DUBLIN AIRPORT CONSULTATION COMMITTEE

Representing the Needs of Dublin Airport Users

Comments on the Report by Booz&Co on Dublin Airport Terminal 2 Operating Cost Assessment

This response is made without prejudice to the unanimous position of Dublin Airport airline users that there is no justification for the costs associated with the construction and operation of Terminal 2 (T2) to be passed onto users during the forthcoming regulatory period.

Terms of Reference, Scope and Work Programme

As made clear in DACC's letter to Booz&Co of 5th October 2009, DACC does not accept that the costs of operating T2 can be considered in isolation from considering what level of costs would represent efficient opex for an airport with the throughput anticipated at Dublin in the forthcoming regulatory period given the absence of actual competition between terminal operators. In the absence of competition between terminals, it is not sufficient to assess separately what might be the efficient costs of operating T2 and then simply subtract some costs associated with the operation of T1 from those taken from the Indecon Jacobs Report, which DACC has already pointed out is fundamentally flawed. DACC considers that the terms of reference given to Booz&Co were inadequate and that a holistic view needs to be taken of the efficient costs of operating Dublin Airport in its entirety, taking into account DAA's already announced cost saving programme and the existing available capacity.

We now go on to comment on the specific findings of the work by Booz&Co but remain of the view that even if the efficient costs of operating T2 in isolation were established, this does not obviate the need to assess the efficient level of opex for an airport of Dublin's size and demand characteristics in total. DACC welcomes, at least, the greater transparency of analysis within the Booz&Co report compared to that presented in the Indecon Jacobs report.

DACC notes the comment by Booz&Co[1] that it was originally intended that the operation of T2 would be competitively tendered by the Government and so excluded from the Determination. This could only be the case if those costs were either not going to be passed onto users or that the operation of T2 would be genuinely competitive, with price competition between the two terminals. This is clearly not the case given the limited scope of the tender and the perversion of competitive processes through the involvement of DAA in drawing up the specification and participating in the tender. Competitive tendering of a facilities management contractor whose costs are going to form part of DAA's opex is not the same as the introduction of competition and would not require duplicate terminal management structures to be put in place.

[1] Page 4.

DACC notes Booz&Co confirms that the CAR is required to circulate a new Draft Determination[2], incorporating the T2 opex costs, and to allow comments on this prior to making the final Determination of the price cap. This is imperative as the CAR has not set out the extent to which it intends to adopt Booz&Co's findings and the price cap implications are not clear from the report. Interested parties must be given the opportunity to comment on the CAR's proposals in respect of T2 opex and its implications for the overall price cap following the Booz&Co report. DACC awaits with interest the revised Draft Determination.

DACC had previously been encouraged by Booz&Co's confirmation at the meeting on 23rd September that it had been asked to consider scenarios involving the whole or partial mothballing of T2, albeit concerned that these instructions were not explicitly included in the formal Terms of Reference for the work. DACC believes such consideration to be essential to determining what level of cost would represent efficient operations at Dublin Airport overall in the light of current market conditions. Whilst some information, which we comment on later, is appended to this report, no justification is given as to why the CAR requested Booz&Co to proceed with its detailed analysis only on the basis of the assumption that T2 would open in November 2010 and handle 40% of the passenger demand at the Airport[3].

DACC agrees with the definition presented by Booz&Co as to what would constitute an efficient operator:

- *"An efficient operator is one that is motivated through competitive forces to drive down costs in every area across the business whilst meeting the needs of its customers;*

- *It will utilise the resources at its disposal to maximise the value delivered to its customers, achieving no more or less than the required levels of service, and reducing as far as possible the resources required to do so.*

- *An efficient operator may sub-contract certain functions and services where doing so would be economically advantageous."*

DACC expects the CAR to apply these principles to assessing efficiency within the totality of the Determination. It is clear that the CAR will be in breach of its statutory duty to *"to facilitate the efficient and economic operation of Dublin Airport to meet the requirements of current and prospective users"* if it allows DAA to pass through inefficient and excessive costs for facilities of a scale not required by users and if it has not first satisfied itself that the costs have been driven down across all areas of the operation and the savings passed on to users as part of an efficient operation. This statutory duty goes much farther than simply assessing the potential costs of operating T2 alone.

Furthermore, the analysis on Page 14 of the Booz&Co report highlights that, at 62%, Dublin Airport has the highest proportion of staff cost as a percentage of opex of any of the comparator airports, close to double the proportion seen at other similar sized airports. It is significant that the efficiency of this practice has not been tested airport wide on a transparent basis in either this report or that by Indecon Jacobs. The CAR is not in a position to determine whether DAA complies with the criteria for an efficient operator until it has performed this testing.

[2] Ibid.
[3] Page 4.

Dublin Airport Traffic Analysis

DACC notes the comment from Booz&Co that traffic at Dublin Airport has been worse affected by the current downturn than other comparable airports in north-west Europe[4]. It is no coincidence that costs at Dublin Airport have been rising faster than elsewhere, leading to greater declines in traffic. DACC calls upon the CAR to take urgent action to reverse the spiral of cost increases and to address the points made in DACC's original submission in response to the Draft Determination regarding the setting of a price cap at a level which will encourage the resumption of growth at Dublin Airport and reverse the cycle of decline.

Terminal 2 Operating Concept

DACC does not accept as valid the assumption[5] that, other than management and retail staff, DAA's staff will not move between terminals. In DACC's view, either the two terminals are stand alone, operating independently and competitively, or resources should be shared across the two terminals to maximise efficiency by matching resources to peaks and troughs of demand. The basis upon which Booz&Co has conducted its analysis, by assuming independence without true competition, is inherently inefficient.

DACC is concerned that Booz&Co has failed to take into account differential demand loadings on different days of the week.[6] By analysing a constant profile of demand in a busy week, it is likely that resource requirements will have been overstated overall as demand will be lower on some days of the week and this can make a material difference to overall resource requirements, once efficient rostering has been taken into account.

The analysis on Page 24 confirms what DACC has always claimed that T2 has been oversized relative to demand and the level of spare capacity in T1. The demand graphs in the Booz&Co report confirm that the capacity in T1 is more than adequate to handle all demand at the present time and for the remainder of the next regulatory period.

T2 Operating Costs

<u>Passenger Operations</u>

No justification is given for why there is a separate operations control centre in T2[7]. Given the functions specified, these activities would be more efficiently undertaken in a single airport-wide control centre. Furthermore, such costs relate to the physical and services infrastructure of the building and should be fixed and not related to passenger numbers. Costs should be excluded saving €600,000 per year.

There is also no justification for duplicating the CIP event team, which is an airport-wide function. Further cost savings of €350,000 can be made.

It is not clear why passenger flow management staff are required in a new terminal[8]. This is surely a sign of inefficiency of design. Even if there is a temporary requirement as noted by Booz&Co, this should be capitalised as part of the commissioning costs. There is no requirement for 14 staff as suggested in the longer term[9]. Longer term costs should be omitted at a cost saving of €462,000 per year.

[4] Page 17.
[5] Page 22.
[6] Page 24.
[7] Page 28.
[8] Ibid.
[9] Page 29.

This submission is made without prejudice to the reasonable requirements of Dublin Airport airline users that, as T1 has more than sufficient capacity to meet forecast demand, no T2 Opex charges should be levied on users

DACC notes that Booz&Co has adopted an uplift of 20% to FTE numbers to make allowance for absence, leave and sickness[10] across all operations. This view accords with DACC's assessment that the maximum uplift which should be applied for these purposes should be no greater than 24%. This serves to highlight the gross inefficiency allowed for in the Indecon Jacobs report, which provided for a 60% uplift in estimating T1 operating costs. There is no clearer indication that the Indecon Jacobs report does not represent an efficient benchmark for operating costs at Dublin Airport and that an estimate of opex overall which relies on that report will fail to meet the CAR's statutory duties. DACC calls upon the CAR to revise its assessment of opex generally in the light of the Booz&Co finding in this regard.

The salaries assumed by Booz&Co appear high for the functions involved. Generally, basic market salaries seem high, given that they are quoted before shift premiums. References are made to an IBEC Survey and IBEC Study but no details are provided so that the data can be transparently verified. No reference is made to trends in airline staff costs nor were DACC members requested by Booz&Co to contribute such information. It is unclear which other private sector service industries have been used for benchmarking. These comments apply to all staff costs. DACC believes further wage efficiencies could be achieved.

Airport Security

The Booz&Co report allows for 7 boarding pass desks – one for each WTMD. This is excessive. For example, there are only 2 boarding card desks for 6 WTMDs at the northern search area in T1. If the design of T2 requires 7 staff for this function, it is a clear sign of inefficiency and the costs should be stripped out. The estimated cost saving would be €890,000.

Booz&Co does not appear to have verified whether DAA's claimed 200 passengers per x-ray per hour[11] represents efficient operations. York Aviation for Ryanair has assessed efficient operations at Dublin to be 280 passengers per hour per x-ray under the current security regime. On this basis, the number of machines and crews required could be reduced by 28.5%. Furthermore, no justification is given for the assumed 20% contingency added to security staff numbers.

In addition, having two staff searches permanently manned[12] at the arrivals and departures levels is an indication of inefficient terminal design and further consideration needs to be given to reducing the costs of operation by having both units only open at peak times for staff access.

Furthermore, there is also absolutely no justification for having 2 x-ray machines staffed[13] for the full operational day to handle the volume of transfer passengers at 0.3%[14]. This equated to 65 passengers per day on average; an absurd four passengers per staff member per day! Even allowing for peaking, the volume of transfer passengers to be processed is unlikely to amount to more than 200 passengers a day, most likely bunched to long haul operating times. The efficient solution is to staff this facility for limited hours only and provide an on demand service for the remainder of the time.

[10] Page 32.
[11] Page 34.
[12] Page 33.
[13] Ibid.
[14] Page 23.

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Overall, DACC considers that, based on Booz&Co's overall assessment of staff numbers required[15], security staff numbers could be reduced by at least 68 across the security search areas and static posts based on efficient operations. This would save of the order of €2.5 million a year.

Notwithstanding our comments about the scope for further efficiency savings, comparison between the analysis carried out by Booz&Co and that by Indecon Jacobs serves to further highlight the inefficiencies assumed by the latter as, unlike Booz&Co, Indecon Jacobs did not consider winter demand levels in assessing the staffing required over the year as a whole and based their analysis on peak period figures only. This overstates staff costs in the T1 opex analysis.

Maintenance

The inefficient design of Terminal 2 is highlighted by the provision of 56 lifts and 36 escalators within the building. Such provision adds significantly to the maintenance costs and demonstrates clearly the extent to which the building has not been designed to be either user friendly (in terms of minimising the need to change levels) or economical in operation.

It is totally unclear why maintenance functions are assumed to be separate in the two buildings as having two separate organisations without independent competition will inevitably lead to duplication and inefficiency. Substantial savings could be achieved by having specialist maintenance operatives operating airport wide in the absence of fully competitive terminal operations.

Even with that proviso, it is unclear how Booz&Co has assessed the level of staffing required. For example, is there really a need for two electricians at night, and two baggage engineers? Is there no synergy between baggage engineers and mechanical fitters – if not, there is a need to state clearly what they would be doing at night? What is 'Technical Services Personnel' and why is there a need for this post at night? Is there really a need for two supervisors at night? Are they working supervisors? If so, what would they be doing? As a minimum, DACC estimates that there could be a saving of 13 out of 54 posts, leaving aside further savings by having site wide specialists. This would result in a cost saving of €750,000 a year.

Cleaning

Booz&Co appears to have assessed cleaning costs based largely upon floor area. To the extent that T2 is oversized, the cleaning costs will be excessive when measured against efficient operations. At the very least, the costs of cleaning the building should be reduced pro-rata to the size of terminal required on the basis of the CAR's Box 1/Box 2 concept. To do otherwise, would be inconsistent with the CAR's treatment of DAA's excessive capital costs for a building which is too large. DACC estimates that T2 is at least 50% too big, so the efficient cleaning costs should be reduced by 50% until demand at the airport exceeds the Box 2 threshold.

In addition, in line with our general comment above, cleaning salaries look high. DACC considers that overall, cleaning costs for an efficient operation would be some €2.5 million less than stated by Booz&Co, principally by reducing the floor area allowed for.

[15] Page 41.

Airport Management and Support

DACC wishes to emphasise that the appointment of a facilities management contractor[16] for T2 does not constitute the introduction of competition. In those circumstances, the level of management which it would be efficient to provide for is a material consideration. The need for the proposed level of additional management staff (14), whose functions would largely duplicate those already existing in T1 or DAA head office and is not consistent with a facilities management solution, only serves to highlight the inefficiency of opening T2 before demand warrants.

DACC notes also that Booz and Co has made substantial allowance for management of each individual function as well as an overall layer of terminal management. This would appear to be double counting to a large extent. In DACC's assessment, the numbers of managers could be reduced by at least 3 by eliminating duplication, even on the basis of independent operation. More fundamentally, the costs would be omitted altogether if a holistic view of an efficient operation was taken.

Furthermore, when benchmarking salaries for the Head of Terminal Management position, Booz&Co has included within the analysis salaries of those responsible for terminal management at a number of smaller airports; noting that these managers appear to be paid more highly than those at larger airports[17]. DACC considers these not to be relevant comparators as, at smaller airports, it is likely that these individuals also hold broader corporate responsibilities, probably at Executive Director level, and will not be comparable with a Terminal Facilities Manager within a larger airport. By averaging salaries across a range of airports including Director level posts, the salary for this function is overstated by 23% compared to a comparable terminal manager level position at a larger airport. DACC believes that savings of €600,000 a year could be achieved in this management area in total.

Retail Costs

It is not clear why these costs are included in the analysis as the Draft Determination was prepared on the basis of commercial income, net of cost of sales, for DAA run outlets[18]. To be consistent with the Draft Determination, these costs should be excluded, giving a saving of €3.6 million.

Overall, DACC considers that Booz&Co have overstated the staff costs associated with T2 by 53% before taking savings in T1 costs through on-site efficiencies into account.

Non-Payroll Costs

DACC stands by its original position that there should be no net increase in staffing costs at Dublin Airport as passenger volumes will not reach 2008 levels for some years and taking into account DAA's planned redundancies and efficiency savings.

Overall, DACC believes that there is no case for an increase in opex greater than 10% overall when T2 opens, with the increase relating solely to unavoidable premises costs. Even this cost increase is inefficient in current market conditions. The comments below are without prejudice to DACC's position that users should not be charged the costs associated with T2 at the present time..

[16] Page 51.
[17] Page 54.
[18] Draft Determination, page 35.

It simply cannot be reasonable for Booz&Co to assume that no efficiency savings are gained from shared contracts or resources with T1 operations in the absence of fully independent and competitive terminal operations, for example there can be no efficient case for having duplicate contract maintenance teams[19]. This demonstrates categorically that the basis of assessment within the report does not accord with efficient operations for the benefits of users. Nor does it comply with what an efficient airport operator would do – seeking to minimise costs by avoiding duplication of functions to the benefit of its customers.

It is clear that many cost items, such as rates and utilities, are driven, like cleaning costs, by the overall floor area of T2. As with cleaning, the Box 1/Box 2 argument applies and DACC believes efficient operating costs can be those relating to no more than 50% of the floor area of the building. Users should no more be required to pay for the operating costs of DAA's excessive building floor area than for its capital costs. The same would apply to water charges. On this basis, the rates and water rates estimates should be reduced by 50%, saving over €2.1 million per year and similarly those for other utilities giving a further saving of €1.1 million. In addition, no justification is given for the assumed 12% increase in energy costs in 2012[20], indicating there may be scope for further savings in outturn costs against those assumed by Booz&Co. This applies also to energy costs in T1[21] which are also inflated by the same percentage. There should be equivalent savings in cleaning materials giving a further saving of €600,000 a year.

Reference is made on page 67 to the use of new technologies to enable efficient operations. If this was so, DACC would have expected to see these efficiencies transparently reflected in assumptions elsewhere in the report about staffing and other operating costs. This appears not to have been done and constitutes a further overstatement of the operating costs overall.

CUTE costs have been estimated based on the assumption that all check-in desks are equipped. Booz&Co erroneously state that Aer Lingus, as the major airline tenant has indicated a requirement for only 20 out of 56 desks. However, this is incorrect and, whilst Aer Lingus will take up to 28 desk positions, only 7 will require CUTE equipment as the remainder will be Aer Lingus' automated baggage drops. Hence, there is no justification for equipping all desks and incurring the operating costs thereof. Assuming other airlines take no more than another 20 desks in total, there would be a saving in CUTE costs of over 50% or €340,000 per year. Savings could be even greater as more and more airlines reduce check-in desk usage.

All costs associated with the opening of T2[22] should be capitalised and treated as part of the T2 capex costs. This applies to legal and professional costs[23] and other one off commissioning costs[24]. These latter costs alone would give a saving of €2.15 million.

[19] Page 62.
[20] Page 66.
[21] Page 99.
[22] Page 72.
[23] Page 72.
[24] Page 76.

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There is no justification for other legal and planning costs associated with T2 if it is not being separately operated on a competitive basis. If the operation is on the basis of a facilities management contract to DAA as now planned, such a contract could not be expected to incur independent planning and environmental fees, which would be an airport-wide responsibility already accounted for. The costs of nearly €700,000 are without justification and should be omitted. The same applies to marketing costs as the terminal is not going to be separately operated. There is no requirement for separate marketing for T2 on top of DAA overall marketing budgets. This would save a further €760,000 per annum.

DACC's views on the PRM contract and the excessive costs are already well known to the CAR. Dublin's PRM charges are excessive compared to other airports. The charge of €0.33 per passenger is more than double equivalent charges at Manchester of £0.135 per passenger[25], highlighting the inherent inefficiency.

Overall, DACC estimates that Booz&Co has overstated the efficient operating costs for T2, taken on its own, by approximately €20 million a year. This is before considering airport-wide efficiency issues.

Cost Savings in T1

At the outset, DACC reiterates its view that there is a requirement to establish the efficient level of opex campus-wide, not simply to make marginal adjustments to the already excessive T1 operational costs. The comments below on the detail of Booz&Co's findings are made without prejudice to this overarching view.

DACC made clear in its letter to Booz&Co that it does not accept that opex costs within the Draft Determination represent an efficient starting point for the airport as a whole. Yet Booz&Co confirms that this is exactly the basis upon which it has proceeded[26]. This is a fundamental flaw in its analysis of efficient operating costs, not least as some of the findings by Booz&Co undermine assumptions made by the CAR in coming to those cost assessments as we have pointed out above, such as allowances for leave etc within staff costs.

DACC cannot reconcile the staff numbers shown on Page 80 of the Booz&Co report with those in the Indecon Jacobs report. For example, the latter reports 668 staff under the heading Airport Police Fire Service, whilst Booz&Co show a baseline of 572 staff under this heading. These figures need to be reconciled and costs assumed for T1 in the Draft Determination adjusted accordingly to reflect the efficiencies assumed in Booz&Co's analysis, such as for security staffing[27]. DACC considers that the Booz&Co report demonstrates clearly the inadequacies in the Indecon Jacobs work on opex which underpins the Draft Determination.

DACC notes that Booz&Co confirms that DAA plans to close Area 14 check-in once T2 opens[28]. This confirms DACC's view that the costs must now be removed from the RAB if the facility is no longer to be used.

[25] Manchester Airport Fees and Charges 2009/10.
[26] Page 81.
[27] Page 87.
[28] Page 97.

Booz&Co's estimate of a 20% reduction in CUTE costs and a reduction from 165 desks in T1 (including Area 14) to 132[29] after the opening of T2 fails to take account of Ryanair's move to 100% web check-in. Given that Ryanair will be the major user of T1, accounting for at least two thirds of the traffic after T2 opens, and only requires a small number of check-in desks, DACC considers that CUTE and other check-in related costs can be reduced by at least 50%, saving an additional €220,000 a year.

Summary

Overall, Booz&Co sets out its estimate of efficient operating costs for T2 of €46 million a year by the year 2014[30]. This is offset by an assumed saving in T1 of €18 million[31]. It is not entirely clear the extent to which these savings are T2 related cost savings or a reworking of figures from within the Draft Determination. Comparison is complicated as the Booz&Co report presents figures in nominal cost terms whereas the Draft Determination is based on real 2009 prices.

DACC estimates that, correcting to a 2009 price base, the incremental opex proposed by Booz&Co would add a further €1.06 to the price cap by 2014. This is wholly unacceptable and will lead to further reductions in demand over and above that associated with the price cap proposed in the earlier Draft Determination.

Stripping out excess costs of at least €20 million, as set out above, from those estimated by Booz&Co would serve to mitigate the impact but would not eliminate the serious inefficiency inherent in opening T2 and passing on the costs to users at all in current market conditions.

DACC rejects the basis upon which so-called 'efficient' operating costs for T2 have been established in the Booz&Co report, which should have been required to assess whether it represents an efficient outcome to pass any costs onto users at the present time.

Even on the basis upon which Booz&Co has assessed the incremental opex cost implications of opening T2, it has overestimated the costs by approximately €20 million for each full year of operation.

Mothballing Scenarios

In the light of the serious concerns regarding whether passing on the costs to users of opening and operating T2 at the current levels of demand using Dublin Airport represents an efficient outcome in the terms defined by Booz&Co at the outset of its report, DACC considers that Booz&Co should have been required to give more detailed consideration as to the extent to which mothballing of all or part of T2 would represent the most efficient outcome overall. DACC does not see how the CAR can reach a conclusion not to consider Scenarios 2 (mothballing) and 3 (airside operations only) further as a basis for its Determination without having examined in detail and consulted on the full cost implications. Inadequate reasoning is given in the Booz&Co report as to the basis upon which the CAR instructed Booz&Co not to take these alternative scenarios forward to full analysis. Without full analysis of the costs and benefits, the CAR cannot transparently verify that it is proceeding on an efficient basis.

[29] Page 103.
[30] Page 107.
[31] Page 108.

In relation to the Scenario 2 options for mothballing the terminal at partial or full fit out stage, DACC considers that Booz&Co has presented an unduly negative position, not least as the claims of potential technological obsolescence apply in any event given the extent to which airlines have adapted their use of terminal buildings, such as by using internet based check-in since the design was completed, or the fact that airlines are already planning to replace some elements of T2 technology and infrastructure to meet their operational requirements, such as Aer Lingus self service baggage kiosks. The scale and design of the building, in particular the deep queuing areas, are obsolete in any event. The risk of technological obsolescence does not appear to DACC to be a justification for rejecting a mothballing solution if it would otherwise be efficient in terms of reducing the burden of costs overall on users. Even allowing for the cost implications cited under this scenario, DACC considers that there would still be a material saving to users compared with premature pass through of the full costs of operation.

In relation to Scenario 3, no assessment of costs is given at all, with the report containing only a checklist of matters which would need to be considered. Given the criticality of the issues being faced by users at Dublin Airport, this cursory treatment is totally inadequate.

In summarising the impact of the Scenarios on Page 126, Booz&Co presents an overly negative picture. The simple use of red and green pictograms conceals the different levels of cost associated with each item. It is not possible to form a balanced judgement as to the merits of these scenarios without quantification of the costs and benefits.

DACC considers that the CAR has a duty to demonstrate that it has not rejected the most efficient solution overall. It can only do so by transparently setting out the costs and benefits of options to mothball T2 until demand warrants its opening.

19/11/09