Response of British Regional Airlines Group plc (BRALG) to Commission Paper CP6/2001

BRALG welcomes the opportunity to respond to the paper, "Proposed Maximum Levels of Airport Charges".

This document will comment on each of the statutory factors which the Commission has had regard to in developing to its proposed position.

General

BRALG believes that the proposed levels of charges will damage the aviation industry in Ireland. Further reducing already tight yields can only serve to reduce the amount of air traffic. We are concerned that the conditions being placed on the airports under review are not sufficiently stringent for monopoly service providers.

Statutory Factors

1) *Investment*

We believe that the commission has acted appropriately by challenging Aer Rianta's CAPEX plans.

More detail concerning the development of the "Recoverable CAPEX Programme" would be useful to airport users. In particular the proposal of IEP£100m CAPEX on Rail at Dublin airport requires further detail. To what extent are airport users to be expected to fund this project? It would be interesting to see how much this single project adds to the level of the price cap.

In addition we are concerned that Commission is proposing that, in effect, CAPEX be pre-funded by current airline users. This is discriminatory in the sense that current users of the airport are potentially subsidising future users. We would ask the Commission to look closely at the example of T5 at Heathrow for evidence of the problems which pre-funding can cause.

Whilst BRALG appreciates the importance of projects to improve and maintain safety, we do not believe it is simply appropriate to accept the costing of these projects at face value. There are two potential issues.

- Regulatory gaming - If the airport operator is fully aware that non-safety projects will be subject to regulatory review and possible amendment, then there is an incentive to load costs into proposed safety CAPEX which will be "passed" without review.
- There is evidence that security related CAPEX in regulated UK airports, which can be passed on to users via the price cap, has been carried out inefficiently.

2) *Reasonable rate of return*

It would be of interest to obtain further details concerning cost of capital estimates. The Commission has estimated a cost of capital between 8% and 9%. The CAA, in a similar review for regulated UK airports, has estimated a pre-tax WACC of between 6% and 9% - a considerable difference at the lower end.

The Commission states the following *"By contrast, if the rate of return of a business consistently exceeded the cost of capital then, in a competitive industry, new firms would be attracted into the industry by the profits to be earned there."*

The Commission then goes on to say "*…would suggest that a regulator should allow a rate of return slightly greater, over the medium term, than the company's cost of capital.*"

BRALG is interested to know how the commission can reconcile these two statements? What can be done to prevent the *monopoly* Airport Company from generating supernormal profits (in the economic sense)? Will there be a mechanism whereby any returns greater than the cost-of-capital will be returned to the airport users?

3) *Efficient and effective use of all resources by the airport authority.*

BRALG agrees with the sentiments contained in this section.

4) *The contribution of the airport to the region in which it is located.*

BRALG agrees that cross-subsidisation of airports within a regulatory regime should be disallowed. However, we are concerned with the absence in the section of a logical link, which goes as follows:

Low Airport Charges----> More Activity ----> More growth in Ireland

Is this not something which the Commission should concern itself with?

5) *The level of income of the airport authority from airport charges at the airport and other revenue earned by the authority at the regulated airports or elsewhere.*

BRALG agrees strongly with the concept of the single till. Airport commercial activity generates profits only because of airline operations. As noted by the Commission, in a competitive environment, airport charges could be set lower to enhance commercial activity. However, the monopolistic unregulated airport has no incentive to do this.

We disagree with new commercial activities being excluded from the till at Dublin. Could this not create opportunities for regulatory gaming? In addition it could lead to a "two-tier" commerical environment, with the commercial areas which feed into the till being neglected in favour of new opportunities. Incentives to improve commerical activity to keep airport charges low would be impaired.

6) *Operating and other costs incurred by the airport authority at the airport*

We agree with the approach taken here, although more transparency would be appreciated.

7) *Level and quality of services offered at the airport by the airport authority and the reasonable interests of the users of these services.*

The concept of the "Default Price Cap" could be applied to the Irish Airports. Here, the level of service to be provided for the price cap is fully specified. Should users wish to contract outside of this price cap then they would be free to do so.

Whilst in theory, contracting below the price cap for a lower service level is possible, it is important to note that much of an airport's cost base is common to all users regardless of their needs/requirements. Indeed, contracting below the price cap can cause some odd results.

For instance, it could be argued that a "low cost", basic airport terminal should result in lower charges for the airlines using it. However, it is likely that this terminal building would generate less commercial revenue for the airport than a fully specified one. Since the users of the basic terminal are benefitting from commercial revenues across the entire airport (through the single till), they are, in effect, being subsidised by other users.
In the case of Dublin Airport, allowing new commercial activity to take place outside of the price cap would further exacerbate the problem.

8) *Cost competitiveness and operational efficiency of airport services at the airport with respect to international practice.*

BRALG believes that the efficiency targets to be set should take account of

- Cost reduction/efficiencies which are specific to Aer Rianta
- Results of the benchmarking process.

9) *Imposing the minimum restrictions on Aer Rianta, consistent with the functions of the commission.*

BRALG questions how the commission sees the incentive effects of a revenue cap working? A per passenger revenue cap incentivises quantity at the expense of quality. How would this be controlled?

In addition, whilst the theory of the "revenue cap" is simple there are many practical issues which would need to be addressed and discussed, including

- incentive effects as stated above.
- treatment of over/under recovery against the cap.
- treatment of discounts from full published charges.

10) *Such national and international obligations as are relevant to its functions.*

BRALG has no comments here.