DECISION OF THE

AVIATION APPEALS PANEL 2010

Established by Order of the Minister for Transport

4 March 2010

APPEAL OF DUBLIN AIRPORT AUTHORITY

AGAINST DETERMINATION OF

THE COMMISSION FOR AVIATION REGULATION CP4/2009

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1. THE DETERMINATION

1.1 The Commission for Aviation Regulation *("the Commission"*) published its final determination on airport charges at Dublin airport for the period 2010 – 2014 on 4 December 2009. The determination has effect from 1 January 2010.

1.2 The table below shows the maximum revenue per passenger Dublin Airport Authority (*"DAA"*) can collect at Dublin airport per the Commission's final determination CP4/2009:

	2010	2011	2012	2013	2014
Maximum revenue per passenger if T2 **not operationally ready**	€8.93	€8.11	€7.90	€7.70	€7.50
Maximum revenue per passenger if T2 **operationally ready 1st November 2010**	€9.32	€10.44	€10.23	€10.03	€9.83

1.3 The maximum revenue per passenger in 2009, under the previous determination, was €7.39 per passenger.

1.4 The above figures or "price cap" represents the maximum amount that the DAA can charge on a per passenger basis for each year between 2010 and 2014. The Commission has pointed out that it is open to the DAA to charge passengers less than this price cap and/or to charge passengers on a *"**differential basis** for the*

facilities that they might or might not want to use, subject to the constraints of competition law and ICAO rules"[1].

2. THE OBLIGATIONS OF THE COMMISSION

2.1 Section 33 of the Aviation Regulation Act 2001 (as substituted by section 22 of the State Airports Act, 2004) provides:

"(1) In making a determination the objectives of the Commission are as follows—

(a) to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport,

(b) to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport, and

(c) to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.

(2) In making a determination the Commission shall have due regard to—

(a) the restructuring including the modified functions of Dublin Airport Authority,

(b) the level of investment in airport facilities at Dublin Airport, in line with safety requirements and commercial operations in order to meet the needs of current and prospective users of Dublin Airport,

(c) the level of operational income of Dublin Airport Authority from Dublin Airport, and the level of income of Dublin Airport Authority from any arrangements entered into by it for the purposes of the restructuring under the State Airports Act 2004,

(d) costs or liabilities for which Dublin Airport Authority is responsible,

(e) the level and quality of services offered at Dublin Airport by Dublin Airport Authority and the reasonable interests of the current and prospective users of these services,

(f) policy statements, published by or on behalf of the Government or a Minister of the Government and notified to the Commission by the Minister, in relation to the economic and social development of the State,

(g) the cost competitiveness of airport services at Dublin Airport,

[1] *Per* 'press statement' published by the Commission on 4 December 2009, accompanying determination CP4/2009.

(h) imposing the minimum restrictions on Dublin Airport Authority consistent with the functions of the Commission, and

(i) such national and international obligations as are relevant to the functions of the Commission and Dublin Airport Authority.

2.2 Section 10(1) of the Aviation Regulation Act, 2001 empowers the Minister for Transport to *"give such general policy directions to ... the Commission as he or she considers appropriate to be followed by the Commission in the exercise of its functions"*. Subsection (2) goes on to provide that *"the Commission shall comply with any direction given under subsection (1)"*.

3. MINISTERIAL DIRECTION

3.1 By letter dated 27 October 2009, the Minister for Transport issued a Direction (*"the Ministerial Direction"*) to the Commission under Section 10 of the 2001 Act. The Commission was directed to:

"ensure that the Dublin Airport Authority's financial viability is protected in order to implement government policy on:

(a) The role of Dublin Airport as an international gateway for Ireland and its key strategic role in relation to air access, inward investment and general economic development;

(b) The desirability that Dublin Airport should have the terminal and runway facilities to promote direct international air links to key world markets, such as new and fast-developing markets in the Far East and the importance of ongoing and planned infrastructure development in this context;

(c) the development of Terminal 2 as quickly as possible as set out in the Government decision of May 2005;

(d) the operation of Dublin Airport Authority on a commercial basis without recourse to Exchequer funding or an equity injection by the State and in that context the need to secure lender confidence and raise debt financing on a cost efficient basis".

4. APPEALS:

4.1 Section 40 of the Aviation Regulation Act, 2001 provides:

> *"(2) The Minister shall, upon a request in writing from a person to whom this Section applies who is aggrieved by a Determination under Section 32(2) or 35(2), establish a panel ("Appeal Panel") to consider an appeal by that person against the Determination.*
>
> *(5) An Appeal Panel shall consider the Determination and, not later than three months from the date of its establishment, may confirm the Determination or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, refer the decision in relation to the Determination back to the Commission for review.*
>
> *(6) An Appeal Panel shall notify the person who made the request under sub-section (2) of its decision under sub-section (5)."*

4.2 The Establishment of the Appeal Panel:

The Minister for Transport received requests from 3 parties aggrieved by the determination of 4 December 2010 and by Order of 4 March 2010 the Minister for Transport established an Appeal Panel to consider the Appeals of: Aer Lingus; Ryanair and DAA against the Determination published as Commission Paper (CP4/2009).

4.3 The Appeal Panel members are: Michael Durack S.C. (Chairman); Professor George Yarrow and John Butler CPA.

5. PROCEDURES FOLLOWED BY THE PANEL

5.1 Section 40(4) of the 2001 Act provides that an Appeal Panel shall determine its own procedure. The Panel took the view that, on the proper interpretation of the section, each of the Appeals should be considered individually. The Appeal Panel adopted the following procedure:-

(i) Each Appellant was invited to make written submissions;

(ii) The Commission was invited to respond to each submission in writing;

(iii) Each Appellant was invited to reply in writing to the Commission's response;

(iv) An oral hearing of each Appeal was held where the Appellant presented its appeal in the presence of the Commission. The Panel decided to conduct these oral hearings otherwise than in public. A stenographer kept a record of each oral hearing and the Appellant and the Commission was provided with a copy of the transcript.

6. POWERS OF THE APPEAL PANEL – SCOPE OF REVIEW

6.1 The provisions of Section 40(5) require the Panel to consider the Determination and having so considered it, to either:

> *"Confirm it or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, to refer the decision in relation to the Determination back to the Commission for review".*

6.2 The Panel may not substitute its own view for the view of the Commission. It does not have the power to reject the Determination or amend the Determination in any respect. It may only refer the decision in relation to the Determination back to the Commission for review where it considers that there are sufficient grounds for doing so by reference to the provisions of Section 33 (in this instance).

6.3 Notwithstanding the limitations on the scope of the review by the Appeal Panel, Aer Lingus submits that it is still open to the Panel, as an expert body, to take a strong view on how it believes the Commission should deal with matters (if any) that it may decide to refer back for review and further that it is not a prerequisite to any referral to show that there has been a breach of procedure or that the Commission had acted unreasonably, as the power granted the Appeal Panel under section 40 is not so limited[2].

6.4 Ryanair went further and submitted that an appeal under section 40 was a "full appeal" and as such on any review the Commission could not, on review, ignore information thrown up through the appeal process and confine itself only to facts that were available to it at the time of the Final Determination[3]. By way of example, it submitted that to do otherwise would have the absurd result of the Commission ignoring the €19.4 million dividend paid to the State by DAA.

6.5 Having considered all of the above submissions the Appeal Panel determined that:

(a) If the Panel was not satisfied that the Commission had properly considered the matters referred to at Section 33 and the Ministers Direction it would refer the Determination back to the Commission for further consideration.

(b) If the Panel was satisfied that the Commission has considered the matters referred to at Section 33 and the Minister's Direction but was satisfied that

[2] Pages 6 and 7 of transcript of Aer Lingus oral hearing, 28 April 2010.

[3] Pages 33 to 36 transcript of Ryanair oral hearing, 29 April 2010.

there were sufficient grounds to do so, it would refer the Determination back to the Commission for further consideration.

(c) In all other events, it would uphold the Determination.

6.6 The Panel also determined that it would have regard only to material which was before the Commission when it made the Determination and not to subsequently procured materials or subsequent events except in circumstances where the later materials or events clearly and directly imply that previous judgments and conclusions, capable of having significant effects, could no longer be reasonably sustained.

7. THE COMMISSION'S APPROACH TO THE APPEAL

7.1 The Commission was concerned with the process proposed by the Panel. It took the view that it could not be a respondent in the ordinary sense. It could not argue for its Determination or make submissions that its decisions were correct as the Panel may decide to refer issues back to it for review and it would then become responsible for making the final decision. It maintained that it was necessary for it to take an independent stand. It decided that it would therefore confine its response to drawing the attention of the Panel to materials, statements, analysis and decisions which informed its Determination.

7.2 The Panel took the view that there was merit in this submission, particularly as the Panel could only decide that there were "sufficient grounds" for a review but the ultimate decision lay with the Commission.

7.3 While the Panel accepts that the Commission may not wish to argue in favour of its Determination, merely stating where its reasoning for a decision is to be found does not protect the decision from review under Section 40. Where the Panel considers the reasoning adopted by the Commission is inappropriate, it is entitled

to say so and refer it back for review. The Panel recognises the logic of the Commission's position that, as it may be asked to review material and aspects of its Determination, its needs to keep an open mind and should therefore avoid getting drawn into having to defend all aspects of its Determination. Nevertheless, the Panel is of the view that it is over-formulistic for the Commission to refuse to engage at any level. It is entirely to be expected that there may be points raised where the Commission itself can quickly and easily come to the view that it should look at the matter again, for example, where there has been a simple misunderstanding or error. It would greatly facilitate the Appeal process if such misunderstandings, once identified and in respect of which there is no fundamental disagreement, could be confirmed by the Commission as matters which should be reviewed. This would allow the Panel to concentrate on areas of fundamental dispute between the Appellant and the Commission.

7.4 Since the Commission was set up in 2001, there appears to have been ongoing interaction between it and the various interested parties which is reflected in a vast amount of correspondence, issue papers, consultants' reports, expert evidence, draft and final determinations and Appeal Panel Decisions. The parties clearly have an intimate knowledge of its contents which is not, and could not, be shared by the Panel. Without the assistance of the Appellants and the Commission in identifying the relevant documents and issues, the Panel could not complete its task in the limited time provided by statute. The Panel is grateful for the assistance offered by all the parties.

7.5 At the Panel's request, the Commission provided written details of this consultation process in a letter dated 23 March 2010. This included a helpful table summarising this process, a copy of which is annexed hereto at **Appendix A.**

8. DAA GROUNDS OF APPEAL AND COMMISSION RESPONSE

8.1 Dublin Airport Authority (DAA) submitted written grounds of Appeal to the Appeal Panel on 24 March 2010. The Commission responded in writing to DAA's submissions on 7 April 2010. DAA in turn, provided a written response to the Commission's written reply on 14 April 2010. An oral presentation was made to the Panel by DAA in the presence of the Commission, on 30 April 2010.

8.2 DAA's appeal to the Panel focussed on 4 specific areas or grounds under the following headings and sub-headings:

(i) The Structure of the Price Cap:
- Error in the treatment of PRM revenues in the calculation of the price cap;
- Retrospective Adjustment for PRM charge in 2010 and 2011 price caps;
- Introduction of cap on recovery against price cap.

(ii) Approach to Operating Expenditure: FTE reductions and efficiency timing;

(iii) Omissions from Opening RAB:
- Error in treatment of inflation in reconciliation of CIP 2006 – 09 outturn costs;
- Disallowance of Pier D costs;
- Treatment of T2 associated projects;
- Omission of temporary forward lounge (TFL) and Pier D fit-out costs;
- Treatment of project management costs.

(iv) Disallowance of Capital Expenditure 2010 - 2014;
- North runway;
- Engine testing facility / engine testing fees;
- Control tower facilitation works;
- Pier B connectivity;
- Fuel farm;
- Fuel hydrant;
- DAA office and tenant accommodation;

- Project management costs;
- Programme management costs.

8.3 The Structure of the Price Cap

8.3.1 ***Error in the treatment of PRM revenues in the calculation of the price cap –*** DAA submitted that the Commission had double counted PRM in calculating aeronautical allowance for the 2009 Determination as it was included under the "other Commercial Income" and aeronautical revenue headings[4] .

8.3.2 The solution proposed by DAA is that the Commission either (i) reduce "Other Commercial Income" by the PRM revenue or (ii) the cap is deemed not to include PRM revenue[5]

8.3.3 It its written reply to DAA's submission, the Commission did not really engage with DAA's point of appeal regarding the alleged accounting. It did not accept or reject DAA's submission that it was included both under aeronautical revenues and under the heading "other commercial income" but stated that *"PRM revenues were not referred to by DAA in its description of revenues covered by other commercial operations"*[6]. It also submitted that in response to the Draft Determination the DAA did not make any representations to the Commission in relation to the alleged inclusion of PRM revenues within the Commission's forecast of other commercial revenues[7].

8.3.4 In DAA's reply to the Commission it submitted that it did inform the Commission of the inclusion of PRM charges under the heading "other commercial revenue" but it is the view of the Panel that DAA could have been much clearer.

[4] Page 14 and 15, DAA's Appeal.

[5] Page 15, DAA Appeal.

[6]Paragraph 15, the Commission's response to DAA Appeal.

[7] Paragraph 17, the Commission's written response to DAA's Appeal.

8.3.5 If a simple error has in fact occurred (as appears to be the case), it is a net issue that in the view of the Panel can be readily resolved using one of the two solutions proposed by DAA above.

8.3.6 **In the circumstances the Panel considers that sufficient grounds HAVE been established to refer the Commission's decision back for review. Specifically, the Commission should review whether there has been an error (however so arising), resulting in a double accounting for RPM charges by it being included under both aeronautical revenues and "other commercial revenue".**

8.3.7 ***Retrospective adjustment for PRM charge in 2010 and 2011 price caps –***

8.3.8 Regulation (EC) No. 1107/2006 mandated Airports provide services for passengers with reduced mobility and this obligation for DAA came into effect mid-way through 2008. DAA's ground of appeal relates to what it submitted was the Commission's retrospective adjustment to include the revenues generated by DAA in relation to PRM charges for the latter half of 2008 and 2009 in its calculation of the under recovery against the price cap in 2008 and 2009.

8.3.9 It submitted that the inclusion of earnings from PRM services in the calculation of the price cap yields for 2008 and 2009 has the effect of reducing the apparent under recovery against the price cap for those years. DAA submitted that the impact of this adjustment amounts to a 5 cent downward adjustment on the 2010 price cap plus a 19 cent downward adjustment to the 2011 price cap or *"in hard sums"* about *"3 million per annum"*[8] (but it would be a once-off adjustment).

8.3.10 In its response the Commission referred to the 2008 Issues Paper and its 'Approach to Regulation' at paragraph 2.13. It does not ordinarily claw back profits or compensate for unforeseen costs.

[8] Page 83, line 25 onwards, transcript of DAA oral hearing, 30 April 2010.

8.3.11 The Panel is of the view that the EC Regulation did give rise to an "unforeseen cost". Disallowing it was consistent with stated policy.

8.3.12 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.**

8.3.13 ***Introduction of cap on under recovery against price cap –***

Prior to the 2009 Determination the Commission approach has been that over and under recovery of the price cap has been lagged on a two year basis[9]. The Commission has changed this approach in the current Determination by (i) providing that over recoveries are now to be repaid within 45 days to the airlines that have been invoiced and (ii) under recoveries on the price cap are limited in terms of their future recovery to no more than 5% of the annual cap[10].

8.3.14 DAA submitted that this change is both administratively difficult but also *"limits DAA's ability to manage its charges and respond to market conditions over the course of the determination period. For example, it limits the opportunity of DAA to respond to user requests to defer some or all of the annual price increase to a later period"*[11]. In relation to the 5% limit on the carry forward of any under recovery DAA submitted that the Commission *"failed to provide any rationale for this restriction"*.

8.3.15 The Commission referred the panel to the consultation process, commencing with the publication of the 2008 Issues Paper, its Draft Determination and paragraph 10.20 of the Final Determination where it set out its reasoning on this issue:

"The decision to allow the DAA to roll forward under-collection is to avoid a situation late in a year of the DAA wanting to increase charges so as to collect all revenues allowed under the price cap, where out-turns have to date yielded a different, lower level

[9] Page 84, line 21 onwards, transcript of DAA oral hearing, 30 April 2010, Mr. Harrison for DAA.

[10] Pages 85 and 86, transcript of DAA oral hearing, 30 April 2010, Mr. Harrison for DAA.

[11] Page 17, DAA Appeal.

of per-passenger revenues to those expected when the DAA set the structure of the charges. The restriction on the amount that can be rolled forward is to protect prospective users from having to pay significantly higher price caps in the event that the DAA does under-collect. The Commission does not want its Determination to be interpreted as an opportunity for the DAA to offer heavily discounted airport charges to current users in exchange for a much higher (potentially non-binding) price cap at a later date."

8.3.16 The Panel accepts that this decision does limit DAA's flexibility to react to market conditions. However, the Panel is of the view that the approach is not so unreasonable that it warrants referral for re-consideration at this review. The question of carrying forward under-recovery of charges to a time when passenger numbers improve is an issue which should be considered in the next review as part of a project to develop better profiling of charges, more correlated with the cyclical movements that might be expected if airports competed for business.

8.3.17 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.**

8.4 Approach to operating expenditure

8.4.1 ***FTE reductions and efficiency timing –***

In the current Determination the Commission is projecting a total reduction of 468 in FTE numbers from 2008 levels by the end of 2011 yet allows no remuneration for associated upfront costs. DAA submitted that the Commission's assumption of a reduction of 468 in FTEs in such a short period without associated costs is *"wholly inappropriate and inconsistent with regulatory best practice"*[12].

8.4.2 DAA also queried the Commission's assumed natural attrition rate of 2.5% in a time of recession and pointed to the Commission's own consultants Indecon Jacobs who *"suggest an average annual reduction in staff numbers of between 1.1% and 0.7% which is believed to be within the range of natural attrition rates*

[12] Page 18, DAA Appeal.

at the Airport" phased over the period 2010- 2014[13]. DAA further submitted that even accepting the Commission's assumed rate of 2.5% to be correct, it only equates to circa 49 FTEs per annum whereas the Commission's assumptions are far in excess of this level[14]. DAA submitted therefore that the Commission should have allowed an associated upfront cost (which it suggested should be €48 million[15]) or spread the reductions over an appropriate period in its Final Determination[16].

8.4.3 The Commission by way of reply submitted that the basis for the reductions in FTE numbers is derived from *"scale effects (i.e. how changes in passenger numbers affect FTEs and costs), efficiencies identified by Indecon Jacobs based on a review of 2008 costs at existing Dublin Airport, and Booz's study of how an "efficient operator" would operate the new T2 and resultant cost savings in T1"*[17]. It also pointed to the fact that the Indecon Jacobs' report advised that *"staff attrition rates for airports are typically around 4% - 6%. The attrition rate for Portuguese Airports (ANA) over the period 2005 – 2007 was 5.3%"*[18].

8.4.4 At the oral hearing DAA pointed to the fact that its current staff reduction programme, of 300 permanent staff and about 100 contract staff, required an investment of €44 million[19] and that it follows that reductions on the scale assumed by the Commission will cost more than that and suggested no less than €48 million. DAA acknowledged that the Commission's written response *"has provided evidence of a consultation process which provided the basis for its approach to consideration of operating expenditure"* but submitted that *"this does not provide a rationale to support its subsequent conclusions"*[20]. It also

[13] Appendix to Indecon Jacobs Report S2.2, page 5, quoted at page 19 of DAA Appeal.

[14] Pages 18 and 19, DAA Appeal.

[15] Page 22, DAA Appeal.

[16] Page 21, DAA Appeal.

[17] Paragraph 37, the Commission's response to DAA's Appeal.

[18] Page 41, Indecon Jacobs Final report.

[19] Page 70, line 14 onwards, transcript of DAA oral hearing, 30 April 2010.

[20] Page 5, DAA's response to the Commission's submissions.

submitted that even if a 5% attrition rate is applied it would still take a number of years to achieve the Commission's targeted FTE reductions.

8.4.5 The Panel is satisfied that the approach adopted by the Commission in retaining independent Consultants to examine and report on this issue is a reasonable one.

8.4.6 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.**

8.5 Omissions from opening RAB:

8.5.1 ***Error in treatment of inflation in reconciliation of CIP 2006 – 09 outturn costs-*** DAA submitted that in calculating the opening RAB the Commission must carry out a reconciliation of its original 2006 CIP budget with the outturn costs for investments made by DAA during the period 2006 – 2009 (i.e. budget versus actual spend)[21]. DAA said it submitted a reconciliation of project outturn costs for the 2006 - 09 CIP in May 2009 as this was originally assessed by the Commission in 2006 prices. This reconciliation deflated outturn costs to 2006 prices using actual inflation for 2006 – 2008 and an estimate of 4% for 2009. However, in the Final Determination DAA argued that the Commission erroneously reinflated this 2006 figure using actual inflation for 2006 – 2008 and deflation of -6.6% for 2009.

8.5.2 DAA submitted that the result is that the 2009 index used for deflation and subsequent inflation are misaligned with the effect of understating DAA's capital expenditure for the 2006-2009 period by over 10%, penalising DAA by circa €59 million[22].

8.5.3 By way of reply the Commission stated that DAA's submission suggested it has erred in restating the opening 2010 RAB in 2009 prices and that it is unaware of

[21] Page 23, DAA Appeal.

[22] Page 24, DAA Appeal.

any such representation being made by DAA during the consultative process. It did however acknowledge that an issue relating to inflation arose under 'Project Management Costs' in DAA's response to the Draft Determination (Supporting Document IV 'Opening RAB Omissions') and set out what it believed to be the relevant extract[23]:

"DAA disagrees with CAR's approach to inflating capital projects, as the majority of the CIP 2006 – 2009 projects were tendered in 2007 or 2008 and so will be unaffected by CAR's proposed deflationary index in 2009. This is a particular issue in relation to T2 and Associated projects as the costs were essentially tendered and committed prior to 2009 but much of the spend occurs in 2009."

8.5.4 The Commission then referred the Panel to paragraph 8.24 of the Final Determination where it rejected this representation:

"the Commission has not accepted the DAA's argument that the RAB roll forward should not apply indexation to capex projects occurring in 2009 because the DAA signed nominal contracts prior to the recent deflation. The Commission has previously indexed for inflationary changes in the CPI and is not convinced that there is any rationale for an asymmetric approach. It is open for the DAA to contract with suppliers in nominal or in real terms and otherwise make arrangements to control its exposure to changes in price index".

8.5.5 The above reply did not really engage with DAA's point that using the material DAA provided to the Commission (which allowed for 4% inflation for 2009) has lead to a flawed reconciliation. However, neither did DAA's written response to the Commission's submission refer the Panel to any particular section of its response to the Draft Determination where this error was highlighted.

8.5.6 At the oral hearing the Panel queried when this error had been brought to the attention of the Commission. DAA submitted it had *"submitted information which would have highlighted this error to CAR"* in response to the Draft Determination but acknowledged that *"the nature and scale of the difference we*

[23] Page 9, the Commission's submissions.

were looking at was much smaller because at the time I think the CAR had applied a 1% inflation or deflation rate for 2009 as being their expectation. So, it was really only when the 2009 determination was finalised and that had been updated to a 6.6% deflation that the scale of this impact became apparent"[24].

8.5.7 It does not appear that DAA objects to the principle of indexation. Rather, it contends that there has been a fundamental mathematical error in the Commission's calculation. To this extent, the Panel considers that sufficient grounds have been established to refer this aspect of the Commission's decision back for review.

8.5.8 **In the circumstances the Panel considers that sufficient grounds HAVE been established to refer the Commission's decision back for review. Specifically, the Commission should review and consider the effect of its application of deflation of -6.6% for 2009 to DAA's submitted figures for reconciliation of project outturn costs for the 2006 -09 CIP (which had allowed for an estimated inflation figure of 4% in 2009).**

8.5.9 ***Disallowance of Pier D costs –***

In the Final Determination the Commission allowed €8.6 million of the additional[25] €31 million spend which DAA incurred on the Pier D Project over the 2006 – 2009 period. This was a reduction from the Draft Determination where €15.7m of the €31m additional cost was allowed. DAA submitted that this reduction in the Final Determination arose from an acceptance by the Commission of Aer Lingus' argument that DAA's cost of capital allowance encompassed risk of capital project overruns but (without accepting the validity of that argument) noted that the Commission made no change to DAA cost of capital allowance on foot of this decision.

[24] Page 89, line 18 onwards, transcript of DAA oral hearing, 30 April 2010, Mr. Harrison for DAA.

[25] The €31 million is in addition to the €93.4 million capital allowance previously provided by the Commission.

8.5.10 DAA submitted that an international benchmarking exercise confirmed that even with the Pier D cost overruns it remains an efficiently delivered piece of infrastructure that is now a central component of T1 operations[26]. It submitted that it provided a detailed explanation to the Commission for the various costs components of the Pier D project which exceed the Commission's allowance and that the overruns were reasonably incurred and should therefore be included in the opening RAB.

8.5.11 By way of reply, the Commission referred back to the consultation process and its position as set out in the Final Determination (paragraph's 8.17 and 8.18)[27].

8.5.12 The Panel is concerned that capital markets might react negatively if the approach to regulation here is seen to disallow large tranches of past investment, as such retrospective adjustment almost invariably gives rise to regulatory uncertainty. The Panel considers that the circumstances under which RAB disallowances might be legitimately justified are in circumstances where (i) the investment is obviously imprudent or (ii) there is some manifest deficiency in the performance of the regulated entity. In considering the latter requirement, merely operating at less than maximum efficiency is not sufficient (most companies fall short of this standard in some areas). Rather, *ex post* disallowance should be only be contemplated where the performance of the regulated company can be considered to fall outside normal commercial parameters.

8.5.13 In relation to the Pier D cost overruns the Panel is not satisfied that either of the above criteria have been met.

8.5.14 **In the circumstances the Panel considers that sufficient grounds HAVE been established to refer the Commission's decision back for review. Specifically, the Commission should review its disallowance of €15.3m Pier D overrun costs.**

[26] Page 26, DAA Appeal.

[27] Paragraphs 50 -52, the Commission's response to DAA's Appeal.

8.5.15 ***Treatment of T2 Associated projects –***

DAA submitted that the Commission has incorrectly classified 22 *"miscellaneous capital projects"* as being associated with T2 with the result that they will not be assessed by the Commission until 2014[28]. It submitted that 16 of these projects have now been either delivered or cancelled and so an assessment of the outturn costs (which DAA submitted is €85m) should have been made by the Commission as part of the 2009 Determination[29].

8.5.16 DAA submitted that in the Final Determination the Commission merely stated that it did not accept DAA's argument that they should be included in the RAB immediately but *"gave no reasons to justify this decision"*[30].

8.5.17 The Commission by way of reply stated that it classified certain projects as T2 as early as the 2007 Interim Review. It considered DAA's submission, in response to the Draft Determination, that it change its approach from that set out in the 2007 interim review and rejected this representation at paragraph 8.29 of the Final Determination[31].

8.5.18 The Panel is satisfied that having indicated in the 2007 Interim Review how certain T2 associated projects would be treated, it is not unreasonable of the Commission to maintain that position and thus ensure regulatory consistency. When the projects are considered in 2014, the company is entitled to expect that reasonably incurred (but not imprudent) expenditure will be allowed.

8.5.19 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.**

[28] Page 29, DAA Appeal.

[29] Page 29, DAA Appeal.

[30] Page 30, DAA Appeal.

8.5.20 ***Omission of Temporary Forward Lounge (TFL) and Pier D fit-out costs –***

8.5.21 DAA submitted that the Commission made no allowance for capital costs it says were reasonably and legitimately incurred during the 2006 – 2009 period associated with either the TFL (€6.2 million outturn cost) and Pier D Fit-out costs (€1.2 million)[32].

8.5.22 DAA submitted that the Commission incorrectly assumed that these costs had been included in the Pier D budget. DAA submitted that the Pier D project was originally tendered on a "shell and core" basis but that it became apparent during negotiations to secure a tenant that a Pier D fit out was required to secure a higher rental income for these areas. DAA submitted that the fit-outs costs have been inappropriately deducted given that there has been no compensating downward adjustment made for the incremental rental income which accrued from the €1.2m spent on fit-out[33].

8.5.23 DAA also submitted that the TFL was presented as a stand-alone project in the CIP 2006 – 2009 and therefore should have been assessed by the Commission as a separate stand-alone project[34].

8.5.24 By way of reply the Commission pointed to paragraph 8.20 of the Final Determination where it *"clarified that the reported outturn capex amount (€124.9m) for Pier D included the costs of both of these projects"*[35].

8.5.25 At the oral hearing DAA reaffirmed its submission that the €124.9m referred to by the Commission did not include the TFL costs or Pier D fit out costs[36].

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[31] Page 11, the Commission's response to DAA's Appeal.

[32] Page 31, DAA Appeal.

[33] Page 32, DAA Appeal.

[34] Page 31, DAA Appeal.

[35] Paragraph 54, the Commission's reply to DAA's Appeal.

[36] Page 166, line 22, transcript of DAA oral hearing, 30 April 2010, Mr. Harrison for DAA.

8.5.26 This would appear to be a matter of fact which can be objectively ascertained. If the expenditure was incurred and cannot be said to be imprudent, allowance should be made for it. This makes for regulatory consistency.

8.5.27 **In the circumstances the Panel considers that sufficient grounds HAVE been established to refer the Commission's decision back for review. Specifically, the Commission should review its disallowance of Temporary Forward Lounge and Pier D fit-out costs.**

8.5.28 ***Treatment of project management costs -***

DAA submitted that the Commission has inappropriately disallowed DAA's internal Project Management costs (of €26.8 million) incurred in the delivery of the 2006 – 09 CIP. DAA submitted these are valid costs related to the *"interaction of the construction site with the working airport (such as project interfaces, permission to work authorisations, compliance with IAA requirements)"*[37].

8.5.29 DAA pointed to the Final Determination where the Commission stated that it *"considers that the 2006 – 09 capex allowance for each project already includes an allowance for project management costs"* and then goes on to quote the Rogerson Reddan Vector Report on 2006-09 costs[38]. However DAA submitted that the 2006 – 09 Project Management costs referred to by RRV related to external Project Management consultants only.

8.5.30 DAA submitted that *"at a minimum, CAR should subject its project-by-project capex reconciliation to further examination, adding back in Project Management costs to each outturn figure and then re-assessing DAA's performance, using the same principles"*[39].

[37] Page 32, DAA Appeal.

[38] Page 33, DAA Appeal. RRV were the Commission's consultants during the CIP 2006 – 2009 Determination.

[39] Page 33, DAA Appeal.

8.5.31 By way of reply, the Commission referred to paragraph 8.22 of the Final Determination where it rejected DAA's argument on the basis *"that the 2006 – 09 capex allowance for each project already includes an allowance for project management costs and that an additional allowance for project management costs would represent double counting"*[40]. The Commission also stated that the 2006 – 09 capex allowance was based on an appraisal of project costs by RRV that included an allowance for project management costs but did not specifically address DAA's submission that these costs related to external consultants only.

8.5.32 The Panel is satisfied that the approach adopted by the Commission in retaining independent Consultants to examine and report on this issue is a reasonable one.

8.5.33 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.**

8.6 Disallowance of Capital Expenditure 2010 – 2014

8.6.1 DAA referred the panel to 9 projects in respect of which it submitted the Commission failed to make adequate provision for DAA's proposed investment:

(i). North Runway
- DAA project value €305m
- CAR allowance €246.3m

(ii). Engine Testing Facility / Engine Testing Fees
- DAA project value €13.8m (testing facility); €0.4m (testing fees)
- CAR allowance €9.2m (testing facility); €0.2m (testing fees)

(iii). Control Tower Facilitation Works
- DAA project value €1.4m

[40] Paragraph 59, the Commission's response to DAA's Appeal.

- CAR allowance €1.4m but triggered to commence with north runway construction

(iv). Pier B Connectivity

- DAA project value €11m
- CAR allowance: Car to review as part of T2 assessment

(v). Fuel Farm

- DAA project value €20.4m
- CAR allowance €13.9m

(vi). Fuel Hydrant

- DAA project value €14.4m
- CAR allowance €0

(vii). Office and Tennant Accommodation

- DAA project value €7.5m
- CAR allowance €0

(viii). Treatment of Project Management Costs 2010 – 2014

- DAA project value €22.5m
- CAR allowance €0

(ix). Treatment of Programme Management Costs 2010 – 2014

- DAA projection €6.5m
- CAR allowance €4.5m

8.6.2 DAA made detailed submissions in relation to each of the above programmes. In relation to some of the projects DAA pointed to what it submitted were incorrect assumptions adopted by the Commission, for example its assumption that a two-tank Fuel Farm will suffice in place of the original three tank solution proposed

(which DAA submitted isn't operationally viable)[41]. In relation to other projects the submissions were more general and essentially amount to a simple disagreement between DAA and the Commission about the necessity for the project as proposed and whether it met with the reasonable requirements of current and prospective users, for example in relation to the Fuel Farm (which DACC submitted did not meet the requirement of airline users[42]).

8.6.3 The difficulty for the Panel is that, as set out in the Commission's reply[43], its determination in relation to DAA's CIP 2010 – 2014 was arrived at following an extensive consultation process. DAA has identified 9 projects where it disagrees with the Commission's conclusions following that process and/or feels the Commission has been unduly parsimonious. However it is probable that there are other projects where the Commission's determination has fallen on the more generous side of the scale in favour of DAA.

8.6.4 DAA submitted that the Commission is engaging in asymmetric treatment of projects in *ex post* evaluations. It submitted that the Commission is looking at individual capex projects and disallowing where DAA have spent more yet at the same time rolling forward any under spend into the RAB. The Panel has sympathy for DAA's position on this. Nevertheless, it is the Panels' view that the *forward looking* CIP must be considered as a whole and it is undesirable for the Panel to attempt to assess and review the allowance or otherwise of individual projects "cherry picked" by one party save in cases of manifest error. Having considered both DAA and the Commission's submissions and those made at the oral hearing, the Panel is satisfied that the Commission's approach to the identified projects is not unreasonable.

[41] Page 47 - 49, DAA Appeal. DAA also submitted that even if a two-tank system was viable the Commission's rationale for reducing the cost estimate by one-third was incorrect, as the bulk of the cost will be incurred irrespective of the number of vertical storage tanks.

[42] Pages 50 and 51, DAA Appeal.

[43] Paragraphs 60 – 73, the Commission's response to DAA's Appeal.

8.6.5 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.**

9. FINANCEABILITY / COST OF CAPITAL

9.1 While not expressly stated as a ground of appeal, DAA also asked the Panel to consider its credit rating and the overall impact of the present Determination on its ability to raise finance going forward in the context of its appeal.

9.2 The Commission stated in the Final Determination that *"based on the evidence available, the Commission is satisfied that enabling the DAA to realise a BBB credit rating is consistent with enabling the DAA to operate Dublin airport in a sustainable and financially viable manner"*[44].

9.3 DAA submitted that an A rating is more appropriate and that the Commission has failed to comply with the statutory requirement to set charges at a level which allows DAA to operate in a sustainable and financially viable manner. It also submitted that since the publication of the 2009 Determination S&P downgraded DAA's stand alone long term credit rating to BBB, with negative outlook and that the Final Determination only delivers a DAA Group FFO:Debt ratio above the 15% threshold required for an investment grade rating half way through the current Determination period[45]. It further submitted that the stand alone financial ratios for DAA's regulated business are considerably inferior to the DAA Group.

9.4 As a general matter, the Panel believes that the issue of cost of capital and financial viability should be considered together. A mechanistic application of rating agency ratios is inappropriate. One must also consider the nature of the business. In this case it is an essential infrastructure for a large population with a State shareholder and a sound long term flow of income. It is the Panel's view that the cost of capital allowance provided for in the current Determination is not ungenerous, and that this

[44] CP4/2009 page 130, quoted at page 10 DAA Appeal.

[45] Page 13, DAA Appeal.

should be sufficient to meet any financial viability problems. However, the foregoing statement is subject to the caveat that, if the concerns expressed by the Panel in relation to some of the grounds above regarding disallowance of prudently incurred past capex are not addressed, capital markets may come to require a higher debt premium to compensate for perceived asymmetries in regulatory risk. Nevertheless, the Panel feels the most appropriate response to this is to address the undesirable regulatory practice, and this has informed the Panels' approach to addressing the issues raised in DAA's grounds of appeal.

9.5 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.

10. CONCLUSIONS

10.1 The Panel concludes that sufficient grounds have been established by DAA to refer the following matters back to the Commission for review:

(a) Error in the treatment of PRM revenues in the calculation of the price cap: the Panel is of the view that the Commission should review whether there has been an error resulting in a double accounting for PRM charges, by it being included under both aeronautical revenues and "other commercial revenue".

(b) Error in treatment of inflation in reconciliation of CIP 2006 – 09 outturn costs: the Panel is of the view that the Commission should review and consider the effect of its application of deflation of -6.6% for 2009 to DAA's submitted figures for reconciliation of project outturn costs for the 2006 – 09 CIP (which had allowed for an estimated inflation figure of 4% in 2009).

(c) Disallowance of Pier D costs: the Panel is of the view that the Commission should review its disallowance of €15.3m Pier D overrun costs.

(d) Disallowance of TFL and Pier D fit-out costs: the Panel is of the view that the Commission should review its disallowance of Temporary Forward Lounge costs of €6.2m and Pier D fit-out costs of €1.2m.

Dated 1 June 2010

Michael Durack SC
Professor George Yarrow
John Butler CPA