Average Charge Per Service Unit in Relevant Year t.	
SC _t	<p>is a base charge per Service Unit in Relevant Year t calculated in accordance with the following formula:</p> $SC_t = SC_{t-1} \left[1 + \frac{RPI_t - X_t}{100} \right]$ <p>Where</p> $SC_3 = £44.63$	
RPI _t	means the percentage change (whether of a positive or a negative value) in the Retail Price Index between the index published or determined with respect to August in Relevant Year t-1 and the index published or determined with respect to August in Relevant Year t-2.	
X _t	means a value set by the CAA in respect of the fourth and fifth Relevant Years which will have the following values:	
	Relevant Year 4:	5.0
	Relevant Year 5:	5.0
K _t	<p>means the correction factor (whether of a positive or negative value) which is calculated in accordance with the following formula:</p> $K_4 = 0.5 \cdot \frac{(Q_3 \bar{M}_3) - TR_3}{Q_4} \left[1 + \frac{I_4}{100} \right]$ $K_5 = 0.5 \cdot \frac{(Q_3 \bar{M}_3) - TR_3}{Q_5} \left[1 + \frac{I_5}{100} \right] \left[1 + \frac{I_4}{100} \right]$ <p>where:</p>	
	\bar{M}_3	<p>means the value of Maximum Permitted Average Charge Per Service Unit which would have applied for Relevant Year 3 under the conditions of the licence in force on 30 September 2002.</p> $\bar{M}_3 = £44.56$

	TR ₃	means the total Controlled Eurocontrol Revenue in Relevant Year 3.
	Q ₃	means the quantity of Service Units attracting a Eurocontrol Charge in Relevant Year 3.
	I _t	means the average of the Treasury Bill Discount Rate (expressed as an annual percentage interest rate) published weekly by the Bank of England, during the 12 months from the 1st September in Relevant Year t-1 where the value of ((Q ₃ M ₃) - TR ₃) is positive, or 3 per cent per annum above this average rate where the value is negative.
S _t	means the service factor (whether of a positive or negative value), as calculated in accordance with the formula at paragraph 5 of this Condition.	

Formula for S_t as used in paragraphs 2, 3 and 4

5. For the purpose of paragraph 1, the term S_t shall other than in the first two Relevant Years (when the value of S shall be zero) be calculated in accordance with the following formula:

$$S_t = F.E_{t-2}$$

provided that S_t may not in any event exceed the following maximums (which, for the avoidance of doubt, will be subject, in the case of delays occurring in Relevant Years 4 and 5, to revision at the end of the first five Relevant Years under the provisions of sections 11 to 19 of the Act):

In respect of delays occurring in Relevant Year 1	£0.19
In respect of delays occurring in Relevant Year 2	£0.18
In respect of delays occurring in Relevant Year 3	£0.49

In respect of delays occurring in Relevant Year 4	£0.49
In respect of delays occurring in Relevant Year 5	£0.49

where:

F	means £0.27
E_t	means the difference in the average minutes of delay per flight in the Relevant Year when compared with the specified permitted levels and calculated as follows: $RD_t - PD_t$

and where:

RD_t	means the recorded average minutes of air traffic flow management delay per flight attributable to the Eurocontrol Business in relation to Relevant Year t, to be calculated by reliance on figures reported to the CAA by the Central Flow Management Unit of Eurocontrol and subject to adjustment in accordance with methods approved by the CAA.	
PD_t	means the permitted minutes of delay per flight attributable to the Eurocontrol Business in relation to Relevant Year t, as specified by the CAA, and which in respect of delays occurring in the first five Relevant Years shall be as follows:	
	Relevant Year 1	1.21 minutes
	Relevant Year 2	1.20 minutes
	Relevant Year 3	1.19 minutes
	Relevant Year 4	1.17 minutes
	Relevant Year 5	1.16 minutes