Commission for Aviation Regulation Paper 3/2020

Dublin Covid-19 Price Regulation Response

IATA Submission - 18 August 2020

IATA appreciates the opportunity to respond to the Commission for Aviation Regulation's consultation on the appropriate response to the impact of Covid-19 including the options being considered with regards to the current price determination.

IATA appreciates CAR's proactive stance in addressing some of the unprecedented challenges posed by Covid-19; but also believes that decision-making would be further aided by gaining clarity on the State's plans with regards to implementation of the Aviation Recovery Task Force recommendations published on 10th July, particularly:

- The prospects for greater government support for the industry through a direct government "rebate directly to the airlines of all Dublin Airport charges and air navigation charges paid by the airlines."

IATA's response to each of the questions posed by CAR are answered in turn below.

1. ***Does the current situation resulting from COVID-19 represent substantial grounds to review the 2019 Determination?***

We see that the Commission has indicated that its charges determination allowed for a reasonable degree of deviation from ex-ante forecasts. Our response is built on that basis.

If we analyse 2020 as a standalone year, it is difficult to argue that the deviation in that particular year wouldn't be unreasonable. However, the "reasonableness test" should only be carried out in the context of the full regulatory period and not just on what happened in part of it. Since there is not enough information yet that could help us determine in a more confident manner how traffic will develop over the rest of the period, it may be too soon to trigger an interim review now. This is further discussed question 3.

2. ***Is a narrow, targeted review in 2020 required to address some immediate unintended consequences of the pandemic as discussed in Section 3 Option 2?***

It may be useful to review regulatory elements that will not serve their intended effect, such as:

- The elimination of the T2 Box 2 allowance, since the passenger threshold will not be achieved at least until 2023.
- The elimination the commercial revenue rolling schemes for the reasons highlighted by the Commission (noting as well that IATA opposed to the implementation of such incentives).

We are not yet convinced that there is a need to amend the rebate mechanism. As the CAR rightly comments, the optimum response of an operator in competitive market would be to lower its prices to stimulate the demand. Since we have not yet seen any reductions in charges, the rebate mechanism may need to be maintained.

Still, we would appreciate for the CAR to further elaborate on why it would be better to carry out a narrow review in 2020 instead of including these elements within a potential future wide-ranging review.

a. ***What is an appropriate timeline for such a review? Our current thinking would be to complete it by the end of 2020.***

If the CAR decided to go ahead with the targeted review, the proposed timeline should be possible. We would appreciate though for the CAR to further explain how this targeted review would work in parallel with the consultation process on charges for 2021.

b. ***What elements should it address?***

Please see above.

3. ***Is a more wide-ranging interim review required which would redetermine the regulatory settlement for the later years of the determination? What are the key developments over the coming months which might indicate whether such a review is required?***

   a. If deemed required, what are the key reasons, for example:

      i. Are the risk allocations within the 2019 Determination insufficient to deal with the impact of the collapse of traffic due to COVID-19?
      ii. Should the passenger target be revisited?
      iii. Should the operating costs and commercial revenue targets be reassessed?
      iv. Should the cost of capital be reassessed?
      v. Is a reassessment of the capital investment plan for the current period required?
      vi. How should we assess financial viability?
      vii. Should we amend the quality of service regime?

Working on the basis that the CAR has indicated that its determination allowed for a reasonable degree of deviation from the ex-ante forecasts, then logically an interim review could be considered when deviations become unreasonable.

As previously mentioned, we consider that the test of reasonableness should be made on the basis whether significant deviations will be consistent throughout the regulatory period and not just on one/two years as the latter could lead to unfair outcomes, since the overall levels of traffic throughout the period could still be within the bounds of reasonableness[1].

To the extreme, it is possible that a wide-ranging interim determination is made for the remainder of period and then be in a situation in which the airport "outperforms" on traffic numbers for that period (and therefore keep the outperformance) but at the same time

[1] To put this in context, in the 2014-19 regulatory period there were around 30 million (25%) more passengers than what was assumed in the determination over the full period (representing an additional year of passenger traffic). This additional number of pax was considered reasonable as no interim review was triggered on that situation, allowing DUB to keep the outperformance.

underperform against the traffic forecast that was made in the original determination. Therefore, **it is too soon to make any decisions for interim reviews based on traffic.**

If, despite the above, the CAR continues to believe that an interim review is needed on the basis of traffic deviations being beyond reasonable (and resets the baseline of the traffic forecasts), then as a matter of consistency the CAR will need to review most of the building blocks affected by the adjusted levels of traffic (e.g. if a lower level of traffic is assumed, compared to the forecast made in the original determination, then this should be followed by a revised, lower, operating cost).

The CAR may also need to update some of the studies is carried out for the 2020-24 determination. This is because the pandemic has forced airports to show how "variable" their costs can really be in a downturn traffic scenario. An updated study could compare the measures taken by DUB to reduce opex during COVID against measures taken at other airports. This would help in determining an efficient baseline level of costs (which may not be the same as that determined in the original studies).

We also see that the CAR is making references to the costs of COVID health related measures. The CAR would need to ensure that passengers are not charged for health measures that should be borne by the State (as stated in Article 40 of WHO's International Health Regulations 2005)

Several considerations are needed when analyzing the cost of capital, and we would welcome the opportunity to discuss with the CAR this subject in more detail. Some initial considerations are described below:

- While recent market data will show that asset betas have increased over the past weeks, this does not mean this will represent "a new normal" since not enough time has passed to consider this a trend. Longer term views are necessary.
- The interim review will be for a shorter period (e.g. 3 years) and therefore the risk for deviations will be lower. This should be reflected in a lower beta.
- If the CAR considers some form of risk from the airport towards users (through the implementation of some risk sharing mechanism), then that should be immediately reflected in a lower WACC.

It is possible that revised assumptions on the building blocks could put pressure to increase charges. In this regard, the CAR may also consider using regulatory depreciation (e.g. push back depreciation to the following period) to avoid any increases in price caps.

There is also the wider subject on **risk sharing** which could be further discussed if the CAR wants to explore this mechanism. Some initial elements for the CAR's consideration:

- Any risk sharing mechanism will need to be thoroughly consulted before the CAR decides to rebalance the current risk allocation
- While this is a potential alternative for dealing with uncertainty, it needs to be proven that it will be in the consumer's interest if it is applied (vis a vis maintaining the existing regulatory arrangements)
- Any changes in risk allocation (compared to the existing arrangements) need to be properly reflected on the allowed WACC. In other words, if risks are shifted to consumers, then the WACC should be significantly lower.
- The sharing mechanism would only be for 3 years, and therefore there is a need to consider whether it is worth implementing it (as previously mentioned, deviations from the baseline traffic in previous periods has been high and still deemed reasonable)
- Any result from the implementation of the risk sharing arrangements should not necessarily lead to increases in charges within the period (or even in an n+2 arrangement), as the CAR could be using different levels of regulatory depreciation (through ex-post adjustments on the RAB) in order to maintain a target level of charges that stimulates growth.

With regards to the **capital investment plan**, IATA believes that essential investments that retain airline backing, sustain the recovery of demand, and those related to safety, security, and regulatory compliance should proceed. All other capital investment plans should be assessed for their continued viability in the face of medium and long-term changes to demand and airline business strategies. This may require reprioritizing investments or changing their timelines or phasing. There may also be a case to continue projects where the cost of stopping is prohibitive or even bring forward certain works that are more cost efficient to deliver during a period of low operations.

The 2019 determination resulted in improvements to the **Quality of Service** regime. These should be retained and further enhanced in the future. The suspension of some aspects of the QoS program is understandable as accurate data collection has been impacted. The health measures themselves should be limited in duration and reviewed on a fixed schedule. There is a likelihood that they may be replaced with more effective and less disruptive measures as they become available. Therefore, changes to the QoS program would best be considered in the year 2021 when there is greater certainty on the health measures being employed.

b. ***What would be an appropriate timeline for this review ? Our current thinking is that such a review would be complete by the end of 2021 and would take effect from 2022.***

As discussed above, it may be too early to determine whether an interim determination is really needed, and therefore it may be prudent to wait for an additional year.

c. ***Should consideration be given to a revised period for the determination (e.g. ending in 2023)?***

This could be considered as an alternative to a wide-ranging interim determination.

4. ***Should the Commission examine new regulatory approaches or methodologies to deal with the exceptional levels of uncertainty resulting from the impact of COVID-19?***

The regulatory elements that could be considered/discussed have already been highlighted in the CAR's consultation document.

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