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daa
Dublin Airport Authority
helping you on your way

28th September 2006

Dear Anne,

Please find attached the DAA response to the Commission document CP6/2006. We would be happy to answer any queries that you may have regarding this submission.

Kind Regards

Tom Haughey
Director Market Development & Strategy

DAA Response to CP6/2006

28th September 2006

"Public consultation on the carrying out of an Interim Review of the September 2005 Determination on the maximum levels of airport charges at Dublin Airport"

Introduction

DAA welcomes the publication of CP6/2006 and the Commission's decision to consult as to whether substantial grounds exist to warrant a review of its 2005 Determination of maximum charges for Dublin Airport.

In CP6/2006, the Commission has advised that in accordance with Section 32 (14) (a) of the Aviation Regulation Act, 2001 (as amended) that:

- There appears to be 'substantial grounds' to conduct a review based on the requirement to analyse the forthcoming 2006 Capital Investment Programme for Dublin Airport arising from the circumstances surrounding the unavailability of a finalised Capital Investment Programme at the time of the 2005 Determination; and

- There may be 'substantial grounds' to conduct a review based on the degree to which airline users of Dublin Airport have revised their anticipated requirements for airport facilities such that the DAA has developed a substantially larger Capital Investment Programme.

DAA supports the Commission's view that the test for 'substantial grounds' should be interpreted in light of the Commission's statutory objectives and the promotion of economic efficiency.

DAA believes that there are substantial grounds to justify a review of the 2005 Determination based on the requirement for the Commission to take account of the 2006 Capital Investment Programme arising from the circumstances surrounding the unavailability of a finalised Capital Investment Programme at the time of the 2005 Determination.

Substantial Grounds

Finalisation of Revised Capital Investment Programme

As the Commission acknowledged, it proved impossible for DAA to provide the Commission with an appropriate finalised Capital Investment Programme (CIP) in accordance with the requirements of the Aviation Action Plan given the legislative timeframe set for the 2005 regulatory review which mandated completion by the 1st October.

The following set of circumstances were exceptional and outside the control of the company:

- The July 2004 Act amended the Aviation Regulation Act, 2001 and provided that the Commission make a new determination for Dublin Airport within twelve months of the Dublin Appointed Day i.e. by the 1st October 2005

- The company submitted its Capital Investment Programme to the Commission on the 9th May 2005, which predated the publication on the 18th May 2005 of the Government's Aviation Action Plan

- This publication, as the Commission has acknowledged announced a revised policy approach in relation to airport capacity. The Aviation Action Plan mandated the provision of a new pier for aircraft stands at Dublin Airport by 2007 and the building of a new terminal (T2) by 2009 by Dublin Airport Authority

- The Aviation Action Plan required the fulfilment of the Government's triple safeguard criteria to ensure the maximum efficiency and cost effectiveness of Terminal 2

  - Consultation: T2 would be designed to meet the requirements of airlines serving Dublin Airport. To this end, the DAA would consult in detail with the relevant airline operators

  - Verification: Government appointed aviation experts would independently verify final specifications and costings of T2

  - Regulation: In setting airport charges, the Commission for Aviation Regulation would ensure that charges reflected costs appropriate to the building of an efficient terminal

- In July 2005, the new board of DAA initiated an assessment of Dublin Airport future capacity requirements (Pascall and Watson Review). The results of which could not be reflected, in the 2005 determination.

- The Government had not initiated the independent verification process prior to the 2005 determination.

Consequently, the Commission based its 2005 regulatory determination on the company's May 2005 CIP. This plan was produced in the absence of final decisions regarding ownership of the 2nd Terminal and it predated both the Government Aviation Action Plan and the Pascall and Watson review of capacity requirements for Dublin Airport. In its 2005 Determination, the Commission stated a commitment to potentially reviewing the Determination once it and other interested parties had time to fully consider the finalised Capital Investment Programme proposed by DAA. Indeed the independent assessment of capital expenditure, on which the Commission relied in 2005, described its work as a provisional assessment in need of a subsequent and more considered evaluation.

User Requirements for Airport Facilities

DAA is committed to providing aeronautical facilities in line with its users' requirements at an appropriate standard of service. The company is faced with the challenge of reconciling the short-term focus (and different needs and perspectives) of its current airline customers with the long-term development and planning requirements of the airport to meet current and prospective user needs.

In the light of the publication of the Government's Aviation Action Plan, DAA commenced a new process of consultation with the relevant airlines serving Dublin Airport in line with international practice and in fulfilment of the Government's triple safeguard criteria. During this peirod, additional information regarding airline users anticipated requirements emerged which has contributed to notable changes in capacity requirements at Dublin Airport which were not envisaged in the company's May 2005 Capital Investment Programme.

The company's updated 2006 Capital Investment Programme is therefore the airport operator's best estimate at this time of airport users prospective requirements.

<u>Cost of Additional Capacity</u>

The company is currently finalising its 2006 Capital Investment Programme which calls for substantially larger and more front-loaded capital expenditure over the period 2006-2009 than the recoverable capital expenditure allowed for by the Commission in its 2005 Determination. This possibility was highlighted by the Commission in CP6/2006 where it accepted *"that the scale of the revised programme may be large enough for its viable implementation to be in doubt without a review of the 2005 Determination"*[1].

The 2006 Capital Investment Programme is DAA's best assessment of the capital expenditure required to rectify clear deficiencies in both capacity and

[1] CP6/2006 page18

current service levels at Dublin Airport and to meet forecast increases in demand at an acceptable service standard, in a manner that is reflective of timescales set by government and which is reflective of appropriate safety standards.

The company now believes that it will be necessary to spend approximately €1.1billion in the period 2006-2009, significantly more than envisaged in the May 2005 Capital Investment Programme a fact which supports the Commission's view.

The degree to which DAA can implement this capital investment programme will determine the minimum level of services that can be delivered to customers in terms of space, comfort and efficiency and how quickly the airport can achieve acceptable sustained passenger service standards. DAA shares the Commission's concerns that "*if in the absence of a review, airport capacity were to be provided too late relative to demand growth, then airport users could be exposed to congestion costs, in the form of time costs(delays) as well as crowding and other discomfort*,"[2].

Airport infrastructure cannot be delivered unless the airport authority is allowed to recover the costs which are incurred. Government policy is clear that the airports under DAA's management must be operated on a commercial basis, covering all costs and with no recourse to Government funding, grants or guarantees. The Commission's 2005 Determination set an average passenger charge of €6.34 in real 2004 terms for the period 2006-2009 which is insufficient to finance the Capital Investment Programme that is now required.

<u>Fulfilment of Statutory Objectives</u>
One of the Commission's statutory objectives is to "facilitate the efficient and economic development and operation of Dublin Airport, which meet the requirements of current and prospective users of Dublin Airport". The level of investment in airport facilities is a key factor for consideration in attaining this statutory objective, as the Commission must ensure that the level of allowed aeronautical revenue is sufficient to develop airport facilities in line with those requirements.

The Commission also has a statutory mandate to enable Dublin Airport to operate and develop Dublin Airport in a sustainable and financially viable manner and therefore in DAA's view it must also ensure that it will:

- Enable the infrastructure development at Dublin Airport to occur at the scale and timing appropriate to demand; and

- Enable Dublin Airport to operate and develop in a sustainable and financially viable manner

[2] CP6/2006 page 16

These statutory objectives are further reinforced and complemented by the mandate to the Commission that was outlined in the Government Aviation Action Plan whereby the Commission is required under the triple safeguard criteria to ensure that airport charges reflect costs appropriate to the building of an efficient terminal.

A failure to take account of Dublin Airport's capacity requirements arising from the 2006 Capital Investment Programme will threaten the viable implementation of the Aviation Action Plan and will limit the company's ability to provide much needed aeronautical capacity, thereby reducing dynamic efficiency and compromising the Commission's statutory objectives. Therefore, there are substantial grounds which require that the Commission reviews its 2005 Determination to take account of the DAA 2006 Capital Investment Programme.

Question 1

Do you agree with the Commission's conclusion on the types of circumstances necessary to justify holding an interim review? Please provide reasons and, where appropriate, evidence.

DAA believes that exceptional circumstances can and occasionally do arise where exogenous effects outside the control of the company occur and compromise the achievement of the Commission's statutory objectives under its original determination. In these circumstances where the financial or other effects give rise to such a loss in efficiency the benefits of holding a review outweigh any detrimental effect of uncertainty surrounding a review.

DAA agrees that in order to assess whether a determination has been compromised it should apply a test whereby it must be established that substantial grounds exist under the Aviation Regulation Act, 2001.

While DAA agrees that in principle it would be detrimental to the incentive effect of regulation were numerous interim reviews permitted to take place over the course of a regulatory period nevertheless where the test of substantial grounds has been met it is appropriate to carry out an interim review.

Question 2 & 3

Do you consider the degree to which airline users of Dublin Airport have revised their anticipated requirements for airport facilities (such that the DAA has developed a substantially larger capital programme) to provide the basis for exceptional circumstances?

Do you consider the degree to which airline users of Dublin Airport have revised their anticipated requirements for airport facilities to be liable to give rise to financial or other effects that are large enough to compromise the Commission's statutory objectives unless the September 2005 decision is reviewed?

Dublin Airport Authority issued its May 2005 Capital Investment Programme to the Commission in order to facilitate the statutory deadline of 1st October 2005. At that time the decision as to who would provide T2 had not been made. DAA was therefore not in a position to adequately consult in sufficient detail with users in the context of the Aviation Action Plan prior to the 2005 regulatory determination being made.

Following the publication of the Government's Aviation Action Plan which required the provision of a new pier for aircraft stands at Dublin Airport by 2007 and the building of a new Terminal (T2) by 2009 by DAA, the company commissioned the consultancy firm Pascall and Watson to carry out a review of aeronautical capacity requirements in July 2005 in line with the Dublin Airport Master Plan. Pascall and Watson engaged in consultation with the key airline stakeholders.

The findings of this study confirmed the outputs of the masterplanning process, the proposed location for T2 and the broad capacity requirements which were envisaged for T2. One of the key conclusions of the Pascall and Watson review was that medium complexity operators i.e. long haul and mixed long haul/short haul operators should be the primary tenants of T2. DAA provided the Commission with the Pascall and Watson conclusions in September 2005. This did not provide the Commission with sufficient time to review the resulting findings.

Following this, DAA was then in a position to commence a process of detailed consultation with the relevant airlines serving Dublin Airport in fulfillment of the Government's triple safeguard criteria. This process led to the development of a detailed design and specification for T2 and other airport facilities. In the course of this process, a number of significant factors were identified which when combined with the requirements of the Aviation Action Plan contributed to notable changes in capital investment requirements at Dublin Airport which were not reflected in the company's May 2005 Capital Investment Programme or taken account of in the Pascall and Watson conclusions.

It is DAA's view that the series of events outlined above provide the basis for exceptional circumstances which constitute substantial grounds for a review of the 2005 Determination.

While overall traffic growth in the medium term is not greatly affected[3], by the more ambitious plans now embraced by Dublin Airport's major carriers it is expected that there will be a significant increase in the traffic share of these carriers. An increase in the share of the home based carrier fleet directly drives demand for apron, runway, terminal, pier and landside capacity.

DAA contends that there are financial effects arising from the updated 2006 Capital Investment Programme which are large enough to compromise the Commission's statutory objectives unless the September 2005 decision is reviewed. The updated 2006 Capital Investment Programme will require substantially larger and more front-loaded capital expenditure over the period 2006-2009 than the recoverable capital expenditure allowed by the Commission in its 2005 Determination. The Commission's 2005 Determination set an average passenger charge of €6.34 in real terms for the period 2006-2009. Given the steep increase in the scale and cost of the capacity to be provided this will be insufficient to finance the implementation of the 2006 Capital Investment Programme.

The potential financial implications arising from higher capital investment requirements were also acknowledged by the Commission at its public meeting on the 11th September 2006 where in its presentation it demonstrated the impact on airport charges necessitated by changes in capital expenditure.

Adequate airport infrastructure cannot be delivered unless the airport authority is allowed to recover the costs which are incurred. Given that a failure to take account of Dublin Airport's 2006 Capital Investment Programme will limit the company's ability to provide much needed aeronautical capacity, this in turn will reduce dynamic efficiency and compromise the Commission's statutory objective to facilitate the efficient and economic development and operation of Dublin Airport, which meet the requirements of current and prospective users of Dublin Airport.

[3] The current forecast projects growth of 34% over the next 5 years, with a compound average growth rate of 4.8% p.a., as compared with 4.6% p.a. over the same 5 years for Forecast 2004.

Questions 4 & 5

Do you consider the circumstances surrounding the unavailability of a finalised CIP at the time of the 2005 Determination to have been exceptional? If you consider the circumstances exceptional, is this for any of the reasons suggested as possibilities in this paper or for some other reason?

Do you consider the circumstances to have been outside of the control of the DAA?

The obligations and timeframe imposed upon both the Commission and DAA through the combination of the legislation adopted in the State Airports Act 2004 and the policy set out in the Aviation Action Plan clearly represent exceptional circumstances.

Under the State Airports Act, 2004 the Commission was required to make a new determination for Dublin Airport within twelve months of the Dublin Appointed Day i.e. by the 1st October 2005.

On the 18th May 2005, the Government published its Aviation Action Plan. This Plan announced a revised policy approach, in relation to airport capacity. The proposals directly relating to the DAA concern the provision of a new Pier for aircraft parking stands at Dublin Airport to be available from 2007 and the building of a DAA owned new terminal T2 at Dublin Airport to open in 2009. The Government regards these proposals as a comprehensive plan for the long-term success and growth of Irish aviation and have placed special emphasis on the need to quickly and efficiently provide extra capacity at Dublin Airport. T2, in particular, has been noted by the Government as representing a critical piece of state infrastructure underpinning the importance of Dublin Airport to Ireland.

Thus, the passage of the 2004 Act had two linked impacts on investment at Dublin Airport. The 2004 Act led (via the appointment of a new DAA Board) to a fundamental re-examination by the DAA of Dublin airport's investment plan, which, in conjunction with the Government's Aviation Action Plan, led to a very substantial increase in the time required by the DAA to produce a new Capital Investment Plan. At the same time, the 2004 Act reduced the time available for a price review by bringing forward the following review from 2006 to 2005. The combination of these impacts was to render the company unable to submit a final Capital Investment Plan to the Commission in time for it to be properly considered for the 2005 Determination.

Against this background, as the Commission has concluded, DAA might reasonably have required a longer period of time to conclude in a proper and thorough manner, a review of an investment programme as critical as the one now contemplated and that these circumstances can be regarded as exceptional.

The Aviation Action Plan set out the Government's triple safeguard to ensure maximum efficiency and cost effectiveness of Terminal 2. The three safeguards were:

- Consultation: T2 would be designed to meet the requirements of airlines servicing Dublin Airport. To this end, the DAA would consult in detail with the relevant airline operators

- Verification: Government appointed aviation experts would independently verify final specifications and costings of T2

- Regulation: In setting airport charges, the Commission for Aviation Regulation would ensure that charges reflected costs appropriate to the building of an efficient terminal

On the 18th August 2005, the Minister for Transport issued a direction under Section 10 of the Aviation Regulation Act, 2001 to the Commission in order that the purpose and intent of relevant Government policy be taken into account in relation to the proposed regulatory price cap for Dublin Airport. The direction drew attention to the importance that the Minister attached to the implementation of the Aviation Action Plan and the financial sustainability of Dublin Airport in that context. The Minister further noted:

> *"I consider the implications of increasing congestion at Dublin Airport are such that priority has to be given to ensuring that the Government's policy decision is implemented on schedule."*

It was not possible for DAA to provide the Commission with an appropriate Capital Investment Programme in accordance with the requirements of the Aviation Action Plan given the legislative timeframe set for the 2005 regulatory review which mandated completion by the 1st October. Therefore, the Commission had to base its 2005 regulatory determination on the DAA's May 2005 Capital Investment Programme.

This plan was produced with uncertainty concerning decisions regarding ownership of the 2nd Terminal and it predated both the Government Aviation Action Plan and the Pascall and Watson review of capacity requirements for Dublin Airport. In its 2005 Determination, the Commission stated a commitment to potentially reviewing the Determination once it and other interested parties had time to fully consider the finalised Capital Investment Programme proposed by DAA.

DAA believes that the above chain of events constitute exceptional circumstances which were outside the control of the company and affected the Commission's ability to produce an all-encompassing determination.

It is appropriate therefore that the company prepare and submit a revised Capital Investment Programme which reflects the requirements of the Aviation Action Plan and that the Commission revise its recoverable capital allowance to permit the implementation of Government policy as mandated by the Aviation Action Plan.

Question 6

What do you consider should be the scope of any review? Do you consider that the scope of any review should be limited as far as possible to the matters directly affected by the circumstances justifying the review?

DAA agrees with the Commission's view outlined in CP6/2006 that the scope of a review should be no wider than necessary to address the grounds for a review[4].

DAA believes that the regulatory risk associated with regular reopening and revisiting of the different regulatory variables in the context of a mid term review could prove detrimental by increasing uncertainty and a weakening of the incentive properties of the regulatory framework.

The Commission's assessment of capital expenditure in the 2005 Determination was clearly tentative whereas, as the Commission has acknowledged, other matters including operating costs and passenger forecasts were comprehensively rehearsed during the work for the 2005 determination. The independent assessment of capex, on which the Commission relied in 2005, described its work as a provisional assessment in need of a subsequent and more considered evaluation.

On this basis, DAA agrees with the Commission that it should not be necessary to revisit assumptions made at the time of the Determination that are not materially compromised by the circumstances relevant to the review.

Given the changing security environment and the potential related impacts on retail revenues and other changes in operating costs, it is possible that exceptional circumstances may arise justifying a further interim review. However, it would be inadvisable for this review to include any of the regulatory variables other than the capital expenditure parameter as signalled by the Commission in its 2005 Determination

In this context, DAA contends that the scope of the review should be the replacement of the May 2005 Capital Investment Programme with the 2006 Capital Investment Programme in the context of the 2005 Determination. This is appropriate given that the requirement for the 2006 Capital Investment Programme arose as a result of the exceptional circumstances outlined above.

[4] CP6/2006 page 19

Timetable for Review

It should be noted that the timelines for delivery of capacity set out in the Government's Aviation Action Plan and the interdependencies of elements of the company's capital investment plan creates a critical path for programme delivery. This necessitates significant early capital commitments to maintain programme schedules, which in turn requires a regulatory decision on remuneration significantly earlier than the timetable recently indicated by the Commission. DAA believe that all options available to expedite the process of the interim review should be explored by the Commission.