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Submission on Draft Decision on an Interim Review of the 2019 Determination (CP3/2022)

14 August 2022

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Dear Sir /Madam

Preface

For the year 2026, the Heathrow Airport passenger price cap set by the UK Civil Aviation Authority (CAA) will be £stg 26.31[1] (about €31.00). In Ireland, the CAR (Commission for Aviation Regulation) will restrict the Dublin Airport charge to €€8.48 for 2026, just 27% of the charge allowed at Heathrow. This means that Dublin Airport's income from airport charges will be capped by Irish law to about 27% of the level allowed to Heathrow Airport by the UK CAA. We should remind ourselves that the air passenger charge cap is a form of rigid price control on airport charges. The consequences of such rigid income restriction on Dublin Airport are already obvious.

Just a few months ago, Ryanair, the largest airline serving Dublin Airport, unapologetically set itself a target of zero net debt by 2024[2]. By contrast, the DAA group ended its 2021 financial year with a debt/equity ratio of 73%. DAA losses for the 2021 and 2021 came to €388 million[3]; and sure enough, its net debt burden climbed by just over €400 million to €835 million[4] in those two years; from a debt/equity ratio of 28% at the end of 2019 to a debt/equity ratio of 73% two years later. I understand that the debt burden is set to climb further to €948 million[5] at the end of 2022. While acknowledging that Dublin Airport (the regulated entity) is not the entirety of DAA, in terms of debt they are virtually indistinguishable.

At the same time Ryanair and Aer Lingus, the two largest airline users of Dublin Airport-a near duopoly[6]- make no secret of their attitude to risk for Dublin Airport. Risk is no problem to those airlines, provided of course that risk is on someone else's balance sheet. Ryanair's view is that "*the ideal capital structure should incorporate a greater proportion of debt financing which could shift the risk away from equity investors*."[7] So we should go back to relying on the bondholders, with the inclusion of a newly formalised promissory note!

Aer Lingus "*argues that due to its strategic importance, the Irish Government would not allow the airport to fail.*" What an interesting insight from big business into government thinking! No doubt those are the kind of views that went down well in banking boardrooms back in 2010.

[1] Reuters, June 28th. "UK to cut Heathrow charges after airline protests"
[2] Airfinance Journal, 16th May. "*Ryanair* plans to reduce this *net debt* to *zero* over the next two years, despite peak capital expenditure during that time."
[3] DAA Annual Report 2021.
[4] DAA Annual Report 2021. Page 130.
[5] CAR Draft Decision, July 22nd. Section 12.18.
[6] CAPA, 11 June 2015. "Near-duopoly at Dublin"
[7] CAR Draft Decision, July 22nd. Section 10.84.

Meanwhile Ryanair's average airfare is set to rise from €40 to €50 over the next five years[8], while the CAR is restricting the Dublin Airport price cap charge to a rise of €0.60 over the next four years, having already reduced the price cap from €10.50 in 2015 to €7.50 in 2020, as per the respective price determinations of those years.

I address the following issues in relation to the determination.

A. The price cap and the level of airport charges.
B. The debt level of DAA and of Dublin Airport.
C. Legislation and the financial viability of Dublin Airport.
D. The reliance on commercial revenues.
E. The Aer Lingus comments as reported in Sections 10.51 and section 12.50 of your report.

A. The price cap and the level of airport charges.

At the outset, it is important to state that the passenger price cap imposed by the CAR is a form of rigid price control on the income of Dublin Airport. The CAR is mandated by legislation to set a maximum price that the airport can charge per air passenger using Dublin Airport. This charge is collected by the airlines on behalf of the airport, as part of the ticket price charged to customers. The entire process is completely opaque as far as the travelling customer is concerned. Airport charges per passenger vary throughout Europe from about €8.00 to €30.00, with Dublin airport being at the very low end of the scale, €8.68 for 2023. In other words, Dublin Airport is being forced to operate on a much lower level of income from air charges that most other European airlines.[9] We have already seen that the Heathrow Airport charge will be £stg26.31 in 2026.

In 2015 the Dublin Airport price cap was set at €10.50 by the CAR. The CAR reduced the price cap to €7.50 for 2020, and for 2026 the CAR is proposing a price cap €8.48. This is close to a 20% reduction from the price cap level eleven years previously in 2015. Such a significant price cap reduction is predicated on passenger volumes continuing to increase, on continuing recourse to debt by Dublin Airport, and on a scramble for commercial revenues to fund operational costs and capital commitments.

But passenger numbers do not always increase as predicted. We have already seen the exceptional falls in 2020 and 2021. There have also been recessions where passenger numbers fell. At Dublin Airport, passenger numbers fell by 12.6% in 2009[10], and fell a further 10.1% in 2010[11], a fall of approx. 22% in two years. There is currently a war going on in Europe, a related energy crisis, and an environmental crisis, all pointing to the reality that the potential for a recession in the European travel industry is certainly not miniscule. If such an unanticipated recession does arrive, is the DAA again expected to further test its borrowing limits, or will be state be left to bail it out with further equity?

[8] Irish Times, 11th Aug. "Era of €10 air fares is over"
[9] Irish Times, Aug 12th: State can't keep 'squeezing the living daylights' out of DAA, departing chief says
[10] DAA Annual report 2010, five-year statistics.
[11] DAA Annual Report 2010, five-year statistics.

There is a simple reality here that should be kept in mind. Air travellers are the better-off citizens on the globe. Why should a strategic national asset like Dublin Airport be burdened with a severe debt load to fund air travellers? And why should Dublin Airport have such a drastic income cap strategy forced upon it for the benefit of the airlines. Whether the airlines pass on the price cap reduction to passengers can never be known. As stated, the process is completely opaque. The reductions were not necessary or desirable, in the context of the essential on-going funding required by Dublin Airport, and in the context of the reality that Dublin Airport had no formal contingency reserve for unforeseen events.

Ireland often likes to compare itself with Europe and with its nearest neighbour. Yet, from scanning the report, there is no comparative price cap table included that shows how Dublin Airport compares with other European airports. This is an unfortunate omission. The Irish Times reports that the outgoing Chief Executive of Dublin Airport[12] has claimed that Dublin Airport charges are 40% to 50% lower than that of other European airports. This is an exceptionally significant difference and, if accurate, surely calls for a table of comparison and an explanation as to why such a significant difference exists. In addition, I think the public would benefit from having such comparative information.

One further point is that the airport passenger charge is never visible on the airline ticket. I believe it should be mandatory to have the airport charge separately itemised on all airline tickets. I doubt that most of the travelling public are aware that a portion of their ticket cost, as charged by the airline, goes as income to the airport to fund its operations. They might be incredibly surprised at how little that amount is! Unfortunately, the entire process is completely opaque to the end customer. Lack of transparency is never a bright idea.

B. <u>The debt level of DAA and of Dublin Airport.</u>

At the end of 2021, DAA net debt stood at 73% of equity, having increased form 28% at the end of 2019; the €388 of losses[13] for 2020 and 2021 were clearly the major factor in increasing the debt level by over €400 million. The Centrus report commissioned by the CAR, and the CAR itself, seems to focus on proposing a debt level consistent with a credit rating of BBB+. Centrus do acknowledge that separating the regulated entity (Dublin Airport) from the DAA in terms of a credit rating is at best a theoretical exercise. [That, I believe, is an understatement and I question the value of any attempt to separate Dublin Airport from the DAA in terms of credit rating.]

Centrus also acknowledge that Dublin Airport benefits, in terms of its theoretical credit rating, by virtue of being a ‘government regulated entity (GRE)’ and Centrus further state that this GRE effect has been factored into its theoretical rating assessment. In other words, if the worst came to the worst, the government would not allow Dublin Airport to fail; a point well noted by Aer Lingus (see section on Aer Lingus comments).

[12] Irish Times, Aug 12th: State can’t keep ‘squeezing the living daylights’ out of DAA, departing chief says.
[13] DAA Annual Report 2021.

Frankly, I do not understand the focus, or the necessity, of pushing Dublin Airport towards its upper borrowing limit when planning for its future. The beneficiaries of such an approach are the airlines, who benefit from immediate lower airport charges. The method of passing on the lower airport charges to customers is entirely opaque. The losers are the DAA, a state-owned entity, in terms of its risk profile. The other losers are those people whose jobs are lost or whose hours are cut when business turns down. We have witnessed such cuts in relation to Dublin Airport staff during the pandemic.

There is also the matter of a significant continuing annual interest expense, running at €26 million for 2021 for the Dublin Airport regulated entity[14], equivalent to the full EBITDA of the Dublin Airport for that year. The interest expense is now running close to one tenth of operating costs for Dublin Airport. The interest expense now absorbs about 50% of the projecting income from parking fees. It would be useful if Dublin Airport put up a notice to that effect in all its car parks. Surely it is time to change the strategy away from reliance on borrowing to the limit.

I am in no doubt that the rising debt levels were a strong factor in the decision to introduce a voluntary severance scheme (VSS) programme at Dublin Airport during the pandemic. It is far too facile to say that Dublin Airport made a mistake in implementing a VSS, particularly when their losses combined with their debt levels pushed them in that direction.

From my perspective, the CAR and the Department of Transport must share a large amount of the responsibility for creating the financial conditions that led to the perceived necessity for the VSS personnel reduction. The consequences in terms of security queues, delays and cancelled flights flowed directly from the financial position Dublin Airport found itself in. It is hard to disagree with the assessment of Michael Lowry TD at the Dáil Transport Committee on June 1st, 2022, that *"nobody can put a price on the reputational damage done to both the DAA and the country in general. If you picked up* The New York Times *last weekend, you would have seen the international publicity the events at Dublin Airport got."*

Going into the pandemic period, Ryanair boasted almost €4 billion[15] in cash reserves. The DAA had cash of €228 million[16] at the beginning of 2020, and with losses of €284million [17] in 2020 that cash reserve simply was not adequate, at all. Why was it thought to be adequate and why was such a low cash reserve signed off on?

While the net debt/equity ratio may be considered old-fashioned in some industries, it is still a key indicator of resilience and financial headroom in any business. The other ratios, such as Funds from Operations/ Debt, or Debt/ EBITDA which are more favoured in the airport management industry become nonsensical in a loss-making situation. It is time to reinstall the debt/equity ratio at the centre of any assessment of the financial position of Dublin Airport.

C. Legislation and the financial viability of Dublin Airport.

[14] Dublin Airport Regulated Entity Accounts 2021.
[15] BusinessInsider.com, 11 April 2020. "Ryanair is among Europe's best-placed airlines to ride out the crisis"
[16] DAA Annual Report 2019.
[17] DAA Annual Report 2020.

The explicit deletion, in pending legislation (ANTB)[18], of the specific objective that the CAR "enable Dublin Airport Authority (DAA) to operate and develop Dublin Airport in a sustainable and financially viable manner" is a very worrying development.

Notwithstanding that the CAR believes that such an objective is "implicit" in its other objectives, there is already considerable blow-back to this view from Ryanair.

Ryanair is referred to in the draft decision (section 5.87) as arguing "**that the Commission should not infer that deleted objectives remain implicit in its decision making, and that the removal of the objective to ensure the financial viability of Dublin Airport is clear and should not take primacy over the interests of users, which it argues are clearly focused on lower costs."**

Contrary to the ministerial policy statement[19], issued in 2017 under the authority of Minister Shane Ross, and contrary to the belief of the CAR, it is clear from the comment that Ryanair do not view the deleted objective on financial viability as being either "implicit" (CAR) or "intrinsic" (Ministerial Policy Statement 2017). The words "implicit" or "intrinsic" are absent from the impending ANTB legislation. That is the reality of the written legislation soon to be enacted into law. It is worth noting that previous ministers sought to defend the inclusion of the financial viability objective in the legislation. One wonders why that view changed. It is hard to understand the raison d'etre or the impetus for the deletion of the objective.

Regarding the ministerial policy statement issued in 2017, the CAR states in section 5.51 that:

"First, the Policy Statement proposed that we shall no longer be mandated to have specific regard to the financial viability of Dublin Airport in making a Determination. The Statement adds that this is intrinsic in the primary objective of protecting the interests of current and future users."

Perhaps I misinterpret, but that reads as if the department of transport, in 2017, was already mandating the CAR to ignore a specific section of the law, for whatever reason.

Curiously, at a Dáil Transport Committee meeting just a few months ago, Dublin Airport has been referred to as a *"strategically important part of corporate Ireland"* [20]. It is unfortunate that the legislation will no longer explicitly mandate the protection of the financial viability of that "strategically important part of corporate Ireland."

Frankly, the deliberate removal of the previous legislative mandate, explicitly requiring the CAR to have regard to the financial viability of Dublin Airport, has now put that very financial viability into play. As far as the airlines are concerned, when demanding ever lower airport charges, the previous legislative underpinning has been explicitly removed and is no longer there.

[18] ANTB; Air Navigation and Transport Bill 2020.

[19] CAR Draft decision, section 5.50 and 5.51

[20] Dáil Transport Committee June 1st, 2022, Michael Lowry TD.

D. The reliance on commercial revenues.

Commercial revenues, which include income from shops, concessions, car parking, drop-off charges, rentals etc, are now forecast to average €290 million over the four-year period 2023-2026, rising to €318.8 million in 2026[21]. Commercial revenues will soon be at the level of the entire operating costs of Dublin Airport.

Crucially commercial revenues will exceed the income from airport charges in each year from 2023 to 2026[22]. It all sounds a bit like relieving the travelling public of their money by any means possible provided it does not come airport passenger charges. But as far as the travelling public is concerned, it is only a matter of which pocket you take the money out of.

In view of the significance of commercial revenues for Dublin Airport, one can empathise with the comment of senator Timmy Dooley at the recent Dáil Transport Committee meeting, that Dublin Airport seemed to him to be more like a "glorified department store"[23].

Again, the forecast, and clearly the push, is for ever increasing commercial revenues. This includes parking**, where "the target for car parking revenue is proposed to increase from €51.8m in 2023 to €64.1m in 2026"[24]** The increased car parking revenue will be facilitated through building additional car parks and increased car parking charges. The increased car parking charges and drop-off charges have already been heavily criticised, but given the enforced low passenger price cap, revenue needs to be found somewhere.

There have been other complaints at high prices in Dublin Airport. Journalist Kevin Doyle was none too pleased recently with the price of the light breakfast at Dublin Airport, as he explained on Twitter. *"Dublin Airport has sorted out the security queues - but breakfast is another story. No bacon, no pastries… and €18.65 for this gourmet selection."* The "gourmet selection" he referred to was photographed for the benefit of Twitter users. Gourmet, it was not. But again, revenues must be found somewhere, given the enforced low passenger price cap.

The CAR report should ideally have included a comparative table showing the relationship of commercial revenues to both airport charges, and to operating costs, at least for some European airports.

It also seems counter intuitive that commercial rents from excess property owned by the airport are being used to subsidise the actual costs of running the airport, thereby allowing lower passengers charges. Taken to its extreme, if Dublin airport owned built a new headquarters for prominent IFSC banks at the airport, would it be appropriate to use the profits from those rentals to subsidise the costs of air travel through Dublin.

E. The Aer Lingus comments as reported in Sections 10.51 and section 12.50.

[21] CAR Draft decision, section 3.2.
[22] CAR Draft decision, section 3.2.
[23] Dáil Transport Committee, June 1st, Senator Timmy Dooley "but it seems that the DAA is more interested in the retail offering and in operating as a glorified department store than in processing passengers."
[24] CAR report, Section 9.16.

The Aer Lingus comments, supporting a reduced cost of capital charge, as reported by the CAR in the section on Cost of Capital are worth repeating. In Section 10.51 you report that:

"Aer Lingus believes that due to the interventions by the Commission and the Irish government during the pandemic, the airport has been protected from global events and is now shown to be a less risky investment, and less susceptible to risk and shocks. It also argues that the Commission must explicitly show the impact on the WACC of any proposed risk sharing mechanism."

In Section 12.50, which deals with recovery of almost €400 losses incurred in 2020 and 2021, your report that:

"Aer Lingus is not in favour of loss recovery as it believes that since the Airport reaped the benefits of excess profits from traffic between 2015 and 2019 then it should also bear the downside risk. It also argues that due to its strategic importance, the Irish Government would not allow the airport to fail."

The comments by Aer Lingus project a cavalier attitude to the potential risk that the state might face in relation to Dublin Airport. The view that it is not necessary for Dublin Airport to recover its losses and that the taxpayer should suffer the burden of the losses is offensive. Those comments also indicate an attitude that risk is not really a significant issue for Dublin Airport, because the taxpayer will bail out the airport in a crisis, in the view of Aer Lingus at least.

The Aer Lingus comments are offensive to the integrity of the state. Aer Lingus should be asked to publicly withdraw those comments. Neither the Irish state or the Irish public purse should be taken for granted, or used as a patsy, just to accommodate the views of any organisation, no matter how large. Thankfully, the CAR rejected both propositions from Aer Lingus. But an apology is warranted.

The Aer Lingus comments taken together with the comments from Ryanair regarding financial viability no longer being implicit in the CAR objectives, make for unsettling reading. Those cavalier comments are the best arguments for explicitly retaining the financial viability objective in legislation.

Conclusion

The CAR should target a zero net debt strategy for Dublin Airport in the medium to long term, with substantial cash reserves to deal with any downturns or crisis. If such a policy is good for Ryanair, why is it not good for Dublin Airport. The alternative is to continue a policy of favouring airlines with ultra-low airport passenger charges, which are already far below those of other European airports.

Dublin airport, as well as Cork, Shannon, and Knock, are valuable strategic national assets. Their future financing should be secured, without reliance on, or recourse to, substantial debt levels. In particular, the balance sheet of Dublin Airport should not become an airport football, to be kicked ragged at the behest of its two largest airline users.

The exclusion of the financial viability objective from planned legislation is a major strategic mistake and bodes ill for Dublin Airport. Both Ryanair and Aer Lingus appear pleased that the financial viability objective is being removed. But, if one explicitly removes the requirement for financial viability, it is not convincing to say that the requirement remains “implicit” or “intrinsic” in other legislative objectives. It would be appropriate for the CAR to take legal advice on this issue because the CAR interpretation of the revised law has already been challenged by Ryanair in its submission.

In summary, I believe that the CAR has gotten the balance of interests wrong in this draft determination, and it also got them wrong in its previous 2019 determination. There is no doubt in my mind that the airlines are the big winners, and that Dublin Airport and the state are the big losers in both decisions.