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**British Airways response to CAP3164 “Final proposals for modifying the Licence to support the implementation of a UK Airspace Design Service”**

Thank you for the opportunity to respond to the CAP3164 consultation on “Final proposals for modifying the Licence to support the implementation of a UK Airspace Design Service”. We set out below our views and areas of feedback.

**1. Approach to costs of the new airspace design services**

- 1.1. We **support the adoption of a cost pass-through approach for the remainder of NR23** to provide an appropriate balance between enabling the timely establishment and initial operation of UK ADS with the confidence to recover its efficient costs.
- 1.2. **The CAA should set clear direction to establishing a determined cost approach as part of the regulatory review for NR28**, representing the soonest reasonable opportunity. This would appear to allow sufficient evidence on the cost of operation and for the scope and obligations of the UK ADS to be established for the CAA to include the UK ADS in its determined cost approach as utilised for NERL’s other regulated businesses and present a stronger cost efficiency incentive on NERL. As part of the review for NR28 as to the future regulatory approach for the UK ADS, it appears appropriate that the adoption of a RAB approach is assessed further.
- 1.3. **The diminished incentive for costs to be incurred efficiently as a result of adopting a cost pass-through approach for the remainder of NR23 needs to be addressed further with stronger safeguards provided.**
- 1.4. **We are highly concerned that the CAA has included provision for a pre-determined operating cost margin allowance. Fundamentally, a regulated monopoly should not receive financial inducement to undertake its licence obligations**, especially when an operating cost pass-through approach is proposed.
- 1.5. Furthermore, **the figure proposed is derived from highly uncertain determining factors**, notably the extent of working capital required with cost estimates uncertain as well as the duration of any working capital to cover the time lag between cost realisation and revenue receipts. **Changes to these parameters would materially impact the working capital costs incurred by NERL** in its



administration of the UK ADS activities and serves as a distinct opportunity for windfall losses or gains to be generated.

- 1.6. We note that **the timing of the charge collection is an undefined element of the CAA's proposals and that whilst NERL has indicated a 3-month period as apparent, this is yet to be consulted on with stakeholders and is unconfirmed.** Collection via the CRCO would present the most apparently suitable methodology and we look forward to engaging with NERL to agree an appropriate solution. If the CRCO collection methodology or comparable timing basis is adopted as the collection mechanism, then the CAA should consider maintaining consistency with its approach to working capital as utilised for NERL's other regulated activities and the application of any appropriate elements of the Eurocontrol Principles to the extent that the CAA needs to be mindful of its international obligations.
- 1.7. Within the CAA's proposed approach, the aiming up of the margin allowance is inappropriate. **The CAA's proposed overall margin figure of 2.0% does not appear to have robust justification and is not itself linked to any evidence to justify the exact amount of additional allowance** proposed beyond that of covering the estimated working capital cost at 1.1%.
- 1.8. Additional allowance beyond actual working capital costs present the potential to act as a perverse incentive against costs to be incurred efficiently under a cost pass-through approach, eroding the effect of any efficiency incentive that may exist.
- 1.9. Any financial allowance should be reflective of the risk faced by the undertaking of the licenced activities, the CAA has repeatedly outlined it will be proportionate and multi-staged in its approach to any licence obligation breaches by NERL in regards to UK ADS, in combination with the fact that a cost pass-through approach is proposed including coverage of working capital costs, we consider the risk faced by NERL is minimal to negligible and any cost of finance considered should reflect this. **We support the CAA's assessment that NERL's NR23 WACC is not the appropriate rate** to reflect the apparent short-term financing costs required, which would be appropriate to be reflected as a cost of debt only. **We ask the CAA to further assess its approach to enabling the recovery of efficiently incurred working capital costs for the needs of the UK ADS and UK ACS for the remainder of NR23 without creating the opportunity for windfall gains or losses.**
- 1.10. The CAA should place the requirement on NERL to include its working capital finance costs as a category in its cost reporting for UK ADS. This will support transparently furthering the evidence base available to the CAA and stakeholders in setting any potential future working capital cost allowances for the UK ADS and minimise the risk of windfall losses or gains arising for this cost category.

## **2. Licence Approach, Obligations and Scope**

- 2.1. We **support the intention of introducing the new entities**, known as the Airspace Design Service ("UK ADS") and Airspace Co-ordination Service ("UK ACS"), to design and deliver a modernised airspace for the LTMA and complete the residual ACOG functions for the non-LTMA clusters across the rest of the UK.
- 2.2. Modernising the UK's airspace is critical to supporting economic growth, reducing delays, and improving environmental performance. There is a clear and compelling need for the entire UK



network system to be modernised to deliver the transformative change that is required to enable UK airspace to meet the challenges of increased traffic in the 21<sup>st</sup> century. Without urgent reform, delays are forecast to worsen significantly, with a greater than five-fold increase to delays from a 28% increase to traffic in the LTMA by 2040<sup>1</sup>, threatening consumer experience and the wider economy.

- 2.3. The direction and establishment of the obligations for the UK ADS and UK ACS from the Secretary of State place clear and time specific requirements on NERL to deliver modernised airspace for the LTMA by 2035, **we support this clear and transparent requirement to ensure appropriate focus is applied to the delivery of a specific delivery deadline.** Furthermore, we support the focus applied to drive the delivery of modernised airspace for the LTMA to be completed before 2035, prior to the commencement of operations from a third runway at Heathrow Airport. **The modernisation of the LTMA airspace, through a singular design, is a critical prerequisite to expansion at London Heathrow** and is further heightened in importance when other London airport expansion plans are considered for their effects on traffic growth within the LTMA.
- 2.4. However, **a vital policy step is to recognise that airspace modernisation is needed regardless of the progress or approval of any airport expansion plans.** Airspace must be modernised, with the clear priority being established for the timely delivery of a modernised LTMA, with the consideration that new runway or airport infrastructure generating incremental traffic growth would be enabled by the new airspace structure. The timeline in determining airport expansion plans must not be an excuse to hold back airspace modernisation.
- 2.5. We urge that the requirement to deliver airspace modernisation beyond the geography of the LTMA is not disregarded or excessively diminished in its prioritisation for delivery. We encourage that opportunities to progress and deploy the non-LTMA clusters remains a conscious requirement for NERL, forming part of the UK's airspace modernisation roadmap or adopted approach in place of the Masterplan, recognising any delivery trade-offs between ACP cluster work that becomes apparent should be consulted on with stakeholders including commercial airlines. Any prioritisation or trade off decision between supporting and, or deploying differing ACP clusters should be transparently evidenced and justified.
- 2.6. We are concerned that the approach adopted creates an apparent over reliance on direction from the co-sponsors, CAA and DfT, in establishing and administering the required deliveries and assessment of deployed methodologies via high-level licence terms and obligations. This continues to appear to present risks of diminishing an appropriate due requirement for future stakeholder consultation and the opportunity for stakeholder representation on critical matters.
- 2.7. The establishment of the licence needs to strike the appropriate balance between providing sufficient direction and focus to ensure the new service delivers the required outputs in the short and medium term and is positioned to do so in an efficient and cost-effective manner.
- 2.8. We envisage there will be developments required to the scope and obligations of the Airspace Design Service in the long term, as an example but not envisioned to be limited to, the form of addressing the airspace design needs emergent from new users such as eVTOL and drone operators. At such point in time that these considerations would be appropriate for undertaking by the UK ADS or UK ACS, it would seem appropriate that statutory consultation is undertaken to

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<sup>1</sup> [UK Airspace Change Masterplan Iteration 2, version 2.2](#)



adjust the scope, obligations and as appropriate the charging arrangements to ensure the ICAO User Pays Principle applies.

### **3. Consequential modifications to the Licence**

- 3.1. We support the proposed additional accounting requirements under Condition 6 and Condition 7 to enable the separate, transparent assessment of the financial position of NERL's En Route, Oceanic and ADS businesses. The update of the regulatory accounting guidelines to sufficiently and transparently address any transactions between NERL's business units, for example in the requirement for the use of simulators or resources, would appear a reasonable requirement.

### **4. Governance arrangements**

- 4.1. The guidance for the establishment of structures, Terms and Reference and governance regarding the multiple bodies and functions including the Advisory Board and stakeholder engagement appear to hold excessively diminished requirement for involvement and consultation of operators, with an excessive reliance on NERL establishing critical elements with minimal necessary input from stakeholders.
- 4.2. We support the creation of the Advisory Board but remain sceptical of the extent of its true ability to act as a point for stakeholders to appropriately influence and provide input based on their extensive knowledge.
- 4.3. We are concerned at the lack of escalation point available to any party that would wish, and holds a meritorious case, to be a member of the Advisory Board should NERL not grant it membership. It would appear appropriate that in the establishment of the Advisory Board, the co-sponsors guarantee an appropriate proportion of membership is afforded to commercial airlines. Subsequent to initial formation, any membership should be considered by the Advisory Board as a whole rather than dependant on a sole party's consideration.
- 4.4. From the CAA's proposals we are also concerned that there is a lack of requirement for stakeholders, especially commercial airlines, to be consulted on the establishment of the structure, Terms of Reference and membership of the Advisory Board. The proposal currently relies on the co-sponsors review alone, which we do not deem appropriate. The CAA should set the requirement for stakeholders to be consulted by NERL in establishing these elements.
- 4.5. We reiterate our previous consideration that commercial airlines, as the funding source for UK ADS and UK ACS as well as being the predominant operators of airspace, should be far more integrated into the decision making and governance structures of the UK ADS, UK ACS and wider diaspora of Airspace Modernisation boards and groups.
- 4.6. Whilst the details of the Advisory Board are to be devised, it is critical that operators are suitably consulted in its formation and are sufficiently represented on the Advisory Board.
- 4.7. We request greater detail be shared on the governance, representation, roles and accountabilities of the varying groups. This should be transparently presented in relation of the proposals for the UK ADS and UK ACS functions.

### **5. The Airspace Design Support Fund**



- 5.1. We support the adjustment to the role of UK ADS in regards of the administration of the Airspace Design Support Fund and support the proposed approach and role to be undertaken by the identified parties detailed in the CAA's Final Proposals.

## 6. The UK ACS

- 6.1. We support the UK ACS consuming the residual functions currently performed by ACOG and the additional clarity provided regarding the geographic scope of the function. It will be essential experiences from ACOG, including establishment and governance, are captured and any identifiable improvements adopted to support the new UK ACS function deliver its requirements.
- 6.2. A clear ring fence both operationally and financially should be ensured between the UK ADS and UK ACS functions to ensure transparency in deliveries and cost association.
- 6.3. The repurposing of the ACOG funding provision within the NR23 price control provides a simple and proportionate approach to funding the new licenced activities to be undertaken by NERL and avoids the need to reopen NR23. However, we question how the differences in roles, with the ACOG functions falling to UK ACS being diminished, are reflected in the approach proposed by the CAA and associated cost allowance for the UK ACS. We would welcome further clarity to be provided as to the cost differentials and the associated source of their generation to be set out by the CAA in its Final Determination to enable stakeholder scrutiny as to whether the wholesale repurposing of the existing ACOG allowance is in fact justified. It could be appropriate for the CAA to take account of any cost requirement differential and we note that it is not necessarily required to redirect the existing ACOG funding provision to UK ACS specifically in part or whole and could be considered to provide funding towards the UK ADS and UK ACS cost totality.

We look forward to engaging further on the development of the proposals and related consultations. Please feel free to approach us with any questions on our response to this consultation.

Yours sincerely,

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