Consultation on the Scope of the Interim Review of the 2014 Determination of the Maximum Level of Airport Charges at Dublin Airport Relating to the Northern Parallel Runway

1. This submission is made by International Airlines Group plc (IAG) in response to CAR's consultation of 25th July 2016 on the scope of the interim review of the 2014 determination of the maximum level of airport charges at Dublin Airport relating to the northern parallel runway (Commission Paper 4/2016). It represents the views of IAG and its subsidiary airlines: British Airways, Iberia, Vueling and Aer Lingus.
2. For ease of reference, this submission broadly follows the same structure as Commission Paper 4/2016 – to which, unless otherwise stated, all references are made.

Introduction

3. We welcome CAR's decision to review the trigger mechanism relating to the construction of the northern parallel runway, set out in the 2014 Determination, which we have consistently maintained was inappropriate.[1] In our view, to review this aspect of the Determination in isolation from what are clearly interrelated elements could lead to suboptimal and potentially perverse outcomes. We therefore consider that CAR should widen the scope of its review, in order to take into account all relevant matters.
4. In our view – and seemingly other airlines and DAA would agree, regulatory treatment of new runway capacity at DUB and the early point at which the 25m passenger threshold was reached, represents substantial grounds for this review. This submission will set out how these substantial grounds pertain to a number of aspects, set out in CAR's consultation.

Establishing Substantial Grounds

5. We recognise CAR's concerns, in regard to interim reviews and their potential to undermine regulatory certainty. Nevertheless, we believe that the development of new runway capacity is unique in the foreseeable future and therefore meets/exceeds CAR's exceptional circumstances criteria. In doing so, it seems unlikely to be any undermining of confidence in DAA or its business.

1. [1] For example, see Aer Lingus response to CP1/2014 of July 2014 and letter to CAR of 25th May 2016.

6. In our view an appropriately scoped review is absolutely necessary, in order to ensure that the right outcomes are delivered, for DAA, airlines, passengers and the wider economy. We do not see how doing this could undermine existing incentives on DAA, unless they somehow worked against the interests of the other parties.

Submissions Received on the Scope of the Review

7. As a matter of principle, our view is that CapEx should only be remunerated when assets come into operation. This would reflect what happens in competitive situations.[2] This approach would support and incentivise DAA to optimal timing for delivery of associated infrastructure, avoiding airport users being forced to pay for assets brought into operation, before their enhanced capacity could be used.

8. This is significantly different from DAA's view that "***<u>all</u>*** efficiently incurred capital expenditure should enter the RAB" (***<u>emphasis</u>*** added).[3]

9. We reassert the point that the new runway capacity has never been subject to a rigorous economic business case process. We again submit that in the absence of such a study or justification, there is a high risk to the overall Dublin Airport economic proposition. We further submit that CAR must engage an independent report on the economic justification for the new runway (whether at the initial or revised proposed costs) and the timing of the application of increased cap on airport charges. We note the confirmation in the recent Department of Transport, Tourism and Sport Public Consultation on the 'Independent Review of Airport Charges Regulation in Ireland' of the requirement for a detailed cost benefit appraisal. [4]

   "It is important to note here that all major capital projects costing over €20 million are required to undergo a detailed cost benefit appraisal, under the terms of the Public Spending Code, published by the Department of Public Expenditure and Reform. It is the duty of the promoting agency (in the case of Dublin Airport, daa) to undertake this appraisal."

10. We further endorse the proposal set out in the above mentioned 'Independent Review of Airport Charges Regulation in Ireland' that any Ministerial Direction on capital investment should be subject to a consultation process, which will include the

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[2] For example – and by way of comparison, airlines cannot and do not recover the costs of new aircraft from passengers flying on existing aircraft; rather, these costs are recovered from incremental passengers, delivered by new aircraft. In this way, competitive firms grow to achieve scale economies.

[3] Paragraph 3.3

[4] Page 5-6, http://www.dttas.ie/sites/default/files/publications/aviation/english/review-regulatory-regime-airport-charges-ireland/consultation-document-review-regulatory-regime-airport-charges.pdf

presentation of a rigorous cost benefit appraisal, to be undertaken prior to the issue of any draft determination by the regulator. To the extent that Ministerial Direction formed any part of the decision making with respect to the Northern Runway, it should nonetheless be subject to a rigorous cost benefit appraisal.

Initial Thinking on Scope

11. DAA's increase in cost allowance, from €247m to €320m (accepting CAR's caveats on relative values) is not validated; however, the proposed mechanism for the treatment of cost under/over-runs entirely fails to incentivise DAA to efficiency, as stated by CAR.[5] On the contrary, it works in the opposite direction:

Actual Cost	Allowance	Under/over-run	RAB Increnent	Annual Return	Incremental Benefit to DAA of Higher Allowance	Return on Actual Investment
€247m	€247m	€0m	€247m	€14.33m	€2.12mpa	5.80%
	€320m	-€73m	€284m	€16.44m		6.66%
€284m	€247m	€37m	€265m	€15.38m	€2.12mpa	5.43%
	€320m	-€37m	€302m	€17.50m		6.17%
€320m	€247m	€73m	€284m	€16.44m	€2.12mpa	5.14%
	€320m	€0m	€320m	€18.56m		5.80%

12. As can be seen from the table, the incremental benefit to DAA is independent of actual cost of construction, but is simply a function of the amount CAR is willing to increase the allowance, factored by the regulated WACC (in this case, 5.8%).[6]

13. For this reason, in our view, the treatment of cost under/over-runs cannot be considered to be risk-sharing, because DAA is able to maximise the amounts users pay, by persuading CAR to increase the allowance – and then spending as much as possible.

14. We agree with CAR that: "… applying a crude rule on €70m of additional expenditure without consulting users on the cost overrun may not be in the interest of current or prospective users."[7]

15. It is somewhat unfair to ask users to commit 'carte blanche' to the outcome of an unknown tender process; however, on the basis that users' involvement would be significant and meaningful - and that the outcome reflected their involvement, it is reasonable to expect users to commit to such an outcome.[8]

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[5] "This mechanism provides Dublin Airport with a strong incentive to maintain control of costs." Paragraph 4.8

[6] Of course, in absolute terms, the more DAA spends, the higher its returns; however, if the regulated WACC reflects DAA's actual WACC, then the impact is neutral.

[7] Paragraph 4.12

[8] Paragraph 4.13

16. We understand that the current planning permission for the Northern Parallel Runway limits overall night-time flights for the existing runways and peak usage of the new runway. This may have a significant and immediate bearing on the economic proposition for the airlines operating in Dublin. The Interim Review should consider the economic impact of the application of such restrictions.

17. Based on planning restrictions and the overall plan for terminal development at Dublin, it is understood that the crosswind runway will be decommissioned. Notwithstanding that the crosswind runway (16-34) is itself useful infrastructure, the absence of this runway will have operational impact. This operational impact will lead to economic consequences for Dublin Airport and airlines operating at the airport. We believe this, of itself, is an important factor to be incorporated into an independent review.

18. Furthermore, the review should confirm that the planning and construction phases will not negatively impact existing and planned operations or, if it is anticipated that there will be such an impact, this should be factored into the independent economic review. The recent Consultation of Relocation of Engine Test Facility at Dublin Airport (the final decision of which was published by daa on 10th August 2016) cited Northern Runway Planning conditions as a factor in locating the test facility in a location that we consider to be operationally suboptimal.

19. The length of the proposed runway is of fundamental importance and should not be excluded from the scope of CAR's review. Runway length is a key driver of utility and cost – and as such, is fundamental to the question. In our view, it would be wholly counterintuitive for CAR to preclude itself from consideration of such an important issue, simply because it had previously formed a view – or indeed, because the matter may be contentious. CAR should regulate with the latest information it has available.

20. We agree with CAR that long runway, as proposed by DAA (3.7km) is wholly unnecessary at DUB; however, we disagree that a 3.1km runway strikes an appropriate balance.[9]

[redacted]

[redacted]

[9] Paragraph 4.15

[redacted]

23. In our view, CAR should set funding for a new runway at DUB according to the requirements of current users. If DAA wishes to present a business case for a longer runway (demonstrating that it would be NPV+, over a reasonable period), based on its anticipated requirements of future users (who are not current users), then it should be prepared to stand behind this – and CAR should be prepared to regulate accordingly. DAA cannot be allowed to deploy the "build it and they will come" approach to infrastructure development.

24. That said; as a matter of prudence, we would not object to DAA safeguarding land which could feasibly be needed to lengthen the runway, sometime in the future. We understand that as this is already in the RAB, there would be no impact on airport charges, until such time as this land was developed.

Capacity Assessments

25. In our view, capacity at DUB is set by a limiting factor – which, with the addition of a new runway, would be some other piece of infrastructure. Therefore, in providing DAA with an allowance for a new runway, CAR must have an eye to other facilities at DUB, which if not developed, would make new runway capacity inaccessible.

26. In addition, we firmly assert that there are other critical infrastructure items required at Dublin Airport that are of a higher priority than the new runway. These other capacity constraints must be resolved in advance of the new runway being relevant. This factor must also be taken into account in the independent economic review which we insist is necessary.

27. It is noteworthy that DAA consistently under-recovers by the maximum 5%, deploying these monies in traffic growth, in order to clawback these amounts two years in arrears, on an indexed per passenger basis and across a broader passenger-base. This in effect means that DAA 'lends' money to airlines, in order for them to invest in growth, only to subsequently call in the loan, with interest. In our view, it is this growth which has led to an earlier than anticipated need for new runway capacity at DUB – and on which DAA now seeks a €70m increase in allowance. Whatever else this may be, it is not risk-sharing.

28. Based on the existing trigger being applied (i.e. at the original proposed cost), there will be a material and significant increase in airport charges, this by itself will run counter to the growth in passenger numbers which triggered the new runway allowance.