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Dublin Airport Authority Submission to the Aviation Appeal Panel

December 2005

***Dublin Airport
Authority plc***

Údarás Aerfort Bhaile Átha Cliath cpt

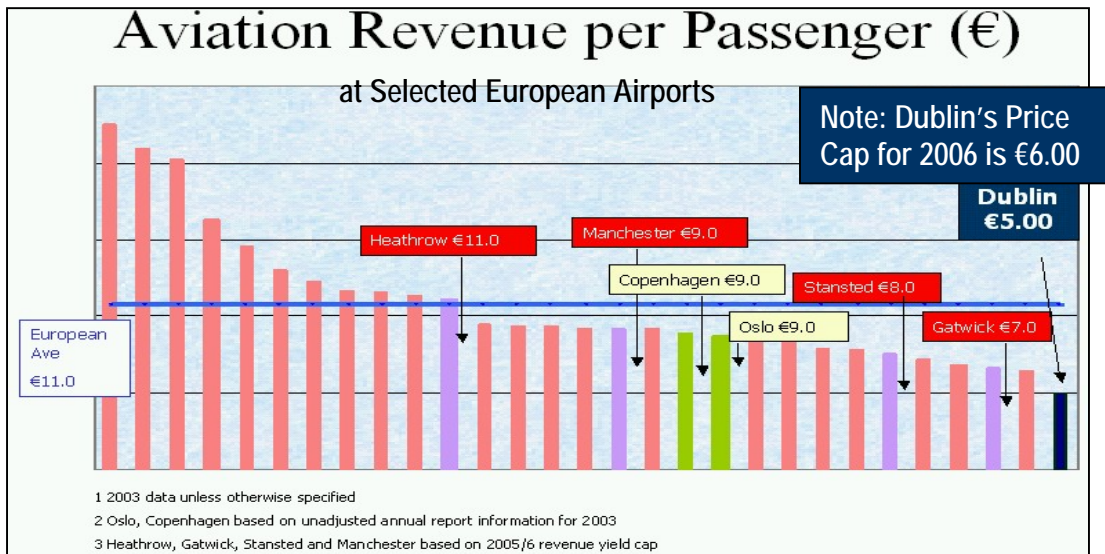
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Executive Summary

Dublin Airport Authority (DAA) is committed to assisting the Commission for Aviation Regulation (the Commission) in its task of ensuring that Dublin Airport is developed to meet the requirements of current and prospective users in an economically efficient way. One of the fundamental objectives set for the Commission is to enable DAA operate and develop the Airport in a sustainable and financially viable manner¹.

Ireland and the Irish economy urgently require sustained investment in airport capacity at Dublin. This is an issue that must be addressed now, as we are already playing catch-up. DAA is not in a position to finance any capital expenditure for which it is not remunerated. Government policy is clear that the airports under DAA's management must be operated on a commercial basis, paying dividends and with no recourse to Government funding, grants or guarantees. However, airport charges at Dublin have reduced in real terms by 42% from 1987 to 2006. Maintaining a charges regime that results in airport charging levels that are amongst the very lowest of comparable airports in Europe (as illustrated in the graph below) is not compatible with the sensible provision of much needed capacity and is a curious anomaly in a country with the second highest cost levels in the euro zone.




In its submission to the Commission, Dublin Airport Authority requested an average per passenger charge of €7.50 over the regulatory period. However in its Determination the Commission only allowed for an average per passenger charge of €6.14 over 4 years. This charging level is inadequate to deliver the aeronautical capacity required to meet demand and provide an acceptable level of service quality.

¹ Section 33(1) of the Aviation Regulation Act 2001, as substituted by section 22(4) of the State Airports Act 2004, sets out the objectives of the Commission in making a determination on airport charges.

The following consequences flow from the Commission's Final Determination:

- The Government's stated policy intentions in respect of the development of capacity at Dublin Airport and fulfilling the requirements of the State Airports Act of 2004 are compromised as airport charges at Dublin Airport fall short of the required level.
- The company has estimated the capital expenditure required to meet forecast increases in demand at an acceptable service standard in its Capital Investment Programme (CIP). Inappropriate reductions in this programme increase regulatory risk and compromise the timely delivery of airport infrastructure.
- Overstated assumptions relating to commercial revenue represent an unreasonable burden on the company. On the last occasion, the difference between the Commission's assumptions with respect to commercial revenues and the actual revenues generated by DAA amounted to some €90million between 2001-05. Through the operation of the single till, airport charges were reduced by this amount in that regulatory period. This also had the effect of permanently increasing the company's debt burden. The Commission has not corrected this error, on the contrary it proposes to compound it going forward whilst at the same time clawing back revenue earned by DAA in respect of funds allowed for Pier D, a far less significant anomaly.

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As a consequence, DAA believes that the Determination (CP3/2005), which sets the maximum levels of airport charges that may be levied at Dublin Airport for the period 2006-2009, does not satisfactorily address the Commission's statutory obligations and that certain elements of this Determination are flawed and warrant review. Accordingly, DAA requests the Appeal Panel to review the following:

Element	Significance for DAA ²
Commercial Revenues	A reduction of c28 cent per passenger on DAA's revenue requirement
Reduction in Allowed Capex	A reduction of €92.6m in allowed capex
Adjustments to RAB	A reduction of €13.4m on the opening asset base

² This is DAA's assessment of the financial impact over four years in December 2004 prices

The combined impact of the shortfall in each of the areas above is to directly reduce cashflows by c€120m over the four year period and to further reduce the prudent borrowing capacity of the Group by a further c€180m; a total deficit in investment capability of c€300m.

From an overall perspective, DAA is concerned that in making its Determination, the Commission has systematically increased the risk for DAA by ignoring all of the downsides for the company and assuming, sometimes on very slender evidence, that all possible incremental revenues and or cost reductions can be achieved. Systematic acceptance of possible upsides while ignoring possible downsides would not be an acceptable approach to business planning in any commercial organisation. This approach has the potential to be extremely damaging for the company and could well prove contrary to the achievement of the Commission's statutory obligations. It is important that the Appeal Panel reviews the Determination with this in mind, and as part of this submission we have highlighted particular instances where this has been a feature of the Commission's approach.

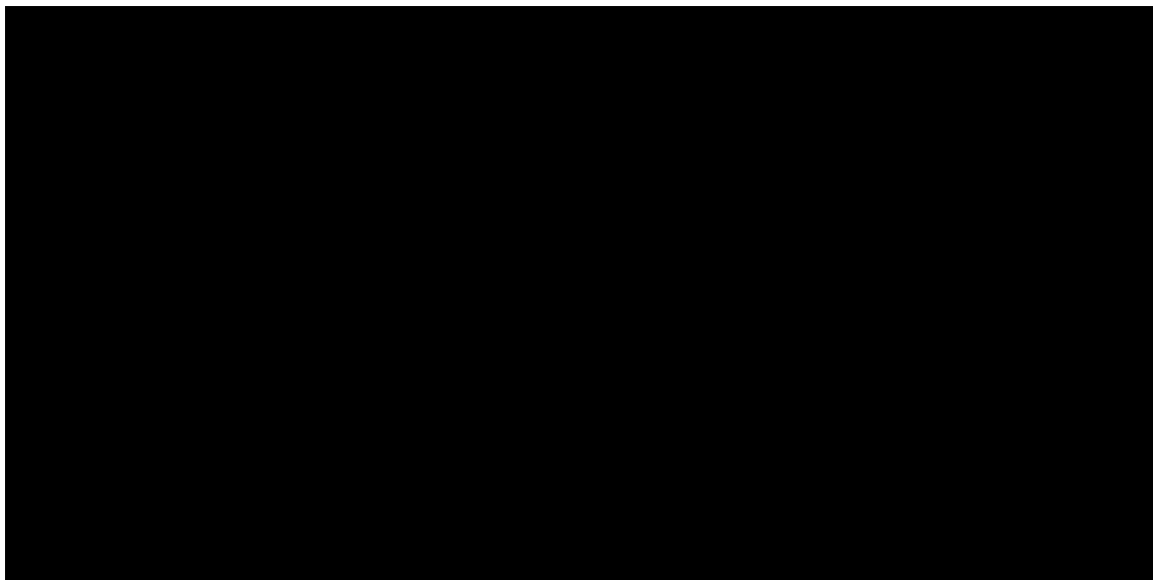
Certain elements of this submission (and all of Appendix 2) have been highlighted in red to denote the fact that they are confidential for reasons of commercial sensitivity. Accordingly, this information should not be circulated to third parties without the prior consent of DAA. DAA would wish to make oral submissions to the Appeal Panel to aid in the understanding of these issues and would be happy to provide additional information on any element of this submission if the Appeal Panel so requires.

1. Commercial Revenues

DAA is regulated under a single till approach where commercial revenues, not directly regulated, are forecasted and factored into the calculation of airport charges, thereby allowing for the cross-subsidisation of aeronautical activities by non-aeronautical activities. DAA considers that the review carried out by the Commission's consultants ASA does not provide a sound basis for forecasting commercial revenues in the 2006-2009 period as it assumes that DAA will earn c€25m³ in excess of that which DAA's own forecasts indicate is achievable. The incorporation of unrealistic commercial revenue forecasts for Dublin Airport in the Determination could have seriously detrimental consequences for the company's finances in the regulatory period and is contrary to the Commission's statutory duty to enable Dublin Airport to operate and develop Dublin Airport in a sustainable and financially viable manner. In this context it should be noted that the Commission made similar unfounded assumptions in its 2001 Determination which assumed that DAA would earn €90million more from commercial revenues in the period 2001-2004 that it did and set its charges to reflect that assumed revenue. No subsequent adjustment for this error was included in the 2005 Determination.

The impact of the Commission's decision is a reduction of c.28 cent per passenger over the four years on DAA's revenue requirement in December 2004 prices

It is a matter of particular concern that the approach adopted by ASA will result in a similar overall position to that adopted by the Commission in relation to this element of the regulatory calculation during the previous regulatory period 2001-2005. A gap in the order of 19% between the Commission's projections and DAA's arose by the end of 2005⁴ as a result of the Commission's approach at the last occasion. While the Commission has reset its expectations from 2005 to 2006 to a level more aligned with DAA's actual revenue generation capability, by 2009 the gap between the total commercial revenue included in the determination and the draft forecasts submitted to the Commission by DAA, has re-emerged and equates to some 9.2%. The chart below illustrates this:-



³ The majority of which relates to car parking, property and retail revenues

⁴ Budget 2005 used as a comparator for the year 2005

If the Commission is to comply with its statutory obligations, the situation that arose in the last determination should not have been replicated. ASA's forecasts are based on what we consider to be a range of unsound, generalised assumptions, the combined effect of which is to include in the overall regulatory determination levels of commercial income that are not achievable.

DAA forecasts growth in commercial revenues based on its extensive commercial experience at airports at home and abroad and to the extent it believes possible taking into account all the factors pertaining to Dublin Airport. ASA's aggressive growth assumptions, included in its forecast for all areas of commercial revenue i.e. retail, car parking, property and operating concessions, appear to stem from the conclusion that in 2002 Aer Rianta's Commercial Revenue per Passenger at Dublin was only 48.6% of the average of the Leading European Airports/ Airport Groups (Source: TRL/ATRS), i.e. a very simple, crude benchmark and a wholly unreasonable basis for business planning.

It is important to recognise that the results of any benchmarking across airports should be viewed with caution. Many factors that impact on commercial activities vary substantially depending on the profile of the airports and should be kept in mind when making comparisons. For example:

- Retailing income may be influenced by such factors as the regional passenger mix (in particular EU/non EU traffic mix), traffic type, available retail space and configuration and geographic location
- Property revenues may be affected by the level of demand for rental accommodation, airport location, availability of land for commercial development, prevailing market rents etc.
- Car parking revenue is affected by, inter alia, ratio of car borne traffic, direct competition, and car park charges in surrounding areas

Thus, it may never be possible for one airport to achieve the level of commercial revenue achieved at another. Certainly it is impossible to estimate accurately, on the basis of a single partial productivity indicator, what kind of improvement is realistically achievable. Even ASA prefaces its report by stating that its analysis provides an *"indication"* of what might be achieved, but *"does not necessarily indicate that the estimated revenues will actually be achieved"*⁵. Interestingly, the Commission itself argues in CP3/2005 in relation to operating costs that it would be wholly inappropriate to reduce overall airport charges by an amount corresponding to an efficiency gap as measured by a single benchmarking factor. However, this logic is not carried through into its treatment of commercial revenues where it appears to accept that an unsupported perception of a gap between DAA's performance and that at other airports is a sound basis from which to assume unachievable revenue gains in this area.

The dangers endemic in benchmarking are clearly evident from the diverging views of other analyses. For example, it is interesting to note that ASA's views regarding the alleged "gap" in DAA's performance when compared with other airports is diametrically opposed to the views of

⁵ Dublin Airport Assessment of Commercial Revenues, ASA, page 4

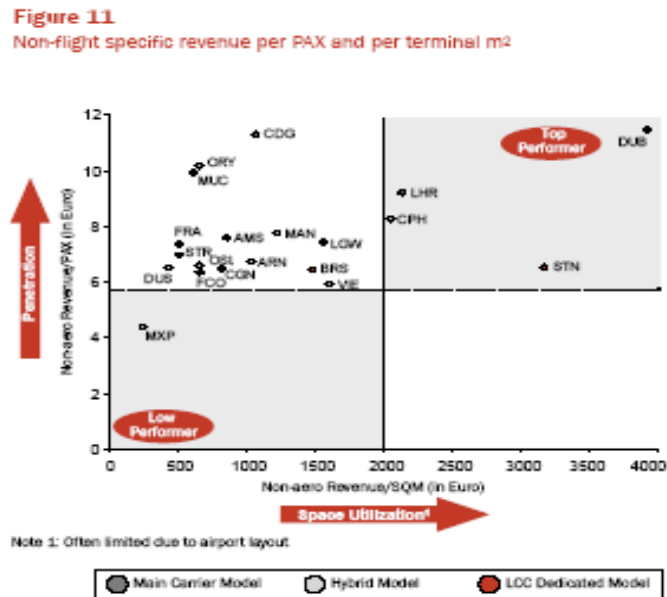
another of the Commission's consultants Booz Allen Hamilton (BAH). BAH recently evaluated data on traffic and economic benchmarks for 25 European airports and notes that Dublin:

"... has the highest proportion of retail and concession business of all the airports in our study"

and;

*"... has been extremely successful in this regard: the operator already achieves over 70% of revenues from non-aeronautical business. The airport has achieved this through the strategic management of additional components and 'value-added' services in the area of advertising, retail and entertainment... these measures can show the way for other airport operators"*⁶

As may be seen from the chart below, its analysis places Dublin in the top performer category of European airports in terms of non aeronautical revenue per passenger and per terminal m².



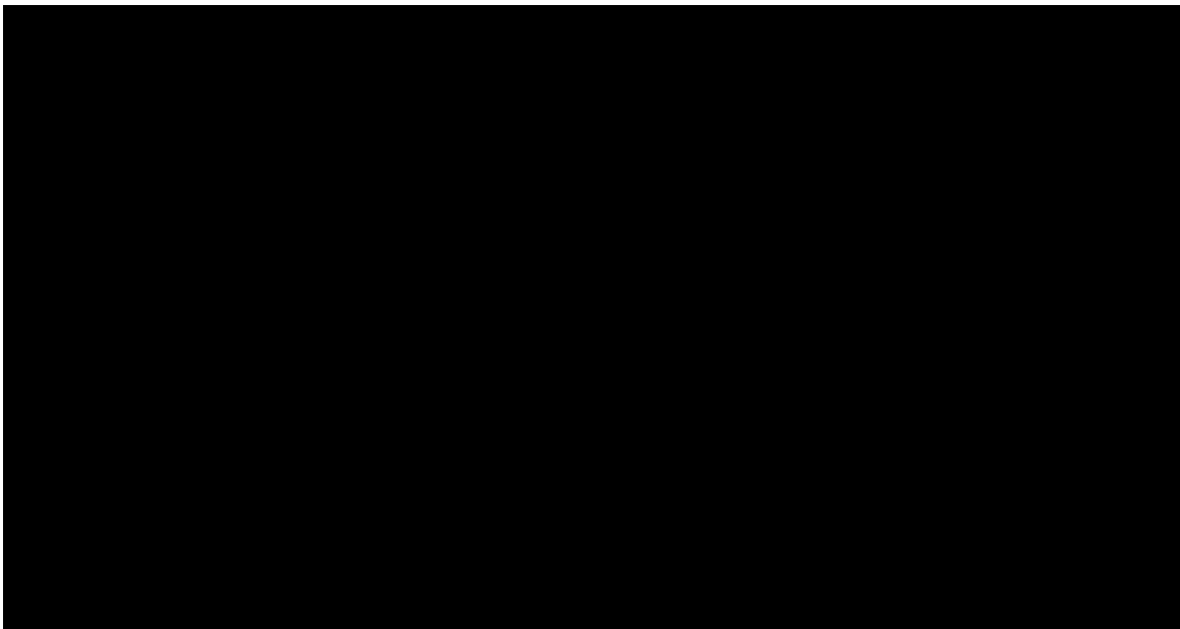
As noted by the Commission itself, *"benchmarking must be approached with caution, particularly in relation to comparator airports"*⁷, therefore using it to substantiate the imposition of exacting revenue targets is a flawed approach. ASA has not only used high level benchmarking to compare the overall commercial revenue performance of Dublin Airport, but it has also used benchmarking to back up its arguments that Dublin Airport can improve on each of its major revenue streams, without making any effort to ensure that data used in each case was in fact comparable.

⁶ Booz Allen Hamilton, "Aero" – Dynamics in the European Airports Sector, pgs 6&8

⁷ CP3/2005, page 86

1.1 Car Parking

ASA acknowledged that there has been a decline in the proportion of passengers parking at Dublin Airport and a reduction in net car parking income per passenger in real terms over the past 3-4 years. Despite this, ASA has assumed that car parking revenue will grow at the rate of 75% of passenger growth over the period leading to a gap when compared to Dublin Airports revenue per passenger as illustrated in the chart below⁸. Over the determination period this gap results in a cumulative overstatement of Car Parking revenues of █████ in Dec 2004 terms.



⁸ XXXXXX

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

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[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

1.2 Property Revenues

ASA has assumed that property income at Dublin Airport will grow by 60% of passenger growth over the period leading to a gap when compared to Dublin Airports revenue per passenger as illustrated in the chart below¹⁴. Over the determination period this gap results in a cumulative overstatement of Property revenues of [REDACTED] in Dec 2004 terms.



This is despite the fact that revenue from established property leases does not vary in line with passenger activity at the airport, a large proportion of property income is determined by leases, some of which are fixed for a number of years at a time and there is no provision in the company's CIP for significant additional space to be provided which will give the scope to develop additional rental opportunities. The various elements of Property revenues are dealt with in turn below:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



XXXXXXXXXXXXXXXXXXXXXXXXXXXX¹⁶





1.3 Retail

DAA believes that the scope for increases in retail revenues per passenger over the regulatory period are far more limited than ASA suggest. ASA's assumptions regarding growth in retail revenue lead to a gap when compared to Dublin Airport's revenue per passenger as illustrated in the chart below¹⁸. Over the determination period this gap results in a cumulative overstatement of Retail revenues by ASA of [REDACTED] in Dec 2004 terms.

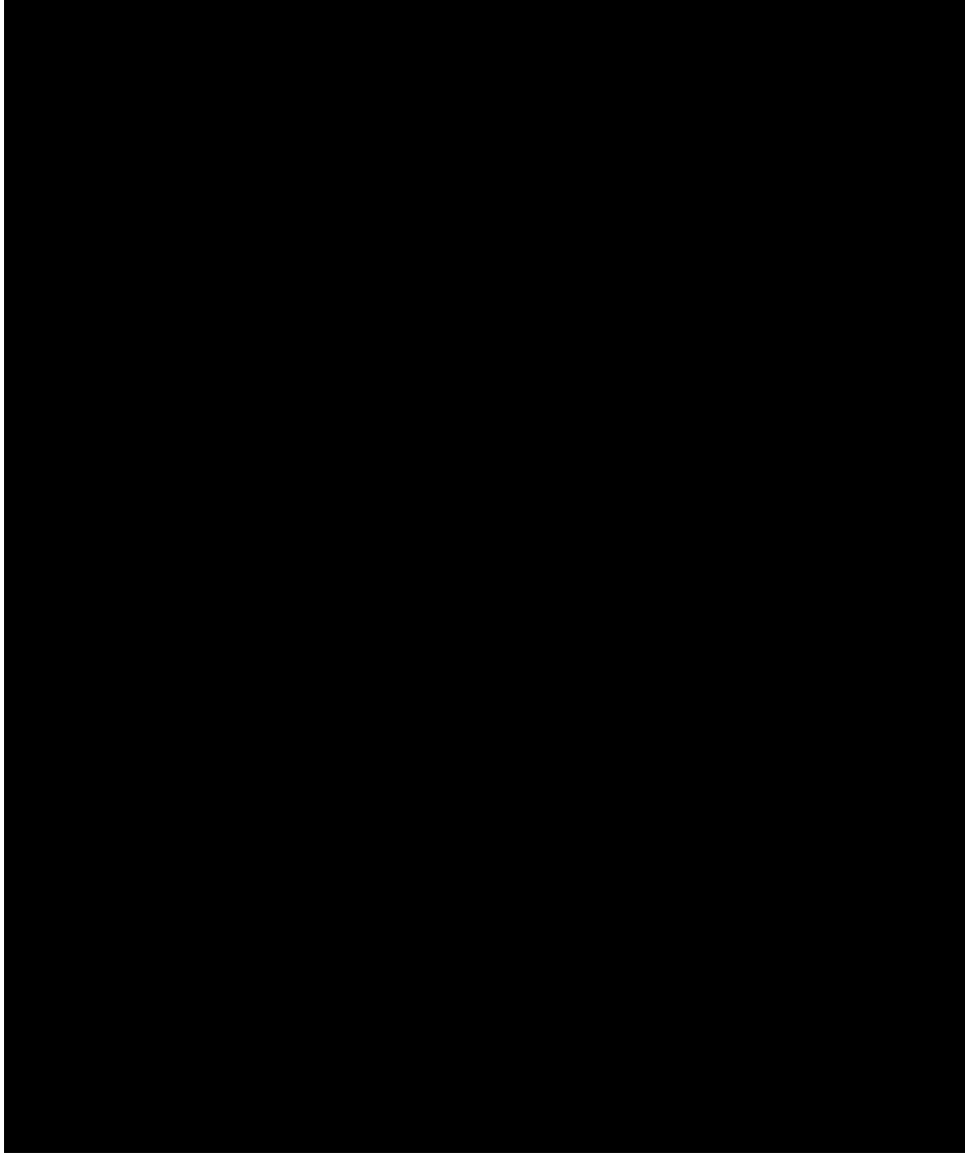


[REDACTED]

[REDACTED]

[REDACTED]


[REDACTED]





1.4 Conclusion – ASA Approach to Commercial Revenues

DAA is concerned that the statutory obligation on the Commission to ensure that DAA is able to operate in a financially viable manner is particularly challenging given the existence of the single till environment where commercial revenues, not directly regulated, are forecasted and factored into the calculation of airport charges. Any significant error in these calculations or forecasts can jeopardise the viability of the company as they directly impact on the level of aeronautical revenue allowed, an issue of consequence given the Commission's statutory obligation to enable DAA to operate Dublin Airport in a sustainable and financially viable manner. As discussed in more detail above, DAA believes there are significant errors in ASA's forecasts, resulting in an overstatement of c€25m²¹ (in Dec 2004 terms) over the determination period in the Commercial revenues used to subsidise the airport charges.



²¹ The majority of which relates to car parking, property and retail revenues

Action Requested of the Appeal Panel

Given the points made above, DAA calls upon the Appeal Panel to recommend that the Commission set aside the forecasts generated by ASA on the basis that their assumptions as regards the scope to increase commercial revenues above the levels incorporated in DAA's forecasts are unsound and unreasonable. DAA's forecasts should be used instead as these represent more credible targets.

3. Reduction in Allowed Capex

It is widely recognised that it is considerably more expensive to correct infrastructure gaps after the event than to prevent them ab initio. Adequate transport infrastructure is now recognised as a national priority as evidenced by the announcement at the beginning of November of “Transport 21”, a massive €35 billion plan to address existing infrastructure gaps. The government approach is thus very different to the approach adopted by the Commission of reducing capacity development to a minimum based on cost minimisation. It is also difficult to reconcile with the ministerial directive to ensure that priority is given to provision of terminal capacity at Dublin.

There is unanimity that capacity is required at Dublin Airport. DAA must be allowed to fully recover its costs if this capacity is to be put in place. The Capital Investment Programme (CIP) is DAA’s best assessment of the capital expenditure required to meet forecast increases in demand at an acceptable service standard, in a manner that is reflective of timescales set by government and which do not compromise safety standards. In making its decision for the forthcoming regulatory period, the Commission revised downwards the level of capital expenditure allowed in respect of the Pier D and T2 projects, among others, compared with the required level of funding as assessed by DAA in its May 2005 CIP. This revision was principally based on recommendations from its consultants WHA/IMR. DAA has serious concerns about the methodology applied in the WHA/IMR analysis. The company believes that the Commission’s decision is unsupportable and does not comply with the statutory objective to facilitate the efficient and economic development of Dublin Airport.

The impact of the Commission’s decision is a reduction of €92.8m in allowed capex

In other jurisdictions, the expertise of the airport authority in planning capital expenditure is recognised by the regulator, and indeed the UK airports regulator has consistently accepted the capex plans of the BAA and Manchester airports. However, the approach adopted by the Commission’s consultants and accepted by the Commission is quite different. The IMR/WHA approach in essence applies a simplistic analysis to a major development project, and replaces the costs arrived at from (more detailed) DAA project plans on this basis. This is despite the fact that it acknowledges several times that the type of analysis it has undertaken cannot be deemed to be a comprehensive review of a capital expenditure programme.

“Our top down analysis is not sufficient by itself to provide a safe basis for a firm capital expenditure review”²²

In the context of such comments, it is surprising that the approach taken has been to act as if the analysis undertaken was, in fact, a comprehensive one, by making capex adjustments based on the analysis. Given the statutory mandate of the company to develop the airport, the well-acknowledged infrastructure deficit along with the fact that development at the airport is subject to such a high degree of scrutiny, and specifically will be reviewed further in greater detail, it would have been more reasonable for the Commission to presume that the DAA capital expenditure

²² WHA / IMR Review of Airport Charges at Dublin Airport, Review of Capital Programme, page 7

programme was well developed, until such time as a comprehensive review revealed that it was not. Instead, the Commission's approach is to presume that the DAA's plan is not well informed, on the basis of a review, which even the authors admit is not comprehensive. This further highlights the Commission's inappropriate attitude to risk and its tendency to systematically incorporate cost reductions based on tenuous evidence and despite high levels of uncertainty associated with achieving same.

On page 19 of CP3/2005, the Commission published a table which presented the differences between the Commission's Recoverable Capex programme used in the Determination and DAA's May 2005 CIP. The main changes are indicated as resulting from the capital expenditure assessment carried out by the Commission. DAA requests that the Appeal Panel review the basis for the adjustments in respect of three major projects (shown in the table below) as the Authority does not accept that the Commission's analysis is robust.

Project	DAA Figure per May CIP (2006-2009)	CAR Allowed (2006-2009)	Difference (per pg 19 CP3/2005)	% Difference compared with DAA Requirement
Pier D	€59m ²³	€45.1	€13.9m	-24%
T2 Planning and Design	€24m	€14.9m	€9.1m	-38%
T2 Construction	€165.2m	€102m	€63.2	-38%
Total			€86.2m	

In Appendix 3 attached, DAA outlines its detailed difficulties with the assumptions and methodology employed by WHA/IMR, and why it does not adequately consider the issues that arise at Dublin Airport. In this section, the key difficulties we have with the conclusions derived by WHA/IMR are summarised.

1.1 Pier D

There appears to be two bases for the reduction in allowed capex for this project:

- A claim by the Commission's consultants WHA/IMR that the Commission's cost consultants RR&V indicated that DAA's costing for the pier at €4,873 per sqm was about 10% too high, relevant to benchmarked costs of €4,421 per sqm
- A claim by the Commission's consultants WHA/IMR that the building size should be 12,513sqm rather than the DAA proposal of 14,800sqm i.e. a 15% reduction

WHA/IMR multiplies the reduced cost per sqm by the reduced area and arrives at figure that is some €13.9m less than that proposed for the project by DAA²⁴. The Commission has incorporated

²³ The Panel should note that €5m was budgeted to be spent on this project in 2005 but was deferred pending the outcome of further consultation on the masterplan for Dublin. This sum should therefore be incorporated into the final amount allowed by the Commission for this project.

²⁴ Costs which were due to be incurred prior to 2006 are excluded.

this lower figure into its allowed capex for the Determination period, with the clearly implied risk based on the Pier C precedent (see Section 4.1) that this sum will be stranded in perpetuity.

Claim that the cost per sqm is too high

1. WHA/IMR claim that the Commission's cost consultants RR&V indicated that DAA's costs for the pier at €4,873²⁵ per sqm were about 10% too high, relevant to benchmarked costs of €4,421 per sqm.

In fact, RR&V do not mention these specific figures in their report, however, the Commission has informed DAA that the figures used by WHA/IMR are built up from a comparison by RR&V of DAA's construction cost for the pier at €3,910 per sqm versus a benchmark cost of €3,500 per sqm. When queried as to the basis for this benchmark figure the Commission indicated that it was derived from "*published benchmark information sourced by Vector Management for UK airports*"²⁶ however, RR&V later noted that

*"The benchmark rate of c. €3500/sqM quoted in relation to Pier D is based on specific experience within the team on a range of airport projects. Unfortunately, confidentiality agreements on these other projects prohibit the publication of specific project details".*²⁷

2. As the Commission is statutorily obliged to give an account of its reasons for making a determination, it is wholly inappropriate that revisions be made to DAA's allowed capex on the basis of unidentified benchmarks. DAA has no way of establishing whether the benchmarks used are reasonable or take into consideration the particular circumstances of the project under review or adjust for country specific differences. For example, if as initially indicated by the Commission, the benchmark is derived from the experience at UK airports, then it should be noted that building tender price inflation in Ireland has significantly exceeded that in the UK (see table below). This alone could account for a large portion of the 10% differential between DAA's number and the benchmark used by RR&V.

Building Tender Price Inflation Index – Ireland and UK 1999-2004						
Country	1999	2000	2001	2002	2003	2004
Ireland 1998=100	111.8	125.9	131.9	125.3	124.5	131.1
UK 1998=100	102.5	106.1	109.3	113.1	116.5	121.2
This index is compiled from data taken from the International Construction Cost Survey by Gardiner & Theobald – January 2005. The indices for both countries are derived independently and no equivalence is implied in the base year.						

There also appears to be a significant divergence between building labour costs in Ireland and the UK, as demonstrated by the international Construction Cost Survey undertaken by

²⁵ This number appears to be a composite derived from the addition of all costs associated with Pier D e.g. apron re-grading and soft costs as well as pier construction, divided by DAA's proposed area of the Pier.

²⁶ Email from Oliver Hogan, Commission for Aviation Regulation to Miriam Ryan, DAA, 15th November 2005

²⁷ Email from John Hughes, Rogerson Reddan to Oliver Hogan, Commission for Aviation Regulation, 17th November 2005

Gardiner and Theobald, where the "All In Rate"²⁸ for semi skilled labour is estimated at €23.66 per hour in Ireland versus €13.77per hour in the UK i.e. circa 72% in excess of UK rates.

3. In any event, contrary to the conclusion arrived at by WHA/IMR in its report; the RR&V analysis did not conclude that DAA's cost per square metre for the pier was too high. In fact RR&V states:

"... a detailed cost plan has been prepared and it may be that the apparent variances are explainable in the context of particular requirements of this project, which may not be readily apparent from the information provided"

"... the costs for the majority of elements appear reasonable"

"In this context it may be appropriate to undertake a more detailed review of these costs."²⁹

4. Despite the fact that the RR&V report is dated three weeks in advance of the deadline for publication of the Determination and no query in relation to the figures was subsequently submitted to DAA, WHA/IMR proceeds to conclude that:

"Although a detailed cost plan has been provided, it included insufficient detail to justify the cost difference. In the absence of this detail, we consider the benchmark cost to be more appropriate."³⁰

In fact, on the 14th July 2005, DAA had submitted a detailed cost plan to the Commission which was prepared by recognised experts Franklin + Andrews (one of the world's leading construction economists, with a core skill of quantity surveying) & Keogh McConnell (structural engineers). It is simply inappropriate that the Commission's consultants, undertaking a desk review without reference to Dublin Airport Authority, would set this information aside in favour of an unidentified benchmark.

In conclusion therefore, there is nothing to support the decision by the Commission to reduce the level of allowed capex for this project on the basis that its costs are too high. Such an approach illustrates once again that the Commission's Determination is characterised by an asymmetrical approach to risk whereby upside revenue potential or cost reductions are systematically factored in to the plans without recognition of potential downside risks.

Claim that the building size is too large

WHA/IMR claims that Pier D should be 12,513sqm rather than the DAA proposal of 14,800sqm i.e. a 15% reduction. In doing so they refer to a view from RR&V that widths of 22-24m are "more usual" than the DAA's proposed 29m wide pier, being broadly equivalent to the dimensions of piers at Stansted. DAA was unable to find this reference in the final RR&V report and raised this with Commission, which confirmed that there was indeed no such reference, but that the comment

²⁸ All In Rate – the gross hourly cost of employing the site operative, based upon the standard working week for the country, including items such as insurances, statutory contributions and taxes.

²⁹ Review of DAA Capital Expenditure Programme, RR&V, page 20

³⁰ WHA / IMR Review of Airport Charges at Dublin Airport, Review of Capital Programme, page 8

arose in the context of correspondence between the consultants. It is clear from material subsequently provided to DAA that RR&V do not state that 22-24m is a 'more usual' width, in fact they specifically caution that for flexibility reasons

"having a little more space to allow areas to be taken out of use without significant detriment to the day-to-day operation proves very valuable."³¹

DAA strongly agrees with this view - a key feature of the company's approach to design is ensuring flexibility to accommodate changing passenger profiles in the future and the pier is designed to enable it to process aircraft up to an including Code E. This approach should be viewed as facilitating the Commission's objectives to protect the interests of current and prospective users and to ensure that the airport is developed to meet their requirements. It should also be viewed in the context of a shift in typical short haul aircraft capacity from 50-130 seats just a few years ago to a current situation where typical seat density varies from 174 to 212. A further step increase of similar proportions would create capacity difficulties even at the design width.

Furthermore, in the table attached below we supply a list of pier widths, sourced through direct contact with a number of airports in Europe, including airports against which Commission usually compares DAA from a service quality perspective. It can be seen that the planned Pier D width is, if anything, on the low side when compared with most comparable airports and therefore the suggestion that it is too large would appear unfounded.

Airport	Pier Width
Pier D, Schipol	47.3m
Pier A, Dusseldorf	45m
Pier F, Stockholm	36m
North Pier Madrid	35m
Skylink Pier, Vienna	33m
S3, Paris CDG	32m
South Pier Madrid	30m
Pier B, Brussels	30m
Piers at Terminal 5, Stockholm	30m
Pier B, Schipol	28.8m
Pier C Manchester	25m

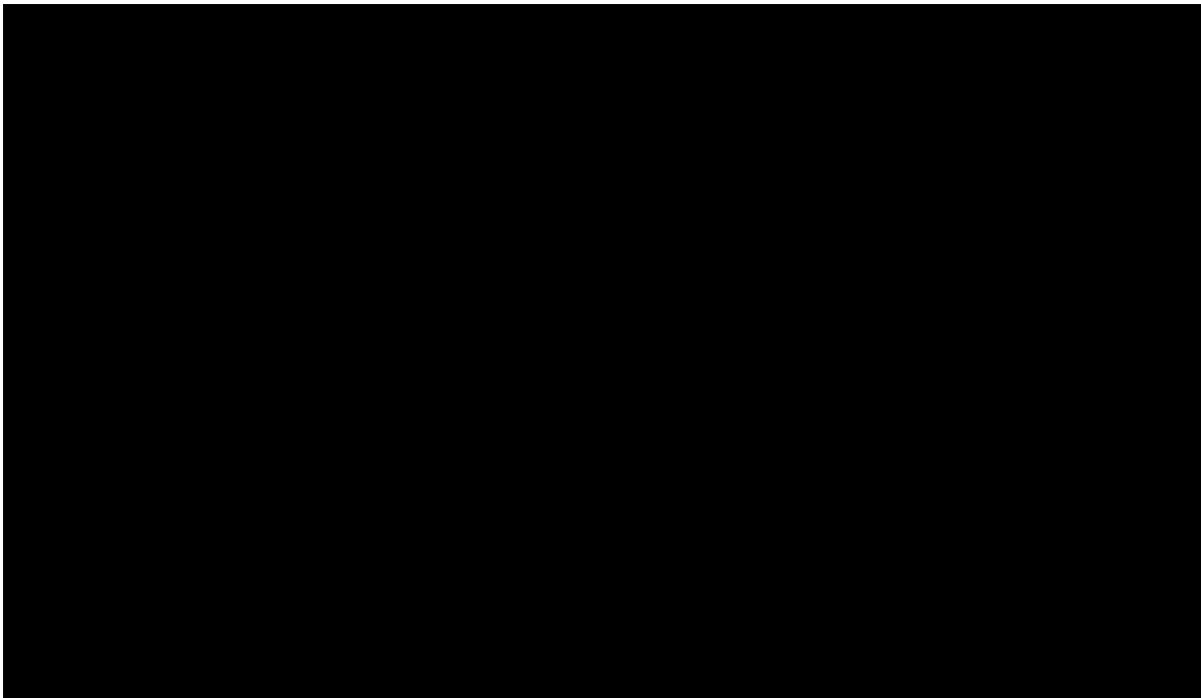
1.2 Terminal 2 (T2)

The basis for the Commission's reduction in allowed capex for T2 (€63.2m) is an unsupported downsizing of T2 following an analysis by WHA/IMR. This approach results in indicative terminal areas that are grossly out of step with recognized benchmarks. DAA has detailed its significant concerns with WHA's approach on a number of occasions in the past and a detailed critique of its approach to the downsizing of T2 is included in Appendix 3.

³¹ Email from John Hughes RR&V to Oliver Hogan, Commission for Aviation Regulation, 17th November 2005

The WHA/IMR approach uses current utilisation levels within the existing terminal as design standards for the new terminal, implying that existing service standards are appropriate for the new terminal. Given that passengers, airlines, media and business interests frequently refer to the level of congestion within the airport, this does not seem to be an appropriate starting point³². In terminal design, most airport planners would make adequate provision for growth or crowding³³, and any adjustments included by WHA/IMR are inadequate. IATA have stated that authorities should ensure that passenger terminal conceptual design solutions are capable of accommodating all traffic types- in case any particular market segment declines or moves away completely³⁴.

The table below illustrates how different the implications of the WHA/IMR's assumptions are to those that apply at comparable airports throughout Europe and North America by calculating "the area per million passenger per annum". DAA is designing Terminal 2 to be 47,000m² in order to cater for 10 million passengers per annum. This implies that the "area per million passenger per annum" is 4,700m², which is near the lower bound of the values below. This suggests that T2 will be operating highly efficiently compared to existing terminals. As part of the UK's White Paper on the Future of Air Transport³⁵, a standard of 6,600m² was used. In comparison, WHA/IMR suggests that the terminal size should be 29,000m², which results in an "area per million passenger per annum" of 2,900m², less than half the UK standard. This is lower than any other benchmarked terminal as illustrated in the chart below³⁶, and is clear evidence of WHA/IMR's propensity to minimise capacity structures to an unrealistic degree.



³² For example, at a recent national tourism conference "Tourism It's the Experience" Gillian Bowler, Chairperson of Failte Ireland noted that many tourists experience of Ireland commences in the baggage hall at Dublin Airport..."need say no more about that".

³³ On the Today Show, RTE Radio 1, 22nd November 2005, media commentator Pat Kenny noted in respect of T2 "I hope it will be big enough by the time it is finished and not already in need of expanding".

³⁴ IATA Paper on potential problems from 'dual-airport' operation New Airport Forum, Lisbon 2005

³⁵ UK Department of Transport: The Future of Air Transport December 2003

³⁶ Sourced from ARUP Consulting Engineers

It is unsurprising that by accepting existing service standards as adequate, IMR/WHA deduces a smaller terminal size is appropriate than that assumed by DAA based on improved standards. It is however surprising that the Commission accepts this analysis and the simplistic pro-rata cost reduction which follows without question.

We have compared (insofar as is possible) the assessed requirement figures used by WHA/IMR in its T1 analysis³⁷ with the actual measurements of the terminal used by WHA in March 2005 to underpin the WHA capacity analysis also relied upon by the Commission (see table).

Terminal 1 Building	WHACP3/2005 Assessed Requirement (Space m2)	Email 24/03/2005 from WHA Actual Area (Space m2)
Departures Concourse	4,940	5,911
Check-In	2,399	3,880
Security	545	576
Street	2,115	2,937
Arrivals Baggage Reclaim	3,002	3,393
Customs	300	213
Arrivals Concourse	1,282	3,417
Total	14,583m2	20,327m2

It is clear from the table above that the WHA assessments of capacity requirements (Column 2) are significantly below (by circa 30%) the area that is actually available in the existing terminal building (Column 3). It is difficult to understand how, given the current congestion in the building (see attached photographs), WHA/IMR could suggest that an optimum area for the terminal would be so much less than that in existing facilities.



³⁷ WHA / IMR Review of Airport Charges at Dublin Airport, Review of Capital Programme, pg 14



It is also worth pointing out that by focusing only on the individual functional areas, WHA/IMR fails to consider the need to ensure that these components are integrated in a coherent and efficient manner. If this does not happen, the interfaces between these key areas may reduce operational efficiency. It is not always possible, even in a greenfield site situation, to ensure that all such linking spaces are optimised and this is even more difficult when constraints, such as the requirement to integrate with existing airport infrastructure are taken into account.

Non Passenger Space Assumptions

When calculating non-passenger space, WHA/IMR again benchmarks T2 with T1. It excludes levels 4 and 5, which provide office space and other facilities and suggests that it makes a separate allowance for some T2 space to be used for this type of activity. In fact, it does this by declaring that T2 will be designed more efficiently than T1 and this gain in space due to efficiency can be used for the kinds of activities carried out in the top two floors in T1.

This assumption ignores a number of pertinent facts:

- Extensive amelioration measures have been employed in the existing terminal area to improve the efficiency of space utilisation, e.g. in security friskem area, baggage make-up area etc. This is, in fact, why we can accommodate the existing throughput within the current terminal area.
- Efficiency of use of the existing terminal building is not simply dependent on the airport authority but also on airline and ground handler activity. WHA's previous calculations have assumed that DAA can force efficiencies on these groups³⁸, which are simply not achievable. In many cases, airlines or handlers are not willing to change their existing practices to improve overall efficiency as it requires additional resources, and hence increases costs for them. This issue of our ability to deliver more efficient use of infrastructure is one that DAA has raised both with the Commission and with the Department of Transport. Changing technology is likely to be a key driver of increased productivity. However, as current trends in technological advances are not clear, it is not possible to identify precisely where these efficiencies may occur. Indeed some measures

³⁸ e.g. by assuming that Aer Lingus passengers will be able to queue up in the same lines as Ryanair passengers for check-in.

e.g. RFID³⁹ may increase efficiency in some areas e.g. check-in, but significantly increase costs in others e.g. baggage systems. Indeed this effect is consistent with the following comment made by WHA/IMR

*“it may be possible to specify a terminal’s configuration perfectly for a snapshot in time, but the optimality of that configuration will degrade as the service requirements of its users change”.*⁴⁰

This is a valid observation and it implies that it is wise to ensure that surplus area exists so that when requirements change, enough space will exist to allow these changes to be made. This is a key point since if a bottleneck develops in one process area; the capacity of the airport is limited by this capacity shortfall, even though other areas still have adequate capacity. Systematic cost minimisation ensures that any changes in the future will be very difficult to implement. However, despite such comments, the approach adopted is in fact to ignore the need to preserve flexibility in the future.

Finally, though WHA/IMR themselves acknowledge that “a reduction in the size of the building would not necessarily imply a proportional reduction in cost”⁴¹, a cost reduction of €63.2m for T2 (and an associated €9.1m reduction in allowed capex for T2 Planning and Design) is incorporated in the Commission’s Final Determination. Once again, this is evidence of a systematic incorporation of cost reductions on the part of the Commission without recognition of risk.

1.3 T2 Planning & Design

The Commission’s capex cost consultants Rogerson Reddan and Associates Ltd, in conjunction with Vector Management Ltd, noted in their report that the DAA’s stated allowance of 15% of total costs for planning and design of T2 (including an allowance for site supervision/construction management), *“appears to be realistic and appropriate for a project such as this”*.⁴²

However, the decision in respect of the reduction in allowed cost for T2 had a knock-on effect on the amount of capex allowed in respect of this element as only 15% of the revised (lower) price for T2 has been allowed, resulting in a reduction of €9m compared with the amount requested by DAA. If the Appeal Panel sees fit to refer back to the Commission its decision in respect of T2, then the T2 Planning and Design should be recognised as a related project and be considered in tandem.

Action Requested of the Appeal Panel

In light of the points made above, DAA requests that the Appeal Panel accept that the techniques employed by the Commission’s consultants in assessing the level of allowed capex for Pier D and T2 are simplistic and do not adequately reflect the complexity of airport operations. We call upon the Panel to recommend that the Commission accepts the soundly based figures put forward by DAA in respect of these projects and allow the full costs in the Regulated Asset Base.

³⁹ Radio Frequency Identification for checked baggage

⁴⁰ *ibid*, page 15

⁴¹ *ibid*, pg 16

⁴² Review of DAA Capital Expenditure Programme, RR&V, page 19

2. Adjustments to the RAB

2.1 Stranded Asset Pier C

The retention of a downward adjustment to the RAB for 'imprudent investment' in Pier C on the basis of the Commission's 2001 conclusion that the average construction cost of Pier C at Dublin Airport was higher than what was considered to be the average construction cost of 'similar buildings' in Dublin, is inappropriate and contrary to the statutory obligation to facilitate the efficient and economic development and operation of Dublin Airport which meets the requirements of current and prospective users of Dublin Airport.

The impact of the Commission's decision is a downward adjustment of €13.4m to the opening Regulated Asset Base on which DAA is allowed to earn a return

In CP3/2005, the Commission decided to retain its downward adjustment to the RAB for alleged 'imprudent investment' in Pier C on a permanent basis. This related back to the decision by the Commission in its 2001 Determination to adjust downwards the value of the assets in Pier C at Dublin Airport on which DAA was allowed to earn a return. This judgment was based on the conclusion by the Commission's consultants IMG that the average construction cost of Pier C at Dublin Airport was higher than what they considered to be the average construction cost of "similar buildings in Dublin" (though no similar buildings to a Pier were built in Dublin at the time or since then). IMG's point of reference for "average construction costs of similar buildings in Dublin" was the "PKS Review 2001", which refers to the average construction cost of a number of building types e.g. hospitals, none of which could be deemed similar to that of an airport pier facility and are therefore wholly inappropriate benchmarks. IMG's superficial conclusions were arrived at in the absence of any discussion with DAA on the project.

In contrast to the Commission's arbitrary decision in respect of stranding a portion of the cost of Pier C, DAA's contention that Pier C was constructed in line with good practice, in accordance with the specific requirements of the regulatory authorities at the time and following extensive consultation with users is supported by facts.⁴³

- Construction costs were benchmarked against the prevailing market levels and also against similar Pier developments in the UK. The comparison against the Irish market at that time and against piers of a similar design compared favourably on a cost per square metre basis with the budget costs.
- The development took place following competitive tendering procedures under EU Public Procurement requirements, the contract was awarded to the lowest tender and was delivered in a cost effective manner within sanction.

⁴³ Appendix 1 sets out DAA's (then Aer Rianta's) detailed arguments against the Commission's proposed decision to write down the cost of investment in Pier C. This paper was originally submitted to the Commission in response to its Draft Determination (CP6/2001)

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- The Minister for Transport who was the regulator at the time, approved the development of Pier C, following recommendations from both the Department of Transport and independent consultants engaged by the Department of Transport.

In our response to the draft Determination CP2/2005, DAA noted that the Commission's original decision with respect to Pier C was seriously flawed but even if the company was to accept the Commission's view we strongly supported a reversal of the adjustments made in the previous determination for "imprudent expenditure". This is because we believe that a symmetrical treatment of the benefits /costs arising from efficiency savings and inefficiency penalties is integral to the framework for incentive regulation. Given that it is accepted that a regulated entity would only get to retain any efficiency savings which it has achieved in implementing its capital investment programme for the duration of a regulatory period (usually five years), any penalties imposed for capital inefficiencies should also have a limited maximum duration.

DAA considers the Commission's decision to continue to penalise DAA 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. This is a very worrying precedent and one which raises a concern about the remuneration of any investment undertaken by the company. This is therefore a matter that an Appeal Panel should recommend the Commission to review.

2.2 Stranded Income Pier D

The unwarranted retrospective adjustment to the RAB for income earned since 2001 in respect of Pier D, despite the fact that the construction of Pier D was delayed due to factors outside of DAA's control and capital expenditure allowed for Pier D was spent on alternative capacity related projects, is inappropriate and contrary to the statutory obligation 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 impact of the Commission's decision is a downward adjustment of €6.6m to the opening Regulated Asset Base on which DAA is allowed to earn a return

In its Determination CP3/2005, the Commission decided to subtract from the RAB its estimate of the income earned by the company, in 2002-2005, from the inclusion of Pier D in the RAB as part of its 2001 Determination. The Commission justified this decision on the basis that, though the cost of the Pier D project had been allowed in the Commission's Recoverable 2001 Capital Expenditure Programme and was therefore factored into the price cap, the project had not been delivered.

However there are a number of reasons why actual capital expenditure undertaken by a regulated entity may fall short of capital expenditure projections over the course of a regulatory period, for example:

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- The regulated firm has achieved cost efficiencies in implementing its capital programme
 - Market or other conditions (such as planning issues) have forced the regulated entity to scale back or defer projects within its capital programme
 - The regulated firm has under-invested when benchmarked against regulatory projections

In this instance, DAA believes that it was particularly inappropriate for the Commission to claw back income related to the Pier D project over the regulatory period 2001-2005 given that:

- The Commission only retrospectively adjusted one element of the price cap model – an adjustment that in this instance penalises DAA. To contain regulatory risk it should have adopted a balanced approach and also retrospectively adjusted the other variables within the price cap determination where there were discrepancies over the 2001-2005 period. For example, it would have been appropriate for the Commission to compensate DAA for its significantly flawed estimation of commercial revenues in the period to 2005 amounting to a gap of ██████ when compared to the actual revenues achieved by DAA, but it chose not to. It is inappropriate to clawback some elements and not others, an action that again supports DAA's contention that the Commission has adopted an asymmetrical approach in its Determination.
- In response to a DAA request for details of the specific projects from the company CIP which was allowed under the 2001 Determination, the Commission referred back to the aggregate values for the various categories of projects listed in its Determination. The Commission also acknowledged that it had *"no statutory mandate to sanction or approve precise investment figures in respect of specific projects"* following its 2001 Determination⁴⁴. In this context, it is difficult to understand how the Commission can proceed to make retrospective adjustments in respect of income earned on a specific project such as Pier D.
- As of May 2005, DAA had invested circa €7.5 million on the development of Pier D taking it to the planning approval stage, despite the fact that construction of the Pier D project had been delayed by factors outside DAA's control. The Government has now re-mandated the company to build a Pier facility by 2007, so this investment will be used, was required and therefore should be remunerated.

DAA understands that there is a consensus in regulatory circles that revenue clawbacks are inappropriate measures, which go against the principles of regulation by undermining the incentive properties of the price cap regulatory model. For example, the CAA in the UK has stated that revenue clawbacks are undesirable and should only be applied in exceptional circumstances.

"... the CAA's general policy is that claw-backs are highly undesirable and undermine the incentive properties of price cap regulation."⁴⁵

DAA requests that the Appeal Panel recommend that the Commission reviews this element of its Determination.

⁴⁴ Letter of the 5th September 2001 from William Prasifka Commissioner, Commission for Aviation Regulation to Margaret Sweeney, Deputy Chief Executive, Aer Rianta.

⁴⁵ Civil Aviation Authority, *Economic Regulation of BAA London Airports 2003-2008, CAA Decision*, February 2003

Action Requested of the Appeal Panel

Given the points made above, DAA calls upon the Appeal Panel to accept that the Commission's retention of a downward adjustment to the RAB for 'imprudent investment' in Pier C and its retrospective adjustment to the RAB for income earned since 2001 in respect of Pier D, was inappropriate and contrary to the statutory obligation to facilitate the efficient and economic development and operation of Dublin Airport which meets the requirements of current and prospective users. DAA further requests that the Panel recommends that the Commission reverses these adjustments to the Dublin Airport RAB. If the Commission decides to retain its retrospective adjustment in respect of Pier D, then to maintain a balanced approach it should also make a retrospective adjustment for the unrealistic and unachieved commercial revenue targets incorporated in setting the maximum levels of airport charges in the period 2001-2005.

Appendices

Appendix 1 – Pier C and Terminal West Development at Dublin Airport

Appendix 3 – Commentary on assumptions and methodology employed by IMR/WHA regarding T2 and Pier D