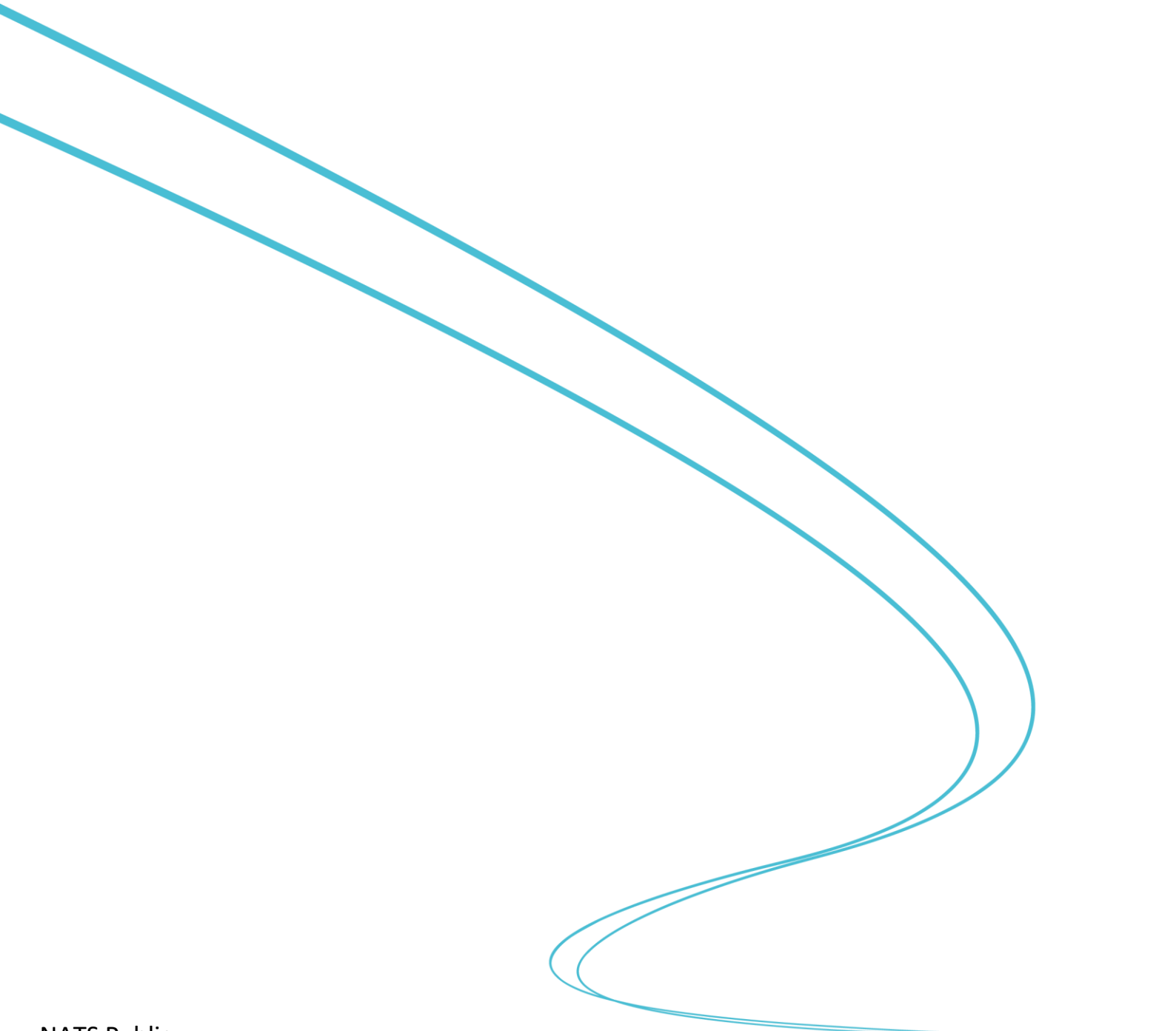


# Economic Regulation of NERL: Initial proposals for modifying the Licence to support the implementation of a UK Airspace Design Service (CAP 3121)

## NATS response

24 July 2025



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# Summary

NATS recognises that the CAA's Initial Proposals are in several aspects a pragmatic step forward, taking account of feedback to the earlier consultation on possible licence changes to establish the Airspace Design Service within NATS (En Route) plc (NERL). Nevertheless, NATS has significant concerns with the current proposals, in respect of both the regulatory risk exposure and the financial return proposed. We make specific proposals to reset this risk-reward balance such that the overall package of Licence changes and associated regulatory policy statements would be acceptable to NATS.

It is critical that any material change in geographic area of accountability for the Airspace Design Service should be accompanied by associated Licence change with appropriate consultation and appeal rights. NATS is concerned that the scope is subject to uncertain conditions by way of inclusion of the whole of the UK airspace and defines the Airspace Design Service obligations with reference to the CAA's Airspace Modernisation Strategy (AMS).

NATS remains concerned that the CAA's proposals expose NERL to unacceptable enforcement risk under the Licence for breach associated with its Airspace Design Service functions. We propose amendments to the Licence to enshrine the CAA's duty of proportionality by ring-fencing any breaches related to Airspace Design Service both in terms of its ultimate termination rights and in the qualifying turnover to relate solely to the Airspace Design Service.

Even when this Licence breach risk is addressed, NATS is concerned that the CAA proposals for risk compensation (via an opex margin or a return on an ADS Regulatory Asset Base) would result in a predictable and inevitable loss to NERL's shareholders. This is contrary to the CAA fulfilling its statutory duty towards NERL finances. It would not be capable of acceptance by the NATS Board. We present further evidence which would support a higher margin (either 3% for the opex margin approach or at least 5% for the RAB approach).

This submission complements and builds upon the earlier exchanges between NATS and the CAA, prior to and during the current consultation period for CAP3121. NATS welcomes the extensive engagement which has been afforded by the CAA to help inform its important regulatory decisions on the economic and legal basis for NERL to assume the functions of the Airspace Design Service under its Licence. We stand ready to work with the CAA to finalise its proposals into an acceptable package of Licence changes and associated regulatory policy statements.

# 1. Design of Licence modifications to implement the Airspace Design Service

## 1.1. CAA initial proposals

The CAA retains the high-level approach to the Licence modification used in the November 2024 consultation, in particular:

- > modifications to Licence obligations will be the simplest and most effective approach to requiring NERL to provide the Airspace Design Service;
- > obligations will, so far as is practicable, be relatively high level to give NERL reasonable freedom to decide how it should best comply with them alongside the responsibility of compliance;
- > these obligations will require NERL to provide the Airspace Design Service and to administer the Airspace Design Support Fund, and will include the matters that NERL will be required to consider in performing that role (including obligations to act transparently and without favouring any groups or individuals); and
- > consequential changes will be necessary, including to NERL's obligations with respect to the Airspace Change Organising Group (ACOG).

With regard to concerns expressed by NERL (in response to the November 2024 CAA consultation) over the risk of enforcement of the proposed new obligations, the CAA has considered this in the broader context of its general approach to enforcement. This approach is: (i) expressly subject to prioritisation; and (ii) founded on a stepped approach that, in the first instance, seeks to resolve issues informally.

The CAA concludes its current view is that, unless a very clear deficiency arose in setting up the Airspace Design Service, it seems unlikely that formal enforcement activity would be appropriate over NERL's approach. Even if the CAA were to launch enforcement activity and found a breach after a rigorous process, its approach would need to be proportionate given its duties, including in relation to NERL's financeability. The CAA cannot envisage any credible scenario whereby delivery issues in relation to the Airspace Design Service would require it to take regulatory steps that would compromise NERL's core air traffic services, for example, by termination of the Licence.

As a result, the CAA does not see merit in creating a "special case" to cover its regulation of NERL's conduct in providing the Airspace Design Service. Its current approach, when combined with the "checks and balances" already, in both its policies and the broader legal framework, provide (in the CAA's view) sufficient comfort that the concerns NERL set out should not be overplayed.

## 1.2. NERL response

In NATS' response to the CAA's November 2024 consultation, we agreed that the CAA's overall approach is aligned with the CAA's primary duty to maintain a high standard of safety in the provision of air traffic services and that the proposals would likely be in airlines' and passengers' interests through the more effective delivery of the AMS. We also agreed with the areas in which Licence modifications would be needed.

We highlighted two main and substantive concerns:

- > the CAA's policy on cost recovery could make it unduly difficult for NERL to finance its activities, and
- > the enforcement risk associated with the Airspace Design Service, especially when compared against the financial terms offered is disproportionate, and the CAA should therefore take a tailored approach to enforcement in relation to the Airspace Design Service.

These concerns have not been allayed by the CAA's initial proposals and remain a material barrier to the NATS Board accepting the terms proposed by the CAA for the Licence changes to support the implementation of Airspace Design Service.

NERL suggests specific modifications to Licence proposals and to the financing parameters under which the provision of the Airspace Design Service would operate. Detailed comments on the CAA's financial framework proposals are outlined in our response to Chapter 5 (Form of control, other regulatory mechanisms and illustrative charges).

The CAA's proposal to regulate the Airspace Design Service alongside NERL's core air traffic services, rather than as a separate, ring-fenced service, does not reflect the reality of the current regulatory regime, which maintains a clear distinction between NERL's regulated and unregulated services. This would be a significant decision, about which NERL continues to have serious concerns.

The CAA takes the stance that formal enforcement activity would be unlikely to be appropriate in the absence of a "very clear deficiency", and (at paragraph 1.19) that "[CAA] *cannot envisage any credible scenario whereby delivery issues in relation to the Airspace Design Service would require us to take regulatory steps that would compromise NERL's core air traffic services, for example, by termination of the Licence*".

However, in the absence of a clear demarcation between the Airspace Design Service and NERL's pre-existing Licence obligations for En Route, Oceanic and Specified Services, there are three important questions about how the CAA will regulate NERL in accordance with the broader regulatory regime. We have addressed these below.

- > First, and most fundamentally, the failure to separate the regulation of the Airspace Design Service from NERL's pre-existing Licence obligations creates a risk (which, while remote, is nonetheless real) that the Licence may be terminated in respect of a breach of Airspace Design Service obligations. This is not a risk that NERL, or presumably other stakeholders in all their guises, can accept. It is therefore our strong view that there is a need for changes to the Licence terms that would ensure termination rights based solely on breach of Airspace Design Service-related matters would be confined to termination of the Airspace Design Service.
- > Secondly, there is a risk that NERL could face financial penalties for breaches of its Licence, under the provisions of the Transport Act 2000, in relation to breaches relating to the Airspace Design Service. In extreme cases, this could mean a financial penalty risk of up to 10% of qualifying turnover for NERL's entire business in the event of an Airspace Design Service-related breach under the Licence. Again, while the CAA may consider this risk to be remote, it is not a risk that we would expect stakeholders to accept, given the critical nature of NERL's pre-existing Licence services. Equally, and given the scale, prioritisation and the circumstances under which the Airspace Design Service is bestowed on NERL, the NATS Board could not, acting responsibly and diligently, accept having the full financial penalty regime applying in these circumstances. It is therefore our strong view that there is a need for changes to the Licence to ensure that financial penalties based solely on breach of the Airspace Design Service are calculated only by reference to that service.

- Finally, CAA's proposal sets a very high bar for Licence compliance in a complex multi-stakeholder environment and, in the absence of clarity on the face of the Licence these enforcement points, grant to the CAA unacceptably broad discretion in its enforcement approach. NERL therefore proposes an amendment to its Licence to enshrine the CAA's duty of proportionality by ring-fencing Airspace Design Service-related breaches both in terms of its ultimate termination rights and in the qualifying turnover to relate solely to the Airspace Design Service.

Delimiting the enforcement risk identified and ring-fencing the financial penalty are critical to NERL. Given the significant efficiency of utilising the Licence structure to introduce the Airspace Design Service obligations, and the extent of the existing proposed changes to the Licence, NERL's proposed additions are marginal and necessary to secure the agreement of the NATS Board to the arrangements. They also bring significant benefits:

- Clearer separation between the Airspace Design Service and NERL's pre-existing Licence services allows for the possibility, at some point in the future, of the CAA hiving off the Airspace Design Service so that it can be awarded to another provider. There are clear public policy arguments in support of allowing for this.
- The proposed changes also allow the CAA to regulate NERL in a proportionate manner, which reduces uncertainty, increases the efficacy of regulation, and avoids risking NERL's ability to carry out its core functions. In this sense, the proposals are also in line with the principles of better regulation.

## 2. Licence modifications to implement the creation of the Airspace Design Service

### 2.1. Overall approach and definition of the Airspace Design Service

#### 2.1.1. CAA Initial Proposals

The CAA maintains its approach that the Licence conditions requiring NERL to provide the Airspace Design Service should be high level, so far as reasonably practicable. In its view, these Licence conditions should provide a clear mechanism for setting the scope of what is required of NERL and that any changes in this scope should be subject to an appropriate process.

As a result, the CAA does not consider it appropriate for the Licence to address questions of whether the output of the Airspace Design Service should be to create one or more designs for UK airspace, or to deal with safety, transitional arrangements, relations with stakeholders or the respective responsibilities of NERL and airports. Rather, it proposes that these matters should be addressed through:

- > the Airspace Change Process and any associated guidance on it issued by the CAA, as well as the priorities and design principles set out by the DfT and CAA in the airspace regulatory framework, including the Air Navigation Directions and Air Navigation Guidance;
- > arrangements that NERL puts in place with stakeholders; and
- > the transitional arrangements to be consulted on later this year by the CAA that will need to be put in place for the Airspace Design Service to assume responsibility for particular airspace change proposals in the Airspace Change Process.

#### 2.1.2. NERL response

We agree with the CAA's proposals for a minimum specification on the definition of the activities of the Airspace Design Service within the Licence itself, with further details to be included within regulatory guidance issued by the CAA. The CAA and DfT have separately issued a 'minded to' Governance Paper<sup>1</sup> which sets out the proposed approach that NERL, as the Airspace Design Service provider, will be empowered to act as a 'guiding mind' to coordinate and deliver holistic airspace design for a geographic area containing multiple major airports and ensure the requirements of different stakeholders are managed effectively. NERL will work with the CAA/DfT to ensure the governance arrangements are appropriate.

### 2.2. Geographic Scope of the Airspace Design Service

#### 2.2.1. CAA Initial Proposals

In response to concerns raised in the previous CAA consultation on the Airspace Design Service geographical scope, notably whether it should be specified in the Licence or defined simply through CAA guidance, the CAA has considered a range of options for setting this scope. It now proposes that the Licence should specify that NERL provide the Airspace Design Service for the

<sup>1</sup> DfT/CAA Policy paper UKADS 25/2, UK Airspace Design Service: Governance and engagement, June 2025



whole of the UK, but, in doing so, requiring it to deliver strategic objectives set by the CAA or Secretary of State which could prioritise sponsoring airspace change proposals in particular geographic areas, such as the LTMA region.

The CAA considers that this would have advantages of flexibility, providing a means of reacting in a timely manner to changing circumstances, and the disadvantages of reduced consultation with stakeholders. It could also allow some simplification of the obligations on NERL, so facilitating compliance, as the geographic scope of the Airspace Design Service would not be derived from a separate obligation but be “rolled up” into the strategic objectives to which NERL would be required to have regard. The CAA also notes that any strategic objectives set would be subject to a requirement to consult and would have the potential to be subject to challenge by way of judicial review.

### 2.2.2. NERL response

We do not support the CAA’s initial proposals on geographic scope.

We made clear in our CAP3063 response that it was important to NERL that any material change in geographic area of accountability for the Airspace Design Service should be accompanied by associated Licence change with associated consultation and appeal rights. The reasoning was that increases of geographic scope may have implications for both resources and risk appetite for NERL, particularly given that the deliverability of even the, more limited, London Terminal Control Area (LTMA) scope remains untested and subject to uncertain conditions by way of as yet incomplete changes to CAP1616 and the Air Navigation Guidance (ANG). However, we were largely content with the definition of the Airspace Design Service obligations as expressed by way of, essentially, acting in the best interests of UK airspace users and in compliance with DfT guidance.

The CAA’s Initial Proposals have shifted substantively in ways which run counter to concerns we expressed previously. The CAA has both moved to an initial scope that includes the whole of the UK airspace and defined the obligations as being essentially to deliver the CAA’s AMS by way of the following Purpose -

*“The purpose (the “Purpose”) is to prepare and submit proposals for permanent changes to the design of UK airspace to the CAA that, if approved by the CAA in accordance with the Airspace Change Process, would deliver the objectives of the AMS.”*

The commentary on CAA’s preferred option, suggesting that it offers protection for NERL by way of consultation, is not compelling. Any consultation is expressed as applying to changes in CAA and DfT guidance, whereas how the exact scope of the Airspace Design Service activity can be amended is not clear on the face of the Licence. Furthermore, the scope is now focused on the AMS objectives which themselves change over time, subject to their own political and regulatory processes.

Those concerns are further compounded by the additional obligation (emphasis added) on NERL as follows –

*“The Licensee shall **use its best endeavours** to have regard to, and comply with, any written guidance and/or strategic objectives issued by the [CAA and/or Secretary of State] **including in relation to the geographic area** in relation to which it shall provide the Airspace Design Service.”*

‘Best endeavours’ has a specific commercial meaning and legal interpretation which imports exceptionally high standards of compliance and concomitant, reciprocal exposure to allegations of breach. A ‘reasonable endeavours’ approach would be more appropriate to allow NERL to allocate its resources and prioritisation across its breadth of Licence obligations.



Furthermore, the obligations around the Airspace Design Service are broadly defined, appear to be applied to matters which may be unilaterally determined by the CAA and/or DfT and, critically, relate to the geographic area - the very issue over which we expressed increased concern for the reasons rehearsed above, and over which we appear to now have no control. Stronger protections for NERL in the Licence are necessary on agreeing changes to geographical scope and much more tightly prescribed limits on any financial penalties arising in the event of a Licence breach finding.

Going back to the CAA's original stated preference for not including geographical scope within the Licence itself:

*"statutory licence modification process in TA00 is time consuming, likely taking three to four months from publishing the statutory consultation to the decision taking effect, and longer if informal consultation is undertaken".*

We suggest that the CAA overstates the timeliness disadvantage of the Licence modification process. The statutory consultation only requires 6 weeks from publication to decision coming into effect. Preceding consultation(s) on initial and/or firm proposals could add 2-3 months to this, resulting in a total (formal) consultation period of 3-5 months. This seems a reasonable timeframe for a potentially material change in the geographical scope of the Airspace Design Service. Given that such scope changes are not expected to occur frequently (perhaps no more than once in the first 5 years of the Airspace Design Service operation), we do not consider that the licence change process *per se* would have any material impact on the timeliness of the Airspace Design Service delivery of any geographical scope change that DfT/CAA might propose.

## 2.3. Nature of the obligation

### 2.3.1. CAA Initial Proposals

Following feedback from NERL and others, the CAA has simplified the draft condition included in the November 2024 Consultation and removed the specific obligations in relation to: programme management; designing flight instrument procedures, carrying out economic and environmental assessments and developing aeronautical information; and post-implementation review. These requirements will be set out in or governed by the Airspace Change Process, and so do not need to be specified on the face of the Licence.

The CAA's initial proposal is, therefore, to create a simplified obligation on NERL to provide the Airspace Design Service. It considers that this would be an appropriate means of requiring NERL to deliver the Airspace Design Service, namely to:

- › combine relevant airspace change proposals such that the outcome is a single design and single airspace change proposal that prioritises maintaining a high standard of safety and secures system-wide benefits and overall network optimisation, while giving due consideration to local circumstances and environmental impacts; and
- › be required to sponsor the single proposal through the Airspace Change Process.

The CAA notes that in providing the Airspace Design Service, NERL will be required to use its best endeavours to achieve strategic objectives set by the CAA. The strategic objectives will be set after consultation with NERL and other relevant parties, including airports and the MoD.

### 2.3.2. NERL response

We refer to above in respect of NERL's response on "best endeavours" standard for compliance.

We welcome the CAA's initial proposal to create a simplified obligation on NERL to provide the Airspace Design Service as a positive step. We consider though the Licence requirement as drafted to be too specific in its reference to 'combining relevant airspace change proposals'. Combining will only be relevant to low level changes proposed by airports in the London LTMA who are part of the Future Airspace Strategy Implementation Programme, whereas the scope of the Airspace Design Service has now been redefined by CAA as UK-wide, subject to the direction from the co-sponsors on the priority areas for the AMS. We suggest therefore that the obligations be recast as follows:

- > Design airspace in accordance with the co-sponsors strategic direction
- > Sponsor airspace change proposals through the CAA's Airspace Change Process.

## 2.4. Matters NERL would need to take into account

### 2.4.1. CAA Initial Proposals

The CAA proposes that the matters NERL should be required to take into account should enable it to plan its work effectively. Central to this will be requirements for NERL to have regard to the ANG, the Airspace Change Process, strategic objectives set by the CAA or Secretary of State and any other guidance issued by the CAA or DfT. The Licence modifications are not proposed to include requirements for NERL to take into account specific elements covered in the detail of the Airspace Change Process or associated guidance, such as design principles or local circumstances. Rather, the Licence should refer to these higher-level materials.

### 2.4.2. NERL response

We agree with the CAA's Initial Proposals in this regard.

## 2.5. Governance, the Advisory Board and reporting

### 2.5.1. CAA Initial Proposals

In line with the Governance Paper, the Licence would require the setting up of the Airspace Design Service to include the structure, membership and published terms of reference for the Advisory Board, subject to consulting the co-sponsors on these matters. The co-sponsors would not have a veto on this structure but may wish to attend the Advisory Board as observers.

The Governance Paper sets out that it would be for the NATS Board to determine the appropriate internal governance arrangements for the Airspace Design Service, albeit that the CAA expects that they should take account of stakeholders' views in doing so and carefully consider the membership of the Advisory Board. As co-sponsors of the AMS, DfT and CAA will manage the practical relationship with the Airspace Design Service, including reporting, through the existing AMS governance arrangements, such as the DfT/CAA Joint Airspace Modernisation Programme Board structure.

### 2.5.2. NERL response

We agree with the CAA's Initial Proposals in this regard.

## 2.6. Relationships with stakeholders

### 2.6.1. CAA Initial Proposals

The CAA notes that the Governance Paper makes clear that NERL, as the provider of the Airspace Design Service, will be empowered to act as a 'guiding mind' to design and deliver holistic airspace for a geographic area containing multiple major airports, manage trade-offs, and ensure the requirements of different stakeholders are managed effectively to deliver the best overall outcome for the UK. As such, it should have the opportunity and ability to build its own

relationships with stakeholders and resolve issues with them directly, without the need for intervention. The Airspace Design Service will not be required to adopt any pre-existing airspace change plans or proposals in its deliverables.

The CAA concludes relatively little modification is needed to the Licence to meet the concerns of stakeholders and to implement these arrangements, save for the requirement for the Airspace Design Service to have regard to guidance from the CAA or DfT and a relatively high-level obligation on NERL to use reasonable endeavours to enter into appropriate arrangements.

#### 2.6.2. NERL response

We agree with the CAA's conclusion in this regard in principle, but the CAA should note that the entering into of appropriate arrangements will rely on the reasonable cooperation of existing ACP sponsors and/or other stakeholders.

### 2.7. Administration of the Airspace Design Support Fund

#### 2.7.1. CAA Initial Proposals

The Support Fund Paper<sup>2</sup> sets out that a fund will be established alongside the establishment of the Airspace Design Service, to be administered by NERL. The Airspace Design Support Fund would only be available to UK commercial airports that are served by airline operators required to pay the Charge, do not fall within the scope of the Airspace Design Service; and are taking forward an airspace change proposal meeting specified criteria.

The CAA proposes that the obligation for NERL to administer the Airspace Design Support Fund can be stated at a high level in the Licence and refer to the detailed rules to be published by the CAA.

#### 2.7.2. NERL response

We continue to consider that the design, decision-making and administration of the Support Fund would be much better delivered as the responsibility of either government department (DfT) and/or regulator (CAA), both public bodies with relevant experience and political accountabilities for such activity. This activity would be brand new to NERL and would not leverage or complement any existing Licensed activity.

We note that the DfT and CAA have decided that administering the Support Fund should be part of the defined obligations of the Airspace Design Service. In that context, and if that Initial Proposal remains the CAA's position, then the CAA's proposals regarding the need for minimal specification on the face of the Licence would provide more scope for the Airspace Design Service to establish its own processes for the Fund.

The scope of the Fund is defined as "available to UK commercial airports that ... do not fall within the scope of the Airspace Design Service" (paragraph 2.88). Elsewhere in the Initial Proposals, the CAA widens the scope of Airspace Design Service to "the whole of the UK but, in doing so, requiring it to deliver strategic objectives set by the CAA or Secretary of State which could prioritise sponsoring airspace change proposals in particular geographic areas, such as the LTMA region" (paragraph 2.31). We suggest that the CAA should further clarify and define the scope of the Support Fund, so that it is a clear complement, geographically, to the focus of the Airspace Design Service.

<sup>2</sup> DfT/CAA Policy paper UKADS 25/3, UK Airspace Design Service: Airspace Design Support Fund, June 2025

## 2.8. The role and scope of ACOG

### 2.8.1. CAA Initial Proposals

The CAA proposes that NERL's current Licence obligation to maintain ACOG's functions would:

- > reduce in area to exclude the London cluster;
- > be scoped to providing only those residual tasks that demonstrably add value; and
- > no longer be required to be provided by a separate impartial unit (that is, ACOG) so that NERL can resource these residual tasks within the part of the business providing the Airspace Design Service.

The CAA considers that this transition would simplify oversight, facilitate knowledge and skills transfer between ACOG and the Airspace Design Service and improve efficiency of resource utilisation.

The CAA further proposes that the existing obligations in the Licence (Condition 10a) would be deleted and replaced by provisions in a new condition relating to the Airspace Design Service to capture the current ACOG activities that would continue. The DfT and CAA will manage the practical relationship with the Airspace Design Service, including reporting, through the existing governance arrangements for the Airspace Modernisation Strategy, such as the DfT/CAA Joint Airspace Modernisation Programme Board structure. As such, the reporting arrangements set out in Condition 10a will not be reproduced.

### 2.8.2. NERL response

We agree with the CAA's Initial Proposals in this regard in principle, subject to having clarity over the future expectations of ACOG.

## 3. Consequential modifications to the Licence

### 3.1. Condition 5 Availability of resources and financial ringfencing

#### 3.1.1. CAA Initial Proposals

The CAA largely confirms its November 2024 suggestions that Condition 5 could be extended to cover funds raised from regulated charges for the Airspace Design Service. It said that much of this could be achieved by amending the definition of “Permitted Purpose” in Condition 1 of the Licence (Interpretation and construction) to cover the Airspace Design Service, but specific changes might also be needed to ensure appropriate ringfencing from the other activities undertaken by NERL.

In our response to the November 2024 consultation, NERL raised significant concerns about the implications of defining the Airspace Design Service as a Permitted Purpose, and the potential conflict in resource prioritisation with safety-critical activities. The CAA now simply states its conclusion (without argument) that it does not consider that the proposed new condition for the Airspace Design Service would oblige NERL to prioritise availability of resources to the Airspace Design Service over safety or operational activities.

The CAA does agree that there may be a need for transactions between the Airspace Design Service and either of the En Route or Oceanic Services business units and that the Licence should provide for such arrangements.

The CAA reaffirms its proposals that revenues associated with the Airspace Design Service should not be included in the calculation of the *de minimis* cap which is designed to ensure that any non-regulated activities undertaken by NERL do not reach a scale that could become a distraction from the regulated activities carried out by NERL.

The CAA has changed its approach to the definition of each “Permitted Purpose” and “Separate Business” set out in the November 2024 Consultation. It now proposes that the distinct NERL unit that provides the Airspace Design Service will also both administer the Airspace Design Support Fund and carry out the residual activities currently carried out by ACOG. The CAA now proposes to implement this by extending the definition of “Permitted Purpose” to include these activities, and to adjust the definition of “Separate Business” so that these activities (taken together) constitute a “Separate Business” within NERL.

#### 3.1.2. NERL response

In its response to CAP3063, NERL agreed that it would be appropriate to designate the provision of Airspace Design Service under a separate business and therefore be subject to a prohibition of cross subsidy in the same manner as the Oceanic and En Route services are prevented from cross subsidising each other.

We do not agree with the CAA’s conclusions and reaffirmed proposals on the inclusion of the Airspace Design Service within the defined Permitted Purposes in the Licence. We do not believe that the CAA has demonstrated that it has given adequate consideration to the significant concerns we raised.

By simplistically making the Airspace Design Service part of the “Permitted Purpose” definition under the Licence, this extends the application of paragraph 2 of Licence Condition 5 to Airspace Design Service and has the unwanted side effect of elevating the Airspace Design Service to

equal importance with the UK En Route and Oceanic services. This creates a risk that NERL will be obliged on occasion to prioritise the availability of its resources for Airspace Design Service over safety or operational exigencies (for example with shared simulator facilities used for both ATCO training and airspace simulation).

In reality, NERL will never compromise nor be expected to compromise safety over the Airspace Design Service; and so this amplifies the risk that NERL may be found in breach of its Licence, and subject to penalties or enforcement action, as a result of prioritising operational activity over Airspace Design Service.

The incorporation of Airspace Design Service into the definition of “Permitted Purpose” should include a modification to paragraph 2 of Condition 5 as indicated by the underscoring in the Licence extract below –

*“The Licensee shall at all times act in a manner calculated to secure that it has available to it sufficient resources including (without limitation) financial, management and staff resources, fixed and moveable assets, rights, licences, consents and facilities, on such terms and with all such rights as shall ensure that at all times it is able to:*

*(a) carry out its Permitted Purpose activities; and*

*(b) comply in all respects with its obligations under the Act and this Licence including, without limitation, its duties under section 8 of the Act*

*provided always that nothing in this Condition 5.2 shall require the Licensee to prioritise the availability of its resources in favour of the Airspace Design Service to the detriment of the En route (UK) Business, the En route (Oceanic) Business or any business or activity within the limits of Condition 5.9 to 5.12.”*

We believe that this proposed wording reflects the CAA’s intentions and the clarity in drafting would be beneficial to CAA, NERL and airspace users on NERL’s priority, as well as making NERL’s Licence obligations clear for the purpose of any potential enforcement action.

## 3.2. Condition 6 Regulatory accounting requirements

### 3.2.1. CAA Initial Proposals

The CAA proposes to amend Condition 6, which would require NERL to prepare separate accounting records for the Airspace Design Service, the Airspace Design Support Fund and the residual ACOG duties, and for the Regulatory Accounting Guidelines (RAGs) to state the accounting policies that set out the basis on which any amounts are charged, apportioned, or allocated between them and other parts of the business.

### 3.2.2. NERL response

We agree with the CAA’s Initial Proposals in this regard - the modifications to be appropriate and proportionate. The draft licence wording in Appendix B of CAP3121 appears consistent with the policy intent and should support transparency and effective financial oversight.

## 3.3. Condition 7 Requirement to maintain an intervention plan

### 3.3.1. CAA Initial Proposals

The CAA proposes amending Condition 7 to include the Airspace Design Service within the scope of the intervention plan.



### 3.3.2. NERL response

We agree with this proposal, which we previously described as a logical step requiring little additional work. The draft Licence wording in Appendix B of CAP3121 reflects this intention and appears proportionate.

## 3.4. Condition 8 Requirement for mandated independent directors and corporate governance

### 3.4.1. CAA Initial Proposals

The CAA has reconsidered its earlier suggestions of additional requirements on independent directors. In light of concerns raised by NERL and others that this could unduly restrict the range of eligible candidates for no benefit in managing any actual or perceived conflict of interest, the CAA now concludes that it would not be proportionate to add an additional requirement into the Licence in relation to independent directors over and above those already set out in Condition 8. It considers that doing so may in fact undermine effective oversight by rendering it more difficult to find suitably qualified candidates. This approach would also have the effect of preserving the current ability for NERL to benefit from a consent in relation to its partnership directors.

### 3.4.2. NERL response

We welcome the CAA's recognition on the points raised in our earlier response, including the risk that additional requirements for independent directors could hinder effective oversight by limiting the pool of suitably qualified candidates. We also continue to support the existing waiver, on the basis that the independence demonstrated by the DfT-appointed partnership directors makes further requirements unnecessary and agree that no change is needed to the current arrangements.

## 3.5. Condition 9 Prohibition of cross-subsidy

### 3.5.1. CAA Initial Proposals

In light of NERL and Prospect trade union comments on this issue, the CAA has developed its previous suggestions into revised initial proposals:

- > to include the Airspace Design Service, the administration of the Airspace Design Support Fund and the residual activities of ACOG within the scope of the prohibition on cross-subsidies set out in Condition 9; and
- > that this should be achieved by amending the definition of "Separate Business" in Condition 1 (Definitions and Interpretation).

The effect of this would be that the prohibition on cross-subsidies in Condition 9 would apply between each of: the En route (UK) Business; the En route (Oceanic) Business; and the provision of the Airspace Design Service, administration of the Airspace Design Support Fund and the residual activities of ACOG, taken separately from one another and from any other business of the Licensee.

### 3.5.2. NERL response

We agree with the CAA's initial proposals in this regard. We agree that NERL will need to ensure that the regulatory accounting guidelines required under Condition 6 are updated so that they are sufficiently robust to capture these transactions effectively. This would allow for the efficient sharing of resources across the three business areas without undermining the prohibition on cross-subsidy.



## 3.6. Condition 10a Reporting requirements

### 3.6.1. CAA Initial Proposals

In light of the changes proposed to deal with the residual functions of ACOG (discussed in the previous chapter), the CAA's Initial Proposals confirm that the reporting arrangements set out in Condition 10a will not be reproduced.

### 3.6.2. NERL response

We support the proposal to remove Condition 10a from the Licence, recognising that the establishment of the Airspace Design Service as a distinct function with its own governance framework renders this condition redundant. The current approach in respect of ACOG, which combines Licence-based requirements with governance-led oversight, contains a degree of duplication. The proposed move to rely solely on governance arrangements for reporting for the Airspace Design Service, with the reporting provisions currently set out in Condition 10a not being reproduced elsewhere, represents a positive development. It simplifies the overall reporting framework and provides the flexibility needed to support the effective delivery of airspace modernisation.

Further, aligning oversight meetings between the Airspace Design Service and the co-sponsors with the reporting cycle of the DfT/CAA Joint Airspace Modernisation Programme Board should support timely information-sharing and reduce unnecessary repetition of effort.

We note that the Licence would still include an obligation for the Airspace Design Service to agree its reporting and meeting approach with the co-sponsors, while the detailed arrangements would sit outside of the Licence itself. In principle, this strikes a sensible balance: it provides a reference back to the Licence while enabling the practical detail to be managed flexibly through governance. However, the effectiveness of this approach will depend on how such agreements are reached and updated in practice. It will be important to ensure that the governance framework supports transparent and constructive engagement on these arrangements, rather than becoming a source of friction or ambiguity over time.

A more significant concern arises from the proposed inclusion of a Licence backstop, detailed in paragraph 25 of Policy paper UKADS 25/2, allowing the co-sponsors to specify the format and minimum requirements of reporting. While we understand the rationale for retaining this as a safeguard, we are cautious about introducing a regulatory provision that could override the collaborative process envisaged in the governance model. In our view, any data required by the co-sponsors should be consistent with what the Airspace Design Service needs to support its own delivery work. As such, we would expect reporting requirements to be agreed through normal engagement and used to enable delivery rather than impose parallel burdens.

To guard against the risk that reporting expectations become overly prescriptive, misaligned with operational realities, or no longer serve a clear purpose, we propose that the governance arrangements include a formal mechanism through which NERL can request a review of previously agreed or appeal against specified reporting formats and requirements. This would provide a proportionate and constructive way of resolving concerns and would help to ensure that the reporting framework remains efficient, fit for purpose, and supportive of the shared objectives of the Airspace Design Service model. We would welcome the opportunity to work with the co-sponsors and the CAA to help define such a mechanism in practical terms.

## 4. Costs of new airspace design services

### 4.1. Eligible costs

#### 4.1.1. CAA Initial Proposals

The CAA proposes that the new Charge should only reflect the incremental costs of NERL providing the Airspace Design Service and administering the Airspace Design Support Fund. In the context of the NR28 price control and once the Airspace Design Service is in operation, the CAA will consider if there are benefits in grouping together the costs of the Airspace Design Service and the Airspace Design Support Fund with those of NERL's wider airspace design activities.

#### 4.1.2. NERL response

We agree that the new Charge should only reflect the incremental costs of NERL providing the Airspace Design Service and administering the Airspace Design Support Fund.

### 4.2. Cost estimates

#### 4.2.1. CAA Initial Proposals

For the initial proposals, the CAA uses the medium cost scenario developed by its consultants (£19m per annum, within a low-high range of £16-24m) to inform its decisions on the initial charges that would apply for the remainder of the NR23 period.

The CAA expects that NERL will provide further information on expected costs in response to its Initial Proposals consultation.

#### 4.2.2. NERL response

We continue to caution against placing too much weight on the current cost estimates. Due to the lack of clarity in the precise scope and nature of Airspace Design Service activities, and the potential demand on the Support Fund from eligible airports, it is not practicable to provide any accurate estimate of start-up and ongoing future costs.

In our response to CAP3063, we expressed concerns on the cost modelling approach taken by the CAA consultants - any cost estimates provided should be considered 'order of magnitude' only at this stage. We also raised the following concerns:

- > inconsistencies in the cost and timing assumptions for the delivery of the Airspace Design Service;
- > uncertainties on the mobilisation date for the Airspace Design Service; and
- > misalignments on the requirements to follow the Airspace Change Process (known as CAP1616).

In June 2025, DfT and CAA announced their intention to launch a public consultation by September 2025 on a range of policy and process changes to the airspace change framework that will be subject to Ministerial agreement. This consultation will propose modifications to:

- > CAP1616 guidance and process for the assessment of the Airspace Design Service;
- > the Airspace Change Masterplan; and

> the Air Navigation Guidance and Air Navigation Directions.

We anticipate that we will be in a much clearer position to provide firmer estimates on the expected costs for establishing and maintaining the Airspace Design Service once the DfT and CAA have concluded these policy and regulatory consultations this autumn and made decisions affecting the Airspace Design Service activities.

We would welcome further guidance from the CAA on the level and timing of demand it expects that the Support Fund might receive from eligible airports in the next 2 and then following 5 years.

## 5. Form of control, other regulatory mechanisms and illustrative charges

### 5.1. Options for cost recovery, incentives and early costs

#### 5.1.1. CAA Initial Proposals

The CAA Initial Proposals in this area are as follows:

- cost pass-through approach to the Airspace Design Service and Airspace Design Support Fund costs remains appropriate;
- the additional costs to NERL of providing these services should be identified by NERL in its separate accounts and the recovery of these costs should not involve any cross-subsidy of NERL's other activities;
- a correction mechanism in NR28 to implement the cost pass-through arrangement during NR23; and
- allowing NERL to recover appropriate and efficient early costs of setting up the Airspace Design Service and the Airspace Design Support Fund, that is, costs which were incurred ahead of completing the statutory processes to modify the Licence.

#### 5.1.2. NERL response

We agree with the CAA's proposal to apply a cost pass-through approach which provides the flexibility to respond to the uncertainties in the scale of costs for setting up and running the Airspace Design Service. This is, however, just one aspect of the overall economic regulatory framework under which NERL would be able to recover the efficient costs of delivering the Airspace Design Service and be compensated for the risk of doing so. We set out in our response to section 5.3 below our significant outstanding concerns on the latter point.

We accept the CAA's proposed correction mechanism for any over/under-recoveries of costs within the NR23 period that will be included in the NR28 price control decision, with adjustment for CPI inflation.

We agree to and have already implemented the recording in separate accounts of the costs of setting up and delivering the Airspace Design Service, and that the recovery of these costs should not involve any cross-subsidy with NERL's other activities.

We agree with the CAA's position not to introduce at this stage any financial incentives on delivery of specific outputs at this stage, with reasons set out in our response to CAP3023.

### 5.2. Duration of the price control

#### 5.2.1. CAA Initial Proposals

The CAA proposes that the initial price control period should be relatively short and aligned with the remainder of the NR23 period.

### 5.2.2. NERL response

NERL agrees with the CAA Initial Proposals that a shorter initial price control period and charge, aligned with the current NR23 period, would be the most appropriate and effective in supporting the initial phase of the Airspace Design Service.

## 5.3. The profile of cost recovery over time and risk and return

### 5.3.1. CAA Initial Proposals

The CAA proposes that, for the remainder of the NR23 period, its duty in respect of economy and efficiency is best served by **cost pass-through** arrangements, and when taken together with allowing NERL to earn a **return commensurate with the limited risks**, this should also support NERL in financing these activities.

It considers there are two approaches to return that are consistent with this approach:

- > the “opex with margin” approach, with the operating margin set at 1%; or
- > the “RAB-based” approach, with a regulated return set at 3% CPI-real.

The CAA’s preferred approach is to implement the “opex with margin” approach and to set the operating margin at 1%, while it considers further as part of NR28 whether a RAB-based approach would be proportionate and in customers’ and consumers’ interests. Nonetheless, it welcomes the views of stakeholders on both these options and the broader question of how best to remunerate NERL for carrying out the activities associated with the Airspace Design Service. The CAA will reflect further on these matters in formulating its final proposals.

Any under-recovery or over-recovery of actual costs, such as through delays in implementing charging arrangements, and differences between forecast and actual costs and traffic, would be dealt with by the correction mechanism. The CAA would reconsider this approach as part of the NR28 review.

### 5.3.2. NERL response

We welcome the shift in the CAA’s thinking since CAP3023 in recognising that NERL would face risk in respect of the Airspace Design Service function and should be compensated appropriately, notwithstanding the proposals for a mechanism to enable the recovery of early set-up costs and an effective cost pass-through mechanism. We also welcome the shift in the CAA’s thinking towards accepting that an approach which capitalised Airspace Design Service costs into its own RAB and then recover them over time, with an appropriate return, could be reconsidered for the NR28 period.

#### *High level assessment of the different approaches*

It is our view that a RAB-based approach for NR28 and beyond would best reflect customers’ interests, as it better matches the timing of the costs of the Airspace Design Service activities with the benefits accruing to customers from these activities. That said, we recognise that as an interim measure an opex with margin approach could be more straightforward to implement and more proportionate given the small number of years involved.

As such, we recommend that the CAA adopts an opex with margin approach for the remainder of NR23, and from NR28 onwards, a RAB-based approach.

#### *Appropriate level of an operating margin*

The CAA is right to recognise that NERL will face risks in relation to working capital, management time, reputational risk and risk of licence breach. However, the suggestion that these risks are appropriately compensated by a 1% opex margin is not plausible in light of current evidence.

NERL's NR23 cost of capital, when expressed in nominal terms, is in the region of 7%. This is calculated by converting the RPI-real WACC of 3.19% to a nominal rate, using the Fisher equation and an RPI inflation rate for the remainder of NR23 of 3.9%<sup>3</sup>, resulting in a nominal WACC of 7.2%. This is the rate that the CAA should be using when assessing the cost of NERL funding working capital related to the Airspace Design Service from within an opex margin.

It is reasonable to assume that the average working capital balance associated with Airspace Design Service activities would be in the region of 3 months' ADS charges. In such a scenario, the funding costs of that working capital would be significantly higher than the operating cost margin being proposed by the CAA. This is demonstrated by the illustration in the table below, that is based on a scenario where annual ADS-related costs are around £20m.

In this scenario, the working capital costs absorb all the 1% opex margin, and more beyond, and there is no expected return for management time, reputational risk and risk of licence breach. Instead, there is a negative margin (i.e. a loss) of 0.6%.

UKADS illustrative operating cost margin model scenarios					
£m, outturn		1% Opex margin		3% Opex margin	
Annual costs			20.00		20.00
Opex margin	A	1.0%	0.20	3.0%	0.60
Revenue			20.20		20.60
Working capital (3 months)			5.05		5.15
Funding cost (nominal WACC)	B	7.00%	(0.35)	7.00%	(0.36)
Profit/(loss) before tax	A+B		(0.15)		0.24
Tax		25%	0.04	25%	(0.06)
Profit/(loss) after tax			(0.12)		0.18
UKADS net margin			-0.6%		0.9%

The actual level of working capital is uncertain. However, the CAA's analysis fails to demonstrate how the 1% opex margin would compensate NERL for the working capital risk.

The scenario in the table above illustrates that when the opex margin is set at 3%, the Airspace Design Service net margin would be slightly under 1%. As such, at an opex margin of 3% the funding of working capital would not consume all the compensation for Airspace Design Service activity risks; namely working capital, management time, reputational risk and risk of licence breach.

If the CAA concludes that for the remainder of NR23 it is most appropriate to take the approach of **a margin on opex, then the margin should be set at 3%** and not 1% to allow appropriate consideration of the risks faced by NERL.

<sup>3</sup> Source: Oxford Economics, July 2025

### *Appropriate level for a return on a RAB*

The CAA's approach to assessing the level of return on a RAB during NR23 ignores two fundamental facts. Firstly, NERL would not be raising new debt and equity in NR23 to finance the Airspace Design Service. Instead, it would be being financed by NERL's existing capital. Secondly, there is no allowance within the proposed return for the risks associated with management time, reputation risk and risk of licence breach.

Given that the Airspace Design Service would be being funded by NERL's existing capital, the proposed 3% return on a RAB would lead to an NPV loss for NERL, even before any consideration of the other ADS-related risks.

We are not necessarily against consideration of a discrete cost of capital for NR28 for each of the UKATS, Airspace Design Service and Oceanic businesses, but if CAA is minded to adopt such an approach, then detailed analysis would need to be undertaken of the risks and funding of those businesses.

Our recommendation for the NR23 period, were the CAA to take a RAB-based approach, is that it allows a margin of 1% on the Airspace Design Service costs and then applies a return on the RAB that is commensurate to NERL's prevailing cost of capital, or for simplicity, adopts a **cost of capital for the ADS RAB, of at least 5% CPI-real**<sup>4</sup>. This would represent NERL's NR23 cost of capital expressed on a CPI-real basis, plus additional return to reflect the risks associated with management time, reputational risk and the risk of licence compliance.

## 5.4. Charge design

### 5.4.1. CAA Initial Proposals

The CAA proposes that:

- > the Charge should initially be payable by airspace users in receipt of en route air traffic services in the UK Flight Information Region;
- > NERL should decide how the Charge will be collected from users; and
- > the Charge should be on a "per service unit" basis.

### 5.4.2. NERL response

We agree with the CAA on definition of charge payers (airspace users in receipt of en route air traffic services in the UK Flight Information Region).

We agree that the Charge should be on a "per service unit" basis.

We welcome the CAA's proposal that NERL should decide how the Charge will be collected from users. We are continuing discussions with Eurocontrol Central Route Charging Office, of which the CAA is aware, around the structure of the Charge, i.e. if this should be included within the existing en route charge but identified as a specific Airspace Design Service cost item, or as a completely separate charge from en route. We will continue to engage with Eurocontrol on the practicalities

<sup>4</sup> For reference, RPI-real WACC of 3.19% is equivalent to CPI-real WACC of 4.2%, using forecast RPI 3.2% and CPI 2.2% for remainder of NR23 (source: Oxford Economics, July 2025)



of establishing an effective and cost-efficient charging mechanism and will keep the CAA informed.

## 5.5. Illustrative charges

### 5.5.1. CAA Initial Proposals

The CAA includes illustrative Charges, using the medium cost estimates. From a comparison of the two charging methods, the RAB-based approach provides the lower average charges over a 10-year period, however, this approach also leads to an accumulation of a RAB which would need to be depreciated and recovered via charges on users over a longer time period. The CAA compares the approaches via an NPV calculation over the Airspace Design Service assumed lifetime, using a 3.5% CPI real discount rate which purports to measure the time preference of passengers. This shows that the NPV of the opex margin approach (£168m) is similar to that of the RAB approach (£170m).

### 5.5.2. NERL response

Our previous comments regarding the high degree of uncertainty around current cost estimates apply here as well. We will be unable to provide any greater clarity and/or certainty around future costs until the nature of Airspace Design Service activities is more clearly set by the context of the airspace policy and regulatory guidance consultations due later this year.

We remain of the view that the CAA should consider the charging options (opex margin versus RAB approach) principally through the lens of NERL financing, as it is required to do so by its statutory duties. It could also consider the implications for the direct users of the Airspace Design Service, namely commercial airlines. The relevant discount rate in that case for NPV calculations would be airlines weighted average cost of capital. This is currently estimated by IATA<sup>5</sup> to be 8.8% in 2025, equivalent to 6.7% CPI real (at 2% CPI), nearly double the rate used by the CAA. Accounting for airline customers' commercial interests would produce a lower NPV for a RAB approach, under which cost recovery is made over an extended period

<sup>5</sup> IATA, Global Outlook for Air Transport, June 2025