



**Decision on Conducting an
Interim Review
of the
2014 Determination of the
Maximum Level of Airport Charges at Dublin Airport**

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Commission for Aviation Regulation

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1. Introduction

- 1.1 After making a determination of the maximum level of airport charges at Dublin Airport the Commission can review it and if it sees fit, amend the determination. This can be at its own initiative or at the request of a concerned party. Before doing so, the Commission needs to establish if there are substantial grounds for conducting a review.¹
- 1.2 On 6 November 2015 the Commission received such a request from Dublin Airport (daa).² It requested a review of the 2014 Determination of the Maximum Level of Airport Charges at Dublin Airport, and thereafter the removal of the 5% cap on the k factor in the price cap formula. The k factor allows under collections in one year to be carried forward to future years. The 2014 Determination caps the amount which can be carried forward at 5% of the price cap in the year of the under collection.
- 1.3 On 13 November 2015 the Commission published a consultation paper, asking if this request constituted substantial grounds for it to conduct an interim review of the 2014 Determination.³
- 1.4 Six parties responded to the consultation: Aer Lingus, Cityjet, daa, International Airlines Group (IAG), Ryanair and Stobart Air.⁴ All responses are published on our website.⁵
- 1.5 The Commission has considered; the three tests posed in the consultation, its statutory objectives and factors, and the consultation responses received. It has decided that there are not substantial grounds and so will not conduct an interim review of the 2014 Determination based on this request.
- 1.6 While deliberating this decision, the Commission has come to the conclusion that there are no substantial grounds to conduct a review of the k factor as requested by Dublin Airport. The Commission is also of the view that there are substantial grounds to review the timing of when the runway trigger enters the price cap. This review will take place in early 2016 and is discussed in Section 3.

2. Background and the Decision

Dublin Airport's Request for a Review

- 2.1 Dublin Airport requested that the Commission review the 2014 Determination, limiting the grounds to removing the cap on the k factor in the price cap formula. The application stated:

"The price cap for 2016 is uncertain, as it is possible that the runway trigger event will occur before end 2015, although this

¹ Pursuant to Section 32(14) of the Aviation Regulation Act 2001, as amended by the State Airports Act, 2004.

² http://www.aviationreg.ie/_fileupload/2015/2015-11-06%20DOC%20to%20DH%20Interim%20Review%20Application.pdf

³ http://www.aviationreg.ie/_fileupload/2015/2015-11-13%20Consultation%20on%20Conducting%20a%20Review.pdf

⁴ IAG is the parent company of four airlines operating at Dublin Airport: Aer Lingus, British Airways, Iberia and Vueling

⁵ <http://www.aviationreg.ie/regulation-of-airport-charges-dublin-airport/2014-determination.576.html>

cannot yet be confirmed. In either case (though the amounts differ) an increase in the general level of airport charges will be necessary, in order not to exceed the 5% cap on under-recovery, as the 'k' term in the price cap is currently defined.

It is daa's preference not to increase the general price level in 2016, which preference we believe would be shared by our airline customers. However, we wish to do this in a manner which does not impact on our ability to earn the total allowed revenues over the regulatory period. Accordingly we hereby apply to you to remove the 5% ceiling on under-recovery in the 'k' term, which we understand is possible through a single issue Interim Review of the 2014 Determination. In our view, this will allow a customer-oriented flexibility with no impact on the substantive terms of the 2014 Determination."

- 2.2 Dublin Airport refers to the general price level, that is, the list price before any rebates for incentives are applied. It should be noted that the average price paid by airlines in 2014 was €10.18 per passenger, the price cap for 2016 is provisionally €10.31, allowing daa to price as low as €9.80 (approx.) and still carry forward the full under collection, thus requiring no increase in the average price paid per passenger.
- 2.3 The difference between list prices and actual price per passenger is being driven by rebates from incentive schemes; the distinction between the two is relevant to the discussion below.
- 2.4 Current expectations are that Dublin Airport will serve 25m passengers in 2015. This is 15% higher than 2014 and almost 3m passengers above the forecast used in the 2014 Determination.
- 2.5 This level of traffic will likely result in Dublin Airport reaching the runway trigger (as detailed below) in late 2015 or early 2016, adding €0.59 to the price cap from either 2016 or 2017.

Relevant aspects of the 2014 Determination

Objective of the 2014 Determination

- 2.6 The ultimate objective of the 2014 Determination is to emulate the market conditions a competitive firm would face.
- 2.7 The 2014 Determination sets an overall price cap per passenger on airport charges. Compliance with the cap is assessed by dividing aeronautical revenue collected by passenger numbers and ensuring the result is under the price cap. The 2014 Determination does not set prices for individual services or for individual users. In addition, the airport operator is not obliged to price up to the cap.
- 2.8 The 2014 Determination aimed for a smooth price path, however, it also made provisions for price increases in certain circumstances. Table 2.1 shows the minimum and maximum price cap possible. In addition, the Determination allows for adjustments for inflation and puts 4.5% of the price cap at risk if certain quality of service measures are not reached.

Table 2.1: Range of Potential Price Caps

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------------------|-------|-------|-------|-------|------|
| Price CAP before adjustments | 10.30 | 9.87 | 9.45 | 9.06 | 8.68 |
| Max k, 5% ¹ | | 0.50 | 0.52 | 0.49 | 0.47 |
| Max Triggers | 0.23 | 0.82 | 0.82 | 0.82 | 0.82 |
| Max Price CAP Possible ² | 10.53 | 11.19 | 10.79 | 10.37 | 9.97 |

¹ Approximate as depends on passenger outturns

² Under collection two years previously needed to achieve this price cap July 2014 Prices. Prices will also increase or decrease depending on inflation.

Capital Expenditure Triggers

- 2.9 The 2014 Determination included triggers for 4 capital projects. Triggers are used for projects which have merit but the timing of when they become necessary or justifiable is uncertain. The projects are: the northern parallel runway, additional line-up points on runway 10/28, Hold Baggage Screening Standard 3 in Terminal 2 and segregation of pier 2.
- 2.10 Triggers remunerate these projects when they are justifiable but they introduce a level of uncertainty in the price. In total the price can increase by €0.82 if all triggers are reached.

K Factor – Carrying Forward Under-collections

- 2.11 The price cap formula includes the potential for an adjustment to allow the airport recover under collections from two years previous. For example, under collections in 2015 can be recovered in 2017. The objective of the k factor is to allow the regulated entity some flexibility on pricing, in particular to mitigate a potential situation where towards the end of the year the regulated entity is not going to reach the price cap without changing prices mid-season.
- 2.12 The amount which can be carried forward is capped at 5% of the price cap in the year of under collection. This cap was first introduced in the 2009 Determination to protect users from large deviations from the intended price cap, thereby, increasing certainty for users on future pricing. Should the airport over collect it has 90 days to return the over collection to users via a refund.

Decision on Conducting an Interim Review of the k Factor

- 2.13 The Commission does not believe that substantial grounds exist to conduct a review of the k factor as requested by Dublin Airport. It has made this decision by reference to; the application for a review received from Dublin Airport, the tests for substantial grounds outlined in the Commission's consultation paper, the consultation responses received from interested parties and our statutory objectives and factors.
- 2.14 The Commission believes this decision does not require daa to increase its list prices. It is for daa to decide on pricing, but reducing incentives would allow it to price to the cap (or the cap less 5%) and maintain list prices as they are. Or it could decide not to price to the cap and retain list prices and the incentives as they are.

2.15 To summarise the circumstances which led to the request for a review:

- Passenger growth has exceeded expectation with about 25m passengers expected in 2015 compared to the Commission's forecast of 22.1m
- Under incentive schemes operated by Dublin Airport, rebates of aeronautical charges are issued to airlines who deliver growth traffic, thus reducing the average per passenger price collected to below the list price
- The runway trigger could add €0.59 to the price cap in 2016 or 2017

The 2014 Determination caps the amount of under collection which can be carried forward at 5% of the price in the year of the under collection. These circumstances above, combined with Dublin Airport's desire to keep headline prices flat result in a situation where it would like to carry forward under collections in excess of the 5% cap.

Are the circumstances exceptional?

2.16 The cap on the k factor has become binding for Dublin Airport. It wishes to under collect now and over collect in future years. The reason it has become binding is due to higher passenger growth resulting in large pay-outs under the rebate schemes it operates. In addition the price cap may increase by €0.59 in 2016 due to the runway trigger. The traffic growth occurred earlier than forecast in the 2014 Determination but it is not exceptional, the Commission forecast almost 25m passengers in 2019. In addition, by including the runway trigger of 25m passengers the Commission acknowledged that this level of traffic was possible at any stage in the period. That being said, when 25m passengers were reached the Commission's expectation was that the Dublin Airport would be ready to commence construction of the runway.

Are the circumstances generally outside the control of the regulated company?

2.17 The principle circumstances driving the request for an interim review appears to be the operation of daa's own incentive scheme in a period of earlier than expected traffic growth. The Commission is not aware of any research on Dublin Airport's price elasticity, that is, how it can effect volume with pricing. That being said, Dublin Airport must believe it can do so to some extent otherwise it would not offer incentives to achieve growth. Even if it can have some influence on growth, it is unlikely that it was solely responsible for the growth experienced in 2015.

2.18 While the growth is somewhat outside of the control of the regulated entity, pricing is not, provided it complies with the cap on airport charges set by the Determination. There is no onus on Dublin Airport to price to the cap. Dublin Airport is free to set individual prices as it sees fit.

2.19 Dublin Airport can if it so chooses use rebates as incentives. Likewise it can end those schemes when it sees fit (as outlined in its own terms and conditions).

2.20 The 2014 Determination, as it stands, does not prevent daa from responding to the current market conditions in a way which will either

allow it to keep prices flat or to price to the cap.

Are the effects of those circumstances liable to be significant enough to compromise the objectives of the original decision without a review (taking into account the incentive and any other detriments that would in general also arise from a review)?

2.21 Dublin Airport's inability to carry forward excessive under collection does not compromise the objectives of the 2014 Determination. The overarching objective of the Determination is to emulate a competitive environment. A competitive firm cannot increase pricing beyond the market price to compensate for times in the past when it priced below the market price for whatever reason.

2.22 While the 2014 Determination envisaged a falling price path, it also envisaged circumstance where the price may increase as outlined above.

The Commission's Statutory Objectives

2.23 In addition to those three tests, establishing substantial grounds for a review should be done in a manner consistent with the statutory objectives of the Commission. These are set out in Section 33 of the Aviation Regulation Act, 2001 as amended by the State Airport Act, 2004. Here we address how this decision is consistent with these objectives:

to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport,

2.24 The 2014 Determination fulfils this objective by allowing DAA to recover revenues sufficient to meet efficiently incurred costs of operating and developing the airport. As Dublin Airport is free to set its own pricing, so long as it complies with the price cap, capping the amount of under collection which can be carried forward does not prevent this objective from being fulfilled.

to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport, and

2.25 The 2014 Determination set quality of service standards and set a price cap that reflected a reasonable estimate of the costs that Dublin Airport need to provide the services users require. Not lifting the cap on the future recovery of under collections does not prevent this objective from being fulfilled.

to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.

2.26 The inability to recover under collections of more than 5% does not prevent the regulated entity from operating and developing Dublin Airport in a sustainable and financially viable manner. The 2014 Determination ensured this objective was met under a range of circumstances. The current market conditions, with increased revenues ensure financial viability levels in excess of those deemed necessary by the determination. The Commission targeted a financial credit rating for the regulated entity

of at least BBB. Since publication of the 2014 Determination S&P have upgraded daa Group's credit rating twice. It currently stands at A-.

Statutory Factors

- 2.27 In addition to the above statutory objectives the Commission has due regard to nine statutory factors. The 2014 Determination details how that decision met the factors. The circumstances identified by Dublin Airport in requesting a review do not change how the Determination addressed those factors. The most relevant factor to this review request is "imposing minimum restrictions on Dublin Airport Authority consistent with the functions of the Commission."
- 2.28 This was met by allowing the airport operator a large degree of discretion in how it manages Dublin Airport, merely requiring compliance with the annual price cap. Dublin Airport was given complete discretion in setting individual chargers. This flexibility remains.

3. Conducting an Interim Review of the Runway Trigger

- 3.1 The Commission believes that there are substantial grounds for conducting an interim review of the 2014 Determination in order to possibly amend the runway trigger to better align remuneration with the reality of the timeline of the project.
- 3.2 As stated above the 2014 Determination includes a trigger to remunerate the capital costs of the parallel northern runway. It adds €0.59 to the price cap the year following 25 million passengers being served in a 12 month period. Current forecasts of traffic predict the trigger will be hit in 2015 or early 2016.
- 3.3 Commencement of construction and opening for operations of the parallel runway is some time away. Collecting the €0.59 per passenger prior to the project being more advanced would represent a large degree of prefunding by users. At the time of the 2014 Determination, based on our traffic forecasts, our expectation was the trigger would not be met before the later part of the determination period and that at such a time the planning and design phase of the project would be complete. In early 2014 Dublin Airport's 2015-2019 Capital Investment Plan stated that the planning and design phase of the project would take 30 months.⁶ Our understanding was this was ongoing and therefore construction could commence in late 2016.
- 3.4 This review will only be concerned with the timing of the trigger, examining if further conditions are required to protect the interests of current and prospective users.
- 3.5 The review will not examine the 25m passengers element of the trigger or the cost of the project, these elements have already been addressed in the 2014 Determination.

⁶ http://www.aviationreg.ie/_fileupload/2014-05-29%20DAA%20Capital%20Investment%20Proposals.pdf

Substantial Grounds

- 3.6 In relation to the three tests outlined above, full funding of the project for a significant period of time in advance of construction would be exceptional. This would be incompatible with the aims of price cap regulation. When setting the trigger, the Commission's rational expectation was that commencement of construction would be aligned with the €0.59 entering the price cap. The 2014 Determination does not include any discretion on the mechanics of the trigger, for either the Commission or the regulated entity.
- 3.7 Allowing remuneration of the runway project before significant expenditure occurs would compromise the objectives of the original determination. In particular it would not be consistent with our statutory objective to protect the reasonable interests of current and prospective users. Fundamentally, by retaining the trigger as is, the Commission would be expecting users to pay the full funding costs of an €247m asset which does not have a clear timeline for commencement of construction. Adjusting the trigger to better align remuneration with the timeline of the project would allow us to protect current and future users while also facilitating the efficient and economic development of the airport.

The Next Steps

- 3.8 In early 2016 the Commission will consult with all interested parties on the timing of the runway trigger in the 2014 Determination.
- 3.9 Any changes to the 2014 Determination will alter the 2016 price cap formula. Therefore, the Commission would advise Dublin Airport not to include the €0.59 when setting prices for 2016 and to maintain the option to review pricing in 2016 depending the outcome of the interim review.

4. Responses to Consultation

- 4.1 On 13 November 2015 the Commission published a consultation asking for interested parties to comment on an application from daa which asked the Commission to review the 2014 Determination. Interested parties were asked if substantial grounds existed for a review. Full submissions are published on our website, below is summary of the key points raised in each submission.

Aer Lingus

- 4.2 Aer Lingus expressed concern that under-collection would lead to higher charges in later years.
- 4.3 It stated that daa are incentivised to stimulate growth, lower pricing is one way of achieving this, however this should be without recovery in later years as daa will have gained from the additional revenues.
- 4.4 Aer Lingus doubt the rationale put forward by the daa for this review, but highlight that, developments on volume since the determination may be exceptional.

Cityjet

- 4.5 Due to the potential for price increases Cityjet believe the review should occur.

DAA

- 4.6 daa expect to experience under recovery in 2015 and 2016 despite keeping the level of charges the same as in 2014.
- 4.7 It states that a review should be confined to only the k term. Stating that removing the 5% cap would not affect any other building block in the 2014 Determination and that it would facilitate the interests of users.
- 4.8 It claims circumstances are exceptional because of the runway trigger adding €0.59 to the price cap, due to passenger numbers being far ahead of forecasts and that the circumstances are outside of the control of daa.
- 4.9 It states that the circumstances result in the 2014 Determination failing to reach its objective of smooth pricing.

IAG

- 4.10 IAG state that it is predictable for an airport under regulation to seek to mitigate its effects. IAG believe that DAA must consider any review undertaken to be asymmetrical, suggesting there would be nothing to lose for daa.
- 4.11 IAG oppose any reopening of the price cap at Dublin Airport, stating to do so would introduce unnecessary and damaging uncertainty into the market for air-transport at Dublin Airport.

Ryanair

- 4.12 Ryanair state that a flaw in the regulatory system is that growth incentives are deducted from aeronautical revenues and so "self inflicted" under recovery can be recovered in subsequent years. Ryanair claim that airports operating in competitive markets do not have the ability to claw back growth incentives via higher charges in subsequent years. It notes that Dublin Airport benefits from the induced growth via economies of scale and non-aeronautical revenues.
- 4.13 Ryanair claim that removing the 5% cap on the k factor would further increase daa's ability to "game the system".

Stobart

- 4.14 Stobart do not believe that Dublin Airport should be encouraged to increase prices, and that the increased flexibility which would result from the removal of the 5% cap constitutes substantial grounds for a review.