Dublin Airport Unions Response to Commission for Aviation Regulation Maximum Level of Airport Charges at Dublin Airport 2014 Draft Determination

July 31st 2014

Dublin Airport Trade Unions Response to Commission for Aviation Regulation Maximum Level of Airport Charges at Dublin Airport 2014 Draft Determination

This paper is a joint union response to the Commission for Aviation Regulation (CAR) Draft Determination on Maximum Level of Airport Charges at Dublin Airport May 2014.

The unions fully accept that Dublin airport must be subject to certain oversight to ensure that the interests of the airport users are appropriately protected. On this basis we accept that the airport charges to its users must be fair and reasonable for the services delivered. We additionally appreciate that the DAA has legitimate responsibility to its shareholders and wider stakeholder community to ensure that it operates in a manner that delivers on its strategic goals and manages its affairs in a responsible, prudent and sustainable manner.

The unions of the airport submit that the per passenger price caps set out in the Draft Determination are inappropriate and inadequate for the appropriate operation and development of Dublin Airport and have failed to properly balance the strategic and financial objectives, (national and international), of the DAA with the desire to minimise the cost charge to users.

This document outlines the key concerns and specific issues of the union group with the draft determination.

As a general observation regarding the CAR draft determination, the unions submit that the document and rationale are extremely narrow in focus and context and do not consider a large range of factors which are relevant to the setting of the airport charge

The broader context within which this decision needs to be taken includes the requirements from the airport in light of:

- The Department of Transport and Tourism and Sport Draft National Aviation Policy for Ireland May 2014
- DAA policy and responsibility to its' shareholders
- The requirements and expectations of stakeholders – both airlines and passengers
- The specific business model of Dublin Airport including future planning both capital and operational and
- The overall impact of the economic downturn of the last 5 years on the outturn and activities of the airport

Given this context, the unions would make the following comments regarding the draft determination:

1. The Gap between CAR and DAA forecasts

The difference between the CAR proposed maximum airport charge and that proposed by the DAA is of such scale that it is difficult to envisage how such a gap could be closed without significant impact on the quality and fabric of the infrastructural asset base, the quality and service experience of airport users and a significant adjustment to the levels, terms and conditions of airport staff.

Assessing the proposals of DAA and CAR, the difference in revenues created by the proposed maximum price over the 5 year period, amounts to more than €470 million with an average difference between the 2 proposals of approximately €90 million per annum. (DAA average maximum price per annum €13.50, CAR average maximum price per annum €9.26 per annum).

CAR price cap calculations assume total operating costs staying broadly constant over the next 5 years. DAA calculations assume operating costs to rise over time increasing to almost €220 million by 2019. These expectations diverge so fundamentally, that it is difficult to comprehend how the airport will function sustainably and continue delivering on stakeholders requirements over the determination period, where there are such diverse views and philosophies held by the airport operator and the Regulator.

Given the current and projected financials of DAA, a forecast differential of €470 million between CAR and DAA proposals has not been adequately rationalised and the acceptance of the CAR price proposal would threaten the overall financial viability of the airport.

2. Operational Costs Average Difference of 90 cent per Passenger

On the basis of our analysis there are a number of key drivers explaining the differences between the CAR and DAA maximum charge proposals. These are as follows:

Charge Building Block Element	5 year Average Difference per pax	5 year Average Annual Impact (M)	Average Annual Impact as a % of DAA forecast total revenue
Operational Expenses	€0.90	€20.04	9.6%
Commercial Revenue Targets	€0.56	€12.63	9.3%
Capital Element of the Charge	€2.77	€61.37	26.9%

An initial point to make on this analysis is that the difference between DAA and CAR average forecasts of operational expenses per passenger over the period amounts to only 90 cent per passenger. On this basis, and when benchmarked with other relevant airports, Dublin airport operational expenses per passenger are more than acceptable and within 90 cent of CARs low targets.

However, as operational expenses are the only variable controllable costs there is an implication that any shortfall must be addressed primarily through operational expenses. The largest proportion of operational expenses is made up of staff costs which will be the pivot around which DAA will attempt to balance the books. To further narrow this focus, given the ongoing cost reduction programmes within the airport, there is very limited room for staff cost reduction remaining and the CAR model and report have implied a focus on 600 staff employed directly by the DAA.

The CAR draft determination refers to the SDG report[1] and notes, referring to improving efficiency, that SDG have offered prescriptive methods of changing working conditions and practices through outsourcing.

Clearly, decisions to change terms and conditions of airport employees are the sole responsibility of the airport operators and can only be undertaken after agreement with the employees. This is part of the operations of DAA and does not and should not involve the intervention of CAR either explicitly or obliquely (by basing future financial assumptions on changed terms and conditions).

It should be clear, that any proposal to outsource 600 jobs within the airport would not be acceptable to the staff of DAA. If the DAA is forced down a route which involves outsourcing as a result of the CAR determination, it will inevitably result in industrial unrest in Dublin Airport.

3. Expectation of Changing the Business Model

The changes that would be required to the operations of Dublin Airport in order to deliver on this draft maximum price determination will not be about efficiencies but instead will be about changing the entire business model and long term investment and deliverables strategy of the airport.

The unilateral disallowing of capital projects (the cost of which have been verified by EY report), which form part of the price determination, form part of the the largest element of the draft price reduction (capital element average €2.77 per passenger over the period).

The setting of medium to long term capital planning for Dublin Airport is the responsibility of the DAA who are accountable to their shareholders and thus to deliver on overall government policy. The effective interference with national and DAA strategy and policy is not within the remit of CAR and the disallowing of these projects (without consultation) has effectively done this.

It is the unions submission that the capital projects disallowed by CAR in this determination are "levels of investment in airport facilities at Dublin Airport, in line with safety requirements and commercial operation in order to meet the needs of current and

[1] 4.12 Maximum Level of Airport Charges at Dublin Airport 2014 Draft Determination

prospective users at Dublin Airport" [2] and part of the overall operational and strategic development of the airport which is the responsibility of the DAA.

4. **Failure to Support National Aviation Policy**

The CAR draft determination, fails to take cognisance of the responsibilities and accountabilities of DAA and DAA employees.

The DAA board and by extension employees, are responsible for the overall strategic and operational control of Dublin Airport including airport management and development and airport investment. This includes contributing to Irish economic growth by developing the airport and responding to the needs of airport users, both airlines and passengers and delivering for the ultimate shareholder.

The 2014 Draft National Aviation Policy for Ireland states that "Dublin Airports development as an interconnecting hub is itself [also] of great importance to the Irish Aviation Sector and the broader economy"[3]. This is the expectation and requirement of the shareholder of DAA. This is government policy and plainly, the assumptions used by CAR in the setting of the maximum airport charge must support the goals set out in the National Aviation Policy. On the basis of the CAR draft determination document and the assumptions made, it will not be possible for DAA to deliver on National Aviation Policy.

The theory and basis of the CAR draft maximum airport charge impinges on all the accountabilities of DAA and DAA staff as outlined above, by removing from the DAA the corporate strategic decisions around capital expenditure, operational efficiencies, financing strategies and risk management.

The narrow breadth of CAR analysis does not include the overarching aims of DAA to shareholders and national strategy and should be reconsidered.

5. **Forecasts Based on Incorrect Assumptions**

The basis used in the CAR calculations includes a number of unsound assumptions which if used, will lead to an erroneous estimate of the future cost base of Dublin Airport.

These include:

- Assumption that reduction of €38 million annual payroll will remain permanent
- €3m discrepancy with historical outturn[4]
- 50 rectification FTEs rather than 100[5]
- Security cost elasticity lower than CAR's own previous value[6]

[2] The Aviation Regulation Act, 2001, as amended
[3] A National Aviation Policy for Ireland Draft May 2014 Department of Transport, Tourism and Sport
[4] Per DAA
[5] Per DAA

- €3m forward-going pension cost excluded[7]
- Energy cost inflation of 2% rather than 8%[8]
- Use of regression analysis including extraordinary conditions of last 5 years
- Assumption, in forecasts, of changed terms and conditions for DAA employees
- Failure to include any allowance for current pay claims
- Exclusion of pension settlement costs

The draft determination states that "the background to this Determination is that operating costs have been much lower than forecast in 2009"[9] . In dealing with the economic downturn and in order to counteract the effect on DAAs profitability and financeability, the company pursued a number of initiatives around the start of the last determination period. Chief among these measures was the cost recovery system which led to an annual payroll reduction of €38 million compared to the 2009 cost level and a further €4 million relating to passenger decline.

Additionally, the use of regression analysis to form the basis of future forecasts costs does not appropriately consider the extraordinary economic conditions of the last 5 years including the significant improvement of DAA purchasing power regarding external providers and the negotiation by DAA of pay reductions with existing employees which were predicated on employee and trade union recognition of the emergency conditions at the time. These "emergency conditions" are now considered over and the unions currently have lodged a pay claim for 6%[10]

The use of this long run time series data places limited value on the current conditions and the fact that the economy is in recovery. On this basis, it would be expected that the any medium term forecast would include post-recession conditions, prices and pay rates and none of this is included in CAR forecasts over the determination period.[11]

As a minimum requirement, in order to be in a position to set a maximum airport charge, CAR must correct the basis for their forecast calculations and rerun their model using the correct base and forecast assumptions.

6. Incorrect Exclusion of Pension Liabilities

The refusal of CAR to include the full liability relating to the IASS pension scheme is not appropriate for a number of reasons. This DAA liability is a legitimate cost of the company, unrelated to inefficiencies, and will be a proper and appropriate charge to the accounts of DAA when crystallised.

[6] Per DAA

[7] Per DAA
[8] Per DAA
[9] P12 Maximum level of Airport Charges at Dublin Airport, 2014 Draft Determination
[10] Lodged in 2014
[11] A similar issue was raised by the 2009 NERA report on CAR determination relating to Cost of Capital

CAR, in making a determination regarding maximum charge, must have due regard to a number of specified items including "costs or liabilities for which Dublin Airport Authority is responsible"[12]. Dublin Airport Authority is responsible for this liability.

The exclusion of a legitimate cost which will be included in the accounts of DAA, does not make sense and is not a justifiable position when setting the draft maximum charge.

The unions would again note that CAR should rerun their financial model and forecasts with an inclusion of this amount and that without this the financial modelling of the future is flawed and unacceptable as a basis of charge setting.

7. Penalising through Regulation

The Commission for Aviation Regulation asserts the use of "incentive regulation" [13] whereby the proceeds of efficiencies are kept for a period and then passed onto the public. In this case, it is the unions' assertion, that the DAA and DAA employees have in fact been penalised for improvements both in efficiencies and cost cutting measures.

As noted in point 5 above, all cost savings, some of which are considered as relating to emergency conditions, have been used as the base for future cost projections thus considerably reducing the maximum charge proposed. Cost cutting undertaken to ensure the survival of the company, then used for future forecasts, is in fact a punitive approach to the good faith of the company and its' employees.

It is also noted that the "incentive" element of the draft determination relating to service quality is structured to ensure that if the new targets, (many of them increased), are not met then revenue from airport charges are at risk and that the scheme included no bonuses.[14]

Additionally, "DAA will continue to assume the risk of traffic deviating from the passenger forecast during the Determination which will last for 5 years."[15] This risk, has unilaterally been assigned to DAA in its' entirety with no provision for possible extraordinary events which would adversely impact passenger numbers. The allocation of all the downside without any ability to manage the risk, does not seem equitable or incentivising.

On this basis, a better description of this would be punitive regulation given that there is no upside available to DAA or its employees and any cost savings or efficiencies made will be used to reduce the maximum charge for the next determination period.

[12] Aviation Regulation Act 2001 (as amended)

[13] Cathal Guiomard says "Arguably our proposals are an example of how incentive regulation is supposed to operate" CAR Press Statement 29 May 2014

[14] P74 Maximum level of Airport Charges at Dublin Airport, 2014 Draft Determination

[15] P3 Maximum level of Airport Charges at Dublin Airport, 2014 Draft Determination

8. Cross Subsidisation of Aeronautical Activities

CAR, in the determination of this charge, appear to have looked at the financials of DAA as a whole as opposed to the sustainability of purely aeronautical activities. Whilst the decision to use a single till basis of assessment in the determination does allow for the recognition of the demand and revenue complementarities between aeronautical and non-aeronautical services, it should not result in the maximum charge having to be cross subsidised by other activities in order to ensure the viability and sustainability of Dublin Airport, as will be the case if this charge level is accepted.

A review of purely aeronautical activities, on a stand alone basis, would show a long term trend of unsustainability in these operations and that without the balance sheet of DAA as a whole financing would not be available.

The setting of a charge at such a low level will significantly increase the level of cross subsidisation within the airport and considerably reduce the capital value of the airport over the determination period, any return to shareholders, Balance Sheet stability and future sustainability.

9. Who Benefits from a Reduced Airport Charge?

In effect, the real beneficiaries of a reduction in the maximum airport charge are the airlines who use Dublin Airport and when further refined, the main key recipients are the 2 airlines who make up the majority of Dublin Airport traffic.

Any proposed reduction in the charge, effectively transfers revenue and profit from the DAA to the bottom line of these airlines, a transfer which the unions submit as being unnecessary and unjustifiable and serving only to further inflate the bottom line of these already profitable airlines.

The Regulators basic premise when reviewing the level of the maximum charge should be the requirements of the users of the airport and the complementing of Government policy through facilitating the airport to deliver services and infrastructure appropriate to the needs of the country and public policy. The Regulators focus should not be on ensuring a reduction in the charge in order to satisfy the profitability requirements of airlines.

In essence, this draft determination does not adequately address the core public service needs and requirements of the airport and allows for private airlines to further increase profitability levels.

10. Benchmarks for Success

The CAR draft determination, whilst on the one hand proposing, (through use of capital, cost and efficiency assumptions), large scale changes in operations and infrastructure planning, has failed to provide any convincing evidence or benchmarks that any airport with similar strategy, passenger numbers, location etc. has been able to achieve these type of aggressive changes to its' core base and business models within the determination timescale.

Dublin Airport is not a greenfield site. It is a fully functioning and operating Airport and the scale of changes required to deliver on this proposed reduction of the Airport Charge cannot be delivered without significant reductions in service and / or industrial unrest.

11. The Cost / Benefit of the Proposed Maximum Airport Charge

As a concluding comment, the unions would note that a cost / benefit analysis of the reduction in the maximum charge versus the many and disruptive changes required within the airport to deliver on this charge does not seem to make sense.

As noted previously, the difference between CAR low forecasts and the DAA operational costs requirements amounts to an average of only 90 cent per passenger. It would be our submission that on this basis, any potential benefits which may arise through delivering this charge are not equal to the upheavals which would inevitably arise.

The implementation of this charge may result in:

- Reduced investment in the airport
- A failure to deliver on the needs and expectations of passengers and airlines
- Potentially disruptive industrial relations activities
- A potential huge change in the business model and operations of the airport through the use of outsourcing
- Reduced returns to shareholder
- An inability to deliver on government aviation policy
- Potential disruptions and risks to service
- An unsustainable main airport
- Reputational damage nationally and internationally
- Negative impact on ability to borrow and/ or refinance
- Negative impact on investment rating of DAA

The structuring of this charge means that CAR have ensured that DAA and its' employees would have to bear the hardships resulting from the drop in revenues and ensuring that they will receive no returns or upside.

The risks and difficulties for DAA in seeking to bring the airport in line with theoretical norms in order to deliver on this draft maximum charge seem entirely out of kilter with the benefits that could accrue and are neither wise, balanced nor reasonable.

In reality, the impacts of this proposed charge level need to be considered as part of a broader, balanced and contextualised approach and any charge should be determined on this basis.

ON BEHALF OF THE DAA TRADE UNIONS:

Greg Ennis – SIPTU

Ian McDonnell – TEEU

Brendan O'Hanlon – Mandate

Johnny Fox – IMPACT

Thomas Fitzgerald – Unite the Union

July 31st 2014