Mr William Prafiska
Commissioner
Commission for Aviation Regulation
36 Upper Mount Street,
Dublin 2,

26 July 2001

Re: Consultation paper - CP6/2001 on Proposed Maximum Levels of Airport Charges

Dear Mr Prafiska

Attached is Shannon Development's response to the Commission for Aviation Regulation's Consultation Paper CP6/2001 on Proposed Maximum Levels of Airport Charges.

Shannon Development, as the Company with responsibility for economic development in the Shannon Region, is firmly of the view that a thriving and viable international airport at Shannon is the most critical element of infrastructure which will drive economic growth, not only in the region but in the West of Ireland in general. We believe that the overall economic interests of the region may not be best served by considering the airport as merely a group of assets on which the rate of return is maximised.

Shannon Development's response to CP6/2001 has, therefore, been prepared from an economic policy perspective. We are concerned that your draft determination does not adequately deal with the requirement under Section 33(d) of the Aviation Regulation Act, 2001, to *"facilitate the development and operation of cost effective airports which meet the requirements of users and shall take due regard to the contribution of the airport to the region in which it is located'*. The National Development Plan 2000 – 2006 clearly sets out the goal of achieving regional balance in economic development. The regulatory environment, including the Commission's determination on airport charges, should facilitate this goal. It certainly should not, as would be the case if the current proposal were to be implemented, mitigate against it.

Finally, I would like to complement you and your team on the consultation process which you have introduced and which has afforded us and other interested parties with the opportunity to interact and contribute on this vitally important issue.

Yours sincerely

Kevin Thompstone

Kevin Thompstone
Acting Chief Executive

Shannon Development submission in relation to the Commission for Aviation Regulation’s Draft Determination and Explanatory Memorandum on the Proposed Maximum Levels of Airport Charges.

Reference: Commission Paper CP6 / 2001. June, 26th 2001.

Date of Submission: July 26, 2001

Proposed Maximum levels of Airport Charges

Observations by Shannon Development on the Draft Determination and Explanatory Memorandum by the Commission for Aviation Regulation (Commission Paper CP6 / 2001)

Shannon Development notes that the purpose of the above paper is to allow interested parties to ascertain, in general, the impact of the proposed determination and also notes that the proposals are preliminary in nature and that no final conclusions have been reached by the Commission.

Having considered the Commission for Aviation Regulation paper CP6/ 2001, Shannon Development would make the following observations:

- Shannon Development's understanding is that the draft determination relates to maximum permitted revenue per workload unit that can be derived from aeronautical charges by Aer Rianta at each airport (landing and take-off charges, aircraft parking, passenger fees and cargo charges).

- Shannon International Airport is a critical part of the infrastructure of the whole West Coast of Ireland. Its impact has been well documented e.g. the *Alistair Tucker, Shannon Airport Impact Study (1996)* and the *'Shannon Airport - Engine for Balanced Growth'* report prepared by the Shannon Airport Marketing Consultative Committee (December 1998). Into the future Shannon Airport can play an even greater role in helping to bring about more balanced regional growth in line with the objectives of the National Development Plan 2000 - 2006. Currently, over one-third of all economic activity takes place in the Western part of Ireland and yet, of the international passenger movements through the three national airports, 81% was via Dublin in 2000. In the case of European passenger movements concentration is even more acute and in 2000 Dublin had an 87% share. Between 1990 and 2000, of the 9.8 million extra passengers through Aer Rianta airports, Dublin accounted for over 8 million (82% of the growth).

- Looking at off-season capacity, between 1995 and 1999 over 2.3 million seats have been added to Dublin Airport's winter services while just 250,000 extra seats were added at Shannon and 170,000 at Cork[1]. Therefore, 85% of the off-season capacity growth has been via Dublin during this five year period. While Shannon and Cork are making progress, air access via Dublin is now even more concentrated than it was a decade ago, which aside from the economic impact, is resulting in significant congestion at one airport and under-utilisation at two airports. Re-balancing is necessary if tourism, industry and service businesses are to prosper throughout the regions.

  Conventional wisdom says that businesses follow market demand and this is generally true. However, in the case of airlines it is not always the case. Airlines don't necessarily respond to market needs and will often, because of their own strategic priorities and powerful marketing capability set out to lead demand, clearly with considerable success (e.g. Ryanair, as a low cost carrier, can lead demand while the hubbing strategy of full-service airlines can determine where

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[1] Source: Aer Rianta - extracted from report on the "Spatial Spread of Tourism & Extending the Season" prepared for the Irish Tourist Industry Confederation by Fitzpatrick Associates Economic Consultants. Published 2001.

they develop routes). This is the case within Ireland and is the reason why there is a contrast between the level and spread of economic activity on the one hand and over-concentration of access on the other. If Ireland is to achieve its objective of better-balanced economic development, the regulatory environment should be working to facilitate this objective rather than against it.

- The commentary in CP6/2001 on the regional impact of airports is largely concerned with the issue of whether cross-subsidies should affect the setting of the maximum levels of airport charges. What is clear is that there is a need to have a lower maximum charge in operation at Shannon and Cork airports relative to the capital city airport in the interests of furthering more balanced regional economic activity. This poses no threat to the capital city region where the city and its airport suffers from congestion while, at the same time, capacity is underutilised at Shannon and Cork. Given the congestion in the greater Dublin area and the fact that other Government policies are aimed at achieving better-balanced economic activity throughout all regions, it seems illogical to set the lowest maximum airport charge at the most congested airport in the most congested part of the country. While price is always an issue, and airport users should always seek value, airlines are likely to be relatively less sensitive in respect of Dublin Airport charges because it is the capital city. They are likely to be more sensitive about even higher charges at Shannon and Cork and therefore, against this objective, a more rational approach suggests that maximum charges should be lower in Shannon and Cork than in Dublin.

- The Shannon Region / West of Ireland has a strong base of businesses that trade internationally and many have a requirement to export cargo. In many cases, though they had choices as to where they might locate, they chose Ireland and the Shannon Region for a number of reasons. For many, a key determinant was proximity to Shannon International Airport to avail of passenger and cargo services. It would be an extremely serious issue for the Region, and for the airport, if cargo rates were to move out of line and were to become less competitive.

- We recognise that the Regulator is only proposing the maximum yield per workload unit that can be derived from aeronautical charges at each airport and that Aer Rianta would be free to charge lower rates consistent with EU and Ireland competition law. Nonetheless, the Regulator is proposing that the maximum rates at Shannon be set at a level 22% higher than Dublin (and Cork even higher again). Although the Aviation Regulation Act, 2001 is also clearly concerned about regional development within Ireland, the Regulator proposes to finesse this issue by claiming that each airport, including Dublin, is a regional airport and that cross-subsidies between airports should be strongly discouraged. Dublin Airport, is a major hub, and with 81% of Aer Rianta's terminal traffic, generates the highest profit margins among their three airports. We believe that the spirit of the statute should be adhered to and that, as per Section 33(d) of the Aviation Regulation Act, 2001, the commission shall *"aim to facilitate the development and operation of cost effective airports which meet the requirements of users and shall take due regard to the contribution of the airport to the region in which it is located'*. Shannon Airport is a critical engine of growth for the West of Ireland. However, it hasn't yet reached the same level of air traffic services as Dublin. In this context, it would make commercial and economic sense to propose a more flexible formula that recognises that a lower level of return will be required at Shannon, compared to Dublin, in order to stimulate the further development of air traffic services.

- Shannon Development notes that the recommendations are based on the assumption that the Aer Rianta airports will remain part of the same system into the future. This may not necessarily be the case and Government could decide on a different ownership structure for the three airports. In this scenario the basis for setting the maximum charges would have to be revisited in order to take account of the new ownership structure, cost of capital, return on capital investment, etc. While the regulator could not be expected to allow for this possibility explicitly in his deliberations he could have anticipated possible future ownership scenarios by raising the issue of different returns on investment for the regional airports relative to Dublin. For example, Dublin would have a different rate of return on capital because of economies of scale and the higher cost of land and construction projects in the capital compared with other parts of the country. This in turn would influence the level of airport charges in Dublin relative to Shannon and Cork. At the very least the regulator should explain why Shannon and Cork should be expected to generate the same return on investment as Dublin when neither, for example, enjoy the same traffic base and commercial advantages which automatically fall to the capital city.

- Critical to optimising the value to the users of Shannon Airport will be its operational efficiency, which ultimately will be reflected in improving year-round east and west-bound air services (full-service carriers and low-cost carriers). Shannon Development agrees that there is a need to ensure that Shannon International Airport achieves the very highest levels of efficiency and that benchmarking against best-practice international comparators is a useful exercise. However, in this context, a particular concern is the choice of airport 'peer group'[2] against which Shannon Airport was benchmarked. The airports referred to in the draft document - Basel (BSL), Cardiff (CWL), Leeds/Bradford (LBA) and London-Luton (LTN) do not have the infrastructure to support intercontinental operations. While this peer group may be appropriate for Cork for cost / efficiency comparison purposes, we believe that airports such as Luxembourg (LUX) and Bangor, Maine (BGR), for example, would be better choices for benchmarking Shannon. There are significantly higher costs involved in providing the infrastructure to support large aircraft operations. To include Shannon and Cork in the same category for peer group review is incorrect. The traffic structure and operating conditions of both airports are completely different because of the transatlantic and transit traffic handled by Shannon and the fact that Shannon is open 24 hours a day as a North Atlantic relief airport. We therefore believe that the peer group selected for benchmarking Shannon should be revisited and that further analysis be undertaken using more appropriate comparators to more accurately determine the full efficiency requirements.

- Against the comparator airports chosen, which we have already questioned, the report proposes that there is scope for a 25% operating efficiency gain at Shannon. Whatever scope there is for efficiency gain could be achieved by a reduction in operating costs or by spreading costs over a greater volume of passengers/cargo or by a combination of both. If Shannon seeks to spread costs over greater volumes then there is a plausible case for it to have a lower maximum airport charge rather than a higher one in order to attract more traffic.

[2] We acknowledge that Swissair briefly provided non-stop services in the Basel - Newark market. However, BSL principally functions as a regional hub for Crossair and the services the airport provides are primarily designed to support small aircraft operations. Shannon, in contrast, has a significant amount of business consisting of large aircraft flying on intercontinental routes which necessitates more expense for the Airport to support. Thus, we believe our point remains valid - that the regional airports used for benchmarking SNN are not appropriate.

Our great concern is that the regulator is ignoring the impact of airport charges on future traffic growth and has concentrated simply on setting charges at a level which will finance the past and planned capital expenditure at the three airports. This explains the anomaly of doubling the maximum charge at Cork even though the report highlights that it is operating efficiently against it peer airports. However, the impact of airport charges on future growth is potentially significant, and is something which Shannon International Airport and regional airports cannot afford to ignore.

- There is considerable variability in the year-to-year CAPEX amounts being proposed for Shannon; ranging from £4.1 million in 2002 to £20.2 million in 2007. As there will be a clear connection between the cost of infrastructural investment and the charge levied on users (which will impact on range of air services and load factors), key stakeholders and frequent users in the Region should be consulted and have a stronger say in the appropriateness of such investments. Also, in relation to assets, it is not clear how the depreciation of assets is being recognised in the rate setting process.

  At a more fundamental level, the proposed charging regime requires that airport users fund what is essential infrastructural investment. Airport users, who ultimately decide the level of air traffic services, are already voicing their resistance to this proposal. In addition, this carries the considerable risk of discouraging investment in essential but non-commercial infrastructure (e.g. cross-runway) as it would increase airport charges while, at the same time, the airport operator would be incentivised to invest in non-infrastructural commercial activities (e.g. retail) which generate yields which fall outside the ambit of the regulator and have minimal regional economic impact.

- The benchmarking exercise, like much else in the document, is heavily skewed toward Dublin and issues impacting on Dublin. Shannon and Cork's specific conditions must receive similar consideration.

Conclusion

As an island nation, ease and low-cost of access to all parts of Ireland is absolutely critical to helping Ireland achieve more balanced development - which is the objective of the National Development Plan 2000 - 2006. In order for Ireland to enjoy on-going success the Government clearly understands that it has to open up all Region's in order to absorb the growth it hopes and anticipates will continue. In this context, aviation is a powerful instrument and engine of economic growth. For instance, ease and cost of air access does influence where, when and how many tourists visit us (and the associated spin off); it influences if and where companies, that trade internationally, locate in Ireland and it impacts generally on the development and trading capability of many sectors throughout all the regions.

As it is now, Dublin is the dominant gateway accounting for 81% of Aer Rianta's international terminal passenger traffic, significantly disproportionate to the economic profile of Ireland. If general economic re-balancing is to occur, there needs to be a concerted effort on many fronts and the delivery of National Development Plan 2000 to 2006 is at the core of this effort. Shannon Development believes that the regulatory environment, including the Commission's determination on airport charges at the three airports, should facilitate balanced regional growth. It certainly should not, as would be the case if the current proposal were to be implemented, mitigate against it.