DUBLIN AIRPORT

Response to CP2/2020

Consultation on the Decisions of the Aviation Appeals Panel on the 2019 Determination

June 2020

Contents

1. Introduction

1.1.1 Dublin Airport welcomes the opportunity to respond to CP2/2020 published by the Commission for Aviation Regulation ("the Commission"). This document is Dublin Airport's response to the Commission's Draft Decision following the two referrals from the Aviation Appeals Panel 2020.

1.1.2 This consultation process is taking place against the backdrop of the outbreak of the global pandemic Covid-19. This event has had a devastating impact on Dublin Airport's passenger traffic and aeronautical revenues. The path to recovery in the aviation sector remains very uncertain at this juncture.

1.1.3 Dublin Airport believes that the regulatory building block assumptions underpinning the 2019 Determination have been radically changed as a result of the Covid-19 outbreak and we support the Commission's decision to consult on the price regulation response to this pandemic and the potential requirement for an Interim Review of the 2019 Determination.

1.1.4 While the timescale and extent of any potential Interim Review remains undecided Dublin Airport is conscious that there are a number of immediate impacts arising from the Covid-19 Pandemic affecting the 2020 and 2021 price caps which we hope can be addressed in the short term.

1.1.5 While Dublin Airport acknowledges that there was a request by the Commission for parties to withdraw their appeals of the 2019 Determination, Dublin Airport decided to proceed with their appeal on the basis that there were a number of aspects of the 2019 Determination that we believed did warrant a review by the Appeal Panel. In particular, there were a number of aspects of the 2019 Determination that we felt aggrieved by and this was our only remaining opportunity to challenge these decisions.

1.1.6 Dublin Airport accepts that given our exceptional circumstances and the pending Interim Review of the 2019 Determination that the outcome of the Commission's decision in relation to the referrals by the Appeals Panel may be somewhat inconsequential. We understand that there may now be a need for a review of the functionality and appropriateness of the current regulatory regime in the light of the Covid-19 impacts. However, it is important for the integrity of the methodologies underpinning our regulatory framework that the current appeal process is completed in an appropriate manner.

1.1.7 Dublin Airport understands and accepts that in responding to the referrals made by the Appeals Panel it is necessary for the Commission and responding parties to look at the material and information available at the time of the publication of the 2019 Determination (October 2019).

1.1.8 Dublin Airport has examined the Commission's Draft Decision in response to the two referrals made by the Appeal Panel.

1.1.9 Referral 1: Dublin Airport – Opex Passthrough Formulae:

- Dublin Airport welcomes and supports the proposal by the Commission to amend its existing regulatory formulae in order to allow for an adjustment in the price cap to correct for any forecasting errors in passenger numbers or qualifying costs impacting on the application of the opex cost passthrough mechanism.

- We do however still have some concerns regarding the ability of the new proposed Y term and the current W term to deliver the full renumeration of qualifying costs over the current determination period.

1.1.10 Referral 2: Ryanair – Opex – Glidepath Extension:

- Dublin Airport is extremely aggrieved that the Commission is now proposing to remove the Opex glidepath for 2022 and 2023 without new evidence to justify such a substantial change in its approach. The impact of this decision is extremely penal for the airport with a resulting €0.13c and €0.07c reduction in the 2022 and 2023 price caps respectively given over €100m of opex was disallowed by the Commission in the Final Determination.

- This decision will further increase the negative impact of the current 2019 Determination on the financial viability of the airport and this is prior to any consideration of the company's current position following the outbreak of Covid-19. The Commissions consultants baseline disallowance of €20m now requires achievement in just two years with no mechanism provided by the Commission to aid such an aggressive targeted reduction in staff numbers and costs.

- Dublin Airport is concerned that the Commission would propose implementing such a penal measure given the enormous business challenges faced by the airport and this scale of reduction imposed has not been imposed in previous determinations. We ask that at a minimum a three-year glidepath be retained.

2. Opex - Glidepath Extension

2.1 Introduction

2.1.1 In its decision regarding the Ryanair Grounds of Appeal, the Appeal Panel referred the decision made by the Commission to increase the opex glidepath from 2 years (as per the 2019 Draft Determination) to 4 years (in the 2019 Final Determination) back to the Commission for further review.

2.1.2 In CP2/2020, following this referral from the Appeal Panel the Commission reviewed its approach in the 2019 Final Determination where it applied a glidepath adjustment in 2022 and 2023 to its annual opex allowance. In this analysis the Commission looked at the following points made by the Appeal Panel in its decision where it stated:

- 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.

2.1.3 This proposed decision will impact the annual price cap for 2022 and 2023 by a reduction of €0.13c and €0.07c respectively and it will reduce the average price cap over the period 2020-2024 by €0.05c.

2.2 Impact of the 2019 Determination

2.2.1 Dublin Airport believes that 2019 Determination is extremely challenging for the company in terms of operating costs. This decision resulted in a disallowance of over €100m[1] of Dublin Airport's forecast operating expenditure in this regulatory quinquennium on the basis of the Commission's consultants'[2] final report which concerningly lacked substantiation for its decisions to continue to disallow significant levels of expenditure and for which there was no support provided to demonstrate to Dublin Airport how and why lower cost levels were justified or achievable in the forthcoming period. Additionally, the disallowance of €100m over the period 2020-2024 is 10 times higher than operating cost disallowances from the Commission's previous determinations and unprecedented versus prior determinations.

2.2.2 The main cost disallowances relate to wage rates allowed for pre-2010 frontline roles and on average 170 staff have been disallowed which mainly relate to frontline areas such as Security, Facilities & Cleaning, Retail and Airside Operations (130) and non-frontline/back office staff (40). In order to achieve this target a significant restructuring of the airport business will be necessary but despite this the Commission made no

[1] Before glidepath adjustment.
[2] Cambridge Economic Policy Associates (CEPA) and Taylor Airey.

allowance for the associated restructuring costs which would be required to implement this level of change.

2.2.3 The Commission recognised the severity of the challenge faced by the airport where in its Final Determination it allowed for an increase in the operating cost glidepath from 2 to 4 years to allow for a more gradual achievement of the ambitious cost savings projected by the Commission's consultants CEPA.

2.2.4 While Dublin Airport continues to have reservations about the Commission's operating cost targets for 2020-2024, Dublin Airport did broadly accept the Commission's approach to operating expenditure in the 2019 Final Determination given that it was proportionate and consistent with its statutory objectives taking account of the competing interests of the various stakeholders concerns. However, given the level of operating expenditure disallowed in the 2019 Final Determination, Dublin Airport believed that it was imperative that the Commission provided its four-year glidepath where the operating expenditure disallowance was phased in to meet the operating cost target set for 2024.

2.3 The Application of the Glidepath

2.3.1 The use of a glidepath is a recognised regulatory tool used to encourage the regulated entity to achieve projected efficiency cost savings. Regulatory precedence clearly demonstrates how glidepaths stimulate the regulated entity to make incremental efficiency improvements beyond those that would be achieved under a regulatory regime in the absence of a glidepath. Therefore, the use of the glidepath delivers additional efficiency improvements with benefits for customers and end users.

2.3.2 A glidepath is an effective method of bridging a gap between projected operating costs set by the regulated entity and the level of achievable cost savings targeted by the regulator.

2.3.3 In its 2019 regulatory review the Commission chose to include a glidepath in its regulatory model both in the Draft and Final Determinations. The 2019 Draft Determination included a two-year adjustment while in the 2019 Final Determination the adjustment phase was increased to four years.

TABLE 1 GLIDEPATH ADJUSTMENT

	2020	2021	2022	2023	2024	Cumulative
	€'m	€'m	€'m	€'m	€'m	€'m
Glidepath						
Final Allowance	9.5	6.6	4.7	2.7		**23.5**
Draft Allowance	8.0	2.5				**10.5**
Difference	**1.5**	**4.1**	**4.7**	**2.7**	**0.0**	**13.0**

2.3.4 In its Final Determination the Commission recognised that the level of efficiency savings which its cost consultants CEPA had identified for 2020-2024 at Dublin Airport required a more extensive glidepath of four years than the previous two-year glidepath used in the Draft Determination.

2.3.5 The Commission concluded that a sharp 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 it applied an achievability adjustment in a broad way across the period. It stated the following in the 2019 Final Determination.

> *"We consider that it is necessary to allow Dublin Airport more time to achieve the efficiencies identified by CEPA. Consequently, we first calculate a 2019 starting point based on actual data from the first 9 months of the year and forecasts for the remaining 3 months. We use this to develop a glidepath starting in 2020 and ending in 2024 at CEPA's target, excluding the CIP uplifts."* [3]

> *"We have therefore concluded that a further adjustment towards achievability within this building block is required, relative to the CEPA finalised figures. We have decided to use the latest expected 2019 figure as a baseline. We run a smooth glidepath from this figure to the CEPA 2024 figure, excluding CIP related cost uplifts."* [4]

2.3.6 Given that the Commission has previously recognised the importance and necessity of this four-year glidepath we are somewhat surprised and concerned that the Commission is now proposing to reduce this to two years with the removal of the current adjustments for 2022 and 2023 putting additional pressure on price levels and consequently operating costs.

2.3.7 In CP2/2020, the Commission has stated that its proposed decision is based on the conclusion that the evidence, when assessed in a more granular way, supports the position that the CEPA operating cost figure for 2022 should have been considered reasonably achievable. However, we have been given no visibility of the evidence used to support this decision and the resulting justification for the reversal of the Commission's current policy approach.

2.4 Requirement for the Glidepath

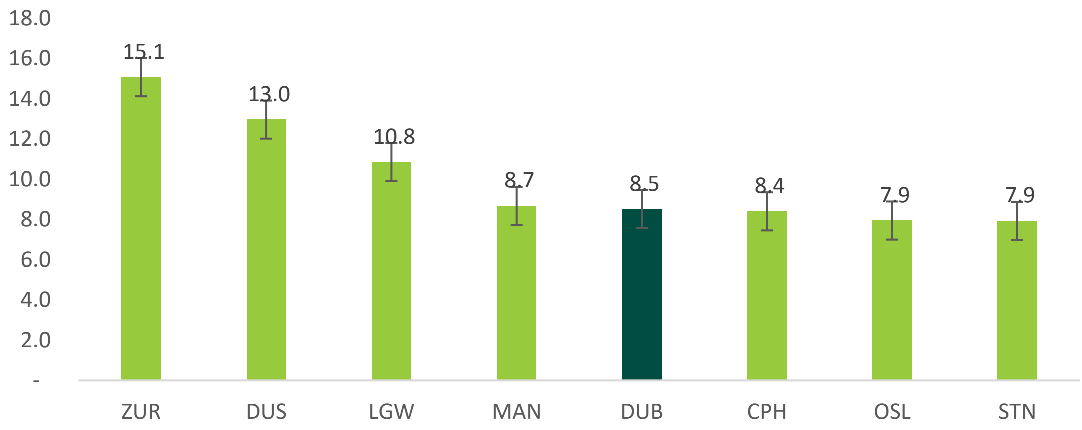
2.4.1 Dublin Airport understand the need for operational efficiency and in recent years we have continually strived to make efficiency improvements at the airport.

2.4.2 The following figure demonstrated that Dublin Airport's operating costs (opex) per passenger from 2018 ranked competitively against peer airports.

[3] Paragraph 6.4 2019 Final Determination

[4] Paragraph 6.28 2019 Final Determination

FIGURE 1 OPEX PER PASSENGER 2018



Source: Dublin Airport/2018 Annual Reports

2.4.3 Dublin Airport faces a number of challenges as an employer in a state-owned company. We are continuing to deal with the implications of having a number of our employees working on different terms and conditions. We are a highly unionised company and this needs to be considered in any proposed changes that we make.

2.4.4 In order to affect the level of cost saving required by the Commission over a shorter period such as the two years which is now being proposed, the only viable option would be the introduction of a Voluntary Severance Scheme but no provision has been made by the Commission for the restructuring costs which would be required to implement such a scheme.

2.4.5 Achieving cost savings through natural attrition takes a certain length of time therefore we believe this would not be viable in the two-year period now being proposed. We believe that three years is the absolute minimum period of time necessary to implement this level of cost reduction.

2.4.6 If the Commission intends to reduce the current four glidepath period we would ask that they consider a three year period rather than two years and extend the glidepath out to 2022 in order to allow the airport a reasonable opportunity to achieve some of the necessary cost saving measures.

2.5 Financial Impact of Removal of Glidepath

2.5.1 The 2019 Final Determination is of critical importance for Dublin Airport given that this regulatory decision determines the underlying profitability of the airport and it will influence the level of airport development that will be achievable over the course of the period 2020-2024.

2.5.2 Under the current legislative framework, the Commission has a statutory objective "*to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner*". Due regard for this objective is particularly important during times of significant investment such as in the present case in view of Dublin Airport's proposed CIP 2020+.

2.5.3 Given the current difficult business environment faced by the airport we are disappointed that the Commission is proposing at this juncture to alter the 2019 Determination in a manner that will result in a lower annual price cap for 2022 and 2023 at Dublin Airport.

2.5.4 Leaving aside the devasting impact of Covid-19 on our business, the 2019 Final Determination was already proving a challenging decision from our perspective with a serious potential impact on the financial viability of our business. This proposed decision is set to worsen our financial position.

2.5.5 We are concerned that the Commission has not provided any evidence to assess the impact of the reduction in the price cap for 2022 and 2023 on Dublin Airport's financial ratios in those selected years.

2.5.6 Given that the Commission has included a financial viability allowance in the 2019 Final Determination of c. €28m p.a. in 2022 to 2024 in order to hold the Net Debt/EBITDA ratio at 4.90x, it would therefore be logical that this proposed reduction in the price cap related to the glidepath would have to be further offset to safeguard Dublin Airport's financeability.

3. Opex Passthrough Formulae

3.1 Introduction

3.1.1 In CP2/2020, The Commission outlined how the stated purpose of this 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 2019 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 which would operate with a two-year lag. The final result would be that the operating costs covered by the mechanism would be recovered in full by Dublin Airport.

3.1.2 We note that the Commission has acknowledged that the input 'LMOpexCARApprovedOutturn' 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. The new Y term is intended to allow for this potential discrepancy to be corrected in the subsequent year.

3.2 The Proposed Introduction of the Y Term

3.2.1 Dublin Airport welcomes and supports the proposal by the Commission to amend its existing regulatory formulae in order to allow for an adjustment in the price cap to correct for any forecasting errors in passenger numbers or qualifying costs impacting on the application of the opex cost passthrough mechanism.

3.2.2 However, Dublin Airport believes it would have been useful for the purpose of understanding the proposed change in the formulae if the Commission had defined further the different elements of the new Y term and the existing W term.

3.2.3 We would also like clarity on the definition of the 'LMOpex' outturn term and how this may be used to allow for the full remuneration of qualifying costs in different circumstances.

3.2.4 While Dublin Airport accepts that expenditure falling within the cost pass through mechanism, but occurring late in the regulatory period, may not be guaranteed of remuneration prior to the end of the period We would however like assurance that if necessary, any qualifying costs which are unremunerated during this determination period could be brought forward into the next regulatory determination period.

3.2.5 It remains to be our position that costs occurring early in the period such as the FCC rates uplift commencing in 2020 should be fully remunerated within the period. It is estimated there will be an additional cost to Dublin Airport for Fingal County Council (FCC) rates from 2020 of €16m which will be unremunerated in the current period. This substantial amount is solely based on what we know today for costs legislatively mandated which are unremunerated at this point in time via base price cap i.e. it is realistic to assume there will be additional unknown costs over the period 2020 – 2024 which will be imposed upon the airport and increase this value.

3.3 The Proposed Change to the K Term

3.3.1 Dublin Airport is surprised that the Commission is now also proposing to make a further change to the K term which is unrelated to the opex cost passthrough mechanism and which is in fact outside the scope of the referrals made by the Appeals Panel.

3.3.2 The Commission is now proposing to replace its passenger forecast number for the price cap year with the outturn passenger number for that price cap year in the calculation of the k factor.

3.3.3 In the example below PAX2022f is being replaced by PAX2022.

k2022 = $Minimum\ ((P2020 - P2020outturn),(0.05 * P2020)) * (1+I2020) * (1+I2021) * (PAX2020PAX2022)$

3.3.4 This will mean that at the end of a price cap year the k factor will have to be recalculated to reflect the year's final outturn passenger numbers. This will add an extra level of complexity for Dublin Airport in achieving price cap compliance.

3.3.5 This proposed change will involve a departure from the current approach where to date the Commission's forecast passenger numbers have been used to calculate the k term and where the airport takes on the volume risk in relation to the calculation of the annual price cap.

3.3.6 Dublin Airport is uncertain as to the rationale and requirement for such a substantive change in the Commission's regulatory approach at this juncture.

4. Conclusion

4.1.1 Dublin Airport is extremely perplexed that the Commission is now proposing to remove the Opex glidepath for 2022 and 2023 without new evidence to justify such a substantial change in its approach. The Commission have failed to provide robust arguments and justifications throughout the 2019 Determination process regarding operating cost allowance decisions. The impact of this decision is penal for the airport with a resulting €0.13c and €0.07c reduction in the 2022 and 2023 price caps respectively.

4.1.2 This decision will further increase the negative impact of the current 2019 Determination on the financial viability of the airport and this is prior to any consideration of the company's current position following the outbreak of Covid-19.

4.1.3 Dublin Airport is surprised that the Commission would propose implementing such a penal measure given the current business environment faced by the airport.

4.1.4 Dublin Airport calls on the Commission to reverse this proposed decision and to retain at a minimum a three-year opex glidepath in its 2019 Determination.

4.1.5 Dublin Airport welcomes and supports the proposal by the Commission to amend its existing regulatory formulae in order to allow for an adjustment in the price cap to correct for any forecasting errors in passenger numbers or qualifying costs impacting on the application of the opex cost passthrough mechanism.

4.1.6 We understand and anticipate that these formulae will allow for the full remuneration of unexpected costs which are mandated on the airport albeit with a time lag in certain cases.

4.1.7 Dublin Airport is seeking further clarification as to the reason and effects of progressing with the proposed amendment to the K factor prior to implementation.

4.1.8 Dublin Airport is committed to engaging further with the Commission with the regard to the technical application of any of issues outlined above.