Aer Rianta Response To Commission Paper CP4/2003:

Notice by the Commission for Aviation Regulation Relating to the Determination on the Maximum Levels of Airport Charges Setting Out the Issues to be Reviewed and Seeking Representations from Interested Parties or the Public

8th December 2003

AerRianta

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EXECUTIVE SUMMARY

Aer Rianta is making this submission in response to the Commission's invitation, in accordance with statutory provisions, to make representations in respect of the proposals set out in CP4/2003.

Aer Rianta is disappointed at the Commission's draft interim proposals for a further reduction in the maximum levels of airport charges. This is particularly significant in the case of Dublin Airport where, if the Commission's proposals are implemented, the sub cap will reduce to an average yield of €4.89 per passenger for 2004, i.e. a further reduction in charges that are already the lowest of any comparable airport in Europe.

Sufficient investment is necessary to ensure that Dublin Airport has the infrastructure to meet growth in passenger numbers, and to ensure that customer facilities are appropriate for an international airport in a European capital city. This will require an increase in the low level of airport charges at the Airport.

Implementation of the low level of the price cap proposed in CP4/2003 will mean that Aer Rianta will not generate sufficient cash flows in the context of the sustainable and profitable operation of the airport as required by Section 33(b) of the Aviation Regulation Act, 2001. Significantly, Dublin Airport will not be able to provide the level of investment in the airport facilities required to meet the current and prospective needs of users. As a consequence, significant capacity constraints will arise, resulting in congestion, delays, lower service levels and increased costs. This will eventually constrain capacity for new airlines and additional routes and services out of Dublin Airport. This will have negative implications for the Irish economy, particularly in relation to trade, tourism, inward investment and employment.

Though the requirements of existing airline users must be addressed there is also a pressing need to give a balance to the requirements of other airport users such as passengers, ground handlers and other service providers, airport staff and potential future airline operators. In this context, there is a significant divergence between the position of the Commission for Aviation Regulation in relation to the level of future investment required at Dublin Airport and the assessment by the company of the level of investment required to ensure the proper development of the Airport to meet the needs of current and prospective users and local and national economic needs. It is also important for economic development to balance the shorter time focus of airlines with the longer time horizon for investment in key infrastructure at the airports. The determination for airport charges for Dublin Airport provides for an investment of less than €3.00 per passenger in airport infrastructure over the regulatory period. This compares with investments levels in other international airports of between €6.00 and €10.00 per passenger. Amsterdam, Schipol is investing €1.45billion, BAA €8billion and Aerports de Paris €2.5billion compared with Dublin Airport investment allowed by the Regulator for five years of €235million. There are serious long-term consequences for Irish aviation policy if Dublin Airport is starved of investment by the Commission.

In a single till environment, additional aeronautical revenue must be forthcoming to remunerate investment as extremely challenging commercial revenue growth is already built into the Determination on the maximum level of airport charges that may be levied. A reasonable return is necessary both on and of required investments in order to attract the requisite capital, be it debt or equity, to support the expenditure. If investment is undertaken without a revenue stream to support it then the regulated entity will simply run out of cash.

The Commission's proposals lack depth of analysis as they avoid making these logical linkages between growing demand for airport capacity from passengers and airlines, appropriate service levels, the infrastructure required to meet this demand and the necessity that investment be remunerated if it is to proceed. The proposals in CP4/2003 are therefore flawed as they do not take due cognisance of key issues which should be addressed if the Commission is to fulfil its statutory objective as set out in Section 33 of the Aviation Regulation Act 2001, to "*aim to facilitate the development and operation of cost effective airports which meet the requirements of users*" whilst having due regard, inter alia, to the sustainable and profitable operation of the airport.

The Commission's spreadsheet model, which underpins the level of prices proposed in CP4/2003, fails to meet its stated purpose and is deficient in a number of fundamental respects:

- It is flawed and incomplete in that it lacks the projections of cash flows which the Commission stated were required in order to chose the "correct level of prices".
- It contains a number of errors, as discussed in Section 2.2 of this document.
- It fails to accurately present a realistic financial representation of the business and includes a series of unrealistic assumptions.
- It does not address one of the key objectives set for it by the Commission, i.e. *"to check that the regulatory parameters do not threaten the financial viability of the regulated firm".*

Any such assessment will clearly require projected profit and loss accounts, balance sheets and statement of cash flows in order to assess the resultant outcomes and financial ratios. However, the Commission's model does not include profit and loss accounts, balance sheets or cash flow statements, either calculated for the individual airports or for the company. Without these, any financial projections will be incomplete and clearly it will not be possible to properly assess the impact of the price caps proposed on the regulated entity's financial position.

It therefore appears that the Commission has not undertaken an analysis of the impact of the interim review proposals on the financial viability of the regulated entity prior to publishing CP4/2003 and its model does not appear to contain the requisite information to allow such a test to be carried out. If so, such an approach exposes Aer Rianta to an unacceptable level of financial risk and would represent a substantial deficiency in the Commission's analysis.

Aer Rianta urges the Commission to reassess its interim review proposals as a result of this submission.

STRUCTURE OF SUBMISSION

The remainder of this submission is structured as follows:

Section 1 reviews the submission made by Aer Rianta in respect of the substantial grounds which it considered there were on which to base a review of the Determination. It is surprising that the Commission has so far chosen to ignore much of Aer Rianta's application in this review process.

Section 2 provides Aer Rianta's comments on the limited range of issues, which the Commission has decided to include as part of its review. In particular, it addresses the inconsistencies in the treatment of passenger numbers and security related capex and the errors contained in the Commission's yield calculations in CP4/2003.

Section 3 provides detailed commentary on the impact of the Commission's proposals on the financial viability of the regulated entity, which the Commission appears, quite astonishingly, not to have addressed prior to the publication of CP4/2003, in contrast to the requirement under Section 33(b) that it have due regard to the sustainable and profitable operation of the airport.

1. ITEMS EXCLUDED FROM THE INTERIM REVIEW

Aer Rianta made a submission on 4th July 2003 in response to the Commission's Public Consultation Notice requesting submissions from interested parties and the public regarding a possible review of its Determination. The company identified many significant developments, which had occurred since August 2001, that provided substantial grounds for a review of the Determination. These grounds are set out below[1], together with a commentary on the Commission's treatment of each in CP4/2003.

GROUND 1

The level of capital expenditure (capex) provided for in CP7/2001 and CP2/2002 falls short of the required investment necessary to deliver IATA level of service standard B facilities and capacity for projected growth at the three Aer Rianta airports.

Not Addressed in CP4/2003

- In the original and varied Determinations CP7/2001 and CP2/2002, the Commission allowed €346 million in recoverable capital expenditure for the three airports over the 5 year regulatory period. This amounted to an allowance of circa €3 per passenger for capital expenditure. In contrast, other airports are investing an average of €6 to €10 per passenger on airport development. For example:
  - BAA, has prepared an 11-year investment programme commencing 2002 and costing £8billion[2] for its London airports at Heathrow, Gatwick and Stansted.
  - Aeroports de Paris (ADP) is spending US$2.5 billion on Paris Charles de Gaulle alone in the period 1999 to 2004[3],
  - Amsterdam Airport Schiphol plans to spend €2 billion in the period 2003-2008[4].
  - Vienna Airport, which has less traffic than Dublin Airport has, plans to invest a total of US$2.6 billion to 2015, half of this amount to be expended by 2005[5].

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[1] Given the recent Government decision, the proposed ground re regulation of the Aer Rianta airports as a group is no longer relevant.
[2] BAA London Airports Capital Investment Programme April 2002
[3] Presentation to IATA Conference on Capacity Issues by Philip Butterworth Hayes, Managing Editor, Janes Airports Magazine, 2001
[4] Air Transport Intelligence News, 2nd April 2003
[5] Presentation to IATA Conference on Capacity Issues by Philip Butterworth Hayes, Managing Editor, Janes Airports Magazine, 2001

It is clear that, as a result of the Commission's Determination, the allowed investment levels for Irish airports are seriously out of step with investment plans for other airports across Europe and with the needs of Irish airports and their users.

- The Commission has the opportunity in the course of this interim review to address this issue[6]. It is incomprehensible that a regulatory agency that is charged with a statutory duty to ensure that the development and operation of cost effective airports that meet user requirements is facilitated, could ignore so completely the requirement for capital expenditure. This is made all the more incongruous given that the Commission has accepted the Aer Rianta traffic forecast which demonstrates the level of future demand and is a key driver of the stated capex requirements.
- Aer Rianta believes that an effective capital planning process is in the interests both of customers and airports. In the medium to long term, lack of appropriate infrastructure and services and adequate capacity at airports will constrain growth in access into Ireland far more than any short term increases in airport charges[7]. The consequences of capacity constraints are significant including congestion, delays, lower service levels, increased costs and reduced choice. There may also be negative implications for the Irish economy, particularly in relation to trade, tourism, inward investment and employment.
- The Commission should address each element of the detailed capex programme submitted by Aer Rianta. To the extent that the views of the airport operator on investment requirements for the airport are not taken into account, the Commission should provide details of any investments that are excluded and reasons why it believes that these investments are not required.[8]

[6] To inform its deliberations, and in response to a request from the Commission, Aer Rianta supplied it on 27th October 2003, with a revised and detailed estimate of its capex requirements for the remainder of the current regulatory period on a project by project basis amounting to €747m for the period 2003-2006. This assessment of the investment requirements of the three principal airports in Ireland is based on a range of factors including masterplanning, passenger growth forecasts, known customer requirements and a detailed assessment of the capacity deficit for each element of airport infrastructure (baseline studies).

[7] Indeed, the recent analysis by Doganis published January 2001, indicates that the level of airport charges has little bearing on airlines route development decisions

[8] The Commission has expressed the view that, given that Aer Rianta is not pricing to the cap at Cork and Shannon, the issue of the levels of allowed capex in the formulation of the price cap is moot. There is a need to separate the formulation of the price cap from subsequent decisions made by the regulated entity in relation to pricing. For example, Aer Rianta intends to ultimately recoup its investment at Cork by increasing charges there as market conditions allow, though this may take a long time. In this context, it is imperative that the full cost of required investment be factored into the Commission's price cap model going forward.

GROUND 2

The exclusion from the Aer Rianta regulatory asset base of a portion of Pier C at Dublin Airport, six aircraft stands at Dublin Airport, a portion of the Shannon terminal building and the exclusion of a portion of capital expenditure for the first nine months of 2001.

Not Addressed in CP4/2003

- The Commission's decision to penalise Aer Rianta[9] for what its consultants claimed was grounds of "excess cost" in the development of Pier C is arbitrary and unjustified, given that the cost for the project was arrived at following a competitive tendering process undertaken in accordance with EU rules in this area. The decision is contrary to the Commission's statutory responsibility under Section 5 (4) of the Aviation Regulation Act 2001 to ensure that determinations, amendments etc *"shall be objectively justified and shall be non-discriminatory, proportionate and transparent".* The populist comments regarding "gold plating" at Dublin Airport from certain self interested parties have no substantiation either in terms of design, service levels or space at Dublin Airport.
- The Commission also disallowed 21.2% of the cost of the terminal extension project at Shannon Airport on the basis that the total terminal area provided was excessive when compared to passenger demand in the short term. However the basis for this conclusion is invalid as it assumed that the entire terminal area is available for passenger circulation, whereas the terminal extension includes a significant portion of non passenger areas e.g. plant rooms, kitchens, offices etc.
- Though Aer Rianta submitted a figure of €136m in respect of its planned capex for 2001, the Commission included recoverable capex of just €43m for the nine month period from January to September 2001. It is clear therefore, that the Commission stranded a large portion of Aer Rianta assets in the first nine months of 2001 without providing any explanation whatever. Similarly, it gave no explanation for excluding the stands at Dublin Airport. Both of these actions are contrary to the requirements of Section 5 (4) of the Aviation Regulation Act 2001.
- The unjustified stranding of assets in the regulated asset base remains a significant flaw in the Commission's approach to the original determination with adverse cashflow

[9] By adjusting downwards the value of Pier C allowed in the RAB by 22.6%

implications for the company, and should be rectified in any new proposals that emanate from this review.

GROUND 3

The impact of the slowdown in the world economy, 9/11 and other events on Aer Rianta's traffic performance in the period since August 2001 and its financial implications for the company.

Inconsistently Addressed in CP4/2003

- The Commission's current proposals incorporate inconsistencies in the treatment of passenger numbers that unfairly discriminate against the regulated entity contrary to Section 5(4) of the Aviation Regulation Act 2001 and should be amended (details provided in section 2).
- The Commission does not appear to have addressed the impact of its proposals on the financial status of Aer Rianta. This is an approach that incorporates great risk for the regulated entity and, if so, indicates a significant deficiency in the Commission's analysis. (See Section 3)

GROUND 4

The cost implications of the enhanced security measures, insurance premiums, regulatory and restructuring costs which have arisen since CP7/2001 and CP2/2002.

Some Elements Not Addressed; Others Inconsistently and Incorrectly Addressed in CP4/2003

- The Commission's current proposals incorporate inconsistencies in the treatment of security related capex that unfairly discriminate against the regulated entity contrary to Section 5(4) of the Aviation Regulation Act 2001 and should be amended (details provided in section 2).
- The Commission has ignored the significant restructuring costs[10] incurred by the company in an effort to minimise payroll cost increases in a period of enhanced security requirements and sustained passenger growth. These costs should be incorporated in the allowed operating costs. Restructuring provision has been taken account of by other

[10] €28.5m provision was made by the company for the Voluntary Severance Scheme in the statutory accounts 2001.

regulators e.g. CER, and the Commission's failure to do so in this interim review represents an internal inconsistency and selectivity in its approach.

GROUND 5

The unrealistic assumptions used in projecting forward commercial revenues in CP7/2001 and CP2/2002.

Not Addressed in CP4/2003

- In its regulatory Determination, the Commission extrapolated forward Aer Rianta's commercial revenues based on unaudited General Ledger figures. It did this by taking the figure for commercial revenues for the first six months of 2001 and dividing these figures by passenger traffic for that period in order to derive per passenger values. These were then projected forward in line with inflation and forecast passenger traffic over the determination period. The extrapolation of a partial accounting period as the basis for the entire five year projection of commercial revenues is clearly an unreliable methodology.
- There is no sound or objective basis for the assumption that commercial revenues are directly correlated with passenger traffic. For example property rents and fuel sales do not grow in line with passenger growth. Actual performance to date confirms that growth in commercial revenues is less than passenger growth. (See section 3)
- Such erroneous assumptions on the part of the Commission have resulted in a situation whereby for the regulatory year 2001/2, the commercial revenues (net of cost of sales)[11] assumed by the Commission, were circa €30million more than those actually achieved by Aer Rianta for the same period equivalent to some €56 million on a gross commercial revenue basis[12].
- The price caps set on the basis of such an assumption, including the current proposals, are therefore fundamentally flawed, clearly not objective and give a discriminatory result. They should be addressed as part of this review.

[11] As calculated by Aer Rianta

[12] The Commission's original definition of gross commercial revenues comprised all commercial revenue turnover net of cost of sales of fuel (but not cost of sales of retailing and other commercial activities)

GROUND 6

The financial inaccuracies underpinning CP7/2001 and CP2/2002.

Partly Addressed in CP4/2003; Errors Remain

- The key financial errors in the Commission's original Determination that were identified by Aer Rianta in the course of the judicial review have largely been addressed insofar as they have been technically corrected, however erroneous assumptions remain (see section 3)
- However the Commission has been inconsistent in that it has made retrospective adjustments for its errors whilst only adjusting for changes in traffic from January 2004 onwards. This must be amended if the consistency of the financial model is to be maintained (Details in Section 2.1.1)
- The Commission has also made new errors in the course of the yield calculation in CP4/2003. (Details provided in Section 2).

GROUND 7

The significant computational errors and errors of principle in the IMG benchmarking analysis used to determine the efficiency factors set for Dublin and Shannon airports in CP7/2001 and CP2/2002.

Not Addressed in CP4/2003

- The Commission required in CP2/2002 that significant efficiency improvements be achieved in personnel costs at Dublin and Shannon Airports over the first three years of the Determination i.e. 18.76% and 21.66% respectively. Despite the submission of extensive analysis showing that the Commission's benchmarking study, which underpinned these efficiency targets was fundamentally flawed, and a meeting with the Commission to discuss these issues prior to the publication of CP4/2003, the Commission has not moved to review the demands placed on the company in respect of the efficiency factors that were set with reference to its flawed report. The impact of this is that opex is not reliably forecasted. The Commission's approach is contrary to its statutory responsibility under Section 5 (4) of the Aviation Regulation Act 2001 to ensure that determinations, amendments etc *"shall be objectively justified and shall be non-discriminatory, proportionate and transparent".*

- The Commission's actions unfairly discriminate against the regulated entity and are contrary to Section 5(4) of the Aviation Regulation Act 2001.

GROUND 8

The assumptions underpinning the subcap on off peak runway movements at Dublin Airport included in CP7/2001 and CP2/2002 and the categorisation of aircraft types for the purpose of this off peak subcap on runway movements at Dublin Airport.

Addendum to CP4/2003 Issued 27th Nov 2003

- Aer Rianta's submission in respect of the Commission's proposals regarding the treatment of the sub-cap on off peak landing and take off charges will be made in a separate paper in response to the Commission's Addendum to CP4/2003 issued on 27th November 2003.

CONCLUSION

Against the background of:

- a public notice requesting submissions
- the responding submission of detailed papers by Aer Rianta
- the provision of further detailed information by Aer Rianta in response to specific requests from the Commission (both written documentation and presentations)

it is difficult to understand why the Commission has taken such a limited approach to the interim review process and ignored crucial elements of the Aer Rianta submission in the matters which it has chosen to review. This gives cause for particular concern given the myriad deficiencies in the Determination, as highlighted by Aer Rianta's submission, and the extent to which it mitigates against the Commission fulfilling its statutory duty to *"aim to facilitate the development and operation of cost effective airports that meet the requirements of users"* by setting the maximum levels of airport charges at a level that does not allow the airport authority to make the appropriate level of investment in airport infrastructure going forward. In essence, the existing regulatory formula yields price caps that are out of line with the underlying business reality.

The Commission's decision in relation to the specific matters selected for review and/or excluded from review lacks transparency as no reasons are given for ignoring what are substantive grounds that may be, as the Commission requires

> *"interpreted in a manner consistent with the Commission's statutory objective observed in the Determination i.e. the development and operation of cost effective airports that meet the requirements of users".* [13]

All of the matters raised by Aer Rianta in its submission in response to CP3/2004 could be addressed under the grounds identified by the Commission as forming the basis for its review i.e. *"commercial consequences of exogenous events"* or *"the correction of matters of computation, calculation and application arising out of information received by the Commission after the date of Determination"*[14]. Although the Commission has proposed that it incorporates in the review *"a correction of all matters of computation, calculation and application of which it is aware"*[15] it is manifestly not following this course by ignoring information provided to it by Aer Rianta in its submission. It appears that though the Commission now has an opportunity to address the serious shortcomings in the Original Determination it has deliberately decided not to do so.

Aer Rianta is resubmitting its July submission to the Commission as part of this document, see Appendix 1, and requests that the Commission take the opportunity to address all of the substantive points made therein in the course of this review[16].

[13] CP4/2003, page 5
[14] ibid, page 5
[15] ibid, page 9
[16] To the extent not incorporated as part of the review, Aer Rianta requires that the Commission comply with Section 32 (9) of the Aviation Regulation Act 2001 and give reasons for rejecting each representation made by Aer Rianta in the course of its report on the review of the Determination.

2. Matters Arising From the Items Addressed by the Commission in CP4/2003

2.1 Matters Relating to 9/11

2.1.1 Inconsistent Treatment of Passenger Forecasts in CP4/2003

The original August 2001 and varied February 2002 Determinations were based on the Aer Rianta 2000 Traffic Forecast, however exogenous events such as September 11th (which occurred just 16 days after the Determination was issued), the slowdown in the world economy and SARS have all led to lower than anticipated growth in air traffic. While performing better than most European Airports in terms of the rate of growth since, in particular, the events of September 11th 2001, traffic at the Aer Rianta airports fell short of the Aer Rianta 2000 traffic forecast which underpinned the Regulatory Determination for the first two regulatory years.

The Commission had an opportunity, following the Aviation Appeal Panel review, to adjust the traffic figures used in the Determination to reflect the situation post September 11th. The Appeal Panel noted *"the tragic events of September 11th last may give rise to a revision of the centerline forecasts for passenger traffic by Aer Rianta which could now be taken into account by the Commission in generating revised maximum charges per passenger*". Had the Commission taken the opportunity to revise downwards the traffic forecasts to reflect the situation post September 11th at that time the inconsistent approach it now proposes, with regard to the use of two very different sets of traffic forecasts, would not have arisen. However, the Commission chose not to do so.

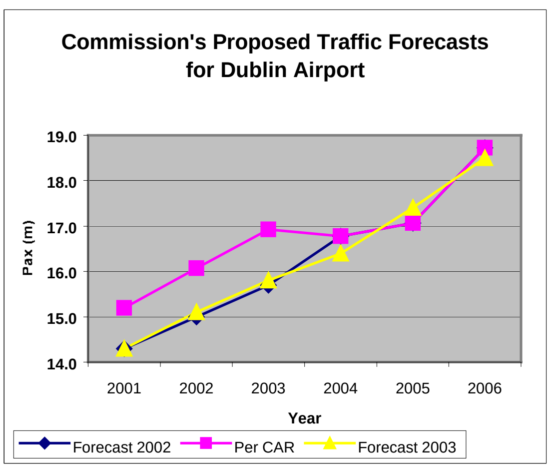
The Commission states in CP4/2003 that "*the matters subject to review here are limited to exogenous factors deemed to be outside the general business risk of Aer Rianta*".[17] It also states in relation to passenger traffic forecasts that "*the effects on traffic after 9/11 are deemed by the Commission to be an exogenous factor outside the general business risk of Aer Rianta*".

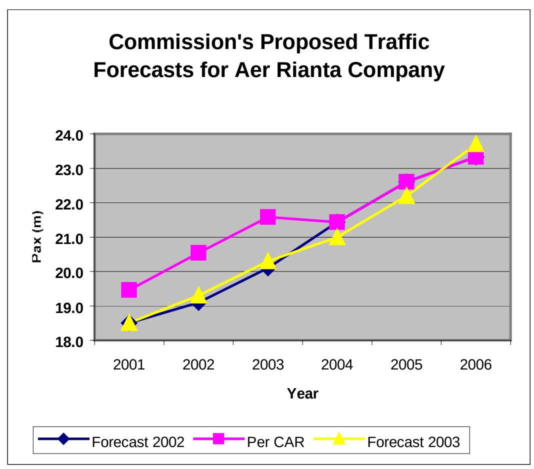
The Commission's proposal to only apply the Aer Rianta 2002 Traffic Forecast from January 2004 onwards is inconsistent with these statements and contrasts sharply with its stated intention to retrospectively adjust all other factors being amended to the beginning of the regulatory period in

[17] Section 2.1, CP4/2003

September 2001. If the effects of 9/11 on traffic are deemed by the Commission to be an exogenous factor, then the traffic benchmark should be adjusted for all years in the Determination, otherwise the Commission is not acting in an objective, proportionate and non-discriminatory fashion as required by Section 5(4) of the Aviation Regulation Act 2001. If the Commission's proposed adjustment is implemented, the Commission's regulatory determination will be based on two different traffic forecasts for the periods before and after January 2004. There is no logic or justification given for this approach, which will render the regulatory Determination inconsistent.

The graphs below illustrate the inconsistency in the Commission's approach and highlight the significant gap between the Commission's proposals and the reality of current traffic patterns. The pink line illustrates the figures, which the Commission is proposing to use in this interim review – effectively a combination of forecast 2000 figures for the regulatory period 2001-03 and forecast 2002 figures thereafter. However as can be seen from the blue line on the graph, the use of the forecast 2000 figures for the period prior to 2004 grossly overestimates the actual traffic at the airports in that period. Furthermore the yellow line illustrates the latest and most up to date traffic figures provided to the Commission by Aer Rianta in recent weeks and are the most informed basis on which to base any price cap proposals for the regulatory period.





Aer Rianta has estimated the effect of this approach on the price cap as per CP4/2003 in the table below.

	Max Yield '01/02		Max Yield 2004	
	Company	Dublin	Company	Dublin
Per CP4/2003 Max Yield (before K&W Adjustment)	€6.01	€5.09	€6.29	€5.04
K&W Adjustment			€1.27	(€0.15)
Revised Max Yield 2004			**€7.56**	**€4.89**
X Factor	5.1%	7.5%	2.9%	3.8%
Per Aer Rianta if Revised Passengers used in Prior Periods	€6.79	€5.82	€6.29	€5.04
K&W Adjustment			€2.79	€1.25
Revised Max Yield 2004			**€9.08**	**€6.29**
X Factor [1]	6.1%	8.9%	2.9%	3.8%

[1] X factor for '01/02 also incorporates security as described in Section 2.2.1 below
The traffic forecast used in the Aer Rianta calculation is forecast 2002 per Table 1 CP4/2003

Given that the Commission has accepted that the traffic out-turn has been affected by an exogenous factor and the fact that it is proposing retrospective adjustments to its Determination for the period 2001-2003 for all other elements of the yield calculation, the Commission should consistently apply the proposed adjustment for the differential between the Aer Rianta 2000 traffic forecast and the forecasts reflecting the effects of 9/11 across all years in the determination period.

2.1.2 Treatment of Security Costs

The Commission has specifically invited representations from all interested parties or the public on both the level of increased security costs and what portion of such costs should be borne by airport users in light of the statutory objective of the Commission as set out in Section 33 of the Act.

Section 33 of the Act requires that the Commission in carrying out its statutory duty must have due regard to, inter alia, the operating and other costs incurred by the airport authority. There was a substantial increase in Aer Rianta's security obligations in the aftermath of September 11th. The company was obliged to implement a series of measures identified by the National Civil Aviation

Security Committee (NCASC) and with the provisions stipulated under the European Regulations 2320/2002 and 622/2003. These additional security requirements have necessitated both additional capital investment and increased operational expenditure. The level of increased security costs incurred in the period since August 2001 is related to the additional security requirements put in place.

Aer Rianta is responsible for the implementation of the various security measures dictated by the relevant regulatory and governmental bodies. Aer Rianta does not determine the level of security requirements, it would therefore be inappropriate and discriminatory if the company were to be penalised by the exclusion of a portion of its security costs from its recoverable cost base.

Aer Rianta is conscious of the need to ensure cost efficiency and it endeavours to implement its security obligations in a cost effective manner. For example, in order to deliver greater cost efficiency, it has established a specialised Airport Search Unit (ASU) to replace airport police in carrying out passenger screening and boarding card checks in the terminal area. The resulting efficiencies are incorporated into Aer Rianta's security cost projections going forward as included in Table 2 of CP4/2003.

Given the obligation on Aer Rianta to provide appropriate security at Irish airports, the impact of the Commission not allowing full recovery of security costs at the airports, would be to negatively effect Aer Rianta's ability to provide services, other than security, in a timely manner and to the appropriate level of service quality.

It is utterly inconsistent that the Commission should factor in an allowance for the operating costs associated with the new security requirements in its current proposals whilst not factoring into its calculation the capital expenditure and associated return and depreciation that is driven by the same events. The Commission has given no reason for this seemingly arbitrary decision. It states that the largest element of security related capex, hold baggage screening, has been included in the recoverable capex in the Original Determination. However, the Commission has only allowed the cost of hold baggage screening as advised in Aer Rianta's July 2001 capex submission. These figures have since been updated and whilst the costs for Shannon and Dublin are very similar to those previously advised, the cost for HBS implementation at Cork Airport is higher. This is due to the fact that the implementation of the HBS in the new terminal at Cork is inextricably linked to the installation of the new baggage system. Contrary to the Commission's statement therefore, the ultimate impact of this is that the shortfall in the capex allowed for HBS across the three airports is €3.561m. (See table below)

CAPEX FOR HOLD BAGGAGE SCREENING			
	Aer Rianta Submission July 2001 (€ 000)	Aer Rianta Submission Nov 2003 (€ 000)	Excess/(Deficit) (€ 000)
Dublin	11,427	10,085	1,342
Shannon	2,692	3,300	(608)
Cork	1,905	6,200	(4,295)
Total	16,024	19,585	(3,561)

In addition, there is a substantial sum of other capital expenditure which relates to security requirements that has not been reflected in the Commission's current proposals. This amounts to circa €15.2m and relates to capital expenditure for essential security related facilities and equipment mandated by regulations imposed on airports across Europe post the events of September 11th 2001. For example, in order to comply with the provisions set out in ECAC Doc 30, EU Regulation 2320/2002 and ICAO Annex 17, Aer Rianta will have to replace its existing access control system. The cost associated with this project alone for the three airports is estimated to amount to almost €5m. Such expenditure cannot be ignored by the Commission without justification and if it is genuine about conducting the interim review on the basis of an analysis of the commercial consequences for airport management arising from exogenous events such as September 11th 2001 then such costs must logically be included in its calculations in arriving at the new price caps.

The Commission's current price cap proposals, which do not factor in this expenditure, are inconsistent, arbitrary and put Aer Rianta at a significant disadvantage. They are therefore contrary to the Commission's statutory responsibility under Section 5 (4) of the Aviation Regulation Act 2001 to ensure that determinations, amendments etc *"shall be objectively justified and shall be non-discriminatory, proportionate and transparent".*

2.2 MATTERS OF COMPUTATION

One of the key drivers of this interim review is to enable the Commission to address the very many errors, which were incorporated in the Original Determination. The Commission has sought in the past to attribute these errors to the fact that it was required to make its initial Determination within a very short period of time (6 months).

In the intervening period since the publication of the Original Determination in August 2001, Aer Rianta has

- exchanged detailed correspondence with the Commission via the Judicial Review process in relation to the genesis of the errors made
- at the Commission's request it has reviewed rudimentary elements of the Commission's 2003 models, such as depreciation and calculation of the RAB, and
- made detailed and specific recommendations in respect of any inaccuracies detected

Against this background the Commission would appear to have corrected the principal errors in its original Determination. However, the Commission's interim review proposals, drafted two years after the original Determination was issued, incorporate a number of new errors. These are set out below:

2.2.1 SECURITY ADJUSTMENT IN PRIOR PERIOD

The Commission has carried out a manual per passenger adjustment to reflect increased security costs. However this methodology results in an incorrect X factor being used as the security adjustment was effectively done outside the model. The correct methodology is to include the security adjustment as additional opex, resulting in an opening maximum yield and an X factor that incorporates the effect of the security adjustment in the future years. The effect of this error is that the minus X factor is increased and Aer Rianta's maximum yield is less than what it would be if this error did not exist, see table below:

	Max Yield '01/02		Max Yield 2004	
	Company	Dublin	Company	Dublin
Per CP4/2003 Max Yield (before K&W Adjustment)	€6.01	€5.09	€6.29	€5.04
K&W Adjustment			€1.27	(€0.15)
Revised Max Yield 2004			€7.56	€4.89
X Factor [1]	5.1%	7.5%	2.9%	3.8%
Per Aer Rianta if security adjusted via X Factor in prior periods	€6.01	€5.09	€6.29	€5.04
K&W Adjustment			€1.32	(€0.11)
Revised Max Yield 2004			€7.61	€4.93
X Factor	4.0%	6.6%	2.9%	3.8%

[1] *In Table 5 CP4/2003 X factor for '01/02 does not incorporate security adjustment. The adjustment was a manual adjustment to the max yield on an annual basis in 02/03 and 03/04, which is not consistent with the CPI-X formula, the chosen method of price cap calculation by the Commission.*
The traffic forecast used is that proposed per the Commission in Table 1 CP4/2003

In the model pertaining to future periods, the security adjustment is included in opex and therefore reflected in the X factor. Thus the approach in prior periods and future periods is inconsistent.

2.2.2 The Commission's Projection of Incremental Security Operating Costs

In order to ascertain the incremental security operating expenditure to be allowed, the Commission compared the security operating expenditure as allowed in the Revised Determination with Aer Rianta's current estimate of security operating expenditure.

In order to ascertain what was allowed in the Revised Determination, the Commission took the actual security operating expenditure for 2001 and extrapolated forward based on the Commission's original methodology (traffic growth plus inflation). The Commission then compared these extrapolated figures with the actual and projected security figures as provided by Aer Rianta and the difference between the two figures was deemed to be the incremental security costs. However, in calculating the security costs included in the Revised Determination, the Commission failed to recognise that the figures as extrapolated should have been reduced by the efficiency factor that the Commission had applied to personnel costs in the Revised Determination. Thus the security adjustment incorporated in the calculation of the price caps proposed in CP4/2003 is understated. It is the extrapolated security payroll costs less the efficiency factor that should have been compared to the actual and projected security payroll costs supplied by Aer Rianta, which reflect the efficiencies resulting from Aer Rianta establishing the ASU, to ascertain the incremental security operating expenditure figure. The effect of this error is as follows:

	Max Yield '01/02		Max Yield 2004	
	Company	Dublin	Company	Dublin
Per CP4/2003 Max Yield (before K&W Adjustment)	€6.01	€5.09	€6.29	€5.04
K&W Adjustment			€1.27	(€0.15)
Revised Max Yield 2004			€7.56	€4.89
X Factor	5.1%	7.5%	2.9%	3.8%
Per Aer Rianta if extrapolated security adjusted for efficiency	€6.06	€5.14	€6.44	€5.19
K&W Adjustment			€1.48	€0.05
Revised Max Yield 2004			€7.92	€5.24
X Factor [1]	3.0%	5.3%	2.8%	3.7%

[1] *X factor for '01/02 also incorporates security as described in Section 2.2.1 above*
The traffic forecast used is that proposed per the Commission in Table 1 CP4/2003

2.2.3 INCORRECT CALCULATION OF TAXATION CHARGE

In the current model, the Commission calculated the tax charge by multiplying the effective tax rate by the return (as adjusted for capital allowances and depreciation). However as the return is actually the profit after tax and before interest, the tax charge should be calculated by grossing up the return to the pre tax level and applying the tax rate to this gross amount (as adjusted for depreciation and capital allowances).The Commission grossed up the return in the Revised Determination but did not do so in the current model. As a result the tax charge as shown in the current model is now understated. The effect of this is shown below:

	Max Yield '01/02		Max Yield 2004	
	Company	Dublin	Company	Dublin
Per CP4/2003 Max Yield (before K&W Adjustment)	€6.01	€5.09	€6.29	€5.04
K&W Adjustment			€1.27	(€0.15)
Revised Max Yield 2004			€7.56	€4.89
X Factor	5.1%	7.5%	2.9%	3.8%
Per Aer Rianta if calculation of tax corrected	€6.06	€5.14	€6.36	€5.10
K&W Adjustment			€1.43	€0.00
Revised Max Yield 2004			€7.79	€5.10
X Factor [1]	3.9%	6.3%	2.9%	3.8%

[1] X factor for '01/02 also incorporates security as described in Section 2.2.1 above
The traffic forecast used is that proposed per the Commission in Table 1 CP4/2003

3. FINANCIAL ASPECTS OF CP4/2003

The Commission bases its determinations of airport charges on a spreadsheet model incorporating assumptions selected by the Commission regarding future passenger volumes, revenues and operating costs. The Commission has stated that its financial model is *"the embodiment of all policy decisions of (the Commission's) Determination (of Airport Charges)".*[18] The Commission has also stated that

> *"Choosing the correct level of prices for a regulated firm requires projections of the prospective cash flows resulting from alternative price structures. A critical factor in the choice will be whether the resulting cash flows are excessive on the one hand or inadequate on the other"*[19]*.*

Following the publication of CP4/2003, the Commission provided Aer Rianta with its November 2003 Review Financial Model that underpins the airport charges proposals contained in that document. In the Commission's Explanatory Note and Assumptions Book that accompanies its spreadsheet model the purpose of the model is stated as being four fold:

- *"To set the correct level of prices for the start of the regulatory period;*
- *To determine the correct level of X;*
- *To determine and analyse the relative effects of alternative policy directions;*
- *To check that the regulatory parameters do not threaten the financial viability of the regulated firm."*[20]

The Commission's spreadsheet model, which underpins the level of prices proposed in CP4/2003, fails to meet its stated purpose and is deficient in a number of fundamental respects:

- It is flawed and incomplete in that it lacks the projections of cash flows, which the Commission stated were required in order to chose the *"correct level of prices".*
- It contains a number of errors, as discussed in Section 2.2 of this document.

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[18] Statement by the Commission's Head of Economic Affairs, Paragraph 13 of his first affidavit, from Judicial Review proceedings.
19 Statement by the Commission's Head of Economic Affairs, Paragraph 9, 1st Affidavit, Judicial Review Proceedings
20 Commission for Aviation Regulation, November 2003 Review Financial Model Explanatory Note and Assumptions Book, pg 1

- It fails to accurately present a realistic financial representation of the business and includes a series of unrealistic assumptions. These have been well documented to the Commission as part of the Judicial Review process.
- It does not address one of the key objectives set for it by the Commission, i.e. *"to check that the regulatory parameters do not threaten the financial viability of the regulated firm".*

INACCURATE REPRESENTATION OF THE BUSINESS

The Commission's spreadsheet model fails to accurately present a realistic financial representation of the business. This is particularly apparent in relation to its projections of commercial revenues and operating costs where there is a complete absence of commercial reality, the combined impact of which results in forecast levels of profitability that are grossly overstated when compared to the actual level of profitability being experienced by the business. In this context, current actual levels of EBITDA[21] - an established profit measure - would need to increase by some 65-70% in order to reach the forecasts assumed by the Commission.

This is clearly illustrated by comparing actual commercial revenues and level of opex cost achieved over the first three "forecast" years of the regulatory quinquennium (plus the levels anticipated for financial year 2004) with those assumed by the Commission (even after revising its assumptions under CP4/2003). This comparison is illustrated in the graphs in Confidential Appendix 2, where the Commission projections for key measures - EBITDA, commercial revenues and payroll and related costs - are shown in blue and actual levels/Aer Rianta's figures shown in red. As Appendix 2 was deemed confidential by Aer Rianta, it has not been published with this statutory representation to the Commission. These figures for the company are a reflection of the basic financial forecasting assumptions made by the Commission and level of return on capital allowed. Effectively they exclude the impact of other factors such as the level of capital expenditure and depreciation and tax calculations.

[21] Earnings before interest, tax, depreciation and amortisation

Commercial Revenues

The Commission's projections of commercial revenues are very important, as a presumption of strong increases in such revenues over the regulatory period has the effect of reducing the level of airport charges that could otherwise result from the regulatory formula.

The Commission has projected that commercial revenues at the three airports will consistently grow in line with passenger growth plus inflation. However, this is not a soundly based assumption, as experience clearly shows. Reasons for this have already been well documented to the Commission and include for example:

- Several streams of revenue are not directly connected to passenger growth, for example, rental income.
- Revenues from other commercial activities that are assumed to have a correlation to passengers do not necessarily increase at the same rate as passenger growth. For example, not all additional passengers result in additional car parking revenue, as several modes of transport to and from the airports are available to passengers, some of which do not accrue revenue to Aer Rianta. Car parking revenue is also dependent on the availability of car parking infrastructure, therefore, as capacity is reached, substantial incremental capital investment is required to ensure continued growth in revenues.

Overall, not only has the Commission made the unrealistic assumption that all commercial revenues will grow in line with both passenger growth and inflation, but the Commission's allowed capital expenditure does not allow for sufficient investment in commercial infrastructure to enable Aer Rianta achieve the commercial revenue projections included by the Commission in its calculation of price caps. The Commission's unrealistic assumptions have resulted in a situation, where for the year 2003 the commercial revenues assumed in CP4/2003, are **€[ ] million (Note: As the figure was deemed confidential by Aer Rianta, it has not been published with this statutory representation to the Commission)** more than those expected to be achieved by Aer Rianta for the same period.

Operating Costs

The Commission has assumed that payroll and other personnel related operating costs will have declined in real terms by a substantial "efficiency factor" amounting to 18.75% and 21.67% at Dublin and Shannon Airports respectively, by September 2004. (Extensive analysis has proved that the Commission's benchmarking study, which underpinned these efficiency targets was fundamentally flawed, as referred to earlier). The total quantum of such savings over the five year regulatory quinquennium amounts to €103 million, resulting in correspondingly lower airport charges over that period. Quite apart from the unjustified savings assumed, the Commission's assumptions also ignore the impact of national pay award increases (which Aer Rianta is committed to), and pay increments (which are a normal feature of many comparable remuneration structures).

In addition, the general assumption that other non payroll costs will grow in line with passenger growth and inflation ignores the fact that increases in infrastructure capacity have a significant impact on incremental cost growth for certain categories of cost e.g. energy, cleaning, rates, insurance etc.

The reliability of the Commission's operating cost projections are also damaged by the fact that the Commission extrapolated a partial accounting period as the basis for the entire five year opex projections, rather than taking a full financial year.

Financial Viability Test

Section 33(b) of the Aviation Regulation Act 2001 requires that the Commission shall, in making a determination, have due regard to the sustainable and profitable operation of the airports. Clearly, the Commission's self imposed, and essential, requirement to test that the prospective cash flows resulting from alternative price structures are adequate, is key to an assessment of such sustainability and profitability. Indeed, one of the four stated purposes of the Commission's model is to check that the regulatory parameters do not threaten the financial viability of the regulated firm.

Any such assessment will clearly require projected profit and loss accounts, balance sheets and statement of cash flows in order to assess the resultant outcomes and financial ratios. However, the Commission's model does not include profit and loss accounts, balance sheets or cash flow statements, either calculated for the individual airports or for the company. Without these, any financial projections will be incomplete and clearly it will not be possible to properly assess the impact of the price caps proposed on the regulated entity's financial position.

The purpose of the financial viability test (or bankability) is to ensure that key financial ratios for the regulated company over the control period are consistent with the credit rating assumed by the regulator, in setting the company's cost of debt, capital structure, and overall WACC[22]. If the financial ratios are not consistent with the assumed credit rating, then the company will face a higher cost of capital than was factored into the calculation of the allowed revenue, which will in turn threaten the viability of the company[23]. In testing for the financial viability of the proposals the model needs to:

- Determine the key ratios that are important in analysing a company's credit rating and assessing financial strength;
- Measure these against minimum threshold values for these key ratios;
- Test the financial projections and the resulting financial ratios and outcomes under downside as well as central scenarios to ensure that the regulated company can finance activities under more difficult economic circumstances than the central case assumes.
- Ensure that these are commercially realistic and achievable

Aer Rianta contacted the Commission's Head of Economic Affairs on 18th November 2003 to ascertain whether the Commission had undertaken such assessments in advance of the

[22] Weighted average cost of capital

[23] In its Determination, the Commission and its expert advisors had regard, inter alia, to Aer Rianta's credit rating, the yield on Aer Rianta's traded Eurobond and in particular the risk premium on that bond. This risk premium will be influenced, inter alia, by the assessment of Aer Rianta's credit rating at any point in time. Aer Rianta's current credit rating is 'A' with negative outlook. This is significantly lower than the 'A+' rating with positive outlook, which pertained immediately following the Commission's draft Determination in 2001. The current rating and in particular negative outlook reflects the expectation of Standard & Poor's that Aer Rianta will continue to have a weak financial profile. There is also uncertainty regarding any improvement (in the interim review) in the company's airport charge regime to support an adequate financial profile for an A rating. Standard & Poor's has commented that "*the implementation of charges in accordance with the Regulatory Determination has eroded Aer Rianta's financial profile*".

publication of CP4/2003, either as part of the financial model or elsewhere. Aer Rianta was informed that though there had been an extensive "financial leg" to the original model the model had been "cut back drastically" this time out and that "the full blown analysis was not in the model this time". This must explain what is meant by the Commission in the introduction to its Explanatory Note and Assumptions Book, that accompanies the Model viz:

> *"The Commission 2003 Revised Financial Model (the "Model") described herein was developed to support the Commission for Aviation Regulation (the "Commission") in its consideration of a review of the price caps published by the Commission in its Revised Determination (the "Revised Determination") of February 2002. It builds upon the financial model used to calculate those price caps* ***by removing extraneous elements of that model*** *as well as incorporating revised assumptions and methods and correcting errors that have come to light in the period since the publication of that Revised Determination." (emphasis added)*

It therefore appears that the Commission has not undertaken an analysis of the impact of the interim review proposals on the financial viability of the regulated entity prior to publishing CP4/2003 and its model does not appear to contain the requisite information to allow such a test to be carried out. If so, such an approach exposes Aer Rianta to an unacceptable level of financial risk and would represent a substantial deficiency in the Commission's analysis which must be addressed prior to the finalisation of the new price caps.

APPENDIX 1 AER RIANTA SUBMISSION 4TH JULY 2003

APPENDIX 2 COMPARISON OF KEY FINANCIAL MEASURES - CONFIDENTIAL

As Appendix 2 was deemed confidential by Aer Rianta, it has not been published with this statutory representation to the Commission.

Aer Rianta Submission in Response to the Public Consultation Notice of June 4th 2003

On

A Review of the Determination on the Maximum Levels of Airport Charges

AerRianta

Table of Contents:

1 Introduction

Aer Rianta makes this submission to the Commission for Aviation Regulation following its invitation of the 4 June 2003 to set out the grounds supporting a review of its Determination of 26th August, CP7/2001 and its varied Determination of the 9th February, CP2/2002.

Aer Rianta believes that many significant developments have occurred in the period since August 2001 which provide substantial grounds for a review of the Determination on the Maximum Levels of Airport Charges applying to Dublin, Shannon and Cork airports.

Airport charges are a very small element of the airlines overall cost structure as confirmed by the Doganis Report to Government and in the case of the Irish Airports, it is well documented that airport charges are unquestionably low. Therefore the provision of long-term airport infrastructure should not be delayed because of short-term airline industry focus. Delaying necessary airport capacity results in low passenger service levels, chronic congestion and safety issues, and inevitably a slowdown in future growth of the airports.

A review of CP/7 2001 is necessary at this time, as the existing Determination on Maximum Airport Charges no longer properly reflects the economics of Dublin Airport, in particular, in the context of:

- A short-term falloff in air traffic as a result of the global economic downturn, September 11th 2001, war in Iraq, the outbreak of SARS and Foot and Mouth. However, forecasts predict strong growth in air traffic in the future

- Major change in airline customer market and in particular a significant refocus by Aer Lingus of its operational model to quick turnaround in its short-haul operations

- Demand from all airlines at Dublin for contact stands and plans by major carriers to remove bussing operation

- The need to provide for increasing competition between major low cost carriers

- A new dividend policy by the Department of Finance

- Recent capacity studies regarding Dublin Airport facilities conclude that the current operation at peak periods is varying between IATA level of service standards C and F. There is therefore an urgent need for investment at Dublin Airport to deliver IATA level of service standard B adopted in CP7/2001

- The trend elsewhere is to increase airport charges in light of urgent need for investment and funding of airport infrastructure capacity in Europe. For example, the recent UK Determination on airport charges provided for an annual increase of RPI +6.5% at Heathrow and RPI at Stansted and Gatwick for 2003-2008

We believe that the substantial grounds for a review of CP7/2001 and CP2/2002 are:

- The level of capital expenditure provided for in CP7/2001 and CP2/2002 falls short of the required investment necessary to deliver IATA level of service standard B facilities and capacity for projected growth at the three Aer Rianta airports

- The exclusion from the Aer Rianta regulatory asset base of a portion of Pier C at Dublin Airport, six aircraft stands at Dublin Airport, a portion of the Shannon terminal building and the exclusion of a portion of capital expenditure for the first nine months of 2001.

- The impact of the slowdown in the world economy, 9/11 and other events on Aer Rianta's traffic performance in the period since August 2001 and its financial implications for the company

- The cost implications of the enhanced security measures, insurance premiums, regulatory and restructuring costs which have arisen since CP7/2001 and CP2/2002

- The unrealistic assumptions used in projecting forward commercial revenues in CP7/2001 and CP2/2002

- The financial inaccuracies underpinning CP7/2001 and CP2/2002

- The significant computational errors and errors of principle in the IMG benchmarking analysis used to determine the efficiency factors set for Dublin and Shannon airports in CP7/2001 and CP2/2002

- The assumptions underpinning the subcap on off peak runway movements at Dublin Airport included in CP7/2001 and CP2/2002 and the categorisation of aircraft types for the purpose of this off peak subcap on runway movements at Dublin Airport

- The need for the regulation of the three Aer Rianta airports as a group

This document assesses the key issues arising under each of the above grounds to demonstrate that a review of CP7/2001 and CP2/2002 under Section 32 (14) of the Aviation Regulation Act is necessary.

Other Regulatory Issues

There are a number of other substantial issues relating to the following matters

- The valuation of the regulatory asset base

- The definition of the regulatory till

- The derivation of the WACC

However, as these issues are matters of detailed principle, Aer Rianta has not included them as grounds for the purpose of this review.

As is evident from recent media comment, there are a number of possible options being proposed for consideration regarding the future of Aer Rianta. At present, it is unclear what the outcome will be. However, any shareholder decision regarding the structure of Aer Rianta or the ownership of future airport infrastructure should have no bearing on the Commission's review of the appropriate price caps for airport charges, or indeed its powers as set out in the Aviation Regulation Act, 2001.

2 Capital Expenditure

In the original and varied Determinations CP7/2001 and CP2/2002, €346 million was allowed in recoverable capital expenditure for the Aer Rianta airports over the 5 year regulatory period. This amounted to an allowance of circa €3 per passenger. This is considerably below the industry average and it is insufficient to meet the capital investment requirements of the three airports going forward.

There are significant factors as outlined below affecting the need for increased investment in capacity at Dublin and Cork Airports and for an adjustment of the recoverable capital expenditure provided for in the Determination of the Maximum Levels of Airport Charges for Dublin, Shannon and Cork airports.

Market Issues

Passenger numbers at the three airports increased by 4.3% last year. Even though traffic is growing at less than the rate forecast, total Aer Rianta traffic continued to show growth in the aftermath of the September 11th attacks in the US. All three airports have extensive route networks and serve a significant number and range of carriers – low cost, full service, charter and cargo operators. In 2002, 14 new routes were opened from the 3 airports and the three airports catered for approximately 83 airlines serving 138 routes.

Aer Rianta is fully committed and statutorily obliged to develop the airports at Dublin, Shannon and Cork. Aer Rianta's objective is to put in place airport infrastructure; runways, terminals, roads, services, communications, ancillary support infrastructure-offices, hangars, maintenance facilities to meet current and future demand for air travel by existing and new carriers in and out of Ireland.

Safety, Regulatory & Security

The Gulf war, 9/11 attack and the war in Iraq have contributed to a significant increase in safety, regulatory and security requirements on airport authorities. Customs, Immigration, Agriculture and Health authorities requirements have increased as a result of increased migratory flows, the recent outbreaks of Foot and Mouth disease and SARS. Significant investment has been required to install 100% hold baggage screening at all 3 airports to be operational from 1 January 2003 and the airports have increased screening facilities for staff and passengers, which in turn required a significant increase in the number of Airport Search Unit staff needed.

Airline Strategies

70 % of business at Dublin Airport is now carried out by airlines with quick turnaround/low cost strategies. Low cost for airlines frequently translates into high cost facilities on stands and piers due to the space requirements of quick turnaround operations. This type of business requires contact stands. Bussing is not acceptable to the airlines.

Airlines are now increasingly demanding that they be allowed to consolidate their facilities within the airport complex. This consolidation reduces flexibility of facilities and can only be satisfied by provision of additional space.

Transport Policy / Statutory Functions

Airports are a major part of the transport infrastructure and airport development is of crucial importance for the long-term growth of the economy and vitality of the travel and tourism industry. Aer Rianta's statutory functions are to provide for the proper planning and phasing, management and development of airport infrastructure and facilities at the three airports to cater for continuing growth in air travel demand for passengers and cargo. Failure to provide sufficient airport capacity at the three airports will have a significantly detrimental impact on Irish economic development, impacting directly on the tourist sector.

Airports are vital elements of national infrastructure and are gateways into the country. The adoption of a long-term view is critical to ensure that there is proper operation and planning of airport development.

Aer Rianta has an obligation to comply with the Department of Transport's strategy in regard to the airports. The Department of Transport's strategy is to ensure that the principal gateway airports of the State are in a position to provide cost competitive and appropriate infrastructure to meet the needs of airline and other aviation companies; consistent with a commercial mandate; to assist in optimising the contribution of the country's network of regional airports to balanced regional development.

Service Levels

A detailed baseline study carried out as part of the Master Planning exercise at Dublin Airport found that several facilities fall well below IATA level of service standard B resulting in passengers experiencing reduced service levels.

Cargo Development

There is no further scope for expansion of the cargo facilities at Dublin Airport. Early indications from the Master Planning process show that further development of the primary passenger facilities will adversely impact on the cargo complex. It is an imperative that the expansion of cargo facilities at Dublin Airport will adequately address the requirements of cargo operators. Capacity shortfalls could have adverse effects particularly for the high technology sector industries which are intense users of air cargo.

Public Transport

Aer Rianta, as a member of the technical group reporting into the Public Transport Partnership Forum, is committed to a best in class modal split at Dublin Airport. The aggressive targets set by the Forum and the Dublin Transportation Office require proper integration of all modes of public transport. At present there are approximately 750 bus movements in and out of Dublin Airport daily and taxi movements average approximately 2,000 movements per day. Demand for facilities for public and private transport is continually increasing with ongoing investment requirements for internal roads, kerbside, parking areas, bus shelters, etc. All of these facilities require investment at the airports, for which detailed requirements are currently being developed in the context of the masterplan for Dublin Airport. The investment requirement for these facilities will be significantly greater than the amount allowed in the Determination.

In addition, Government policy supporting a metro connection from the centre city to Dublin Airport and onwards requires the commitment of significant investment in an inter modal interchange at the airport to conform to the targets referred to above.

Environment

Environmental issues are assuming greater significance in the Airport context. Local Authorities are imposing stringent requirements for all forms of development with consequent impact on the capital investment required. Issues which have to be dealt with range from complex water retention systems and de-icing fluid controls to noise mitigation and the measures to mitigate impact on flora on the airfield.

In addition, it is now evident that Local Authorities intend to impose severe levies on any project to ensure contribution to the support of county development infrastructure. On receipt of planning permission for the proposed Pier D project, a special development levy of €2 million was unexpectedly imposed.

Pier D

Under the Determination, an allowance of €71.7 million[1] was included for a number of projects including a new pier at Dublin Airport. In January 2002, Professor Rigas Doganis in his report, *Consultancy Advice on Aviation Issues for the Department of the Taoiseach*, supported the view that a pier, Pier D, should be built at Dublin Airport.

The original Pier D design was not appropriate in the changed traffic, security and regulatory context of 2002. This design could not deliver on capacity, security and segregation requirements, satisfactory aircraft stand areas, adequate gate lounge areas and other operational requirements. In addition, this view was supported when the Department of Justice stated that the segregation of all arriving and departing passengers was necessary and EU originating passengers should be segregated from International arriving passengers for presentation to Immigration Authorities.

The brief for a new Pier D was developed by specialist airport development consultants in conjunction with airlines, groundhandlers, the Irish Aviation Authority, Customs & Immigration Authorities, the Gardai, the Department of Transport and other Government departments. Individual stakeholders such as FLS Aerospace and the fuel companies were also intensively involved. Various options of Pier configuration were presented. The final agreed option was a two storey pier which met the requirements of airlines and regulatory authorities.

The only suitable site which would allow the Pier to be delivered within the desired timeframe was a site north of the Old Central Terminal Building (OCTB). As the airlines are against bussing and the OCTB has inadequate capacity for passenger flows and is a listed building that cannot be altered, the only options available to allow passengers to walk to and from the Terminal building were by tunnel or high level walkway. Following exhaustive consultation, the combination of a

[1] It is not possible to isolate precisely how much the Commission allowed for a new pier at Dublin since, as the pier is included with number of other projects, which in total are allocated €71.7m in the recoverable capex

twelve gate segregated two storey pier, accessed by a high level walkway from the main terminal, skirting the OCTB, proved to be the only cost effective way to provide walk on, walk off facilities for passengers.

The resulting design including access is significantly more expensive than that allowed for in the Determination. Extensive value engineering exercises have been carried out on the project in the context of the foregoing and to ensure efficient life cycle costing.

Construction was planned to commence early in 2003 for completion by the summer season of 2004. However, a series of planning appeals considerably extended the proposed time frame. The appeal process has now been exhausted with planning permission being granted in March 2003, and the project is currently in a tender process.

The decision to grant planning permission is now the subject of a judicial review application.

Dublin Airport Master Plan

Aer Rianta is currently consolidating its Master Planning process and other parallel studies including internal transportation, road access and car parking, into a revised capital expenditure programme which will identify the requirements and the timing of capital expenditure necessary to meet the needs of all airport users. The following outline indicates the scope of the work and highlights issues that will significantly impact phased capital expenditure. These intensive studies confirm that the level of capital expenditure provided for in CP7/2001 and CP2/2002 falls short of the required investment necessary to deliver IATA level of service standard B facilities and capacity for projected growth at Dublin Airport.

The process began in January 2002 and will conclude in Autumn 2003. The output will consist of a series of integrated studies and options for terminal expansion incorporating appropriate capacity analysis and flow requirements with an emphasis on delivery of a significantly improved finished product to meet the requirements of all stakeholders.

Using broad precepts such as site maximisation, flexibility to accommodate different scenarios, balanced development, co-ordination with ground access systems, support of all business sectors and phased implementation to meet demand, up to 30 high level options have been reduced to four options for detailed examination and costing.

To ensure all options being examined conform to the stated flexibility precept, three possible business scenarios are considered for each option:

- Traffic will grow in the same proportion as exists at present
- Low cost carrier business will grow and become a major proportion of traffic
- Dublin Airport will become a major hub

Capital cost estimation and phasing is being prepared for each option.

The process has been preceded by the development of a baseline study for Dublin Airport based on 2002 operating characteristics and updated to reflect the changed 2003 operating environment. This study served to highlight capacity constrained areas within the existing system.

A major section of the baseline study concentrates on capacity analysis. A significant finding of the study is that the existing terminal facilities will be capacity constrained earlier than expected. The capacity analyses carried out on all main processors within the Dublin terminal complex clearly indicate that the terminal is operating below IATA level of service standard B for most of the main processors.

The theoretical capacity calculated for each of the main areas and processors have been "de–tuned" to realistically reflect the varying effects of building shape and passenger behaviour dictated by physical layout and airline functional operation. Once this detuning process is allowed for the estimated capacity of the system is 16 to 17 million passengers per annum.

Proposals for a terminal expansion have therefore become an urgent requirement with consequent impact on the phasing and requirements of capital expenditure.

This clearly demonstrates that the capacity and facilities at Dublin Airport are significantly below IATA level of service standard B and need significant investment to bring them up to the agreed IATA level of service standard B.

In the context of the above issues, now clearly identified in the masterplanning carried out to date, the allowable capex in CP7/2001 of €203 million for Dublin Airport over the regulatory period is inadequate to support the development of facilities to satisfy demand at an appropriate service standard going forward. A failure to address this for the remainder of the regulatory period would lead to a serious deficiency in capacity at Dublin Airport and would restrict the ability of the company to meet its statutory requirements under the Air Navigation and Transport (Amendment) Act, 1998.

Cork Airport

In 1999 a firm of airport consultants, Scott Wilson Kirkpatrick (SWK), were appointed to identify the requirements for the development of the Cork airport system to enable the airport to deliver capacity for up to 3 million passengers per annum in the mid term and 5 million passengers per annum in the long term in line with projected passenger growth.

SWK concluded in 1999 that given traffic levels the terminal at Cork Airport was at that time operating close to its maximum capacity based on IATA level of service standard B and therefore there was no margin for significant traffic growth, no opportunity for improvement in airline facility standards and no significant gains in capacity were possible based on the reorganisation of operations within the existing terminal building.

SWK recommended that, initially, terminal facilities at Cork Airport should be extended to add the additional apron, passenger processing capacity and airbridge served stands necessary to provide capacity for 2 million passengers per annum (anticipated to be reached in 2005). This was to be followed in the medium term by the construction of a new terminal facility to the north of the existing facility with a capacity of 3.5 million passengers per annum.

In 2001, Aer Rianta appointed a consortium led by Jacobs Engineering and including international airport architects HOK to review the 1999 master planning study and to prepare options for expanding the airport's capacity.

A more detailed assessment of SWK's proposed first phase i.e. the extension of the existing terminal, unveiled a series of complex and costly projects that would have had to be implemented to facilitate the development as originally mooted. The analysis required to progress such projects delayed the overall process and in the meantime passenger traffic continued to grow at a rapid rate – year on year percentage growth of 14% was experienced in 1999 with almost 12% growth delivered in 2000. Given the rate of growth it became clear that it was no longer appropriate to implement SWK's phase one solution.

A capacity study for Cork Airport concluded that the existing terminal is currently operating at IATA level of service standard F, this is described as an unacceptable level of service, a condition of cross flows, system breakdown, unacceptable delays and an unacceptable level of comfort. The study indicated that given the current unbalanced service levels at the airport, future passenger increases would have a further detrimental effect on services standards within the terminal.

Intensive stakeholder consultation informed the high level decision making, scoping and detailed design processes for the development now being undertaken at Cork Airport. The final design concept was in effect a modified version of the intermediate phase of development proposed by SWK in its 1999 study. The development also incorporates other projects identified as necessary in the SWK report, including the fire station, multi-storey car parking and control tower. The design capacity of the terminal is 3 million passengers per annum, this represents an appropriate balance between capital cost and the provision of capacity for a reasonable period of forecast growth. The design is highly flexible and easily scaleable to deliver growth from 3 to 5 million passengers per annum.

CP7/2001 allowed €52.6 million in the recoverable capital expenditure programme for a terminal extension at Cork Airport. Following a review of the development of Cork Airport in the context of master planning requirements, a new terminal development project, multi-storey car park, fire station, internal roads and ancillary infrastructure for Cork Airport with a capital expenditure requirement of c. €150 million is necessary. The development comprises a 25,000 square meter terminal building with a capacity of three million passengers per annum. This project also includes the development of associated infrastructure and car parking works comprising a central utilities building, services upgrade, a new road network, a 600 space multi-storey car park and additional surface car parking.

On this basis we believe that there are substantial grounds for a review of the recoverable capital expenditure allowed in CP7/2001 for Cork Airport.

3 Stranded Assets

In CP7/2001 a portion of the cost of Pier C at Dublin Airport, six stands at Dublin Airport and a portion of the capacity of the Shannon terminal project were disallowed from the RAB. The basis for disallowance of an element of the cost of these assets is mathematically incorrect and we believe should be reviewed as part of the review of CP7/2001.

The following additional information is relevant:

Pier C, Dublin Airport

- This facility had to be constructed in the current location as a single sided pier to avoid encroaching on the obstruction limitation surfaces. For this reason it is a tightly designed pier, kept deliberately narrow to account for the single loading.

- Construction of the facility is not out of line with other similar structures. The costs per square meter in this case are neither out of line with similar facilities elsewhere whose costs are driven by the particular location, difficult site levels and expensive site preparation, the requirement to link with a complex terminal facility (terminal west extension), complex security arrangements and a less than ideal ratio of perimeter length to enclosed area driven by the nature of the building required.

- There is no over provision of space in this pier. It has been calculated that with maximum achievable gate lounge space of 282 square metres for a wide body aircraft, the level of service achievable is less than IATA level of service standard C.

- This is the best performing pier at Dublin Airport in terms of turnarounds per day. The performance of the pier has achieved 11.2 aircraft turnarounds per day on average relative to the industry average of 10.

Dublin Parking Stands

- In the IMG study their base line stands were 65, this is only correct in a maximum narrow body mode situation. Given that the apron contains MARS configurations at Pier C, South Apron, Cargo Apron, Remote Central Apron and part of Pier A, once wide body aircraft are introduced into the mix, the stand capacity at Dublin Airport can range between 57 and 65. If maximum combined mode is adopted the apron capacity is 19 wide body plus 38 narrow body (total 57).

Existing Stands 2001			
	COMBINED MODE		
Location	MAX WIDE	REMAINING NARROW	MAX NARROW
CARGO	1	3	5
PIER C	3	0	6
SOUTH APRON	3	6	11
PIER B	5	4	9
PIER A	0	15	15
REMOTE	7	7	16
NORTH	0	3	3
Total	19	38	65

- At Dublin Airport peak demand for stands in the morning is not created from peak hour operations but from the home based fleet (overnight parking) and thus Dublin Airport has consistently had the most amount of aircraft parked between the hours of 05.00 and 07.00.

- Previous apron extensions provided apron taxiways and new taxi routes as well as stands to cater for planned Pier developments. These planned pier developments consume large areas of apron (stands and taxi routes) in both their footprint and provision of aircraft access to same. It would be prudent airside planning to have the required apron extensions in place prior to any pier development commencing thus not drastically affecting the overall airside capacity or vital taxi routes when pier development commences.

- Inevitability the construction of new stands and new taxi routes temporarily withdraws from service existing taxi routes and stands to facilitate construction, and therefore, extra stands must be included in order not to have a deficit during the construction phase. It is prudent to minimise disruption by constructing say 3 or more stands at a time rather than 1 each time it is required.

  In doing so, apart from minimising disruption, better economies of scale are obtained and given that the design, tendering and construction period can take up to eighteen months, the rates of handover have to stay ahead of demand.

- Likewise the essence of good airside planning is to fully develop each available location before moving on to the next location. This will obviously take cognisance of current and future aeronautical restrictions at each available new stand location, the result of this is that the rate of stands coming online will be slightly different to the theoretical stands to be built each year.

- Stands must be provided to cater for operational flexibility i.e. cater for a number of unexpected (unscheduled) aircraft, technical delays, new operators, aircraft missing slots, Low Visibility Procedures being declared, existing operators up gauging aircraft type etc.

- From time to time existing stands are required to be withdrawn from service to facilitate maintenance and repair of existing apron concrete areas. Typically in the case of contact stands at Pier A, parts of this pavement are in excess of 50 years old and stands are frequently withdrawn to facilitate repair.

- All reports prepared for Government since 1999 conclude that additional stand capacity is required at Dublin Airport, it is therefore appropriate that the disallowance of investment on six stands at Dublin Airport form part of this review.

<u>Shannon Terminal Extension</u>

The Determination on the maximum level of airport charges adjusted downwards the net book value of the terminal extension at Shannon Airport.

The terminal development, associated road realignment and car parking developments have all proved to be necessary, were provided to a specification agreed with all relevant users and in a cost effective manner based on a transparent public tendering process.

Should the Commission decide to carry out an interim review, Aer Rianta would welcome the opportunity to further clarify this project during the review, with particular emphasis on calculated areas and capacity analysis. The project has been proven to have delivered cost effective, flexible and efficient terminal facilities at Shannon Airport.

4 Traffic Performance

CP7/2001 was based on the Aer Rianta Centreline 2000 Traffic Forecast which was submitted to the Commission in February 2001. However, air traffic in the majority of airports in Europe has been impacted by a series of events since 2001. The slowdown in the world economy led by the IT sector, the September 11th terrorist attacks, the conflict in the Middle East, the outbreak of Foot and Mouth in the UK and SARS have all contributed to lower than anticipated growth in air traffic.

While performing significantly better than most European Airports in terms of growth since September 11th 2001, traffic at Dublin Airport is still falling short of the traffic forecast underpinning CP7/2001. Actual traffic performance for the years 2001 – 2003 for Dublin Airport is compared against forecast performance for each of these years in the table below.

Dublin Airport				
Year	**Forecast 2000**	**Actual/Budget**	**Variance**	**Variance %**
2001	15,192	14,334	(858)	-6%
2002	16,070	15,085	(985)	-6%
2003	16,931	15,779*	(1,152)	-7%
Total	**48,193**	**45,198**	**(2,995)**	

* Budgeted traffic for 2003

As the table illustrates the shortfall in traffic at Dublin Airport in the 2003 calendar year compared to the Aer Rianta 2000 centreline forecast is expected to be close to 1.2 million passengers. The rate of growth which is now anticipated for the remainder of the regulatory period is lower than previously forecast and this lower growth rate is being applied to a lower traffic base in 2003. The combined impact is such that in the regulatory year 2005/06, the passenger base from which the price cap is derived will be on average circa 1.5 million passengers per annum less than that provided for in CP7/2001 for Dublin Airport.

This shortfall in passenger traffic numbers has direct implications for the price cap applied at Dublin airport, whereby the price cap is a function of the maximum allowable revenues divided by the forecast number of passengers. It follows that where the forecast passenger numbers are too high the price cap per passenger will be too low. This is precisely what has happened at Dublin Airport. If the maximum allowable revenues as set out in CP2/2002 were divided by the actual passenger numbers the price cap for Dublin Airport would have been €0.35 higher in that first regulatory year. Aer Rianta believes that the shift in traffic forecasts for the aviation industry since CP7/2001 was issued and its implications for the derivation of the price cap at Dublin airport forms a substantial ground for review.

5 Security Costs

Aer Rianta's regulatory obligations in relation to security have increased substantially in the period since August 2001. In the immediate aftermath of September 11th, Aer Rianta was obliged to implement a series of measures identified by the National Civil Aviation Security Committee (NCASC).

European Regulations 2320/2002 and 622/2003 have come into force establishing common basic standards in the field of aviation security based on the current edition of the European Civil Aviation Conference Document 30. These European Regulations have laid down security requirements for the airports in the following areas:

- Airport planning
- Access control
- Screening of passengers and staff
- Separation of passengers
- Screening of cabin baggage, items carried and vehicles
- Hold Baggage Screening
- Physical security and patrols

As a result of these increased regulatory requirements, Aer Rianta has been obliged to implement certain unforeseen additional security measures at its three airports in the period since August 2001.

These include the following provisions:

- Enhanced screening of passengers and baggage
- Accelerated introduction of Hold Baggage Screening at the three airports for operation by January 2003

- Introduction of extended staff screening at airside terminal entrances to security restricted areas

- Screening of all materials and goods at airside terminal entrances to security restricted areas

- Enhanced background checks on all persons gaining unescorted access to security areas

- Upgrading and replacement of parts of perimeter fence

- Vehicle checkpoints

- Required introduction of an integrated access control system

- Improved CCTV coverage, in particular in the security restricted areas

- Enhanced patrols and inspections of perimeter fencing, restricted area, terminal areas, navigational aids and facilities and all remote areas

- Enhanced training for aviation security personnel

- Acquisition of additional x-ray equipment for the passenger screening process

These additional security requirements have necessitated both new and additional capital investment and increased operational expenditure. In terms of capital expenditure, Aer Rianta has implemented Hold Baggage Screening, in compliance with regulatory requirements and undertaken works in the area of airport perimeter fencing, staff screening, aer access, CCTV and X ray equipment. €16 million capital expenditure has been undertaken in this area from 2001 to date, and further investment is required to meet imposed regulatory requirements. In addition Aer Rianta has also recruited additional Airport Security Unit staff for passenger screening / boarding card checks in this period The company intends to recruit further staff in this area in order to satisfy security requirements while maintaining appropriate service standards. Aer Rianta believes that the impact of new and expanded security measures since CP7/2001 forms a substantial ground for a review of the Determination.

6 Operating Costs

The fundamental assumption underpinning CP7/2001 and CP2/2002 with respect to operating costs is that these costs are projected to grow in line with growth in passenger numbers plus inflation[2]. For reasons outlined below growth in certain cost categories has far exceeded inflation and actual passenger growth over the past three years.

[2] The amount allowed in CP7/2001 reflects the application of centreline 2000 traffic forecasts. Any downward adjustment to traffic forecasts for the remainder of the period will, based on the current regulatory assumptions result in a downward adjustment to the level of operating expenditure allowed in deriving the maximum yield.

Security Costs

The operating costs for security and safety at the airports have increased by more than 50% since 2000. This increase is a net increase after allowance for restructuring and productivity improvements. Were it not for these productivity gains which are already captured in the X factor applied in the Determination, the increase in costs would have been significantly higher. Underlying the cost increases are net increases in staff numbers since 2000 of close to 30% in the areas of security screening and the provision of dedicated staff screening entrances to airside areas. Increases in payroll security costs also reflect the application of national wage agreements, mandatory for Aer Rianta. Pay increases under national wage agreements in Ireland over the past number of years have exceeded inflation and are forecast to continue to do so over the remaining regulatory period.

Insurance

Similar to other companies, there has been phenomenal increases in Aer Rianta's insurance premiums in the period following September 11th 2001. Again this is a cost category where costs far exceed inflation plus actual passenger growth. For example, insurance costs over the period 2000 to 2003 have increased by €6.7 million (+356%). The projection for insurance assumed in CP2/2002 was c. €3.4 million for the regulatory year 2001/02. In fact Aer Rianta's actual cost for the same period was over €6 million.

Restructuring Provision

As part of the ongoing process of adapting to change in the aviation industry Aer Rianta made a one off provision in its 2001 accounts of €28.5 million to meet restructuring costs including a voluntary severance scheme. This provision, necessary to ensure that Aer Rianta adapts to changing economic and regulatory conditions should in Aer Rianta's view be taken into account in the figures underpinning the price cap calculations. The need to reflect this provision in itself forms a substantial ground for review.

7 Commercial Revenues

In CP7/2001, revenues from Aer Rianta's commercial activities including airport retailing, concession, car parking and rental revenues for the first six months of 2001 were projected forward for the Determination period on the basis of Aer Rianta's forecast traffic growth further inflated by CPI. These projections for commercial revenues were based on the assumption that all commercial revenues are directly correlated with passenger traffic volumes on a one to one basis. This is not a realistic assumption and actual performance to date confirms that in fact growth in commercial revenues is less than passenger growth. In the period 2000 – 2002 passengers increased by approximately 8%, while commercial revenues increased by only 5%. While growth in passenger numbers is a driver of retail and car parking revenues, there is no evidence to support the assumption that growth in passenger numbers will generate a corresponding growth in property and rental revenue streams.

The driver of increases in the rental revenue stream is the periodic review of leases/renewals and/or the addition of new capacity. To Aer Rianta's knowledge, there was little or no provision in the Recoverable Capital expenditure programme for additional commercial property that would generate additional rental revenue streams. Furthermore the base figures used for projecting commercial revenues included unrealised exchange gains which have not materialised in subsequent periods. These assumptions have resulted in an assumed level of contribution from commercial revenues which when combined with traffic forecasts that exceeded actual traffic figures over the past three years has not been realistic nor is likely to be going forward over the remainder of the regulatory period.

For the regulatory year 2001/2, the gross commercial revenues assumed in the Determination, CP7/2001, were €56 million more than those actually achieved by Aer Rianta, as reflected in Aer Rianta's audited regulated entity accounts provided to the Commission. Aer Rianta therefore believes that in the context of the application of the single till principle in calculating maximum levels of airport charges, the underlying assumptions for commercial revenues need to be reviewed and form a substantial ground for review of CP7/2001 and CP2/2002.

8 Financial Errors

From various dealings between the parties which have taken place since CP7/2001 and CP2/2002 were issued, a number of financial inaccuracies in the financial model underpinning the price cap have come to light. The existence of these inaccuracies in Aer Rianta's view forms substantial grounds for review of the Determination.

9 Benchmarking of Operating Expenditure

Following the publication of CP7/2001, Aer Rianta carried out an analysis of the IMG benchmarking study as set out in CP8/2001. Aer Rianta carried out a similar benchmarking exercise, using the same IMG "peer" airports, data sources and methodology as IMG. Aer Rianta's analysis highlights significant errors in the IMG benchmarking. Since the IMG benchmarking report supported the conclusion in the Determination on the scope for improving operating efficiencies at Dublin and Shannon airports, Aer Rianta believes that the basis used in CP7/2001 for estimating the scope for future operating efficiencies was fundamentally flawed.

A critical flaw in IMG's approach is that the comparisons used in the analysis did not compare like with like. IMG failed to adjust for the differences in the activities carried out by the airports. For example, Aer Rianta operates a number of activities (notably car parking and retailing) directly, whereas these are outsourced at many of the comparator airports. Similarly, Aer Rianta does not provide groundhandling services as many of its comparator airports do. If Aer Rianta operates a non-aeronautical activity (e.g. car parking) in-house, then both the associated costs and revenues will appear in its accounts. If a comparator airport outsources the activity, then the comparator airport's accounts will only include the net revenues from the concession fee. Unless these differences are adjusted for, the comparison of the cost accounts of the two airports is meaningless.

The IMG analysis also contains a number of calculation errors.

- Cargo throughput figures for Dublin airport are not included in the number of Work Load Units for Dublin but are included for all peer airports
- Group Head Office costs for Aer Rianta have been included in the cost base for Dublin Airport, but related employee numbers have been excluded
- Cost of sales for retail goods are included as part of airport operational costs

In Aer Rianta's analysis, checked by the firm of Economic Consultants, NERA, adjustments were made to ensure that the airports analysis compared like with like, in terms of the range of activities undertaken and the costs/revenues associated with same, viz:

- Figures relating to Aer Rianta were adjusted for those activities not performed directly by the majority of the "peer" airports i.e. retailing, catering, fuel and the operation of car parks
- The errors made by IMG in relation to employee numbers and cargo throughput figures were corrected.

From the corrected analysis, it is clear that the performance of the Irish airports is substantially better than suggested by IMG's report. In the adjusted outcome, the main indicator that was relied upon by IMG in analysing Aer Rianta's efficiency levels i.e. Operating Expense per Work Load Unit emerges as follows:

	Operating Expense per WLU- Dublin	Operating Expense per WLU- Cork	Operating Expense per WLU- Shannon
Amended Results	€5.1	€4.8	€9.8
IMG's Results	€10.5	€8.2	€20.6
Average of "Peer" Airports (per IMG)[3]	€7.34	€13.6	€13.6

- When compared to the average of €7.34 per Work Load Unit for IMG's defined "Best of Peers", Dublin's operating expenditure per Work Load Unit at €5.1 is over 30% lower. This contrasts sharply with IMG's assertion that Dublin's operating expenditure per Work Load Unit is 29% higher than the average of its "best of peers", or 35% if Oslo were excluded from this group.

- Shannon and Cork compare very favourably to the IMG average of the "peer" airports, which is €13.6 per Work Load Unit. Shannon's operating expense per Work Load Unit at €9.8 is 28% below the average of the "peers"; Cork's operating expense per workload unit at €4.8 is 65% below the peer group average. This shows that IMG's conclusions in regard to Shannon and Cork's operating costs were incorrect.

- The adjusted employee related measures also demonstrate the inaccuracies in the IMG report. For example, the adjusted labour cost per employee at €35,876 for Dublin Airport is 14% lower than the IMG figure of €41,869. Work load units per employee are significantly higher at all Aer Rianta airports than was portrayed by the IMG analysis and IMG's operating expenses per employee indicator was also found to be inaccurate as demonstrated below:

[3] In the case of Dublin, the comparative average is calculated using IMG's results for the "Best of Peers" as defined by IMG

	Dublin	Shannon	Cork
Amended Results			
WLU's per Employee	11,571	8,308	12,797
Operating Expenses per Employee	€59,102	€81,134	€61,963
IMG's Results			
WLU's per Employee	10,248	3,591	10,452
Operating Expenses per Employee	€106,086	€74,026	€86,196

It is clear that the IMG Benchmarking results were inaccurate. This results in Aer Rianta being incorrectly identified as not performing as well as peer airports and is therefore portrayed as being inefficient which is very damaging for the company. There is therefore a need for a review of the basis used in assessing the scope for Aer Rianta's future operating cost efficiencies. Aer Rianta will provide the Commission with a report detailing the correction of the benchmarking analysis which has been reviewed and supported by International Economic Consultants, National Economic Research Associates (NERA)

As the operating efficiencies applied to Dublin and Shannon airports are substantially incorrect, we believe that this forms a substantial ground for review of CP7/2001.

10 The Sub-Cap on Runway Movement Charges

In CP7/2001 and CP2/2002 a sub-cap on off-peak runway charges at Dublin Airport was introduced for the purpose of encouraging the efficient use of airport infrastructure. However Aer Rianta contends that this price cap structure is flawed as the empirical analysis supporting the structure and levels of the caps and the specification of the off-peak periods used were incorrect and incomplete. The introduction of this sub-cap has restricted Aer Rianta's ability to manage its business effectively.

There is no recognition in the analysis used to support the sub-cap off peak on runway movement charges that efficient prices may be different from marginal costs. Whether efficient prices are above or below marginal costs depends upon the nature of cost conditions (whether there are increasing or decreasing returns to scale) and on whether the airport is regulated on a single or dual till basis.

The level of the sub-cap on off-peak runway movements implemented is said to reflect only the short run marginal costs of use falling on Aer Rianta. This definition of marginal cost therefore excludes important cost impacts of aircraft noise and congestion, which should be included in efficient charges that reflect marginal social costs. Furthermore there is no consideration as to whether or not off peak runway operations may impose additional marginal costs on other elements of the airport system.

In the aircraft categorisation used to support the level of off peak runway movement charges, certain aircraft with similar numbers of passenger are included in widely different categories, this may have the effect of discriminating between airlines competing at the airport encouraging the users of one aircraft type over another. Furthermore no adjustment is made to take into account the fact that larger aircraft are more efficient in terms of numbers of passengers carried than smaller aircraft and as such the measure could promote inefficient use of the airfield.

There is insufficient evidence to support the specification of the off-peak periods set in the original and varied Determination CP7/2001 and CP2/2002. The analysis is based on traffic patterns on two particular days (the fifteenth busiest days of the summer and winter scheduling periods), selected according to rigid pre-determined criteria. The analysis assumed that the distribution of demand for capacity in 2006 would be similar to the distribution of demand in 2001. There is no support for this assumption, such as an analysis of traffic distribution patterns over the past 5 years. Nor does the analysis address the issue of how differential charges might alter the pattern of demand, resulting in peak shifting and the appearance of congestion in a designated off-peak period. The creation of a large number of off peak daily periods leading to a thirty minute peak in one case, is extremely cumbersome from an administrative perspective. This latter cost has not been factored into the marginal cost for off-peak operations.

11 Regulation of the Aer Rianta Airports as a Group

Aer Rianta believes strongly that Dublin, Cork and Shannon airports should be regulated as a group. This is consistent with the company's strategy as submitted to the Government in 1999. This approach to regulation would best allow the company to achieve its statutory obligations as set out in the Air Navigation and Transport (Amendment) Act, 1998.

Regulation as a group would ensure that demand for additional capacity and capital expenditure at the three airports are balanced in an economically efficient manner. There are exceptionally high costs associated with the development of new airport capacity as the sector is characterised by the lumpiness of its investment. Dublin, Cork and Shannon airports are currently at different stages in their development cycles, therefore the investment requirement at each airport differs considerably. For example, Cork Airport currently requires significant capital investment in order to deliver increased terminal capacity.

If the capital expenditure requirement at each airport is directly related to the revenue derived from each airport under individual price caps, investment will be constrained at the individual airports. Therefore regulation of the airports on an individual basis restricts capital investment at the individual airports and reduces the ability of the airports to meet their long-term capacity requirements in line with traffic forecasts. Regulation as a group would greatly assist Aer Rianta in balancing the capital expenditure requirements across the three airports with respect to the investment cycles of the individual airports.

The airport industry is characterised by economies of scope and scale where airports can spread their corporate functions, compliance and regulatory costs and other overheads across a number of aeronautical and non-aeronautical related functions. The management of the three Aer Rianta airports as a group gives rise to cost efficiency gains through the pooling of resources in areas such as human resources, retailing, property, finance, compliance/regulation, information technology marketing, procurement and technical/engineering. The regulation of the airports as a group would present greater opportunities for maintaining these benefits derived from economies of scale, scope and density.

CP7/2001 provided for a price cap on the maximum average revenues per passenger at Dublin Airport and at the Aer Rianta airports. In CP6/2002, a price cap of €5.26 was set for Dublin airport and €6.99 across the three airports for the current regulatory year 2002/03. Full implementation of this price determination would have resulted in an average maximum airport charge per passenger for Cork and Shannon airports of €13.27 in 2002/03. Such a differential in charges between the two airports and Dublin would damage the comparative competitiveness of Cork and Shannon airports with regard to Dublin. Aer Rianta estimates that the resulting loss in traffic at the two regional airports combined could amount to 500,000 passengers per annum. Even though the Determination is cost related, Aer Rianta is currently foregoing significant revenue by not pricing up to the maximum cap at Cork and Shannon Airports, in order to allow them to compete effectively with respect to Dublin. This charging policy has financial implications for the company and is therefore not sustainable in the medium term. Regulation of the three airports as a group would ensure long-term competitiveness and sustainable growth for Cork and Shannon airports. A continuation of the present approach will have consequences for regional development in Ireland and is contrary to aspirations set out in the National Development Plan.

12 Conclusion

Given the substantial developments which have occurred in the period since August 2001, it is necessary that there is a review of CP7/2001 and CP2/2002 under Section 32(14) of the Aviation Regulation Act, 2001. Aer Rianta is willing to engage with and provide whatever information is required in relation to each of the substantial grounds above to support the review process.