

**Consultation on the
Decisions of the Aviation Appeals Panel
On the 2019 Determination
Commission Paper 2/2020
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Commission for Aviation Regulation
3rd Floor, Alexandra House
Earlsfort Terrace
Dublin 2
Ireland
Tel: +353 1 6611700
Fax: +353 1 6611269
E-mail: info@aviationreg.ie

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1. Executive Summary

Introduction

- 1.1 On 24 October 2019 the Commission published its fifth Determination of the Maximum Levels of Airport Charges at Dublin Airport (CP8/2019)¹. The Determination covers the five-year period from 1 January 2020 to 31 December 2024 and is expressed as an annual per passenger price cap.
- 1.2 On 4 February 2020 the Minister for Transport, Tourism and Sport established an Appeals Panel under Section 40 (2) of the Aviation Regulation Act 2001 to consider the appeals of two parties, Dublin Airport and Ryanair, against the 2019 Determination. The Appeals Panel issued its decisions on these appeals on 4 May 2020. The decisions of the Appeals Panel are summarised in Section 2 below and are published alongside this paper on the Commission's website www.aviationreg.ie.
- 1.3 The timing of this consultation is dictated by legislation. The Minister established the Appeals Panel on 4 February. It reached its decision on 4 May; from that date the Commission has two months to reach a decision on variations to the Determination pursuant to the decisions of the Appeals Panel.

COVID-19 Pandemic

- 1.4 The COVID-19 pandemic is having a devastating impact on the global aviation industry and on economic activity generally. Passenger numbers at Dublin Airport are currently down 99% relative to expectations. The timing and pace of recovery is very uncertain.
- 1.5 The wide-ranging impact of COVID-19 means that many of the assumptions and expectations underlying the 2019 Determination on the maximum levels of airport charges at Dublin Airport are no longer valid or reflective of reality. The regulatory model used in the 2019 Determination is intended to allow for a reasonable degree of deviation (whether up or down) from ex-ante forecasts over the five-year period, without a requirement for an Interim Review. The current situation is not a reasonable degree of deviation from those forecasts, and it does not appear that this will change in the short term.
- 1.6 Section 32 (14)(a) of the Aviation Regulation Act 2001, as amended, allows the Commission to amend a determination after conducting an Interim Review. Our current thinking is that at least one such review is likely to be required and that the regulatory settlement set out in October 2019 for the later years of the current Determination period is unlikely to apply in its current form.
- 1.7 During 2020 we intend to consult with industry on the appropriate price regulation response to COVID19. We expect that that consultation will include topics such as:
- The need for an interim review and the timing of any such review(s)
 - New methodologies for conducting analysis in a time of extreme uncertainty
 - New mechanisms for responding to different scenarios which may unfold
 - A re-examination of risk
- 1.8 We will commence this dialogue with industry and stakeholders in a consultation paper in

¹ www.aviationreg.ie/regulation-of-airport-charges-dublin-airport/2019-determination.841.html

June. We expect that new arrangements will be in place for 2022 to 2024. There may also be a requirement for more immediate measures to adjust certain terms within the price cap formulae in 2020 and 2021 (such as service quality adjustments being affected by requirements for social distancing, for example). It should be noted that airport pricing will not remedy the current situation either for Dublin Airport or other stakeholders; pricing would not be sufficient to bridge the gap between costs and revenues, given the lack of demand.

- 1.9 The Appeals Panel, in consultation with the participants, considered the degree to which it should take account of events which occurred since October 2019. It concluded “that it would be appropriate for it to have regard only to material which was before the Commission when it made the Determination, and not to subsequently procured materials or subsequent events”. All parties engaged with the Appeals Panel in this way, and therefore did not consider the impact of COVID19. We do the same in this paper and intend to also do so in our decision on these referrals. The likelihood of an Interim Review is not a reason to either vary or not vary the Determination pursuant to an Appeals Panel referral.
- 1.10 Because of COVID-19 and the likely Interim Review process ahead, we expect that the outcome of our decision in relation to the points of appeal referred to us is somewhat inconsequential. As the Appeals process was underway, and it was becoming clear that COVID-19 would likely lead to a requirement for an Interim Review, the Commission suggested that parties may wish to withdraw their appeals against the Determination as set out in October 2019. Nonetheless, the appeals were not withdrawn, the Panel has issued its decisions on those appeals, and it is now important to address the points referred to us fully, within the statutory time period allowed. This will help to ensure that the determination methodologies are as robust as possible.
- 1.11 Most points of appeal within the various grounds were rejected by the Panel. Two points were referred back to the Commission for review. Only the Ryanair referral could affect the base price cap and only by a relatively small amount, €0.13 in 2022 and €0.07 in 2023.

Decision of the Panel

- 1.12 The appeals were wide ranging, touching on almost all aspects of the Determination, including passenger forecasts, operating costs, the cost of capital, financeability, allowances for new capital projects, reconciliation of past capital expenditure and the quality of service regime.
- 1.13 We welcome the Panel’s overall validation of the analysis undertaken by the Commission to arrive at the price caps in the 2019 Determination. On most points of appeal the Panel concluded that the Commission did not err, that we gave proper consideration to material we were presented with, and that we had full regard to our statutory requirements.
- 1.14 An aspect of one of Dublin Airport’s appeal grounds was referred back to us. The Panel asked us to test whether the Opex passthrough mechanism in the price cap formulae is working as intended. During the appeals process, the Commission supported the referral of this aspect of the Dublin Airport appeal, so that it could further consider whether the mathematical application of this mechanism could be improved. This does not impact the base price caps set out in the 2019 Determination, however it may impact the adjustment to be made to the price caps within the period such that the adjustments are fully aligned with the purpose of the mechanism as set out in the Final Determination.
- 1.15 Ryanair appealed the operating costs allowances from a number of perspectives, including the quantum of allowed increases from the Draft to the Final Determination, as well as the Commission’s decision to provide a glidepath (achievability) adjustment and the length of that adjustment. In the Final Determination we allowed for a 4 year glidepath, derived from 2019

actual Opex, before arriving at the more efficient level of Opex by 2024 (as per the report by CEPA). While the Panel's view was that allowing time to achieve the Opex efficiencies from a 2019 starting point was reasonable, in relation to the decision to increase the glidepath from 2 years in the Draft Determination to 4 years in the Final Determination, the Panel produced the following findings:

- It was not convinced that the more efficient CEPA figure was not achievable over a shorter time period than allowed for in the Final Determination.
- It was not convinced that the Commission had subjected this possibility to rigorous analysis.

1.16 The Panel therefore referred the decision to continue to provide a glidepath adjustment in years 3 and 4 back to the Commission for further review.

Draft Decision for Consultation

1.17 We agreed in submissions to the Panel that the Commission should look again at the cost pass through formula (which applies to certain categories of operating costs) to ensure it works as intended. In this paper we propose some adjustments to the formulae which, we consider, will better achieve the intended outcome. These are set out in Section 3.

1.18 We accept the views of the Panel in relation to the glidepath. More detailed analysis of the achievability of operating costs, and consequently the need for a glidepath of a particular length, is possible and should be conducted. After conducting this analysis we have concluded that the glidepath is not necessary for the years 2022 and 2023 and we propose to remove it. We do not propose to make any changes to the glidepath in 2020 and 2021, therefore the price caps in those years remains the same. There is no change proposed to the price cap in 2024 either. This referral is discussed in Section 4.

1.19 This is a consultation paper. We invite representations on our proposals in sections 3 and 4 by email to info@aviationreg.ie by **15 June 2020**. Full details on making a submission are set out in Section 5.

2. Appeals Panel Summary of Decisions

2.1 Below we summarise each of the grounds of appeal brought by Dublin Airport (daa) and Ryanair and the rationale for the decision of the Appeals Panel in relation to each. Full details are in the decision documents published alongside this consultation.

Dublin Airport - Grounds of Appeal

2.2 Dublin Airport submitted eight grounds of appeal to the Panel. Within each ground there were a number of points of appeal. As noted above, the Panel decided to refer back to us one point within the second ground of appeal (the operating cost pass through mechanism) for further review. The referred aspect is the mathematical application of the cost pass through formula. Otherwise, the Panel concluded that the eight grounds of appeal did not give rise to sufficient grounds to refer the decision back to us. It also concluded that we properly considered the matters referred to in Section 33 of the Aviation Regulation Act 2001, as amended by the State Airports Act 2004.

Ground 1: Passenger Forecasts

2.3 Dublin Airport's appeal was based on its claims that:

- we had used an inappropriately simplistic forecast model.
- we had ignored the facts that it presented to us with regards to the 2020 traffic, and that we did not undertake a risk assessment.
- we had ignored the infrastructure constraints at the airport.

2.4 In its decision, the Panel concluded that:

- our GDP based approach is simple, transparent, easy to replicate and to check for robustness.
- our model is as valid for the first year of the Determination (2020) as it is for any other year, and that our approach to risk was valid.
- Stakeholder passenger forecasts, whether produced by daa on the one hand or airlines on the other, must be treated with some circumspection.
- there was room for growth at Dublin Airport despite capacity constraints through the various mechanisms that we had identified in the Final Determination.

Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 2: Cost Pass Through mechanism

2.5 Dublin Airport's appeal was based on its claims that:

- we left insufficient scope to broaden the categories of costs covered by the mechanism if required.
- two or three years of costs may not be fully remunerated via this mechanism within this regulatory period.

- we have not specified how the costs not remunerated in the period 2020 to 2024 will be potentially allowed as part of a future determination.
 - the K factor formula is not working as intended, which is to ensure that any adjustment between costs incurred and those estimated by us in the W factor are adjusted for two years later.
- 2.6 The Panel decided to refer back to us for review the question of the K factor formula only. This point is discussed in Section 3.
- 2.7 Otherwise, the Panel was satisfied that:
- we had not made an error in narrowly defining eligible costs because the cost passthrough mechanism is an exception to the general rule in relation to Opex risk allocation, and consequently needs to be tightly defined.
 - the lag in revenue stream should not alter the overall outcome for Dublin Airport, and that the mechanism is symmetric, so the same potential lag will apply if there are allowances that Dublin Airport should repay to users.
 - eligible costs occurring late in the period should be dealt with in the next determination and that there is no reasonable alternative mechanism to guarantee the remuneration of those costs prior to the end of the period.
- 2.8 Therefore, the Panel did not refer these elements of this ground of appeal to the Commission.

Ground 3: Cost of Equity

- 2.9 Dublin Airport's appeal was based on its claims that several errors had been made in the calculation of the cost of equity, in particular in the calculation of the asset beta, the risk-free rate and the total market return. The Panel stated that, of the various alleged flaws, the most material seemed to be that the methodology to estimate the asset beta placed undue weight on poor comparator airports.
- 2.10 The Panel considered the submissions of Dublin Airport on this issue, but ultimately, acknowledging that there is room for judgement in such decisions, the Panel did not agree that the approach of the Commission was in error.
- 2.11 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 4: Cost of Debt

- 2.12 Dublin Airport's appeal was based on its claims that the cost of debt range was underestimated, due to inaccuracies or errors in the methodology used to derive the cost of embedded and new debt and the forward rate adjustment.
- 2.13 The Panel considered that the alleged errors in the calculation of the cost of debt were relatively not as material as the issues raised on the asset beta and contributed less to the alleged overall error in the calculation of the cost of capital.
- 2.14 The Panel examined separately each alleged error of the cost of debt. Overall, acknowledging that there is room for judgement in such decisions, the Panel did not consider that the Commission had made any errors.
- 2.15 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 5: Capital Expenditure (capex) Disallowance 2015 to 2019

- 2.16 Dublin Airport appealed our decision to disallow some €60m of actual capital expenditure in 2015-2019, which was above the allowances set in the 2014 Determination, because Dublin Airport did not adequately consult with stakeholders as set out in the 2014 Determination. It claimed that this was an error, because Dublin Airport had justified the additional investment which was linked to circumstances beyond its control, such as safety issues.
- 2.17 The Panel concluded that our disallowance was not in error. It accepted that it was appropriate to consider expenditure at the grouped level, as the Commission had done, rather than on an individual project level. The Panel was not convinced by Dublin Airport that consultation could not have been carried out in advance of exceeding the relevant group allowances or why it would have necessarily resulted in delayed projects.
- 2.18 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 6: Capital Expenditure Disallowance 2020 to 2024

- 2.19 Dublin Airport's appeal was based on its claims that we disallowed some €44 million of 2020-2024 capex due to incorrect assumptions that were made by our consultants, Steer.
- 2.20 The Panel concluded that our consultants considered the representations made by Dublin Airport and adjusted their recommendations to take account of those representations. The Panel concluded that there is no mistake of principle in our approach or that of our consultants. The Panel also noted that of the nine projects under consideration, seven are included in StageGate, which means that, if necessary, adjustments can be made as the projects proceed.
- 2.21 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 7: Reprofitting Triggers

- 2.22 Dublin Airport's appeal was based on its claims that:
- we had failed to properly consult on the possible introduction of the triggers and to provide adequate reasons for their inclusion.
 - the reprofiling triggers effectively prohibit Dublin Airport from implementing innovation through outputs. Dublin Airport claimed that the sole emphasis would be placed on the timing of delivering the projects associated with the triggers, rather than allowing scope for driving sustainable and financially robust operations for passengers and airport users.
- 2.23 The Panel did not agree that we failed to adequately consult or provide adequate reasons. The Panel accepted that the consultation on these triggers arose late in the Determination process, but it was because of the reaction of Dublin Airport to the Draft Determination, when it said that the CIP programme would need to be reassessed as to what projects would proceed. The Panel considered that even though it was relatively late in the process, we gave Dublin Airport time to comment and we considered those comments. The Panel found that the rationale for the triggers given in the 2019 Determination is reasonable, and the response was proportionate, as it would not have been appropriate for Dublin Airport to be remunerated in respect of large capital expenditure projects that it is not undertaking, particularly where it has stated in advance that it may not undertake them.
- 2.24 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 8: Service Quality Measures

- 2.25 Dublin Airport's appeal was based on its claims that three quality of service measures are not proportionate, namely: walking distance, ground transport information on arrival, and wait times for passengers requiring additional assistance.
- 2.26 The Panel concluded that our approach to including the walking distance metric in the Determination is reasonable as it will incentivise Dublin Airport to consider this issue when deciding on future airport designs. On ground transport information on arrival, the Panel accepted that Dublin Airport could have opposed the inclusion of the metric on the grounds that there was no historical performance data to inform the target level, and that Dublin Airport did not raise this point. The Panel did not conclude that we made a mistake by setting the target level in line with the airport's own internal target. Likewise, the Panel did not conclude that we made an error in respect of the wait times for passengers requiring additional assistance, as we used the Service Level Agreement targets that were in place at the time of publication of the 2019 Determination.
- 2.27 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ryanair Grounds of Appeal

- 2.28 Ryanair submitted eight grounds of appeal, four of which refer to operating expenditure (opex) and overlap to a certain extent. Within each ground there were a number of points raised. After considering the submissions and available evidence, the Panel decided to refer one aspect of this ground back to us for review, namely our decision to increase the opex glidepath from the two years which was used in the Draft Determination to four years in the Final Determination. Otherwise, the Panel concluded that the eight grounds of appeal did not give rise to sufficient grounds to refer the decision back to us. It also concluded that we properly considered the matters referred to in Section 33 of the Aviation Regulation Act 2001 as amended by the State Airports Act 2004.

Grounds 1 A-B-C-D Operating Expenditure (opex)

- 2.29 Ryanair's appeal was based on its claims that we did not properly justify:
- increasing the Opex allowances despite our findings that the Opex level is still not efficient.
 - allowing Dublin Airport more time to achieve the efficiencies identified by our consultants CEPA and Taylor Airey, from a period of two years in the Draft Determination to a five year period in the Final Determination.
- 2.30 The Panel concluded that our approach and that of our consultants was reasonable in that it established the level of efficiency for Dublin Airport to achieve, given the constraints under which it operates. The Panel also considered it reasonable that we allow time for Dublin Airport to achieve the level of efficiencies identified to avoid the risk of adversely affecting service standards. The Panel concluded that it was not an error to have used the latest expected 2019 Opex figures as a starting point, because that represents a realistic picture of actual costs.
- 2.31 Therefore, the Panel did not refer the above elements of this ground of appeal to the Commission.
- 2.32 The Panel did not regard the decision to alter the glidepath from two years to four years as having been properly explained to it by us. It produced the following findings:

- It was not convinced that the more efficient CEPA figure was not achievable over a shorter time period than allowed for in the Final Determination.
- It was not convinced that the Commission had subjected this possibility to rigorous analysis.

2.33 This referral is discussed in Section 4.

Ground 2A Capital Expenditure (“Capex”) Efficiency of scale of capacity allowed

2.34 Ryanair’s appeal on the amount of allowed Capex was based on its claims that we erred in relation to the scale of Capex that we permitted to enter the RAB, and that we failed to adequately account for the substantial planning risks which may affect the ability of Dublin Airport to deliver the allowed projects within the timescale at the scale proposed.

2.35 The Panel considered that we did not err in deciding that the entire CIP should be allowed to enter the regulatory asset base (RAB) in the 2020-2024 regulatory period because:

- we considered both the views of stakeholders and the “lumpy” nature of capital projects.
- we assessed the need for each project and its likely benefit for users of Dublin Airport, both present and future, and provided adequate details in that regard.

2.36 The Panel also accepted that it was appropriate for us to proceed on the basis that Dublin Airport would address the planning issues. The Panel noted that we have put in place mechanisms, such as the StageGate process and the reprofiling triggers, to mitigate the risks that either a project is subsequently found to be wrongly scoped or that a project is significantly delayed, including as a result of planning risks.

2.37 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 2B Capex uncertainty mechanisms

2.38 Ryanair’s appeal on capex uncertainty mechanisms was based on its claims that:

- our use of reprofiling triggers was not the correct approach, instead we should deduct the total covered by those triggers from the price cap, and then allow remuneration to be triggered when projects proceed.
- a material portion of capital costs should not be allowed into the price cap until a project has been agreed through the StageGate process.

2.39 The Panel considered that our approach was justified by the clear need for capacity expansion and our requirement to ensure that the regulatory settlement was financially viable. The Panel agreed that the introduction of the reprofiling triggers was a reasonable balance of our statutory objectives: it allows for Dublin Airport on the one hand to develop the airport in a way which is in the interest of airport users, while on the other hand seeking to ensure that the timing of remuneration does not become entirely misaligned with the programme.

2.40 Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 3A Financeability

2.41 Ryanair’ appeal on financeability was based on its claims that:

- even if it was legitimate for us to allow the full amount of Capex to enter the RAB, the advice that we had received from our consultant, Centrus, did not identify that a financeability adjustment was necessarily required.
- Centrus had recommended a review of financeability mid-way through the regulatory period, rather than simply making an upfront adjustment as we had done.
- our assumption that there would be a dividend issue as a matter of course weakened the financial ratios in the base case and increased the need for a financeability adjustment.

2.42 The Panel was satisfied that:

- the Centrus report, properly read, in fact provides support for the financeability adjustment made by us.
- While Centrus did suggest the possibility of a review of the financeability midway through the period, it was reasonable for us not to follow such an approach as it could introduce negative unintended incentives.

Therefore, the Panel did not refer this ground of appeal to the Commission.

Ground 3B Cost of capital

2.43 Ryanair's appeal made detailed submissions in respect of the following components of the cost of capital: the asset beta, the total market return, the forward rates and aiming up.

2.44 Overall, the Panel concluded that there was no error in our approach on these issues as we had carefully considered all the submissions made to us on the Draft Determination and had taken the detailed advice of Swiss Economics which is encompassed in its Final Report.

2.45 The Panel acknowledges that we had to make various judgement calls and we must be allowed a reasonable margin of discretion in making those calls. The Panel was not convinced that there was any error in principle in the data sets that were used by Swiss Economics and there was a reasonable and logical explanation in respect of each.

2.46 Therefore, the Panel did not refer this ground of appeal to the Commission.

3. Referral 1: Dublin Airport – Opex Passthrough Formulae

Summary of the Appeal Ground and Referral

- 3.1 Dublin Airport alleged a number of errors on behalf of the Commission in relation to the Opex passthrough mechanism set out in the Final Determination. Among these was a submission that the mathematical application of the passthrough mechanism would not fully work as was stated in the Final Determination.
- 3.2 In reviewing the material in relation to this ground, the Commission agreed that the Panel should refer the mathematical application of the passthrough mechanism back to the Commission for review, to ensure it resulted in the intended outcome, as set out in the Determination.
- 3.3 The Panel duly referred the mathematical application of the passthrough mechanism back to the Commission for further review. It did not refer the other aspects of Dublin Airport's appeal.

Proposed Action Arising from the Referral

- 3.4 The stated purpose of the mechanism is to allow for certain costs, over which there is uncertainty at the time the Determination is made and which are largely outside the control of Dublin Airport, to feed through to the price cap within the Determination period. The intention was that the mechanism would firstly allow for an up-to-date estimate of such costs to adjust the price cap with a one year lag, through the W-Factor term in the price cap formulae. Forecasting error could then be corrected once outturn numbers were known for the year in question; this would be done through an amendment to the K-Factor term, which operates with a two year lag. The result would be that the operating costs covered by the mechanism would be recovered in full by Dublin Airport.
- 3.5 The Commission has reviewed the mathematical application of the passthrough mechanism and considers that it can be both improved and simplified, such that it will better adjust the price cap as set out above. The issue is in relation to the K-Factor term, rather than the W-Factor. We propose the following:
- To make no change to the components of the W Factor, which will continue to allow for the remuneration of the best estimate of the quantum of qualifying costs, with a one-year lag.
 - To undo the change to the K-Factor pertaining to the passthrough mechanism. The K-Factor would therefore be unrelated to the passthrough mechanism, but would revert to dealing with general under-collection as has been the case in previous determinations.
 - To introduce a new term which we will call the Y Factor. This term will adjust for forecasting error in passenger numbers or qualifying costs, to the extent that such error has caused imperfect remuneration through the W Factor. This term operates with a two year lag.

- 3.6 The W Factor would therefore be included in the price cap formula for each of the years 2021-2024. The Y Factor would be included in the formula for each of the years 2022-2024. Examples of the proposed terms to be included in the 2022 price cap are set out below:

$$P_{2022} = (\text{€ } 7.75 + \textit{Trigger}_{2022} - \textit{QS}_{2022}) * (1 + \textit{CPI}_{2021}) + w_{2022} + y_{2022} + k_{2022}$$

Where:²

$$w_{2022} = \frac{(LM \textit{OPEX}_{CAR} \textit{ApprovedOutturn}_{2021} - LM \textit{OPEX}_{CAR} \textit{Forecast } 2021)}{PAX_{2022f}}$$

$$y_{2022} = \left(\frac{(LM \textit{OPEX}_{CAR} \textit{ApprovedOutturn } 2020 - LM \textit{OPEX}_{CAR} \textit{Forecast } 2020)}{PAX_{2022f}} \right) - w_{2021} * \left(\frac{PAX_{2021}}{PAX_{2022f}} \right)$$

$$k_{2022} = \textit{Minimum} \left((P_{2020} - P_{2020\textit{outturn}}), (0.05 * P_{2020}) \right) * (1 + I_{2020}) * (1 + I_{2021}) * \left(\frac{PAX_{2020}}{PAX_{2022}} \right)$$

And where all other terms and inputs are as defined in the 2019 Final Determination.

- 3.7 In reviewing the K Factor formula, we noted that a latest expected forecast for passenger numbers in the year to which the adjustment applies is included; for example k_{2022} includes the input PAX_{2022f} . Ultimately, while a latest forecast will need to be used to set the provisional K Factor, the final adjustment is driven by the actual outturn level of passengers as set out in the Final Determination. We therefore intend to replace PAX_{tf} with PAX_t , as has been done in K_{2022} above.
- 3.8 These changes do not impact the base price caps set out in the Determination; rather they may impact the level of adjustment to be made to those price caps within the period.

² It should be noted that the input 'LMOpex_{CAR}ApprovedOutturn' for a given year t may be different in the W term in year t+1 relative to the Y term in year t+2. This is to allow for forecasting error in the input included in W, which will need to be calculated before the end of year t. Ultimately, should the final exposure of the Regulated Entity differ from that allowed for in the W term, this can be corrected through the Y term in the subsequent year.

4. Referral 2: Ryanair – Opex – Glidepath Extension

Summary of the Appeal Ground and Referral

4.1 Ryanair’s appeal to the Panel in relation to the Opex allowances alleged a number of errors on behalf of the Commission:

- Not adopting an efficient level of Opex from 2020 having regard to past determinations, or at a minimum, the decision to extend the glidepath (achievability) adjustment to also include 2022 and 2023.
- Increasing the total allowed Opex by €118.9m between the Draft Determination, without providing adequate justification for this ‘major change’.

4.2 In order to contextualise these statements and the relative impact of the various changes, the Commission set out the following table in its submission to the Appeals Panel.

Table 4.1: Breakdown of Opex Changes from Draft to Final Determination

Year	Draft (€m)	CEPA changes (€m)	Start Point (€)	Glidepath Extension (€m)	Final (€m)
2020	273.1	7.8	9.5	0	290.4
2021	273.1	15.9	6.6	0	295.6
2022	283.9	21.6	0	4.7	310.1
2023	289.7	23.7	0	2.7	316.1
2024	291.1	26.5	0	0	317.6
Total	1410.9	95.5	16.1	7.4	1529.8

Source: CAR published Financial Models

4.3 The Panel did not consider that there was an error in the CEPA assessment, nor in the Commission’s decision to use 2019 as a starting point.³ In relation to the decision to continue to apply a glidepath adjustment in 2022 and 2023, and having regard to the material and evidence presented by Ryanair, the Commission, and Dublin Airport, the Panel made the following points:

- It was not convinced that the more efficient CEPA figure was not achievable over a shorter time period than allowed for in the Final Determination.
- It was not convinced that the Commission had subjected this possibility to rigorous analysis.

4.4 The Panel therefore referred the decision to increase the glidepath from 2 years (as per the Draft Determination) to 4 years (in the Final Determination) back to the Commission for further review.

³ Dublin Airport Opex Efficiency Assessment: Review of Consultation Responses, CEPA www.aviationreg.ie/fileupload/2019%20Determination/Final%20Determination/Final%20Opex%20Efficiency%20Report.pdf

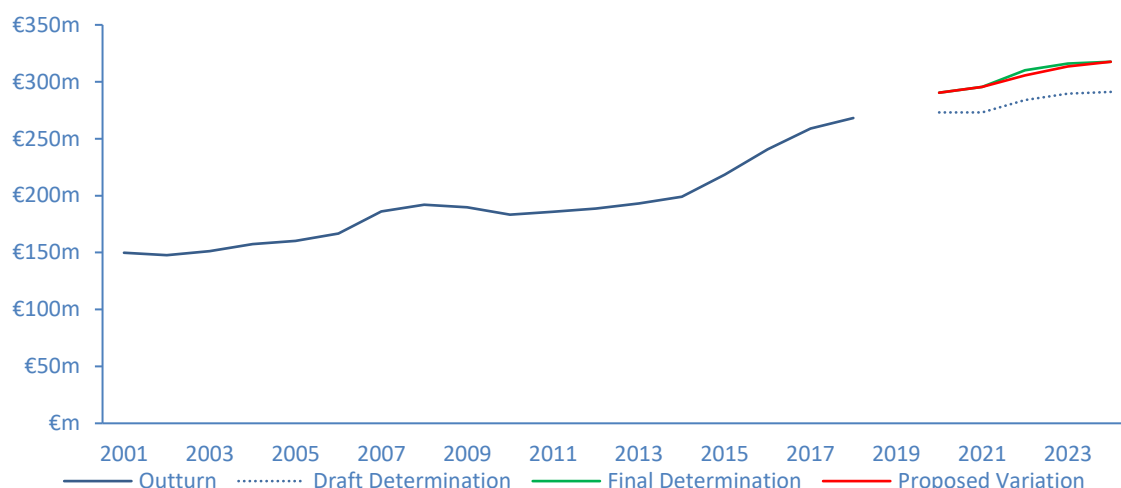
Proposed Action Arising from the Referral

- 4.5 In the Final Determination, we applied a broad achievability adjustment having regard to the 2019 actual level of Opex. The scope of the CEPA project was not to assess whether the more efficient figures it arrived at were immediately achievable, but rather to trace more efficient expenditure through the previous regulatory period and then project continued efficient expenditure forwards over the period 2020-2024. The Commission concluded that too immediate a reduction in Opex could have had implications for Dublin Airport's ability to meet our targets relating to other building blocks, most notably service quality, and applied an achievability adjustment in a broad way across the period. This was done by running a smooth glidepath from our latest expected 2019 expenditure forecast, to the CEPA 2024 figure excluding the CIP related adjustments. The CIP adjustments were then added back in to arrive at the level of allowed Opex for each year of the period.
- 4.6 Following the referral, however, we have specifically reassessed whether the CEPA Opex figure for 2022, as well as the assumptions underpinning it, could reasonably have been considered achievable given the 2019 level of Opex. We have considered the 2019 Opex forecasts produced by Frontier Economics on behalf of Dublin Airport in early 2019, as well as detailed data provided by Dublin Airport in July 2019 in relation to staffing levels and Opex by airport business unit, comparing these to the CEPA allowances by Opex category for 2022.
- 4.7 We have concluded that the evidence, when assessed in this more granular way, supports the position that the CEPA figure for 2022 should have been considered reasonably achievable. We therefore propose to vary the Determination such that the glidepath adjustment for 2022 and 2023 is removed. We do not propose to vary the Determination in any other way as a result of this referral; in particular, we do not consider there to be interrelatedness between this adjustment and other building blocks such that consequential changes are required elsewhere in the Determination. The impact of this change is to remove the 'glidepath extension' column in Table 4.1, which reduces the level of allowed Opex by €4.7m in 2022 and €2.7m in 2023. Overall, this is a reduction of just under 0.5% in the level of allowed Opex across the regulatory period, relative to the Final Determination.

Table 4.2: Proposed Variation in Opex Allowances following Appeals Panel Referral

Year	Draft Determination	Final Determination	Proposed Variation from Appeal
2020	273.1	290.4	290.4
2021	273.1	295.6	295.6
2022	283.9	310.1	305.5
2023	289.7	316.1	313.4
2024	291.1	317.6	317.6
Total	1410.9	1529.8	1522.4

Source: CAR

Chart 4.1: Proposed Opex Variation from Appeal Panel Referral

Source: CAR

4.8 This change in allowed Opex consequently reduces the price cap by 13c in 2022 and 7c in 2023.

Table 4.3: Proposed Variation of 2019 Final Determination Price Caps

Year	Final Determination	Difference	Proposed Variation from Appeal
2020	€7.50	0	€7.50
2021	€7.50	0	€7.50
2022	€7.88	-13c	€7.75
2023	€8.12	-7c	€8.05
2024	€8.32	0	€8.32
Average	€7.87	-5c	€7.82

Source: CAR Financial Model

4.9 At first take, we note that adopting the CEPA figures for 2022 allows for cost increases both in payroll and non-payroll costs, in real terms (i.e. before inflation is added), relative to 2019. The target would therefore be to contain cost increases across Dublin Airport as a whole, rather than achieve cost reductions.

4.10 The data suggests that overall there is approximately 100 more FTEs assumed by CEPA in 2022 (including the implicit FTEs associated with the Capital Investment Programme), relative to Dublin Airport in 2019. Considering the assumed number of FTEs per Opex Category, we drew the following conclusions:

- Increases in certain categories, in particular Retail and Security, are partly offset by reductions predominantly in non-frontline areas, particularly Central Functions.
- Natural attrition of staff over 2019-2022 would have enabled Dublin Airport to staff at or very close to the assumed levels in 2022, in the categories where reductions were identified as achievable from an operational perspective by CEPA. This is not the case for 2021 or 2020.
- Having regard to the specific areas where CEPA identified that there was scope for improvement, the nature of that improvement set out by CEPA, and the material

provided by Dublin Airport, we have not identified any persuasive evidence indicating that it should not be considered achievable from an operational perspective by 2022.

- There are a number of categories where arriving at the CEPA FTE assumption for 2022, given the actual 2019 position, poses a challenge. On the other hand, there are other categories which CEPA concluded are largely efficiently staffed, or where certain efficiencies are more quickly achievable. In the round, therefore, we consider that overall CEPA's assumptions are achievable from 2022 following the two year glidepath.
- 4.11 We therefore consider that adopting the CEPA FTE assumptions from 2022 strikes an appropriate balance between challenge versus achievability, a core principle upon which Opex allowances are set.
- 4.12 Overall, the unit cost assumption in the CEPA figures, relative to the material for 2019 provided by Dublin Airport, would allow for an element of real unit payroll cost escalation. The data suggests that this increase would be in the order of 1.5% to 3% over the three year period (the variance arising from differences in the material submitted by or on behalf of Dublin Airport at different stages). By contrast, the 2014 Determination assumed that unit payroll costs would be flat in real terms, ie they would increase in line with inflation only. The price cap is adjusted for actual inflation across the period; Dublin Airport does not hold the inflation risk. The inflation forecasts used by CEPA for the period ranged between 1.5% to 1.9% annually. As well as the scope for real unit cost escalation, we note the CEPA findings on this topic over the period 2015-2019, and have again reviewed the responses to the Draft Determination on the topic of pay progression. We were not presented with evidence to suggest that the CEPA target for 2022 is unreasonable or unachievable, given Dublin Airport's 2019 position.
- 4.13 In relation to Non-Payroll costs, the CEPA 2022 figure would again allow for real cost escalation relative to 2019. The scope for efficiencies identified here largely relates to different views of the future, rather than baseline disallowances. The notable exceptions to this relate to Insurance and Non-Payroll IT. Having regard to the details set out in the CEPA report, as well as responses to the Draft Determination, we do not see evidence which would support an argument that these targets are not achievable by 2022. Furthermore, in the case of IT, this forms part of an overall 'Totex' type allowance, which also includes Payroll IT costs in relation to which CEPA has allowed for relatively higher cost escalation, as well an IT Capex allowance which is considerably higher than in previous periods. Costs associated with Rates are subject to the passthrough mechanism and consequently are not relevant in this context. Following this analysis we do not see evidence to support a contention that the extended glidepath is required in relation to Non-Payroll costs.
- 4.14 Therefore, as suggested by the Panel and in line with the appeal of Ryanair on this specific point, we consider that the evidence does not adequately support a continued glidepath adjustment in 2022 and 2023. We are therefore proposing to vary the 2019 Determination such that these adjustments are removed in these two years. We do not propose to make any other adjustments to the Determination on the basis of this referral.
- 4.15 We would reiterate that our Opex targets, and indeed the building blocks approach generally, is not prescriptive but rather is outcome focused. While the targets are derived based on granular assumptions, it is open to Dublin Airport to achieve these targets in different ways, or alternatively respond to a regulatory settlement in way which enables it not to achieve an individual building block target at all.
- 4.16 It is open to Dublin Airport to overspend the Opex allowances and compensate for this through other building blocks (as occurred during 2015-2019). In the 2019 Final Determination, we gave the example of retail staff costs associated with Dublin Airport's decision to bring more

retail in-house. In the Draft Determination, we had sought to exclude both the incremental revenues and incremental costs associated with this change, meaning that the surplus revenues could have paid for the Opex overspend. Another example might be an expansionary HR initiative; where Dublin Airport considers that such an initiative will lead to efficiencies elsewhere in the business, offsetting the likely overspend within Central Functions resulting from the initiative, nothing in the regulatory framework prevents it from embarking on such an initiative. Dublin Airport is encouraged to take such initiatives where the business case is robust and positive. Evidence in relation to achieving the desired results can then be submitted at the subsequent determination. In this way, Dublin Airport is incentivised to act as a company facing competitive constraints would act.

5. How to Respond to this Consultation

- 5.1 We seek the views of interested parties regarding the proposals in Sections 3 and 4 of this Consultation Paper. The deadline for responses to this Consultation is 5:00 PM, 15 June 2020. We will not consider submissions received after the deadline.⁴
- 5.2 Responses should be titled “Response to the Consultation on the Decisions of the Aviation Appeal Panel On the 2019 Determination CP2/2020” and sent:
- By email to: info@aviationreg.ie (preferable); or
 - By post to: 3rd Floor, Alexandra House, Earlsfort Terrace, Dublin 2, D02 W773
- 5.3 We may correspond with interested parties who make submissions, seeking clarification or explanation of their submissions.
- 5.4 Respondents should be aware that we are subject to the provisions of the Freedom of Information legislation. Ordinarily we place all submissions received on our website.⁵ We may include the information contained in submissions, in reports and elsewhere as required. If a submission contains confidential material, it should be clearly marked as confidential and a redacted version suitable for publication should also be provided.
- 5.5 We do not ordinarily edit submissions. Any party making a submission has sole responsibility for its contents and indemnifies us in relation to any loss or damage of whatever nature and howsoever arising suffered by us as a result of publishing or disseminating the information contained within the submission.

⁴ The time of receipt of submissions, whether in electronic form or otherwise, shall be the time when we receive the submissions at or in our offices. If we receive a portion of a representation prior to the deadline, and the remainder after the deadline, we reserve the right to only consider the portion received prior to the deadline.

⁵ While we endeavour to ensure that information on our website is up to date and accurate, we accept no responsibility in relation to the accuracy or completeness of our website and expressly exclude any warranty or representations as to its accuracy or completeness.