IATA submission in response to the Commission for Aviation Regulation “Issues Paper” on Maximum Levels of Airport Charges at Dublin Airport

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This submission presents the response of the International Air Transport Association (IATA). IATA's mission is to represent, lead and serve the airline industry and brings together some 240 member airlines comprising 84% of the global air traffic.

IATA welcomes the opportunity to provide comments to the Commission for Aviation Regulation on regulatory policies, methodologies and data sources to be used in the next determination on charges at Dublin Airport.

Please find below our responses to the questions raised by the CAR in the paper.

Approach to regulation.
What changes, if any, should be made to the approach to regulation that the commission adopted in 2009?

1) What should be the duration of the next determination?

- In order to provide the adequate incentives for outperformance, a long regulatory period is needed. In this regard, we support implementing 5-year periods for setting charges.

2) Should he DAA face incentives to beat efficiency targets?

- In the absence of competition, incentive regulation (via the implementation of price caps) is the "second best" solution. The implied incentive would be that DAA would get the rewards from outperformance (and assume the costs if it does not reach its targets).
- In order to this approach to work it is necessary that the CAR sets challenging efficiency targets.

3) How should risk be treated? What cost and demand risks should the DAA have to assume?

- We consider that the current setup should be maintained. DAA should face traffic risk. Otherwise, airlines would not only face their own traffic risk, but also the airport's traffic risk.
- The DAA should also face the cost risk. Otherwise, incentive regulation would not exist.
- It should be noticed that the DAA is already being compensated for these risks via the allowed cost of capital.

Passenger forecast issues.
What is the appropriate approach we should adopt for making passenger forecasts at Dublin airport?

4) What information should a traffic forecast model for Dublin airport include?

- A combination of a generic (simple approach) with a more specific route analysis might be the best solution. However, inputs from airlines are a must, particularly when two airlines hold a significant proportion of the airport's traffic.

- Probably the most important variables to take into consideration include GDP (Irish, UK, US) and oil prices. The significance of these variables should be able to be determined by simple statistical analysis. There should not be a great number of variables, as that could make the model meaningless.

5) Which strategies should be adopted to deal with uncertainty in traffic forecasts?

- As answered in question 3, traffic risk should be borne by the airport. However, there could be thresholds which could reset the calculation of charges when there are significant changes in traffic (i.e. when traffic is above/below 10% of the assumed forecast).

- It is difficult to have a situation in which the DAA would be unbiased. Unless such forecasts are agreed with the airline community, it should be responsibility of the CAR validate such results (and decide whether the CAR itself should carry out its own analysis).

6) What forecast methods and external data sources should we consider?

- The CAR should consider GDP figures from the IMF, Governmental sources and other respected private forecasts. The CAR should apply its judgment in deciding which final figure to use.

Operating expenditure issues
What allowance should we make for operating costs at Dublin airport after 2014?

7) How significant are economies of scale? How might the efficiency frontier shift in response to changing passenger numbers?

- In an industry in which large investment costs are required (a runway, a terminal, etc) there is scope for economies of scale once the asset is better utilized. Although this applies to a higher degree when dealing with capital costs (i.e. depreciation), this should also apply to a certain degree to operating costs, as some of these costs are linked to the size of the asset, rather than traffic (maintenance, energy, cleaning, etc.). In this regard, the frontier, on a per passenger basis, could shift.

8) What is the potential for "catch up" by the DAA so as to realize efficient operating costs?

- The CAR should determine the catch-up factor by using the methods that have been described in the paper (i.e. a combination of bottom up and top-down approaches). However, the CAR should review why there was a significant difference between the operating expenditure assumptions in the last determination and the actual operating expenditure reported by DAA (and amend its bottom up approach accordingly).

- As well, measures such as total factor productivity should also be taken into account as a measure to recognize the frontier “shifts” over time.

9) What measures, such as rolling schemes, should be adopted to change the incentives for the DAA to realize efficiency gains?

- The underlying idea behind rolling incentives is to encourage the regulated company to also outperform on the latter years of the regulatory period. From this point of view, rolling incentives might be an acceptable regulatory tool. However, it is imperative that challenging efficiency target is set. Otherwise, rolling incentives would just prolong any windfall gains for the airport due to soft targets (i.e. there is a significant difference between the existing determination forecast and actual operating expenditure, which bring some doubts on whether these targets were really challenging).

- If rolling incentives are applied, we favor option 2.

Page 46, commercial revenue issues
What assumptions should we make about commercial revenues at Dublin airport after 2014?

10) What relationships between passenger numbers and commercial revenues should we assume? Are there other factors that are significant?

- In principle, there should be a positive correlation between traffic growth and the increase in commercial revenues. This assumption should be maintained by the CAR. However, some adjustments might be necessary after understanding the "passenger mix" at the airport. For instance, if the overall share of passenger flying on low cost airlines increases, it might be possible that commercial revenues, on per passenger basis, decreases. The CAR would need to verify first if such an assertion was true.

11) Aside from outturn data at Dublin airport, what information should we look at before forecasting future commercial revenues?

- There is published information of revenue/passenger for a number of airports worldwide (i.e. Leigh-Fisher). The CAR should be able to use this information as an additional input when forecasting commercial revenues.

12) For what categories, if any, should we change the incentives for the DAA to maximize commercial revenues? How?

- We do not favor rolling incentives on commercial revenues.

Capital costs issues
What return on and return of capital should we permit?

13) What level of investment would be appropriate for the next four-plus years at Dublin airport?

- The level of investment should be decided after consultation with users. If no agreement can be made, it should be the responsibility for the CAR to determine the appropriate capital expenditure allowance.
- Care is needed when profiling the investments. Profiling should be based on when the capital expenditure is needed. Otherwise, if too much capital expenditure is allowed at the beginning of the period, the airport might be incentivized to delay those investments towards the end of the period (as that would allow the airport to enjoy from "free" depreciation and cost of capital allowances due to the timing differences). A solution could be to implement an adjustment to the price cap formula if capital expenditure is not delivered on time.
- We favor triggers for large capital investment projects.
- Aggregation: The difficultly that we found from aggregation is that it is not possible to measure outperformance/underperformance. It might be necessary to budget on a project by project basis. If there was a change needed throughout the period, then this should be agreed with the airlines.

14) Given previous regulatory commitments and outturn investment levels, what should the opening RAB in 2014 be?

- It should not be enough that the overall level of capital expenditure is in line with the allowance in the determination. The CAR should disallow from the RAB elements in which is confirmed that there has been underperformance in the delivery (i.e. if the T2 was EUR 150 higher than expected due to underperformance, it is not fair to reduce capital expenditure at other projects. That would imply "cutting corners", and this is not something that the CAR would like to pursue.
- In order to determine the opening RAB we fully support the process described by the car on slide 50 (scenarios 1 to 7)

15) What is an appropriate cost of capital to allow?

- The appropriate cost of capital should reflect the low risks that an airport, as a monopoly, bears.
- We support the methodology used by the CAR in the past for determining a return (WACC, CAPM, etc).
- We support the usage of UK gilts and German bonds (as latter being the "safest" bond in EUR denomination) for the assessment of the risk free rate.
- We support the inclusion of a debt premium. The CAR maybe should revise whether a BBB rating is acceptable enough, or if whether a "BBB+" or a "A-" rating could be achievable. This clearly has an influence on the amount allowed for debt premium.
- We do not support the usage of "embedded" debt, as that would significantly lower the airport's incentives to be minimize the interest rate it pays (i.e. if a bond is sold at a high interest rate, even if the airport lose out during that determination, the airport would be guaranteed that an automatic adjustment in the next determinations).
- We do not believe that airports have become "riskier" since the last determination. For DAA, this can be seen from the healthy financial ratios it has (despite the fact that Ireland has been in a very difficult economic situation).
- We support the theoretical approach for adopting a gearing ratio, as that would be consistent with the minimum credit rating assumed.

Financial viability issues
What is the appropriate approach we should adopt to assess financial viability of the DAA?

16) Has the DAA's financial position changed significantly since 2009?

- Based on the information presented in the Issues paper, it is clear that DAA's financial viability is improving. This is reflected in the improvement of the DAA's credit rating from BBB Neg to BBB stable. As such, we do not see any reason for charging airport charges to adjust for financial viability (i.e. via accelerated depreciation).

17) How should financially viable operations at Dublin airport be enabled?

- In principle, we do not believe that adjustments should be made for "financial" viability. An airport is rewarded for its risk via a cost of capital. The airport's owner should be responsible for correcting any viability issues that have been caused by financial mismanagement (i.e. via equity capital increases) rather than via airport charges.
- We believe that financial viability should only be assessed from a Dublin airport's operations perspective (i.e. as a standalone business) and not the group. It would be unfair to make adjustments to airport charges due to any mismanagement/increased risk from unrelated ventures.
- We do not believe that risks should be reduced to make the company more financially viable (as these risks will automatically need to be "transferred" to users). If the CAR continues looking at this path, then it should also reduce substantially the cost of capital being assigned to the airport (i.e. compared to that allowed in the previous determination).

18) What developments in the financial markets, if any, might be relevant?

- No comments at this moment.

Page 80, quality of service issues
How should we treat service quality when making a determination for Dublin airport?

19) What service quality targets should be set for the DAA?

- There is room for tightening the securing targets. A 20 minutes target might be necessary in order to ensure that passengers arrive on time at the gate (instead of the existing 30 minutes).

- As well, and additional security measure could be considered in order to encourage that, on the majority of the time, security queues are much lower (i.e. 5 minutes 95% of the time).

20) What aspects are important when thinking about service quality at Dublin airport and how might they be measured?

- No comments at this moment.

21) What link should there be between service quality and the price cap

- The current price cap adjustment (up to 4.5%) could be higher (in Heathrow and Gatwick it is up to 7%) in order to maintain adequate incentives to meet all targets.
- We support the view that there should only be penalties (via lower caps) should DAA fail to meet its Service Level targets.
- We do not believe that there should be bonuses for meeting the targets. By definition, the price caps should already allow DAA to reach those targets. Also, the CAR should note that outperformance might not be desirable, as that could imply unnecessary/expensive investments being made for very little gains.

Other issues
What other factors should we consider, and how, when making the 2014 determination?

22) Should we require differential pricing?

- Differential charges could only be justified when there is a genuine difference in the level of service being provided (i.e. boarding bridges). Moreover, any differential should be cost related. Finally, it is imperative that access to the facility (that has such differential charge) be made available to anyone that wishes use it (i.e. no discrimination via the utilization of restrictive conditions of use).

- We do not favor the implementation peak charges as that would not affect airline behavior (scheduling issues, passenger requests). If the a peak charge is being proposed on the basis the additional capacity it would generate, the CAR should also take into consideration the commercial revenues that such type of airlines/passengers would generate at this particular time (i.e. it would be unfair to introduce peak charges for some users, when all users benefit from the commercial revenues that are generated at this moment in time).

23) How should Shannon airport's separation from the DAA Group affect our determination?

- No comments at this moment.

24) Are changes needed to the price cap formula or the way that we ensure compliance?

- The formula looks acceptable.

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