IATA submission in response to the Commission for Aviation Regulation “Issues Paper” on the 2019 Maximum Levels of Airport Charges at Dublin Airport

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This submission presents the response of the International Air Transport Association (IATA). IATA's mission is to represent, lead and serve the airline industry and brings together some 285 passenger and cargo airlines comprising 83% of the global air traffic.

IATA welcomes the opportunity to provide comments to the Commission for Aviation Regulation on the 2019 Determination of the maximum level of airport charges at Dublin Airport.

Please find below our responses to the questions raised by the CAR in the paper.

Q1. Which elements of National and International policy should we have regard to and how?

- In addition to the papers on national policy, we believe that the CAR should also have regard to the relevant ICAO documents (i.e. Doc 9082), the relevant European legislation on airport charges (Airport Charges Directive, PRM legislation, etc), as well as the work developed by the Thessaloniki forum.
- We would also request for the CAR to take into account the various IATA's position papers on airport charges (link). These positions cover a wide range of topics such as, economic regulation, consultation, single till, service level agreements, peak pricing, among others. We would welcome the opportunity to present them to the CAR.

Q2. What high level methodology should we use to arrive at a price cap? Should we continue with the building block Regulatory Asset Base approach?

- We support the methodology used by the CAR to arrive at the a price cap:
  - Using the building block methodology, under a single till environment
  - Defining the building blocks on the basis of efficient costs
  - Establishing a link between such costs and the quality of service provided, to ensure that the airport does not "cut corners"
- We also agree on establishing the cap on a per passenger basis
- We agree with the need for cost-effective, fit-for-purpose infrastructure that is delivered at the right time and correctly scaled; all in agreement with users.

Q3. How should risk be allocated in the regulatory model?

- We consider that the current setup should be maintained subject to our later comments on how the traffic forecast is developed and by whom
  - DAA should bear the traffic risk. Otherwise, airlines would not only face their own traffic risk, but also the airport's traffic risk.
  - The DAA should also face the cost risk. Otherwise, the incentive to outperform would not exist.

Q4. What duration should we set the price cap for (4+ years)?

- We are supportive of using periods of 5 years for determining price caps, as that gives the regulated entity sufficient incentive to outperform its targets.

Q5. What methodology and data sources should we use to forecast passenger numbers?

- Both "top down" and "bottom up" approaches should be used for setting the traffic forecast:
  - Top down (statistical analysis) for the medium-term growth figures
  - Bottom up (i.e. airline inputs) for adjusting the earlier years of the forecast
- It is imperative that the CAR utilizes its own (and not DAA's) traffic forecasts for determining price caps. Given that traffic risk is being allocated to the airport, the airport will be incentivised to underestimate such forecast.
- We would welcome the possibility to engage with the CAR in the elaboration of traffic forecasts for the next regulatory period, since IATA has in-depth experience on the subject.

Q6. Should we forecast an aggregate or disaggregate passenger forecast?

- This is linked to the previous question, it is important to determine whether there are variables (other than national GDP) that could have an effect on specific traffic segments. If there are, then there may be a need to disaggregate forecasts.

Q7. What methodology should we use to forecast operating costs? What are appropriate benchmarks?

- Without a proper efficiency analysis, independently carried out by the CAR (directly, or via a consultancy study), it is difficult for us to determine whether the increases in operating costs (above those predicted by the CAR) are related to unrealized efficiency gains or due to an error in the CAR forecasting (i.e. wrong elasticities). As such, we cannot conclude at this point in time whether the methodology should be changed. We strongly encourage the CAR to carry out such efficiency analysis, as that will have a significant impact in the scope for efficiencies that DAA could achieve in the next regulatory period.
- For the next regulatory period, the CAR should continue applying separate elasticities for the different major cost components since passenger growth could affect them in various degrees (for staff costs, further disaggregation may be needed for the same reasons)
- For staff costs, the PAX/FTE should be a consistent downwards trend. The airport should be encouraged to invest in infrastructure or technology that reduces the degree to which additional staff are needed.
- We strongly encourage the CAR to continue carrying out bottom up analysis of DAA's operating costs efficiency. This is a best practice example we have been recommending in other countries.
- Top down analysis/benchmarking of airports could be a very powerful tool, however, there is not enough available European airports' financial information that would allow a proper analysis (the financial information is not collected or published in a consistent manner). We encourage the CAR to use the Thessaloniki forum to agree among ISAs on the consistent collection (and sharing) of airport financial information, as this may allow top down analysis in the future.
- As per previous regulatory periods, Dublin airport should have the operating cost risk. The only circumstance in which adjustments could be considered in when changes in

regulatory requirements occur. However, these should only be allowed after an appropriate efficiency analysis (as otherwise, the airport would not be incentivised to deliver such new requirements in the most efficient manner and just seek a pass through). An interim determination may be the best way of dealing with these situations on an ex-ante basis rather than an ex-post.

Q8. If efficiencies are identified, how long should Dublin Airport have to achieve them?

- Higher operating costs from non-materialised expected efficiencies cannot be allowed in the following regulatory period through a "resetting of the operating cost baseline", as that would diminish the incentive to achieve them. In this regard, the baseline operating cost does not necessarily need to be the "actual" operating cost, but the expected efficient one (defined at the beginning of the regulatory period, with relevant adjustments). Otherwise, the incentive would be to "pad up" the costs at the latter years of the regulatory period.
- However, income from outperformance should not be kept for longer than current regulatory period, as that would be to the detriment of the interests of passengers.

Q9. Should we continue to use rolling schemes to maintain a consistent incentive to realise efficiency gains throughout the regulatory period?

- The underlying idea behind rolling incentives is to encourage the regulated company to also outperform on the latter years of the regulatory period. From this point of view, rolling incentives might be an acceptable regulatory tool. However, there are a number of factors that need to be considered:
    - It is imperative that challenging efficiency target is set. Otherwise, rolling incentives would just prolong any windfall gains for the airport due to soft targets.
    - Linked to the above, it is concerning that the CAR cannot yet conclude whether the higher than forecast operating cost in the current period is linked to inefficiency or due to the wrong elasticity assumptions. Had the situation been the other way around (ie. Lower operating costs than forecast combined with lower traffic, we would be rolling incentive territory, but without actually knowing whether the lower operating costs were due to traffic or due to efficiencies). It is imperative that this is resolved before the continuation of any scheme.
    - Linking the rolling incentive to a "per passenger" would not necessarily solve things either. The fact that operating costs are not perfectly correlated to traffic means that lower costs on a per passenger basis would not necessarily mean an efficiency per se, but simply due to an elasticity effect.
- In summary, while rolling incentives on operating costs can be a useful, we are not yet convinced that these could work in the current environment.

Q10. What methodology should we use to forecast commercial revenues? What are appropriate benchmarks?

- As stated by the CAR, there is a need to further develop the current revenue forecasting models. We see that there are several potential indicators that could be taken in account to improve the predictability of each revenue stream (as per table 7.4), but also note the difficulties the CAR mentions in terms of availability of future data. Probably a way forward would be for the CAR to first determine the correlation between the candidate variables and the actual revenue numbers. Should the

correlation be high, only then it should focus on how to obtain future data for those variables. External consultancy to further analyse this approach (or other alternatives) may be needed in this regard.

Q11. Should Dublin Airport be incentivised to maximize revenue from all commercial activities?

- Not necessarily. It may be prudent to apply a cost-based approach for certain services that are key to airline operations. US pre-clearance is an example of this.
- In relation to example on the adjustment for ATI fees, it should be noted as well that EUR 1.9m is not an insignificant number.

Q12. Should we continue to use rolling schemes to maintain a consistent incentive to realise commercial opportunities throughout the regulatory period?

- In our submission to the Issues paper for the 2014-19 regulatory period, we commented that we were not in favor of rolling incentives for commercial revenues, and we continue with the same view. The large differences in actual commercial revenues vs. forecast, and the CAR's admission that its forecasting models need to be adjusted reinforces this view. We suggest stopping the application of rolling incentives for the next regulatory period and assess their possible reimplementation on the period after that once the predictability of the CAR's amended models has been tested.

Q13. How should we establish if a capital investment project should be given an allowance?

- The level of investment should be decided after consultation with users. If no agreement can be made, it should be the responsibility of the CAR to determine the appropriate capital expenditure allowance.

Q14. Should we continue to group projects together to allow flexibility?

- As well identified by the CAR on the issues paper, too much flexibility could lead to regulatory gaming & inefficiency, which is why grouping projects could become an issue. The more projects that can be identified as deliverables, the lower the risk for such gaming.
- If there were to be groupings, a strong governance mechanism must be in place in which user agreement is a precondition for reallocations.
- In any case, it is too soon to determine if there should be any groupings (and how many there should be), as that could only be determined after consultations on the forecast capital expenditure plan.

Q15. How and when should we establish the efficient cost of a project?

- We consider appropriate that a combination of ex-ante and ex-post evaluations are the best way to establish the efficient cost of a project (as described in paragraph 8.24 of the issues paper).

Q16. How should we reconcile completed projects against the allowance?

- We agree with the principles highlighted in table 8.2 of the Issues Paper as the basis for rolling forward the RAB.

- However, we do not yet see why there should be a 50% risk sharing mechanism on capex of significant scale. Risks should be allocated to the party that is best able to manage them, and we would therefore appreciate for the CAR to further explain why the airport should not have such risk allocated to it.
- In terms of the depreciation allowance:
    - We agree with the annuities concept, as that would imply the same level of annual costs being allowed for over the life of the asset.
    - We also encourage the use of the "same annual cost per pax" for large scale projects with significant spare capacity. The CAR has applied this approach in the past and we encourage the CAR to continue using it where appropriate
    - Care is needed when profiling the investments. Profiling should be based on when the capital expenditure is needed. Otherwise, if too much capital expenditure is allowed at the beginning of the period, the airport might be incentivized to delay those investments towards the end of the period (as that would allow the airport to enjoy "free" depreciation and cost of capital allowances due to the timing differences). There should be an effort to tie the allowances to the timing of the investments. Otherwise, an alternative approach could be to reconcile the allowed investment profile with the real investment one and make adjustments in the following determination.

Q17. What methodology and data sources should we use to calculate an appropriate return on capital?

- The appropriate cost of capital should reflect the low risks that an airport, as a monopoly, bears. The cost of capital should resemble that of an efficiently run business.
- We support the methodology used by the CAR in the past for determining a return (WACC, CAPM, etc).
- We support the usage of German bonds for calculating the risk free rate (as latter being the "safest" bond in EUR denomination) for the assessment of the risk free rate.
- We support the inclusion of a debt premium (the key item for decision is what rating to use, and would welcome further discussion on this).
- There may be some merit in considering debt indexation, and would appreciate to further discuss such an approach with the CAR.
- We are not fully convinced on the usage of TMR as the basis for determining the ERP, since it reasonable to believe that expected returns would be lower in periods where interest rates are low. DMS statistics on ERP alone should be enough.
- We would appreciate to further engage with the CAR on the calculation of the asset beta (particularly, the selection of the comparators).
- We support the approach for adopting a notional gearing ratio, as the cost of capital should be calculated on the basis of an optimal capital structure.

Q18. How should we enable Dublin Airport to operate and develop in a sustainable and financially viable manner?

- Adjustments for viability should only be done (it at all) in very rare circumstances, and only on the basis of an efficiently run company (i.e. there cannot be financial viability adjustments because the company did not meet its efficiency targets or extracted too

much cash from the company or is unable to inject equity, as that would defeat the purpose of incentive regulation and be in detriment of the interest of users).

Q19. Is investment grade the appropriate benchmark to use?

- Yes, investment grade is the appropriate benchmark to use.

Q20. Should the current scheme of Quality of Service targets and penalties be amended? What outcomes should be targeted and how?

- We look forward to participating at consultations on the KPIs to be used in the next service quality regime. Some initial thoughts/comments:
  - We support that only rebates (rather than bonuses) should apply. By definition, the price caps should already allow DAA to reach those targets. Also, the CAR should note that outperformance might not be desirable, as that could imply unnecessary/expensive investments being made for very little gains (and there is a high probability that those costs will be passed on to users)
  - There is need to increase the level of objective (rather than subjective) measures, as that would allow clearer link between the costs and the service levels provided.
  - We recommend for the CAR to review our position paper on SLAs (link)

Q21. What is an appropriate amount of revenue to put at risk?

- The current price cap adjustment (up to 4.5%) could be higher (in Heathrow and Gatwick it is up to 7%) in order to maintain adequate incentives to meet all targets.
- There may also be a need to further amend the rebate percentages of each of the KPIs, and put higher percentages on those indicators that, if failed, can cause significant additional costs on airline operations.

Q22. How should incentive schemes be accounted for in the regulatory model?

- We invite the CAR to review our position paper on incentive schemes (link)
- One of the main principles in this position paper (as well as highlighted in ICAO's policies on charges, Doc 9082) is that users not benefiting from these schemes should not be paying for those that do. In this regard, the cost of schemes should not be included in the calculation of cap, but separately. Therefore, the approach of considering incentives as a non-recoverable operating expenses appears to go in this direction.

Q23. How should we address imperfect pricing by the regulated entity (over and under collection)?

- The application of a "k" factor is not uncommon. However, we would like to point out the recovery of the k should be on the basis of the most recent traffic forecast (as otherwise, DAA could recover more than what it should if the latest traffic estimates are higher than the forecast assumed in the determination). We would appreciate further discussions with the CAR on the matter.

Q24. How should we treat costs related to Passengers of Reduced Mobility (PRM)?

- There needs to be a solution in which PRM charges are in line with PRM legislation, but also there is an approach in which there is also a framework that incentivises

DAA to deliver PRM services in an efficient manner. We would welcome further discussions with the CAR on the matter.

For additional information or clarification, please contact:

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