Dublin Airport Authority Comments on Other Parties Responses To CP2/2005:

Draft Determination and Explanatory Memorandum for Maximum Levels of Airport Charges in respect of Dublin Airport

22nd July 2005

DUBLIN AIRPORT AUTHORITY plc
ÚDARÁS AERFORT BHAILE ÁTHA CLIATH cpt

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Introduction

Dublin Airport Authority (DAA) and other parties made submissions to the Commission for Aviation Regulation (the Commission) on 1st July 2005, in accordance with the process outlined by the Commission in its consultation document CP2/2005. This document is DAA's response to the submissions of other parties as invited by the Commission.

As a preface, the key points put forward by DAA in its original submission are summarised as follows:

- There is unanimous agreement that additional capacity is required at Dublin Airport. Airport infrastructure cannot be delivered without an adequate income from charges to fund the investment. Maintaining a charges regime that is unsustainably low and circa half the level pertaining in comparator airports is not compatible with the sensible provision of this much needed capacity.
- The Capital Investment Programme (CIP) is DAA's best estimate of the capital expenditure required to meet forecast increases in demand at an acceptable service standard.
- DAA must maintain funding confidence and preserve an appropriate credit rating if it is to finance investment and do so efficiently.
- DAA has been advised that it will be required to pay dividends to its shareholder. This is a reasonable expectation of a regulated commercial entity with large-scale capital investment.
- In deciding on the final cap, the Commission must ensure that it adopts a symmetrical approach to risk, altering its price cap scenarios to incorporate possible downsides as well as upsides in its analysis of possible outcomes.
- The Commission's interpretation of the DAA draft financial projections incorporating planned capital expenditure shown in scenario 4, while representing a superior option to the other scenarios put forward, need to be incremented to reflect the changed business environment (including higher pension and security costs) since the projections were submitted, general business risks and to ensure the DAA's financial profile is sufficient to maintain its credit rating and ensure its financial viability.
- DAA does not accept that the levels of commercial revenue and operating costs can be improved to the extent assumed in S3 and has set out clear reasons demonstrating why some of the Commission's analysis leading to these conclusions overestimate revenue and cost efficiencies.
- Financial engineering of the scale necessary to bridge the FFO/Debt ratio as implemented in scenarios S5 and S6 simply defers the core financeability problem.
- The WACC (real, pre-tax) of 7.4% estimated by K&H significantly underestimates the WACC and is lower than required for a company facing the many risks currently faced by DAA, combined with the need to finance a sustained period of significant capital expenditure.
- Exceptional efficiency was achieved in the last few years, however, it should be noted that the period was also characterised by high traffic growth, staff reductions and no capacity additions. The company will continue to strive for efficiency gains in its cost base, though it will be increasingly difficult to achieve these gains – a commonly acknowledged issue for companies approaching the efficiency frontier. It is important that assumptions incorporated in the Final Determination regarding operating cost improvements are demonstrably realistic and achievable. In this context, the Commission must make adequate provision to cover the up-front costs associated with the operation of a voluntary severance scheme if headcount reductions are assumed.

- DAA acknowledges the largely positive conclusions of the TRL/ATRS benchmarking analyses of its efficiency performance. DAA is disappointed with the predominantly negative conclusions drawn by the Commission regarding benchmarking which DAA believes are at variance with the body of the benchmarking reports.
- Pension costs form a legitimate part of operating expenditure and as such should be allowed in operating expenditure as part of the Commission's Determination. DAA's projected costs are based on an actuarial assessment of the future costs of maintaining the existing pension benefits being paid.
- DAA strongly supports the Commission's amendment of the adjustments made in its previous determinations for so-called "imprudent expenditure". The clarification of the position in relation to the reintroduction of stranded assets as part of the roll forward of the RAB for Dublin Airport would improve investment incentives and reduce regulatory risk.
- Agreement of appropriate SLAs is a legitimate objective. But the process cannot be achieved in the time before CAR's final determination. Instead, it is a much longer-term process that can be progressed independently of the price cap regulation framework. The company reiterates its willingness to engage in more detailed discussion on this issue subsequent to the publication of the Final Determination.

Financial Viability

In their discussions with the Commission, S&P has identified the two main types of financial measure that are particularly closely monitored for credit rating purposes, namely interest cover (FFO interest cover ratio) and debt cover (FFO to debt ratio). S&P has further stated that the while DAA's business profile supports a rating in the A category:

> *"the financial profile is weak for an "A" category rating. The main threats to the company's future financial profile are: lower-than-needed airport charges; and the potential retention of liabilities associated with assets to be transferred to Shannon and Cork airports without adequate financial compensation in the form of further charge increases in the future. If these two issues are resolved negatively for DAA, the financial profile could be too weak for the current rating for the next five years".*[1]

Aer Lingus appears to argue, in its discussion on Scenario 5, 6 & 7, that FFO to debt ratios are only a concern for unregulated companies and states that:

> *"if interest costs rise, CAR will increase DAA's WACC to compensate and this will be passed on in higher prices".*

Aer Lingus' position is seriously undermined by the fact that it runs directly contrary both to that of the agency actually responsible for credit rating and practice in ratings assessments generally. Aer Lingus mentions a number of other ratios in passing but does not ascribe appropriate thresholds for DAA in respect of these. Further, its discussion on interest cover ratios fails to take account of the need to repay debt in addition to financing interest charges. Finally Aer Lingus implicitly recognises the difficulty with its logic by raising the prospect of retrospective price increases "to compensate".

[1] S&P Commentary Report June 22, 2005.

DAA welcomes the Commission's approach in stress testing the financial robustness of regulatory proposals. However, the scale of the adjustments computed by the Commission in S5 & S6 demonstrates that it is not appropriate to address financial viability by adjusting the time profile of regulatory depreciation in these circumstances. The Commission's S3 model, which does not meet requisite financial viability standards, in part given the inclusion of significant positive assumptions on operating costs and commercial revenues, demonstrates that the cost of capital applied (7.4%) is inadequate. The application of the cost of capital used in S4 (8.5%) would give rise to a considerably smaller scale of adjustment using the mechanism of accelerated depreciation, which would be more consistent with the regulatory precedents noted by the Commission.

Aer Lingus also rejects the time profiling of charges for financing reasons and states that it is unaware of any regulatory precedent for using this measure to adjust regulated cash flows. In fact, many UK regulators (including the recent Determinations from OFGEM, OFWAT and the UK Competition Commission) have included FFO to debt or similar measures (such as retained cashflow to debt or debt to EBITDA) in assessing financial viability.

Aer Lingus notes that "*Investment should only be reflected in charges once that investment is in use for the benefit of passengers*"[2]. If this approach was implemented by the Commission, this would place further pressure on DAA's revenues, which would possibly require a further forward adjustment in order to enable DAA's financial viability.

Capital Expenditure

As noted by DAA in its submission, airport infrastructure cannot be delivered without an adequate income from charges to fund the investment. Numerous independent reports, including those produced for the Commission, have highlighted the fact that Dublin's airport charges are amongst the very lowest in Europe. The current level of charges is inadequate if the company is to deliver the capacity required to meet demand and to provide an acceptable level of service quality. DAA welcomes statements from a number of respondents, which appear to support this core point:

- "Aer Lingus recognises the need for additional capacity investment at Dublin Airport and is of course willing to pay appropriate charges reflecting the cost of this investment"[3]
- "IBEC views it as important that, in making a price cap determination for our leading airport, a revenue base is provided which will allow Dublin Airport Authority to fully implement its capital investment programme within a reasonable timeframe. In this regard, we note the Commission's conclusion that relative to comparator airports, aviation charges at Dublin are at the lower end of the scale."
- ITIC stresses that a "no development" scenario "is simply not an acceptable option", despite the increases in airport charges that this implies.
- The TNS-mrbi survey published with the Commission's Draft Determination illustrates clearly that a majority of passengers are willing to pay up to an additional €3 per passenger in airport charges to fund improvements in key services/facilities.

The 2001 Determination was insufficient to fund capital expenditure to meet growth. As a result, capital expenditure reduced dramatically to a level of €10m in 2004, while at the same time

[2] See RAB section for further discussion of this point
[3] Aer Lingus Submission, pg 12

passenger numbers grew to the highest ever level. Service standards have also seriously deteriorated, reflecting the lack of investment. If the Commission accepts the views put forward by some parties that the price cap scenarios presented in CP2/2005 are "over generous" then future development will be compromised. Similarly, suggestions that no allowance be made in the Final Determination for urgently required capacity improvements, contradicts all the evidence substantiating the need for expansion to facilitate growth. Some respondents have made submissions that, if accepted, would ultimately result in a deterioration of the current unsustainable situation to the disadvantage of the airport, the travelling public, other airport users and the wider economy. In this context, we note the recent paper by the CAA[4] which indicated that

> *"Whilst consultation implies an active engagement and preparedness to listen to the views of current airlines, it is important to recognise that the obligation to consult does not mean that the agreement of all, or any, current airline users is required prior to an investment being included in the [Stansted] RAB. This is for the simple reason that the views of current airlines do not necessarily represent the views or interests of passengers or future airlines. Nor can the views of airline representative bodies be taken definitively to represent these views and interests. In theory at least, current airlines might also have a commercial interest in foreclosing opportunities for new entrant airlines, which outcome could be contrary to the long- term interests of passengers. So, no single airline, nor indeed group of airlines, can – or should – have the right to veto a particular investment or investments."*

T2

The recent government decision to allow DAA to construct the second terminal confirms that the terminal costs included by DAA in its capital investment programme should be retained. Aer Lingus suggests that, as an alternative, it could agree an exclusive use and long-term occupancy agreement with DAA, resulting in the airline controlling construction of the building[5]. IATA for DAOC notes, however, that:

> *"Passenger terminal facilities should not be designed specifically to suit the needs of one particular type of traffic or airline – as the airline business is continually changing and carriers are regularly going out of business (Sabena/Swissair). Therefore, the proposed terminal should have the flexibility to accommodate all carriers".*

T2 has been noted by the Government as representing a critical piece of State infrastructure underpinning the importance of Dublin Airport to Ireland. Charging and regulatory certainty is essential to facilitate a speedy progression of the Government's decision. The key issue for the Determination, therefore, is to allow a sufficient quantum of capital expenditure to facilitate delivery of the specified facility once the consultation process on the project has been completed. The best estimate of this quantum is contained in DAA's CIP document.

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[4] Further Consultation on the Regulatory Treatment of Preliminary Expenditure on New Runway Capacity, A CAA Consultation Document, July 2005

[5] We note that the Minister for Transport Martin Cullen T.D. recently stated that while he had not received such a proposal from Aer Lingus he was not supportive and the Government's decision is that the terminal will be owned and built by DAA. (Reports in Irish Times and Irish Independent, 12th July 2005).

Pier D

Aer Lingus claims that DAA's inefficiency resulted in the non-delivery of Pier D are difficult to understand. A number of well-publicised events intervened to delay the proposed construction of Pier D. These were as follows:

- An (ultimately unsuccessful) appeal to An Bord Pleanala by Ryanair taken in 2002
- An (ultimately unsuccessful) application by Ryanair for a judicial review of the Bord Pleanala decision taken in 2003
- A request from the previous Minister for Transport, Seamus Brennan T.D. in March 2004 for the Board of the company to refrain from entering into any contractual or other irrevocable commitment in relation to the proposed Pier D development until further notice. (This request remained in place until the Government issued its Aviation Action Plan in May 2005 and the location of the next pier is now being examined in the context of the current consultation process in relation to the Government approved T2 development).

In this context, suggestions that some of the costs of this project be effectively stranded due to inaction by DAA are untenable.

Parallel Runway

Uproar's submission refers exclusively to matters relating to the proposed parallel runway at Dublin Airport. DAA made a formal application to Fingal County Council in December, 2004 in respect of this project and the company is currently in the process of completing a supplementary submission to Fingal County Council as part of the statutory planning process. In the context of comments made in the submissions by Mr. Harley, DAA wishes to draw the following points to the attention of the Commission;

- The parallel runway project is currently the subject of a formal planning submission to Fingal County Council. This process is governed by the relevant statute, which is highly prescriptive regarding both form and content, including the need or otherwise for an Environmental Impact Assessment.

- It is the explicit intention of the Authority to ensure that this application (the December submission and the impending additional information submission) fully complies with all sections of the Planning Act in a manner that will enable Fingal County Council in the execution of their statutory duties with regards to the assessment of this application.

- At this point in the process, Fingal Council Council is the sole statutory authority with responsibility for assessing the compliance and validity of DAA's application for a new runway at Dublin Airport.

- The Dublin Airport Authority delivered a planning application of manifest robustness and quality, backed up by comprehensive studies and analysis produced by world class consultants with demonstrable expertise and track record in their respective disciplines.

- The DAA is engaged in a statutory process with Fingal County Council and intends to conclude this process prior to commenting on submissions from other interested parties, including Uproar, in line with normal practice.

Ryanair suggests that expenditure on the parallel runway should be deferred until the airport handles 35m passenger per annum on a single runway, similar to the situation at Gatwick Airport in the UK. Passenger throughput relates to passenger terminal capacity and runway capacity relates to aircraft movements. The comments regarding Gatwick Airport also ignore the influence of passenger mix, average aircraft size, as well as routine aircraft queuing/ stacking at Gatwick, which is very different to the situation at Dublin Airport making the comparisons invalid.

Dublin Airport is involved in a program to maximise runway capacity on the existing runway 10/28. The program is aimed at increasing runway capacity by around 5 movements per hour from 2004 to 2009 and involves benchmarking runway operations at Dublin airport with those at London Gatwick. Consultants (NATS UK) who also provide capacity assessment work for Gatwick are assisting in this project. The program is being driven by the Dublin Airport Runway Capacity Group which comprises representatives from Aer Lingus, Ryanair, Aer Arann, Cityjet and Air Traffic Control. Aircraft movements on runway 10/28 are expected to be operating at the maximum runway capacity level, based on the traffic forecast figures, before the parallel runway comes into operation.

CIP Consultation

Ryanair's submission is principally based around a letter sent to DAA regarding the Capital Investment Programme (CIP). Many of the issues raised in this letter had previously been discussed with Ryanair in consultation meetings and in other correspondence. DAA has since responded to this letter.

Similarly, DAOC's submission[6] is composed of a series of detailed queries regarding the CIP. We received feedback on the CIP from DAOC only through the Commission's website, although there had been many opportunities to comment on DAA's capex plans since the current CIP consultation process began late last year. Nonetheless, we welcome the response, as we are anxious to engage with users in a constructive debate on this important issue. DAA has since responded to DAOC in respect of the issues raised in the IATA document.

The Commission has separately been provided with copies of DAA's responses to both DAOC and Ryanair.

It is interesting to note Aer Lingus' comments on the consultation process in the context of the Commission's desire for consensus between airport and Dublin Airport users on capital expenditure viz:

> *"we are concerned that the burden of agreeing DAA's plans will fall disproportionately on Aer Lingus….we are also doubtful that other major carriers at Dublin would participate cooperatively in the process".*

DAA has consistently tried in good faith to develop an inclusive consultation process and to address our customers' concerns. However, it is clear, as illustrated by these comments from Aer Lingus, that consensus can only be achieved if airlines are willing to engage constructively in the process.

In this context, the Commission must decide whether the DAA's informed view of capital expenditure requirements of the airport for the next ten years is appropriate in the context of the

[6] We note that the DAOC document bears a date after that set as the deadline for receipt of statutory submissions in response to CP2/2005.

strong demand projections for the future, CAR's statutory obligations to facilitate the development of the airport to meet that demand and the expressed views of other users i.e. passengers. In making its decision, the Commission should note the short-term focus of airlines as opposed to the long-term planning and development requirements of airports and assess whether it is appropriate that this short-term focus should determine the level of investment in airport facilities in the long term.

Operating Efficiency

DAA refutes the claims made by Aer Lingus and Ryanair that the proposed DAA operating expenditure allowance for 2006 as set out in the draft Determination is too high and that there is scope for more challenging efficiency targets to move Dublin Airport closer to the efficiency frontier.

Benchmarking

Airport users have based their calls for higher efficiency targets on a predominantly negative view of DAA efficiency. This is demonstrated where Aer Lingus state that

> *"The benchmarking evidence presented suggests that Dublin Airport is a long way from the efficiency frontier defined by its best comparator airport."*

However, this is at variance with a number of positive conclusions arising from the TRL/ATRS benchmarking analyses of DAA's efficiency performance, for example,

- Dublin Airport's labour costs per passenger are 44% lower on a comparable basis than the average of European airports[7]
- Total core costs per passenger are ranked second lowest out of a group of 25 European airports
- Passengers processed per gate is twice that of others reviewed
- Runway utilisation is highest in the sample[8] except for the 2 largest UK airports

The TRL/ATRS benchmarking analyses confirms that Dublin Airport is in the top quartile in terms of efficiency when compared to peer airports[9].

TRL's unfavourable comparison of Dublin Airport with Copenhagen Airport is related to the fact that Dublin Airport engages directly in retail, car parking and other activities, while Copenhagen Airport does not. As the direct costs associated with these activities are included in Dublin Airport's operating costs but do not feature in those of Copenhagen, any comparison of results is apparently adversely skewed against Dublin Airport, without it being evident or necessarily the case that there is any underlying inefficiency arising from the Dublin operating model. Therefore the assumed gap

[7] Despite being located in a high wage economy
[8] A sample of 33 European airports
[9] It should be noted that DAA has previously highlighted the shortcomings associated with the use of partial productivity analysis in assessing airport efficiency. This form of analysis looks at a single comparative measure and does not take account of differences between comparator airports such as the proportionate use of capital and labour resources, the range of activities carried out by the airport, passenger mixes, the airport's stage in its investment life cycle, capacity availability, service quality, peakiness of traffic and levels of airport charges. Such partial productivity analyses give indicative information at best, and in some cases can produce misleading outputs.

between the so called efficiency frontier and Dublin Airport is smaller than suggested by ATRS/TRL and may not even exist when like is measured with like. It is also worth noting that aeronautical revenue per passenger at Copenhagen is approximately double that at Dublin, so despite appearing more efficient, Copenhagen is also a considerably more expensive airport.

In addition, it should be noted that the TRL/ATRS benchmarking is predominately based on 2001-2003 data. It is important to bear in mind that DAA continues to achieve productivity gains. In particular, DAA in a response to the Commission's queries re operating costs, submitted on 19th May, demonstrated efficiencies in payroll and non-payroll operating costs amounting to 20% and 25% respectively for the period 2001 to 2005, with a significant element of these efficiencies gained during 2004 and 2005. These efficiencies are already factored into the cost base assumed for the DAA projections.

Efficiency Targets

DAA does not accept the Aer Lingus suggestion that there is a need for an imposition of a general efficiency target to ensure that DAA keeps pace with the general rate of productivity improvement in the sector as a whole. Regulatory precedent recognises that, since general economy-wide productivity growth is already reflected in changes to the CPI, efficiency targets should be based on the rate of productivity growth that might be realised by an efficient airport operator, and whether this is higher or lower than the economy-wide rate of productivity growth. There is therefore no evidence to support the Aer Lingus proposition that further efficiency targets need to be added to take account of the general rate of productivity improvement in the sector as a whole.

DAA strongly supports the suggestion made by Aer Lingus that if DAA does outperform its operating efficiency targets then it should be permitted to retain this benefit for a period of five years by being granted an out-performance allowance in addition to its base level operating expenditure allowance in the next Determination. This is particularly appropriate given that inefficiency penalties tend to have a duration of five years and a symmetrical treatment of the benefits /costs arising from efficiency savings and inefficiency penalties is desirable. Any alternative approach would be asymmetrical with the regulatory approach to the 2001-2005 period.

Incorporation of Real Wage Inflation

In its submission, Aer Lingus states that firms should not be allowed to build real wage inflation into their cost estimates, and asserts moreover that this view *"is consistent with regulatory precedent, including the treatment of BAA and Manchester Airports at their most recent price review".*

This statement is highly misleading, and appears to draw an incorrect conclusion. It may perhaps be based on

- a general statement in the Competition Commission's 2002 report on BAA that *"We have no objection to such an assumption of real pay increases as long as it is financed by real productivity increases"* (see paragraph 2.350) or
- a decision by the Competition Commission to reduce Manchester Airport's projection of real wage increases from 2% a year to 1% a year.

In both cases, and contrary to Aer Lingus' assertion, the Competition Commission did allow BAA and Manchester Airport to build real wage inflation into their cost estimates. In BAA's case, the Commission accepted BAA's projections. In Manchester's case, the Commission did not take a

view that real wage increases should not be allowed at all, but simply that Manchester Airport's projections were too high.

In general, regulators consider projections of real wage inflation taking account of all relevant factors (market conditions, changes to working practices, etc) rather than adopting the approach suggested by Aer Lingus. These are then taken into account, alongside other input price changes, when projecting operating expenditure. Aer Lingus seems to be suggesting that the Commission should set efficiency targets for DAA, but not take account of the impact on real wage inflation when translating these efficiency targets into operating expenditure projections. This is clearly inconsistent and is certainly not in line with regulatory precedents.

In addition, it should be noted that in its report, BAH consultants to the Commission comment on that historically in DAA

> *"Pay cost inflation has been high, but has been in line with national pay agreements with the addition of a productivity agreement in 2001, and is very similar to Aer Lingus."*

Efficiency and Security Screening

Aer Lingus asserts that queues at security screening are a result of a historical failure on the part of DAA *"to invest in the infrastructure necessary to expand screening capacity".* This is not an accurate portrayal of the current situation and the following points are pertinent:

- It is true that operational congestion problems at the airport derive principally from the lack of investment in recent years. However, it is inherently contradictory for Aer Lingus to oppose capital expenditure by the airport authority, as it did in very strong terms at the last Determination[10], and subsequently complain when the result is an inability on the part of the airport authority to provide capacity when required.

- The recent additional security measures have resulted in the introduction of an extra 60 FTEs[11] at security screening and an increased number of x-ray points. This has taken place at significant cost to the company. While these actions will assist in processing passengers more quickly, increasingly onerous security measures will counterbalance them[12]. There are, of course, additional costs involved in installing and operating an increased number of security units and, given Aer Lingus' stated concern regarding security screening queues and the effect on its operation, we look forward to its support for the incorporation of these costs into the Commission's analysis of DAA's operating costs for the Final Determination.

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[10] "*We do not support any of the capital expenditure projections or the recoverable capex programme set out by the Commission*"; " *We require that the Commission sets allowed capital expenditure at zero for all investment categories*" Aer Lingus Submission in Response to CP6/2001, Pages 3,5

[11] Equivalent to approx 135 reduced hours staff

[12] It is important to note that the general trend in security cost has been upwards over the past few years as new aviation security regulations are imposed and implemented. EC No.857/2005 of 6th June 205 amending Commission Regulation (EC) No.622/2003 Laying Down Measures for the Implementation of the Common Basic Standards on Aviation Security is the latest development of this nature and applies from 27th June 2005. It requires increased hand searches at security screening points at airports and DAA is currently assessing the costs associated with its implementation. The Commission in its Determination must also acknowledge the risk of further externally imposed requirements.

Weighted Average Cost of Capital

Aer Lingus sets out an estimate of the real pre-tax WACC of 6.1% for DAA compared to the Kearney and Hutson estimate of 7.4%. Both of these estimates are significantly lower than required. The Aer Lingus estimate is based on selective use of Kearney & Hutson parameters, which are themselves downwardly biased, and other selective adjustments.

Risk Free Rate

Aer Lingus states that it agrees with Kearney & Hutson's estimate of the real risk-free rate of 2.6%[13]. NERA have set out a number of reasons why this estimate is downwardly biased[14]. These are summarised as

- Downward bias of UK ILG yields from 1997 onwards;
- Incorrect deflation methodology of nominal German government bond evidence;
- Erroneous deduction of inflation risk premium for the cost of debt; and
- Lack of robustness in inflation risk premium derivation and incorrect application to risk-free rate estimate.

NERA has also set out evidence on Eurozone index-linked government yields showing a real risk-free rate of 3.0%[15].

Equity Risk Premium

Aer Lingus suggests that Kearney & Hutson's estimate of the Equity Risk Premium (ERP) of 6.0% is too high. Aer Lingus makes a number of incorrect assumptions in setting out its comments on the ERP.

- Aer Lingus cites a geometric average of 4.6% for a world index and 5.6% using arithmetic averages derived from Dimson, Marsh and Staunton (DMS)[16], which is inappropriate. The citation of a geometric mean contradicts DMS' approach to estimating the prospective equity risk premium and reference to mean reversion in support of the use of a geometric mean is therefore irrelevant. DMS (2001) state that *"when decisions are being taken on a forward-looking basis, however, the arithmetic mean is the appropriate measure since it represents the mean of all the returns that may possibly occur over the investment holding period".*[17]

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[13] Kearney and Hutson (2005) "Dublin Airport Authority's Cost of Capital: Report to the Commission for Aviation Regulation" (hereafter K&H)

[14] NERA (2005b) "The Cost of Capital for the DAA: A Response to the Kearney and Hutson Paper".

[15] NERA (2005a) "The Cost of Capital for the DAA; A Final Report for the DAA"

[16] We are assuming Aer Lingus are referring to DMS (2002) *"Triumph of the Optimists: 101 Years of Global Investment Returns".*

[17] DMS (2001) "*Millennium Book II: 101 Years of Investment Returns". DMS do consider adjustments to the arithmetic mean for differences in volatility historically versus likely forward looking volatility and other factors. We take account of the former (contested (DMS are themselves cautious about their volatility adjustments)) view in determining the ERP in NERA (2005a) and with regard to the latter, adjustments for these factors are highly contested and it is recognised by the authors themselves that their bases for adjustments are naïve and simplistic in a number of cases.*

- Aer Lingus argues that an arithmetic ERP on the world index over rolling ten year periods of 4.7% shows mean reversion in equity returns and that this evidence would suggest an ERP of 5.0%. This would result in an internally inconsistent estimate of the cost of capital for the DAA as the World Index is heavily weighted towards US returns. Significant differences between the US and European markets in capital market behaviour existed during the earlier parts of the 1900-2000 measurement period referred to by Aer Lingus and the World Index cannot be considered an appropriate reference market. As a forward looking proxy for the ERP, Eurozone evidence is most appropriate and is internally consistent with a real-risk free based on Eurozone government bond yield evidence. The average arithmetic equity risk premium for the Eurozone countries cited in DMS (2002) consistent with Aer Lingus's cited reference is 6.5%. This is slightly higher than the NERA and Kearney & Hutson estimate of an ERP of 6.0%.
- Aer Lingus also cites the UK Competition Commission's use of a 3.5% estimate of the ERP in the calculation of the cost of capital for BAA. This citation of a single piece of outdated UK regulatory precedent is selective. More relevant European regulatory precedent is consistent with an ERP of 6.0%, as outlined by NERA. We also note that more recent UK regulatory precedent has started to move away from the use of small sample survey evidence which underpinned comparatively low estimates of the ERP, and towards long run historical evidence of equity returns and use of ex-ante evidence in addition to survey evidence. This is consistent with recent UK regulatory precedent on the ERP, which has been significantly higher than previously, as set out in NERA (2005a).

NERA has estimated an ERP of 6.0% based on DMS long-run historical evidence for the Eurozone and world average. This is consistent with Irish and European regulatory precedent. [18]

Beta

Aer Lingus agrees with an estimate of an asset beta of 0.5 for BAA but does not accept the 20% uplift applied by K&H in deriving an asset beta for DAA. Aer Lingus' agreement with K&H's 0.5 asset beta estimate for BAA is unjustified as K&H make a significant error in their estimation of BAA's asset beta. As outlined by NERA, K&H's incorrect use of current gearing in de-levering BAA's asset beta instead of the correct use of gearing over the beta measurement period leads to an underestimation of BAA's asset beta by 0.13. The corrected de-levering of K&H's estimated equity beta for BAA results in an asset beta of 0.67.

Aer Lingus dismisses K&H's arguments for the conclusion that DAA faces higher risk than BAA for a number of unfounded reasons. The Aer Lingus criticisms of K&H's justifications for a higher DAA beta vis-à-vis BAA are either incorrect or misinterpret the evidence presented.

Aer Lingus suggests that DAA's rating is lower than BAA due to differences in gearing which is incorrect. Firstly, S&P state that DAA's current credit rating is primarily driven by business risk exposures and DAA's downgrade from A+ (which is BAA's current rating) to A (negative outlook) was attributed by S&P to business risk assessments.[19] Secondly, whilst BAA does currently have lower gearing than DAA, this is irrelevant to DAA's current rating vis-à-vis BAA. DAA's current

[18] We use the world average in analysing DMS long run historical returns, which is significantly less weighted towards US evidence than the World Index referred to by Aer Lingus.

[19] S&P (20/10/2004) "*Summary: Dublin Airport Authority Plc*" (p2): *"The negative outlook reflects the uncertainty surrounding the company's future credit profile. The competitive position is expected to remain strong, but the outcome of the expected regulatory reset will be key for the ratings. The negative outlook will remain until the company's future operating environment can be assessed. Furthermore, any decision to approve an independent terminal at Dublin Airport could be detrimental to credit quality."*

gearing of 47% is in line with its average gearing over 2002 (48% as of December 2002 and 46% as of December 2001).

Aer Lingus comments that it is unclear that DAA is subject to more uncertainty regarding construction and legal challenge than BAA, however this is not justified. T5 is underway and investors are certain of BAA's operation therefore there is no competitive threat, which would be substantial to DAA should operation be undertaken independently. Aer Lingus also argues that, by definition, uncertainty regarding T2 will be resolved before the project starts therefore the WACC should not include an allowance for this. This is not the correct way to interpret the increased risk exposures to DAA arising from T2 given that, under all scenarios, DAA will face higher risks to demand from competition and/or greater capital expenditure risks.

With regard to K&H's other key point regarding asymmetric risk, Aer Lingus incorrectly interprets K&H's analysis. K&H state that

> "*in the aftermath of 9/11 and the recent Asian influenza epidemic, there is a greater perceived possibility of downside shocks in the aviation sector. Although our analysis in section 2.3.1 demonstrated that there does not appear to be unusually negative skewness in the historical distribution of airport stocks returns, it is possible that such global shocks to the travel and aviation business may have a greater effect in the future.*"

We agree that outturn analysis of historical returns does not correspond to expectations of risk which drive the cost of capital. The study of outturn returns does not necessarily inform on *perception* of risk to investors. It is clear that repeats of 9/11, SARS-type scares and regulatory risk are almost wholly negative in terms of real impact on profits, however short term the persistence of effects a real loss in profits occurs. Inverse positive shocks of similar likelihood or magnitude cannot be identified within the airport sector, indicating a negative skew to expected returns.

Funding of Incremental Investment

Aer Lingus states that

> *"CAR, however, is failing to appreciate the scope for the use of limited recourse debt to fund individual projects or activities within an airport, and thus obtain marginal funding at rates well below the WACC without raising the cost of equity. Limited recourse debt involves the lender taking on some of the project risk. This is achieved by ring-fencing the debt to a particular project (for instance the baggage handling system) and linking repayments to some metric of performance (e.g bags carried, passengers served) rather than a fixed repayment schedule"*

However, Aer Lingus does not provide evidence that incremental finance is available to DAA on a limited recourse basis and/or securitised against specific activities and that it would be efficient for DAA to raise finance in such a manner. Even where structured finance products have been used by regulated activities, regulators have generally not adjusted the cost of capital for the overall entity.

In the UK Water Sector, for example, which is arguably the sector most reliant on securitised structures, the regulator Ofwat recently rejected the adoption of a structured finance approach in assessing the cost of capital at the PR04 price review. Ofwat based the cost of capital on a conventional financing structure (gearing of 55%), stating that

"to rely wholly on debt would risk forcing the whole sector into an unsustainably brittle structure to the ultimate detriment of customers. Accordingly, we believe that our approach to setting price limits should create conditions under which the funding for the additional investment required could come from debt or equity."[20]

In the electricity transmission sector, Ofgem also based the cost of capital on a conventional financing structure (gearing of 57.5%) in setting prices for electricity distribution companies (DNOs) in November 2004 even though many of the distribution companies have adopted highly leveraged structures.[21]

The reason why regulators have not taken account of the specific costs of structured debt finance is that there is no conclusive evidence that the use of this type of finance does reduce the overall cost of capital for the entity as a whole. A significant body of studies on the issue of securitised finance has been undertaken in the UK as a result of recent developments in the UK debt market, notably with respect to the UK water sector. A paper by Oxera commissioned by Ofwat in 2002 did not conclude on whether securitised structures should be taken into account in setting prices

"On balance, we would urge caution and not place too much weight on the recent water company restructurings. Over time, evidence may be accumulated of real benefits to the new governance arrangements and at that stage the costs of the equity model may legitimately be deemed too great."[22]

A real reduction in the cost of capital for a particular entity can only be attained if an actual reduction in risk or elimination of market inefficiency can be attained via securitisation. The main possible ways that this may occur under securitisation have been suggested as[23]

- Exploitation of incomplete (missing) and niche markets via the process of tranching undertaken as part of securitisation;
- Reduced agency costs and business risks arising from the covenants and conditions imposed on business operation and managerial discretion associated with securitised issues;
- Reduced bankruptcy costs and enhanced recovery rates.

However, the degree to which these factors are actually significant is unclear, particularly where whole groups of activities are securitised as an entity and particularly for activities where there is a high cost to the loss of managerial discretion and the imposition of restrictive covenants. This is echoed by Oxera (2005)

"…the entire securitisation set-up might prove to be simply not worth it. Costs associated with setting up an independent legal entity, the public verification process (rating), custodians, lawyers, paying agents, and arrangers (the lead managers) all render securitisations among the most expensive financial contracts of all. Net of all these expenses, only some companies are likely to benefit substantially from these financing schemes."[24]

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[20] Ofwat (2004) *"Future water and sewerage charges 2005-10: Final determinations"*
[21] Ofgem (2004) *"Distribution Price Control Review - Final Proposals"*
[22] Oxera (2002) *"The Capital Structure of Water Companies"*
[23] See for example Oxera (2005) *"Seeking the rationale behind structured finance"*
[24] Oxera (2005) *"Seeking the rationale behind structured finance"*

Finally, Aer Lingus' argument that the ring-fencing of activities means that the cost of capital of existing equity will not be affected is not correct. Firstly the type of incremental investment activities likely to arise for DAA will not be feasibly separable or perfectly ring-fenceable from other activities as argued by Aer Lingus in its justification of the immunity of the cost of equity to their proposed type of financing. Secondly, notwithstanding this, equity holders (and indeed existing debt holders) do not base their behaviour on static operating conditions – the cost of capital is determined by equity and debt holders' perception of risks around *future* cashflows, including returns on expected investments. Securitisation is most suitable for lower risk activities. Airports' regulated activities, particularly for single-till regimes, vary greatly in risk (e.g. aeronautical vs non-aeronautical). By separating out the returns on safer investments from those available to equity holders in the way suggested by Aer Lingus, the weighted risk to future returns to equity holders will increase. The cost of equity will therefore increase. We would expect to see the forward looking non-securitised cost of debt to increase in a similar fashion.

Extracting value from securitisations may also simply arise from the spinning off of riskier activities. Apparently lower costs of debt in the water sector for securitised assets may be a result of the separation of lower risk activities from riskier non-regulated activities as the issuer of debt rather than any real elimination of inefficiency or risk. This does not mean that the cost of capital of the underlying core regulated activity in totality (averaging across classes) is any lower following securitisation, merely that securitisation enables the cost of capital on the pure regulated activity to be observed.

The Suitability of DAA to Securitised Finance

Notwithstanding the lack of evidence that securitisation reduces the cost of capital, the use of securitisation in the context of DAA is not feasible nor attractive for four key reasons

- Incremental airport sector investment in general is less amenable to securitised structures, due to lack of divisibility of assets and revenues from activities (e.g performance of baggage system will impact demand for other regulated activities and vice-versa) and relatively high variability of risks of various activities contained within the regulatory scope (particularly under single till regimes). Notwithstanding this, the relatively small scale of incremental investments will mean that the high upfront costs associated with establishing a separate legal entity, ratings and legal costs and other costs discussed above will make securitisation unfeasible. This is evidenced by the scale of securitisations commonly undertaken in the UK water sector which tend to occur at the regulated entity level.[25]
- As discussed, securitisation structures best suit sectors characterised by stable cash flows, simple technology, and established business models where limiting managerial discretion is relatively low cost. It is not clear that this is the case in the airport sector where investment growth in new assets (as opposed to maintenance which is significant in sectors such as water) is relatively high and technological developments may have a greater role than in sectors such as water and electricity transmission.
- Securitisable investment opportunities in the airport sector are likely to be only feasible from both regulatory divisibility and cost effectiveness (with respect to transactions costs) perspectives at the level of significant investment projects such as new terminals as cited by

[25] Northumbrian's securitisation against the revenues it receives from running Kielder Reservoir is a notable exception. However this project is significantly sized – the amount of debt raised was €310m compared to DAA's group entity value of €820m in 2004. This compares with a significantly lower estimated cost for the entirety of terminal two.

Aer Lingus. However, at this level of activity, it is not clear that the cost of securitised debt on the total asset returns will be any different from conventional financing on existing assets (it may in fact be higher due to higher risk associated with new investment).

- The tax benefits of debt instruments are significantly lower in a low tax environment such as Ireland, where the tax rate is around a third of that in the UK where notable securitisation activity has occurred in regulated utilities.

Regulated Asset Base

Adjustments for "Imprudent" Investment

DAA strongly supports the Commission's proposed reversal of prior adjustments made for so-called "imprudent expenditure", as the clarification of the position in relation to the reintroduction of stranded assets into the Dublin Airport RAB will improve investment incentives and reduce regulatory risk[26].

Some commentators have argued against the Commission's proposal to add back the value of assets previously excluded from DAA's RAB. While endorsing the principles underlying a rolling incentive mechanism, Aer Lingus argues that

> *"this rolling adjustment process should not be confused with the need to adjust DAA's RAB for investments that have been imprudently undertaken or not carried out at all".*

DAA agrees with the Commission that a symmetrical treatment of the benefits /costs arising from efficiency savings and inefficiency penalties is integral to the framework for incentive regulation. Given that it is accepted that a regulated entity will only get to retain any efficiency savings which it has achieved in implementing its capital investment programme for the duration of a regulatory period (usually five years) it is therefore appropriate that any penalties imposed for capital inefficiencies should also have a limited maximum duration.

The adoption of this balanced approach to capital investment expenditure, with an even-handed treatment of both the efficiency saving and inefficiency penalties, is critical, if the Commission is to maintain the incentive properties of the price cap regulatory model.

Treatment of Assets in the Course of Construction

Aer Lingus proposes that assets should only be included in the RAB once they come into operation and that DAA would not be remunerated for assets in the course of construction until this had occurred. Aer Lingus also proposes that the Commission should apply a "logging up" mechanism in relation to the incorporation of new assets in the RAB. Under this proposal, expenditure would be

[26] DAA has expressed its opposition in earlier submissions to the stranding of certain assets over the regulatory period 2001-2005 and would like these points to be reviewed by the Commission as part of its deliberations. In addition to the case made in earlier documents, the conclusion from the Commission's consultant WHA in the Assessment of 2003/04 Handling Capacity of Dublin Airport that there is *"an overall stand capacity deficit, with a particular need for additional aircraft contact stands"* strongly supports the reintroduction of the six aircraft stands stranded at Dublin Airport at the last Determination.

logged as soon as it took place but assets would not enter the RAB and become remunerated until the start of the following regulatory period.

These proposals, if implemented, would create a time lag between DAA's initial investment and the potential remuneration of its investment and would as Aer Lingus acknowledges

> "…*leave DAA in a difficult position, because if capex is not included in the Draft Determination, then it is not clear that DAA will be remunerated for it*".

The introduction of this proposed mechanism would create additional risk and uncertainty in relation to the remuneration of capital expenditure which would hamper DAA's ability to raise adequate finance for development and weaken incentives for the delivery of much needed investment in airport capacity. Given the increase in regulatory risk, it could potentially increase the cost of capital. Importantly, such an approach would, in the circumstances, be in conflict with the regulatory objective to enable DAA to operate and develop Dublin Airport in a sustainable and financially viable manner and could increase the financeability adjustment required.

In addition, we note that UK regulatory practice has favoured some degree of "pre-funding" of investment rather than face the prospect of very steep rises in airport charges at some time in the future. In paragraph 2.264 of the Competition Commission's 2002 report on BAA, it is stated that

> *"In our view, some additional funding while assets are being constructed remains necessary to secure funding for a major project and/or reduce the costs of funding. Allowance for AICC [assets in the course of construction] is also desirable to avoid undue volatility in prices: a factor in previous MMC reports, airlines previously telling us they disliked volatility. Allowance for AICC would also, in our view, reflect what would be reflected in more competitive markets, with prices somewhat higher when pressure on existing demand is greatest, and lower when capacity comes on-stream."*

We also note the Commission's support for the inclusion of assets in the course of construction in the RAB in its last Determination where it stated that it had

> *" ….included in the RAB the capitalised value of assets in the course of construction (AICC) in order to ensure that Aer Rianta has sufficient funds with which to fund the capital costs associated with the construction of such assets (that is, the cost of equity or of debt), thereby facilitating the sustainability of its airport operations, to maintain price continuity, to reduce the risk of assets stranding and consequent cost of capital increases and to ensure investment is made at the appropriate time."*[27].

DAA believes that the Commission's arguments for the inclusion of assets in the course of construction in the RAB remain entirely valid and sees no economic reason why the approach should be altered.

Proposal to Excluded Capital Expenditure on the Basis of Uncertainty

Aer Lingus suggests that there are too many unresolved issues relating to the proposed T2 for its inclusion within the RAB in the forthcoming Determination. If Aer Lingus' proposals in relation to the

[27] CP9/2001 page 37

funding of T2 were accepted, this would result in all remuneration in relation to this project being delayed until future regulatory periods.

Uncertainty about future investment costs is not a good argument for excluding these costs from the Determination altogether. DAA believes that issues surrounding uncertainty in relation to capital expenditure can be adequately addressed if the Commission adopts the proposed methodology as suggested by DAA, whereby the RAB is rolled forward on the basis of actual net investment (capital expenditure less the value of asset disposals). However, this will require that any adjustment process that applies when capital expenditure is higher or lower than expected will need to be stated explicitly. Once such an adjustment process has been defined, then the price cap can be set on the basis of current expenditure forecasts, even if there are uncertainties attached to them.

This approach has been used by a number of UK regulators in situations where some or all of a firm's capital expenditure was uncertain. Examples include

- the Civil Aviation Authority's treatment of NATS' general capital expenditure, especially for the first control period as the price cap was set before the government's strategic partner had been selected and there was therefore considerable uncertainty about NATS' entire business plan
- the Office of the Rail Regulator's 2000 treatment of expenditure on train control systems (eg signalling and telecoms) – this category of expenditure was particularly uncertain, and therefore ORR provided for a specific adjustment in relation to these costs at the next price review.[28]

Aer Lingus' proposal risks delaying much needed investment[29], especially if the suggested logging up process is cumbersome or if DAA needs to incur significant expenditure in advance of the project being defined in sufficient detail. This process also has some similarities to the framework for approving "necessary new investment" that was briefly applied, rather unsuccessfully, to regulated airports in Australia. Commenting on this system, Professor Peter Forsyth notes that

> "*these provisions resulted in very detailed intervention by the regulator, which was required to make an assessment even for quite minor investments – this led to high compliance costs*", and also that "*Given the information asymmetries, there is a high chance that the regulator will get it wrong, refusing price increases when investment is needed, and granting price increases where they are not necessary*".[30]

While there may be uncertainty associated with the T2 project, Aer Lingus does not demonstrate why its proposed approach is better than including the best current estimate of T2 costs in the determination and making a retrospective adjustment if required where costs are higher or lower than this.

[28] See Section 16 of Office of the Rail Regulator, "The Periodic Review of Railtrack's Access Charges: Final Conclusions", October 2000.

[29] It should be noted that if the Commission ultimately decides to incorporate a reduced level of capital investment then this may have implications for future operating expenditure and commercial revenues which also will need to be taken into account by the Commission in its regulatory projections.

[30] Forsyth P, "Replacing Price Regulation: Airport Price Monitoring in Australia", in Forsyth P, Gillen D, Knorr A, Mayer O, Niemeier H-M and Starkie D (eds), *The Economic Regulation of Airports*, Ashgate, 2004.

Proposal for a Rolling Incentive Mechanism

Aer Lingus states that it supports the suggestion of a rolling incentive mechanism for capital expenditure and refers to OFWAT's system as a possible model. This proposal would require both a clearly articulated and costed investment programme and a clearly articulated statement of the outputs that will be delivered in future. This would also require a level of detailed intervention by the regulator which may greatly increase the cost of managing capital expenditure programmes or affect its timing, which could potentially drive up the costs of regulation. There is also a concern that this mechanism could blur responsibility for the effective delivery of capital programmes. There could be a number of issues such as the difficulty of measuring certain important aspects of outputs (such as safety, service quality, etc), the uncertain relationship between inputs and outputs and the need to ensure that remuneration for efficient investment is not withheld "by accident" within such a framework.

Aer Lingus' reference to the OFWAT model ignores the fact that there are certain aspects of the UK water industry, which particularly facilitate the use of a rolling incentive mechanism. In OFWAT's case, it benefits from the ability to draw information from ten different regional companies.[31] OFWAT also benefits from the fact that compared with airport projects, investment in the water industry is significantly more homogenous and certainly much less "lumpy". The difficulties of costing a new terminal at a particular airport are likely to be far greater than the difficulty of costing the continuation of a mains replacement programme for one of ten regional companies.

Where the mechanism is based on outputs delivered (rather than investments undertaken – ie inputs), this will require both the ability to specify outputs clearly and robustly (e.g. in a way that does not depend on airline behaviour) and also a clear and accurate understanding of the relationship between inputs and outputs. Both areas are likely to be problematic. In addition, as noted above, the logging up process is also likely to be cumbersome and could delay or even deter investment that is needed because of mid-term developments.[32]

Pensions

Pension costs incurred by the company form a legitimate part of operating expenditure and as such should be allowed as part of the Commission's Determination. We note that Aer Lingus concurs with DAA in concluding that any adjustments for additional pension costs should be made via operating costs rather than capitalised in the RAB as proposed in CP2/2005.

A confidential Appendix is attached in relation to this issue which forms part of this response.

[31] This also applies in the other main case where such a mechanism has been used – by OFGEM for regional electricity distribution companies.

[32] This applies in any case, but especially if airlines are involved in the logging up process, as suggested by Aer Lingus.

Service Quality

DAA fully accepts that users are entitled to understand the levels of service they should expect in return for the airport charges levied. It is interesting to note, in this context, that DAA is achieving the targets established for it under the existing Service Level Agreements (SLAs) - except for security screening, which is being addressed at present[33]. The company publishes details of its performance against targets on a regular basis.

Given that airports are part of an integrated structure of activities and processes where each part impacts and depends upon the others, DAA believes it is important that service standards be applied to all service providers at the airports, including airlines and handlers[34]. Minister Martin Cullen echoed this view in a recent interview where he stated that it takes all parties involved in operating the airport to make things run smoothly:

> *"Everyone has a responsibility in this, all of the servicing companies not just one. I am convinced that if they work together everyone wins"*[35]

DAA supports the selection of a monitoring approach to service quality based on the existing SLAs, rather than a more complex penalty based system that would more likely lead to regulatory complications and associated distortions.

Aer Lingus has stated statement that it *"needs to understand the SLAs that DAA is willing to enter into with regard to the new terminal and the penalties for failure to deliver against those SLAs"*[36]. This statement is simply unrealistic given that the Government has indicated that an open tender competition will be held to select the operator of Terminal Two.

Agreement of appropriate SLAs is a legitimate objective. But the process cannot be achieved in the time before CAR's final determination. Instead, it is a much longer-term process that can be progressed independently of the price cap regulation framework. The company reiterates its willingness to engage in more detailed discussion on this issue subsequent to the publication of the Final Determination.

Sub-cap on Off Peak Runway Movements

DAA welcomes Aer Lingus' suggestion that there is no longer a need for a sub-cap on off peak runway charges given that Dublin Airport will become fully slot coordinated from 2006. This concurs with DAA's view that in the current capacity constrained environment, the existence of the current structure of off-peak charges adds an unnecessary layer of complexity without demonstrating any additional economic benefits.

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[33] As noted in the section of this document entitled "Operating Efficiency", DAA has now introduced additional security units at Dublin, which will assist in processing passengers more quickly, although increasingly onerous security measures will counterbalance this. There are, of course, additional costs involved in installing and operating an increased number of security units.

[34] In contrast to the transparency espoused by DAA, at present airlines and handling agents refuse to allow publication of their performance against the SLAs entered into in respect of their operations at the airport that impact on the efficient operation of the facility and the passenger experience.

[35] "Decision on second terminal site within weeks, says Cullen", Irish Independent, 12th July 2005

[36] Aer Lingus submission, page 13

However, DAA (and implicitly Aer Lingus) opposes Uproar's proposal for the introduction of new sub cap, which would be designed to penalise night-time flight operations. In principle, DAA is opposed to the application of any sub caps, as they severely restrict the ability of the airports to use the structure of airport charges to maximise economic efficiency. In regard to the introduction of a sub cap on night-time flights, DAA feels that this would be a particularly blunt instrument if the underlying intention is to minimise noise levels. As an alternative, DAA as the airport manager should be allowed to consider the implementation of noise based charges within the overall confines of the price cap set by the Determination. DAA also believes that the implementation of a further sub-cap relating to the use of the runway at Dublin Airport would be incompatible with the legislative requirement for the Commission to place the minimum restrictions on DAA.

Commercial Revenues

Aer Lingus draws a comparison between

- DAA commercial revenues of €2.58 per passenger up to 2009 and
- the UK Competition Commission's projection of more than £6 per passenger for Manchester Airport.

This comparison is misleading, as the €2.58 figure relates to net retail income per passenger, whereas the £6 per passenger figure includes all non-regulated revenues. Thus we note that

- The Commission's Annex 6 report states that DAA's total commercial revenues per passenger (including car parking, property income and a small amount of other operating concession income, as well as net retail income) are projected at between €6.24 and €6.33 between 2005 and 2010
- The £6 plus per passenger at Manchester includes a number of categories of revenue that are not included in the Commission's Annex 6 report, notably revenues from other charges to airlines (including charges relating to the use of the baggage system, check-in desks, aircraft refuelling facilities, etc), and also revenues from utilities and recharged costs (mainly utility and telecoms services) and revenues from cargo-only aircraft. Together, these revenues account for well over a quarter of the projected revenues for Manchester.[37]

[37] See Table 9.6 of the Competition Commission's 2002 report on Manchester Airport.

Appendix

Confidential Appendix - Pensions