DECISION OF THE

AVIATION APPEALS PANEL

Established by Order of the Minister for Transport

29th September, 2009

APPEAL OF

DUBLIN AIRPORT AUTHORITY

AGAINST DETERMINATION OF
THE COMMISSION FOR AVIATION REGULATION CP6/2007

1. **INTRODUCTION**

1.1 Section 40 of the Aviation Regulation Act, 2001 provides:

> *"(2) The Minister shall, upon a request in writing from a person to whom this Section applies who is aggrieved by a Determination under Section 32(2) or 35(2), establish a panel ("Appeal Panel") to consider an appeal by that person against the Determination.*
>
> *(5) An Appeal Panel shall consider the Determination and, not later than three months from the date of its establishment, may confirm the Determination or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, refer the decision in relation to the Determination back to the Commission for review.*
>
> *(6) An Appeal Panel shall notify the person who made the request under sub-section (2) of its decision under sub-section (5)."*

1.2 Section 33, as amended by the State Airports Act, 2004, provides:

> *"(1) In making a Determination the objectives of the Commission are as follows -*
>
> *(a) to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport,*
>
> *(b) to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport, and*

(c) to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.

(2) In making a determination the Commission shall have due regard to-

(a) the restructuring including the modified functions of Dublin Airport Authority,

(b) the level of investment in airport facilities at Dublin Airport, in line with safety requirements and commercial operations in order to meet the needs of current and prospective users of Dublin Airport.

(c) the level of operational income of Dublin Airport Authority from Dublin Airport, and the level of income of Dublin Airport Authority from any arrangements entered into by it for the purposes of the restructuring under the State Airports Act, 2004,

(d) costs or liabilities for which Dublin Airport Authority is responsible,

(e) the level and quality of services offered at Dublin Airport by Dublin Airport Authority and the reasonable interests of the current and prospective users of these services,

(f) policy statements, published by or on behalf of the Government or a Minister of the Government and notified to the Commission by the Minister in relation to the economic and social development of the State,

(g) the cost competitiveness of airport services at Dublin Airport,

(h) imposing the minimum restrictions on Dublin Airport Authority consistent with the functions of the Commission, and

(i) such national and international obligations as are relevant to the functions of the Commission and Dublin Airport Authority."

Order of the Minister for Transport establishing the Appeal Panel

1.3 By Order of the Minister for Transport of 29th September, 2008 the Minister established an Appeal Panel to consider the Appeal of, inter alia, Dublin Airport Authority ("DAA") against the Determination of the Commission for Aviation Regulation ("The Commission") published on 30th July, 2007 *"Maximum levels of airport charges at Dublin Airport, Final Decision on interim review of 2005 Determination"*. This Determination is published as Commission Paper 6/2007 (CP6/2007).

1.4 The Appeal Panel members are Paul Gardiner S.C. (Chairman), Niall Greene and Alan Doherty.

2. POWERS OF THE APPEAL PANEL - SCOPE OF REVIEW

2.1 Section 40(4) of the 2001 Act provides that an Appeal Panel shall determine its own procedure.

2.2 As stated, the provisions of Section 40(5) require the Appeal Panel to consider the Determination and having so considered it, to either:

Confirm it or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, to refer the

decision in relation to the Determination back to the Commission for review.

2.3 The power of the Panel does not therefore extend to one where it may substitute its own view for the view of the Commission. It may only refer the decision in relation to the Determination back to the Commission for review if it considers that there are sufficient grounds for doing so by reference to the provisions of Section 33 (in this instance).

2.4 The Appeal Panel determined that:

(a) If the Appeal Panel was not satisfied that the Commission has considered the matters referred to at Section 33 it would refer the Determination back to the Commission for further consideration.

(b) If the Panel was satisfied that the Commission had considered the matters referred to at Section 33 but was satisfied that nevertheless there were sufficient grounds to refer that consideration back to the Commission it would refer the Determination back to the Commission for further consideration.

(c) In all other events, it would uphold the Determination.

2.5 The Panel also determined that it would have regard only to material which was before the Commission when it made the Determination and not to subsequently procured materials or subsequent events.

3. THE DETERMINATION AS CLARIFIED

3.1 Determination CP6/2007 was significantly clarified on foot of High Court proceedings brought by Ryanair against the Commission and which were the subject of two decisions by Mr. Justice Clarke, the first on 11th April, 2008 and the second on 20th May, 2008.

3.2 It is against this Determination as clarified that the DAA has appealed.

3.3 In his decision of 11th April, 2008, Clarke J. observed that there was a significant lack of clarity as to what was or was not regarded by the Commission as being properly considered to be part of the formal determination made by it under the provisions of Section 32 and recorded by it in CP6/2007. In those circumstances he referred the matter back to the Commission with the Direction that the Commission clarify what matters contained within its decision were regarded by it as forming part of the formal statutory Determination rather than other non-binding matters (such as whether the allowed capital expenditure into the RAB was a Determination or an indication).

3.4 Clarke J. then went on to consider whether the decision (whether it be a Determination or an indication) of the Commission was rational or not. He found that the role conferred by statute on the Commission was *"very much at the end of the spectrum where the body concerned has to exercise a general judgment based on the materials available to it, including those which may be provided by interested parties, but also bringing to bear on its conclusions its own expertise. It is, indeed, an expertise which the Courts do not share. It is clear that the overall approach of the legislation is to attempt to fix maximum prices by reference to a regime which is fair to all. It is necessary to provide reasonable security for the continuing operations of a vital element of national strategic infrastructure in the shape of an airport. However, it is also necessary that those using the airport are treated fairly and reasonably. A balance has to be struck. Precisely where that balance is to be struck and the manner in which an appropriate price regime is to be structured, are matters which require considerable expertise which the CAR has and the Courts do not."*

3.5 Mr. Justice Clarke referred the decision back to the Commission *"for the purposes of the CAR clarifying the extent to which the statements contained within the decision paper concerning the inclusion of capital expenditure in the RAB form, in its view, part of its Determination in the exercise of its statutory function on the one hand or simply indications of its current thinking on the other. I propose directing the CAR to come to a revised decision which makes those matters clear in exercise of what I have found to be an inherent power of the Court. I will arrange for the matter to be listed before me again when the CAR has issued such a revised decision."*

3.6 The Commission on foot of that direction clarified that in its view *"those elements of the review decision concerning the inclusion of capital expenditure into the RAB formed part of its Determination in the exercise of its statutory powers."*

3.7 The terms of that clarification are set out by Clarke J. in his Judgment of 20th May, 2008 and are as follows:

> *"As part of the exercise of its statutory function to review its earlier Determination and, if it saw fit, to amend that Determination, the Commission for Aviation Regulation (CAR) set out in its final decision on its interim review of the 2005 Determination ("the Review Decision") the reasoning which led the CAR to the conclusions it reached on such review. The CAR regards such reasoning and the individual decisions which it takes in the course of such reasoning as an integral part of its Determination in the exercise of its statutory functions. In particular, in the view of the CAR, statements and decisions contained in the Review Decision concerning the inclusion of capital expenditure in the Regulatory Asset Base (RAB) form part of its Determination in the exercise of its statutory functions. Decisions such as decisions on the inclusion of capital expenditure in the RAB have to be taken to enable the CAR to decide on the maximum level of airport charges or whether (on a review) a previous Determination should or should not be amended. Thus, such decisions are regarded by the CAR as necessarily part of the formal exercise of its statutory powers. The CAR's reference in the Review Decision to making no change to the existing Determination was intended to be and, looking at the document as a whole is, in the view of the CAR, clearly a reference to the fact that it decided to make no change to the maximum level of airport charges. So understood, there is in the view of the CAR no inconsistency between (a) the fact that some of the factual circumstances, reasoning and individual decision leading to the conclusion differ from the earlier Determination and (b) the fact that*

the conclusion is to leave the maximum level of airport charges unchanged."

3.8 Clarke J. in his decision of 20th May, 2008 stated that he was not bound by the clarification offered by the Commission, and found that:

"The statutory determination, properly construed, is to the effect that the Determination was in fact changed in the sense that there was an alteration in an important building block of the regulatory model even though other counterbalancing changes did lead to there being no alteration in the maximum price permitted. For those reasons I am satisfied that the proper construction to be placed on the statutory determination of the CAR is that it gave effect to a change in the original Determination by virtue of the alteration of the RAB."

4. PROCEDURE

4.1 The Appeals Panel adopted the following procedure:-

4 DAA was invited to set out its grounds of appeal and reasons therefor in writing.

5 The Commission was invited to respond.

6 DAA was invited to respond to the Commission's response.

7 An oral hearing of the Appeal was held where:

(a) DAA presented its appeal.
(b) The Commission responded.
(c) DAA responded to the Commission's response.

5. COMMISSION APPROACH TO THE APPEAL PROCESS

5.1 The Commission expressed itself to be concerned with the process proposed in light

of the fact that it would have to consider any matter referred back to it for review. It decided that it would therefore confine its response to drawing the attention of the Panel to materials, statements, analysis and decisions which informed its Determination and which were presented in the consultation on the interim review which ran from September, 2006 to July, 2007.

5.2 This approach informed the Commission's approach to the entire process and, as will be seen later in this Decision, meant that it was not possible for the Panel to uphold the Determination as it appeared to the Panel that the Commission did not vigorously seek to have its Determination upheld.

6. DAA GROUNDS OF APPEAL; COMMISSION RESPONSE AND DAA REPLY

6.1 DAA furnished its Grounds of Appeal on 29th October, 2009. The Commission responded on 6th November, 2009 and DAA replied on 14th November, 2008.

6.2 DAA sought the referral of the Determination back to the Commission on the grounds that the following aspects of the Commission's decision lacked transparency of reasoning and were inconsistent with the Commission's Statutory objectives (as set out in Section 33 of the Aviation Regulation Act).

1. The production of new approaches to the remuneration of capital expenditure based on a flawed assessment of T2 sizing.

2. The failure to include certain capital costs as allowed capital expenditure.

3. The inappropriate use of a unitised method of depreciation for certain project costs.

4. The adoption of an inappropriate approach to financial projections.

5. The increasing of regulatory risk for DAA.

6.3 DAA stated that it had serious concerns with the approach taken by the Commission towards effective regulation and remuneration of capital expenditure. It believed that the decision was debased by errors stemming from, in particular:-

- A severely flawed methodological approach as a result of reliance on poorly reasoned and time constrained external reports.

- The absence of appropriate procedural safeguards to ensure feedback from key stakeholders.

- The introduction of new policy measures without proper consultation and which signalled a more interventionist regulatory model leading to increased uncertainty, risk and ambiguity.

- Insufficient deference to government policy documents and a corresponding failure to recognise the constraints imposed on DAA by government policy.

- Overzealous concentration on the "wants" of a small number of current airlines with a failure to recognise that DAA must build airport facilities to meet the reasonable requirements of a range of users which might be expected to use the airport in the future and a corresponding failure to consider the needs of the wider economy, the travelling public or the need to build facilities that would attract prospective users not operating a low cost model.

- A failure to balance the needs of all the various stakeholders and interested parties in Dublin Airport to the detriment of DAA's interest as an independent company and its ability to develop a Dublin Airport in a sustainable and financially viable manner.

- The systematic increasing of risk for DAA brought about by ignoring all downsides while consistently accepting possible upsides, thereby distorting the incentives under which DAA operates, and

- An apparent motivation to keep charges low rather than appropriately focusing on statutory objectives.

6.4 DAA contended that the Determination did not reflect the Commission's obligation to keep regulatory restrictions at a minimum and did not reflect the objectives to facilitate the efficient and economic development and operation of Dublin Airport meeting the requirements of current and prospective users of Dublin Airport while also enabling Dublin Airport to operate and develop in a sustainable and financially viable manner.

6.5 DAA pointed out that Section 33(2)(h) required the Commission to only impose on DAA the minimum restrictions and that Section 33(2)(a) required the Commission to have due regard to DAA's modified functions.

6.6 It pointed out that following the issuance of the Aviation Action Plan DAA developed a Capital Investment Programme to address the serious capacity shortages in Dublin Airport. It asked Pascall & Watson to review and update its Master Plan and went on to assemble a team of expert advisers, including the consultancy firm Turner & Townsend, Arup, MACE and Davis Langdon PKS to advise on the development of T2 and the other elements of the Capital Programme. It consulted widely and its work culminated in the publication in October, 2006 of an updated Capital Investment Programme.

6.7 DAA contended that the 2006 Capital Investment Programme was the outcome of a well managed, extensive and comprehensive planning consultation process drawing on the expertise and experience of DAA as advised by a range of highly qualified and internationally experienced consultants responding to the demands of the airport and the requirements of airport users.

6.8 It pointed out that in September, 2006 the independent verifier appointed by the government (consultant firm Boyd Creed Sweet) confirmed that the methodology, approach and execution of planning objectives and considerations adopted by DAA were in accordance with best practice and it verified that the estimated costs for the

T2 project was within the industry norm for this type of project in a European capital city.

6.9 In order to finance the capital investment requirements and deliver the Aviation Action Plan, DAA calculated that it would require an uplift in the then existing average price cap of €1.16 (from €6.34 to €7.50) for the regulatory period 2006/2009.

6.10 It relied upon the fact that by Ministerial Direction of 3rd April, 2007 the Minister for Transport had issued a direction to the Commission under Section 10 of the Aviation Regulation Act which DAA contended provided explicit recognition that the government's Aviation Action Plan consciously put the DAA in a position of having to commit to a very significant level of capital expenditure within a short period of time.

6.11.1 DAA gave greater detail in respect of each ground of appeal as follows:

(The grounds of appeal are here set out in bold type.)

The Commission introduced new approaches to the remuneration of capital expenditure based on a flawed assessment of the sizing of T2

6.11.2 DAA asserted that:-

> *"In its Decision, the Commission introduced a new "two box" approach to the way in which capital costs relating to T2 will enter the RAB. The Commission has determined that €379 million of allowed T2 project costs should be subject to this approach whereby €278 million will only enter the RAB from the date T2 becomes operational while the remaining €101 million will be added to the RAB once passenger demand exceeds 33 million per annum."*

6.11.3 It went on to assert that:-

> *"The Commission has introduced a series of corresponding price*

triggers which make remuneration of capital expenditure conditional on meeting the Commission's set targets:

- *€141 million of capital expenditure relating to T2 associated projects will only be included in the RAB when T2 is "operationally ready";*

- *DAA will not receive financing costs for "box 1" after 2009 if T2 is not operationally ready; and*

- *DAA will not receive financing costs for "box 2" after 2018 if passenger demand at Dublin Airport does not reach 33 million passenger per annum."*

6.11.4 DAA submitted that:

- the "two box" approach and the use of price triggers represented a significant policy departure in the regulatory process and had been introduced in an inappropriate manner and without proper consultation with DAA;

- the "two box" approach was a conceptually flawed policy tool in relation to the remuneration of "lumpy" investment projects (such as significant terminal capacity) and was used by the Commission without any corresponding assessment of the directions of Government or economies of scale;

- the Commission engaged in unjustified second-guessing of DAA's expert's methodologies for terminal design and sizing, ignoring the findings of the Government appointed Independent Verifier;

- the Commission determined the costs to enter the RAB and triggers for remuneration on the basis of a flawed methodology developed by the Commission's own consultants who, it asserted, were unable to carry out the kind of thorough analysis conducted by DAA's experts (it asserted that the

Commission accepted that this was the position);

- the Commission had demonstrated an inappropriate interventionist stance towards regulation; and

- the Commission's approach was an example of its policy of adopting downward adjustments while not accepting adjustments that would operate in DAA's favour.

6.11.5 It submitted that the conclusion to be drawn from the said assertion was that:-

> *"All of the above signal unbalanced and inappropriate regulation by the Commission, significantly undermine the position of DAA as an independent company and threaten the ability of DAA to develop Dublin Airport in a sustainable and financially viable manner."*

6.12.1 In elaborating upon each of its propositions DAA asserted as follows:

6.12.2 **The Commission's approach represents a significant policy departure**

> *"The use of the "two box" approach and the stated intention to introduce price triggers is a new policy by the Commission that creates a more regulatory interventionist model going forward, with increasing uncertainty, risk and ambiguity in regard to the remuneration of the DAA's future capital investment. DAA believes that this measure is at odds with the Commission's obligation to keep regulatory restrictions at a minimum and, more importantly, does not contribute to the fulfilment of the Commission's statutory objectives to facilitate the efficient and economic development and operation of Dublin Airport which meets the requirements of current and prospective users while also enabling DAA to operate and develop Dublin Airport in a sustainable and financially viable manner.*

The Commission did not signal that it was considering any such changes to the standard methods for remunerating capital investments either in its consultation on the requirement for an interim review (CP6/2006) or in its subsequent decision to conduct an interim review (CP9/2006). Triggers and price profiling were referenced in CP1/2007. However this document was presented as an initial and high level probe with the approach being principally to pose a series of questions to interested parties on the matters raised. The paper emerged late in the process and just four weeks were allocated for responses. A discussion paper regarding triggers accompanied CP1/2007, however this was largely theoretical and CAR noted that the views expressed in those (accompanying) papers do not necessarily reflect those of the CAR". In its response to CP1/2007 DAA noted that any policy changes could have a significant impact both on the DAA and airlines and thus required much more detailed consideration if they were to be pursued further and there was not enough time remaining in which to do that. Furthermore in presentations made by the Commission to users during this period (11 September, 2006 and 24 October, 2006) the Commission illustrated the potential impact of including additional capex in the price cap ("Possible prices to 2009"), without reference to considering any alternative remuneration methodologies. As a result, the first time DAA, as regulated entity, learnt of many of these initiatives was in the draft decision which greatly limited the scope and time for real debate and discussion regarding their efficacy."

6.12.3 DAA further asserted that as the introduction of the alternative remuneration methodologies

"also has the effect of pushing out the remuneration of investment to later dates, DAA would question whether the Commission's primary motivation with their implementation was to keep charges unchanged

at their currently low levels rather than seek to facilitate the spirit of the Commission's statutory obligations."

6.12.4 DAA noted

> *"that the Commission itself has acknowledged that the two box approach represents a "significant departure from previous cost recovery mechanisms used in the past", that there remains "some uncertainty around how the two box approach will work in practice" and it is currently "minded to use the consultation on the 2010-14 price control to agree a final structure for the two box approach" (CP5/2007, p.108)."*

6.12.5 DAA contended that:-

> *"It is inappropriate for this kind of regulatory risk to be imposed on a regulated entity at the outset of a major investment programme, particularly one that had been independently verified by Governmental consultants."*

6.12.6 In addition to its complaint that there had been inadequate consultation, DAA argued that the Commission's approach was not properly reasoned in the following respects

Triggers

6.12.7 DAA believed that the Decision to only allow remuneration of capital costs contingent on T2 being operationally ready by 2010 was unjustified and inappropriate. It stated that there were numerous possible reasons for delay to T2 which would be wholly or largely outside the control of DAA. It asserted that the Commission was fully cognisant at the time it set out these trigger points that T2 had not yet had planning permission confirmed and the project was still the subject of An Bord Pleanála hearing and adjudication, and that therefore, even the commencement date for construction was subject to considerable uncertainty for reasons completely

beyond the control of DAA. This was quite apart from the overall level of programme risk associated with an infrastructural development of the size and complexity of T2 once it got underway.

6.12.8 Similarly, DAA believed that the Commission provided no basis to justify its decision to make its "box 2' contingent on passenger demand reaching 33 million per annum by 2018 particularly as the DAA traffic forecasts which were relied on by the Commission in making its decision projected that this level of demand will not be reached until 2019.

6.12.9 DAA stated that it:-

> *"is opposed to the introduction of price triggers because they result in a more interventionist regulatory system and would require the Commission to become more involved in the micro management of the business, adding to regulatory cost and the regulatory burden."*

6.12.10 It asserted that in its response to the Draft Decision CP5/2007 (at page 59) it had suggested:

> *"that if the Commission was committed to the use of price triggers, then rather than implementing negative triggers only, the Commission should also consider introducing positive triggers to allow for more advanced recovery of costs where DAA completes investment ahead of its time schedule. This would allow for a more incentive oriented and symmetrical approach to regulation whereby DAA would also benefit from doing things exceptionally well, rather than solely being penalised in the event that circumstances do not develop as envisaged by the Commission."*

6.12.11 DAA expressed itself as disappointed that the Commission did not respond to DAA's commentary regarding trigger prices in its final Decision

6.12.12 DAA asserted that there were methodological flaws in the analysis of T2 Sizing.

> *"The key reason underlying the implementation of the Box 1/Box 2 approach and associated triggers is the Commission's view (informed by the analysis undertaken for it by its consultants Rogerson Reddan/Vector Management Limited and Aviation Economics) that the size of T2 will initially be too large and in excess of the initial foreseen demand."*

6.12.13 DAA disagreed with the Commission's conclusions in regard to the sizing of T2. It asserted that there *"are serious misinterpretations and inappropriate assumptions contained in the RR&V/AE analysis used by the Commission to underpin its "two-box" approach to the remuneration of T2 capital expenditure."*

6.12.14 DAA asserted that the Commission had requested that the *"RR&V work on T2 broadly consider two issues: (i) the robustness of the DAA's estimated costings per square metre; and (ii) what is the appropriate capacity of the T2 terminal, given the likely demand going forward."* and concluded that

> *"Ultimately the approach adopted by RR&V/AE involved undermining the approach adopted by DAA for some specific aspects of its analysis, undertaking inappropriate and inaccurate historical benchmarking and making a number of significant changes to some key underlying assumptions to derive a purportedly more appropriate T2 size."*

6.12.15 In summary of more detailed analysis set out in Appendix 2 of its Submission, DAA was concerned about the following elements of the RR&V/AE analysis:

- *There appears to be a serious error in RR&V's calculations, underpinning the RR&V analysis. RR&V (or IMR) seems to have misread the traffic data supplied to them by DAA. In its original report (RR&V Report No. 4 - Review of DAA Terminal Sizing 16th*

May, 2007) reviewing DAA's terminal sizing, the number of departure ATMs per hour that corresponds to the passenger figure is incorrect in the majority of cases. This has led directly to RR&V undersizing its estimate of T2 by 14%.

- *Designing for congestion - Adding peak capacity to a congested system: The DAA believes there is a high degree of confusion about the position of the RR&V analysis relating to the effect of additional peaking. While it does estimate the effect of additional peaking, it spends a considerable amount of time arguing against additional peaking occurring. Given the constrained environment in Dublin Airport, it could never be reasonable to suggest that the current constrained profile is an appropriate basis for terminal design purposes. This simplistic "design by ratio" approach would result in current congestion being designed into the new facility.*

- *The DAA also rejected RR&V's attempts to benchmark a new (uncongested) Terminal in Dublin with some UK airports as the profile of operations is different in these airports or these airports are already congested. The DAA hired consultants that have been involved in some of the most significant airport developments worldwide, including being directly responsible for the analysis and the review underlying such projects. These consultants worked for a total of 12 months on the design of T2, in the course of which there were detailed interactions with the key users concerned regarding their operations and growth plans. This ensured that the design of T2 was based on both best in class knowledge about worldwide airport design and the unique requirements of Dublin Airport users. To have this work summarily dismissed because it isn't particularly comparable to other airports seems rather simplistic at best, deceptive at worst."*

6.12.16 DAA was critical of the work undertaken on behalf of the Commission by

IMR. It asserted that:-

> *"As part of the interim review process, the consultancy firm IMR provided its interpretation of historical traffic data to RR&V. This information was then applied by RR&V in their analysis concerning the proposed sizing of T2. DAA believes that IMR provided RR&V with an incorrect calculation of the 2006 95% Busy Hour Rate (BHR) a fundamental data item used in capacity analysis. This BHR was then applied by RR&V in its analysis and has led to what DAA views as incorrect conclusions in relation to the appropriate sizing for T2. The Commission has used these T2 sizing assumptions as the basis for the introduction of the two-box approach to the remuneration of T2 capital expenditure.*
>
> *The 95% Busy Hour Rate is the passenger throughput rate associated with a given hour such that 5% of passengers travel in busier hours. DAA does not have an issue in principle with a 'rolling hour measure' when evaluating the 95% BHR as advocated by IMR but in this instance the methodology used was flawed and led to a resulting value which does not correspond to the actual 95% BHR (over the relevant time period more than 5% of passengers travel in busier hours).*
>
> *In its calculation IMR treated 4 interdependent series as if they were independent of each other. This resulted in some passengers being counted more than once thus introducing a bias into the data and leading to an error in the result. IMR calculated a 95% BHR for prospective T2 airlines where it can be clearly seen that 7.6% of passengers travel in busier hours. This cannot be the correct value to use. Similar inaccuracies appeared when IMR calculated the 95% BHR for Aer Lingus.*
>
> *It should be noted that as part of its limited interaction with RR&V, DAA provided the consultants with its own assessment of the 2005*

95% BHR. It was therefore surprising given the scale difference between the two evaluations of this measure, that no effort was made by the Commission's consultants to verify their results.

6.12.17 DAA further asserted that due to a lack of consultation with DAA, IMR also made some other incorrect assumptions and failed to look at other relevant information, including ignoring the schedule time of departure, and set out these concerns in an appendix to its submissions.

6.12.18 DAA was also critical of the duration of the RRV/AE analysis. It stated:-

"The RR&V analysis, we understand, took approximately 5 weeks, from early April, until 17th May. This compares with a DAA project that involved a large team both from DAA and its consultants working for a total of 12 months (including the three month review by Pascall and Watson of the Masterplan in 2005), in the course of which there were detailed interactions with the key users concerned regarding their growth plans."

and provided a table illustrating what it said was the extent of the documentation provided by DAA to underpin its programme when compared to those of the Commission's consultants.

6.13.1 DAA asserted by reference to a letter dated 17th May, 2007 from Commissioner Guiomard to DAA that:-

"The Commission has acknowledged in written correspondence to DAA that

> *"I do not consider that the (RR&V) work can, or ought be compared to that work carried out by the DAA and their advisers in preparing the CIP 2006. The tasks cannot be compared in size scope detail or purpose."*

Thus the scope of the project undertaken by the consultants was never expected by the Commission to be equivalent to the DAA programme."

6.13.2 It complained that Despite frequent requests to do so, DAA had the opportunity to meet only once with the consultants working on the T2 sizing analysis for the Commission. It referenced correspondence supporting this complaint and asserted that *"Had adequate interaction taken place, the company is confident that some of the areas of disagreement could have been eliminated."*

6.13.3 It complained that:

> *"RR&V/AE appeared in several cases to ignore or discount information on user plans provided by DAA/Arup. This approach is hard to reconcile with the Commission's constant emphasis on the need for DAA to ensure that it meets the expressed needs of its airline customers.*
>
> *In the short period of time they took to undertake their analysis, these consultants appeared to take a somewhat simplistic overview of the whole project, despite having access to the most detailed information available from DAA. The Commission has seen fit to attach greater weight to this analysis than to the comprehensive DAA/Arup programme, although it has acknowledged the former is not comparable with the work carried out by DAA and its consultants.*
>
> *Though a more limited timeframe might be expected for a verification of DAA's work on cost sizing and other considerations, it would not allow for alternative proposals to be properly developed by RR&V or the Commission on such issues."*

6.13.4 DAA submitted that *"the brief desk-based analysis developed by RR&V/AE without extensive interaction with the DAA should not be the basis for a highly significant*

regulatory decision such as the proposed sizing of the new second terminal at Dublin Airport. The Commission was clearly in breach of its statutory objectives in ignoring the detailed work undertaken by DAA."

6.13.5 DAA asserted that the Decision taken by the Commission to accept the analysis of its consultants RR&V/AE was not in accordance with its statutory objectives *"of facilitating the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport in relation to Dublin Airport while also enabling Dublin Airport to operate and develop Dublin Airport in a sustainable and financially viable manner."*

6.14.1 DAA also rejected the concept of the two box approach on the basis that this approach did not take account of the potential cost efficiency arguments for providing more capacity than is initially required in order to maximise economies of scale.

6.14.2 It argued that all airport terminals fill gradually otherwise airports would be building new terminals every year which would be inefficient. It asserted that DAA was being punished for unavoidable lumpiness of investment, not over investment. It argued that:

> *"There is no evidence provided of consideration by the Commission of the potential cost efficiency arguments for providing more capacity than is initially required, even though the Commission acknowledged in CP9/2006 (page 10) that a larger investment plan may be more efficient, and DAA's response to CP1/2007 set out the arguments against (and precedents from other airports in relation to) "modular" provision of capacity."*

6.14.3 DAA asserted that

> *"The problem of excess initial capacity in new investments is almost universal, from motorways to power stations and airports. We are not aware of any other regulatory body having adopted a two box solution*

and we believe that the Commission should not have launched such an unusual measure without proper consideration of the principles and application.

The Commission also does not appear to comply with the intention of the Ministerial Direction by failing to allow the DAA to recover the full costs of T2 from the outset and by requiring it to carry some of the risk that the terminal will be too large. This is inconsistent with the clear direction of the Minister that the DAA not only operate on a commercial basis but also deliver the second terminal to serve passenger growth needs and a growing economy."

6.14.4 DAA complained that

"In its Decision, the Commission appears to adopt an entirely different approach towards the Independent Verifier from that directed by the Minister. The Commission considers that the direction means that it must ensure that the Determination enables the DAA "to add additional capacity, and in particular a second terminal, in an efficient and timely manner and without recourse to Exchequer funding". Such a narrow interpretation fails to recognise the full text of the Minister's direction. In giving his direction, the Minister clearly had in mind not just any additional capacity or terminal but the specific proposal as verified by the Independent Verifier."

6.15 DAA submitted that the Panel should conclude that the Commission had disregarded its statutory objectives in particular insofar as:

- it proceeded on the basis of manifestly erroneous information regarding terminal sizing as produced by its consultants;

- it proceeded on the basis of a logically inconsistent premise - i.e., that T2 could (or should) be built in a modular format such that additional capacity

would only be added if passenger numbers reach a certain threshold; and

- it imposed a risk on DAA that certain costs of providing the additional capacity would not be properly remunerated even though those costs had been independently verified.

6.16 DAA submitted that as a consequence, the Commission should be directed to review the Decision in light of a correct factual basis as regards the design and sizing of T2 and should conduct its assessment of the remuneration for additional capacity on principles which safeguard the ability of DAA to develop Dublin Airport in a sustainable and financially viable manner. The Commission should be directed to ensure that balanced regulatory incentives exist for DAA in accordance with DAA's functions under the State Airports Act.

6.17 DAA complained of:

> *"the persistent tendency of the Commission to accept downwards adjustments to the DAA position, while not accepting adjustments that would operate in DAA's favour."*

6.18.1 In its response the Commission asserted that:-

> *The Commission's final decision on the Interim Review included both "output triggers" (T2 ready for operations) and "demand triggers" (demand exceeding 33 million passengers per annum (mppa)). It is a matter of fact that Commission has not employed triggers in its previous Determination on the DAA price cap. However, as regards the use of triggers as a policy, the Commission has previously used such an approach in determining the price cap for Air Traffic Control (ATC) services provided by the IAA at the three main Irish airports (see "Final Determination of ATSCs", Page 34 CP4/2007 March, 2007, attached as Exhibit 1). Specifically, the Commission employed output triggers (in this context they were labelled "milestones") for*

the remuneration of the capital costs relating to proposed building of new ATC towers at Dublin and Cork. The Commission points out that the use of triggers is also accepted policy in many other regulated settings. For example, in the regulation of UK airports, the Civil Aviation Authority (CAA) has used similar trigger policies in relation to remunerating capex investment in Heathrow Terminal 5 and Heathrow East Terminal.

6.18.2 It further asserted that it was incorrect to claim that the introduction of trigger policies was done in an inappropriate manner and without proper consultation. On the contrary, it asserted that there were several rounds of consultation prior to the final Determination. It relied upon the following documents and process to assert that *"The documents and process described below show that, in fact, precisely the opposite is the case."*

- ***February 2007**, CP1/2007 – Consultation on Dublin Airport Charges following the Capital Investment Programme 2006. See Section 3.2.1, Page 9 (attached as Exhibit 2).*

- ***February 2007** – Presentation by the Commissioner on the publication of CP1/2007, outlining consideration of risks around demand forecasting (attached as Exhibit 3).*

- ***February 2007** – Review of DAA's CIP 2006 (IMR) pages 9-26, published with CP1/2007, informing the Commission's thinking on T2 sizing and demand forecasts (attached as Exhibit 4).*

- ***February 2007** – Developing Capex Incentives for DAA: Triggers (CEPA) published with CP1/2007 (attached as Exhibit 5).*

- ***February 2007** – Cost benefit analysis of Terminal 2 and runway 2 (CEPA), published with CP1/2007 (attached as Exhibit 6).*

- ***February 2007*** *– Presentation by IMR: High level analysis of DAA investment plans, slides 4-8 informing the Commission's thinking on T2 sizing (Exhibit 7).*

- ***May 2007****, CP5/2007 – Draft Decision of Interim Review – Section 6, pages 69-72, 95-111 (Exhibit 8).*

- ***May 2007*** *– RR&V Report 4 – Review of DAA terminal sizing (published as Annex 10 to CP5/2007), pages 9-21 & 25-30, informing the Commission's thinking on T2 sizing and demand forecasts (Exhibit 9).*

- ***May 2007*** *– Presentation by the Commissioner on the publication of CP5/2007 (Draft Decision) outlining in greater detail Commission's proposals on the use of triggers (and unitisation) (Exhibit 10).*

- ***July 2007****, CP6/2007 – Final decision on Interim Review of 2005 Determination – Section 3.3, pages 15-17 ("Pricing Policy") and Section 3.4, pages 37-39 ("Assessment of Proposed Investment Costs") (Exhibit 11).*

- ***July 2007*** *– IMR response to methodological issues raised by DAA, published with CP6/2007 (Exhibit 12).*

- ***July 2007*** *– RRV response to DAA comments on RR&V Report 4, published with CP6/2007 (Exhibit 13).*

6.18.3 With respect to the DAA contention that the two box approach is a flawed policy in relation to lumpy investment projects and was introduced without regard to government policy or economies of scale, the Commission stated:

> *The DAA appears to make two points – that the two box approach was inappropriate for lumpy investments as it does not account for economies of scale – and that it does not have regard to Government policy.*

Regarding economies of scale, it is the Commission's view that it is incumbent on the DAA to justify that it would be more efficient to develop a facility with significant over-capacity with associated costs to users than to develop capacity in stages. During the Interim Review the DAA failed to provide the Commission with evidence to support its assertion that it would achieve economies of scale by developing significant excess capacity or that these economies would outweigh any associated cost that users would have to bear. The Commission's views on this issue are set out in Section 3.4 of CP6/2007, in particular the second paragraph of page 38. The Commission notes that the DAA has not provided the Appeal Panel with evidence in this regard either.

The Panel is also referred to the High Court's Judgment on the Ryanair Judicial Review of the Commission's Interim Review where Mr. Justice Clarke explicitly states that, in relation to both the two-box approach and the Commission's assessment of the overall costs, that "there were more than ample materials before the CAR which would have allowed the CAR to take the view that the [two box] regime sought to be put in place met the statutory requirement of being balanced to all concerned ... I am also satisfied that its judgment as to the phasing ["Phasing" is Mr. Justice Clarke's description of the two-box approach] was well within the range of decisions which were open to it" (see paragraph 9.6 and further comments in paragraph 9.7 of the Clarke Judgment, attached as Exhibit 14).

Regarding Government policy, the Commission refers the Panel to the Ministerial Direction of 2007 (3 July, 2007, Exhibit 15) and the 2005 Aviation Action Plan (Exhibit 16) which regarded regulation by the Commission as part of the "triple-safeguard" to ensure maximum efficiency and cost effectiveness of Terminal Two.

The Commission's views on how it complied with Government policy are set out in Section 4 of CP6/2007 (July 2007, Exhibit 11), in particular Sections 4.2 and 4.3. Additionally the Commission wishes to draw the attention of the Panel to an attached extract from Mr. Justice O'Sullivan's Judgment in 2003 in Judicial Review 707/2001 (attached as Exhibit 17). The extract relates to the Commissioner's duties regarding a Ministerial Direction.

6.18.4.1 With regard to the DAA contention that the Commission engaged in unjustified second guessing of DAA's experts and ignored findings of Government's independent verifier, the Commission stated:

The Commission considered the work of the Government's independent verifier Boyd Creed Sweet (BCS) in CP5/2007 (May 2007, see Section 7.2, pages 90-91). The Commission noted that BCS did not assess the issue of T2 sizing which was the central issue that led to the introduction of a two-box approach to T2 remuneration. Thus, there was no second-guessing or ignoring of the BCS work, as the BCS review did not address the issue of size at all.

The DAA's justification of its sizing of T2 is based on its demand forecasts and set out in a document entitled "T2 Gateway 2". For a discussion on forecasts see Section 8 of this Report and in particular Section 8.7. A redacted non-confidential version of this Report was published on the Commission's website ... This document did not satisfy the Commission that T2 was based on robust demand forecasts. The submission of Ryanair in response to CP1/2007 (February 2007) also raised serious concerns as to the size of T2 (attached as Exhibit 19).

In summary, the Commission sought independent consultancy advice on T2 sizing on the basis that the independent verifier did not examine T2 sizing. The Commission had genuine doubts regarding the size of

T2 and the quality of evidence in support of the size. Additionally users had concerns relating to the size of T2 and the level of evidence provided to support the size. Both the DAA and its consultants had the opportunity to provide either the Commission or its consultants with greater information in support of its forecasts but did not do so. The Commission's view is that the burden should lie with the DAA to provide robust demand forecasts.

The Commission also wishes to point out that the demand trigger that underlies the two-box approach is not a direction to DAA to build a terminal of a particular size or in stages. Rather it is an approach which, following consultation with all interested parties, the Commission believes provides a more balanced sharing of the risks that demand outturns may or may not be in-line with the DAA forecasts supporting the overall T2-build. There is always a risk that demand projections might turn out to be significantly above or below historical forecasts. The Commission's view is that it is appropriate for at least some of this risk to be shared between airport users (both current and future) and the DAA – an outcome that more closely reflects constraints that might operate in a more competitive market. The fact that the DAA proceeded with the investment programme as set out in CIP2006 leads the Commission to conclude that, as a commercial company, it was confident that it could operate within the constraints (whatever they might be) of the Interim Review decision.

As an aside, it is worth noting that the issue of T2 sizing was considered at length by An Bord Pleanála at the T2 planning inquiry. The Panel may wish to review evidence presented to An Bord Pleanála including oral evidence on the size of T2.

6.18.5 With respect to the DAA assertion that the Commission had determined the costs to enter the RAB and triggers for remuneration based on a flawed methodology developed by its consultants who were unable to carry out a thorough analysis unlike

DAA's consultants, the Commission submitted:

> *There is some overlap between this point and others raised by the DAA. Regarding the use of triggers and allowed capex proposed to enter the RAB, ... (these are addressed elsewhere)*
>
> *Regarding the work of the Commission's consultants, RR&V and IMR, the Commission denies the accusation that the methodologies employed are flawed. The Panel is referred to the responses of said consultants to the same DAA accusation, provided as Annexes to the Final Decision on the Interim Review (July 2007, "Annex 1 & 2: RRV responds to issues raised during the consultation", Exhibit 13, and "Annex 3: IMR response to Methodological issues raised by DAA", Exhibit 12).*

6.18.6 With respect to the DAA assertion that the Commission had demonstrated an inappropriately interventionist approach to regulation, the Commission submitted:

> *The Commission is of the view that its approach to regulation as set out in CP5/2007 and CP6/2007 is consistent with the views expressed in the High Court (Mr. Justice O'Sullivan) Judgment referred to earlier in the role of the Commissioner in reviewing capex plans.*

6.18.7 The Commission characterised the DAA appeal as:

> *"seeking a referral of the introduction of the use of trigger pricing and a two-box approach to T2 remuneration"*

6.18.8 As a general observation the Commission asserted that

> *"the issues raised by the DAA in the current Appeal are not necessarily consistent with certain of the materials and statements made in the context of the DAA acting as a Notice Party to Judicial*

Review taken by Ryanair last year (1246/2007). In particular, it will be seen that the DAA's position – depending on the issue – then appeared either to overtly support the Commission's stance in its 2007 Determination or did not raise any issue or objection to the manner in which policy issues were handled by the Commission."

and the Commission referenced an Affidavit of Vincent Harrison, in this respect, where he had stated:-

Para. 18

"... The consistent practice of regulators worldwide is to review investment plans before they are finalized to determine if they will be allowed into the RAB. That allows the operator to build the facility after the decision on the RAB has been taken which also allows it to fund that expenditure, since otherwise the financial markets will be loath to advance financing for a project that might not be remunerated. This is consistent with the valuation of the RAB being the opening RAB (at the start of the determination period) plus any allowed capital expenditure during the determination period. Since all or the vast majority of CIP2006 was at the time of the decision forecast to be incurred during the current determination period, CAR was obliged to assess how much of it should be allowed into the RAB."

Para. 25

"In addition, the Commission expressly stated in the Final Decision that all of the constituent parts of its 2009 decision on airport charges will be reviewed at the time of the next Determination."

Para. 32 – 33

"As regards the contention at paragraph 39 of Mr. Callaghan's Affidavit that there is no statutory right conferred upon the Commission to give any consideration and/or issue any indication or clarification in relation to a determination that has not crystallized or

to give a statement of intent in relation to the next determination, it is clear that such a position ignores the Commission's statutory objectives in reaching a Determination. The Commission are expressly obliged to have regard to DAA's ability to operate and develop Dublin Airport in a sustainable and financially viable manner. Moreover, such a contention would mean that the Commission is only competent to deal with those projects that start and finish within the same determination period. This is patently absurd and would be unworkable in practice.

The Decision to allow the capital expenditure relating to T2 to enter the RAB when it becomes operational is not fundamentally different to a decision to allow a project with capital spend spread across two determination periods. In fact the 2005 Determination allowed in the RAB a number of projects that were expected to commence towards the end of the regulatory period and continue with significant spends into the next period ...".

Para. 52-53

"The Commission have taken the view that DAA has overestimated the busy hour given an annual throughput of 11.4mppa. As a result the Commission has, in a novel approach, decided that some of the costs associated with T2 should only be included in the RAB once annual passenger numbers reach a set target (33mppa). In the Commission's view airport users are thereby protected from the risk of DAA investing in an excessively large second terminal.

While DAA is disappointed that the Commission did not accept all of its submissions or data and therefore delayed the recovery of all costs associated with T2 until it is demonstrated that the scale of terminal proposed by DAA meets the needs of users, DAA is nonetheless confident that, looking forward to the 2009 Determination, it can be demonstrated to the Commission's satisfaction."

6.18.9 The Commission asserted that the foregoing should lead to the conclusion that:

> *"while the DAA would have preferred the Commission to have concluded otherwise on certain core issues, nonetheless it acknowledged the Commission's right to address issues in the manner it chose, to deal with matters arising under future determinations, (in effect, the two box approach) and it described at the time the Commission's policy as no more than a "novel approach" – a matter already accepted by the Commission – when this has now been characterized as a "significant policy departure". Finally, it is clear that the DAA were content to await the commencement of the 2010 Determination process to engage further on the relevant issues."*

6.19 In its response to the DAA submission that the Commission persistently made downward adjustments, the Commission states:-

> *"While the DAA does not provide any evidence to support this assertion [of downward adjustment] the Commission can draw the Panel's attention to the following:*
>
> - *Upward adjustments which the Commission made in its final decision compared with its draft decision. See CP6/2007 page 33-40 and in particular Table 3, page 34. Additionally the Commission removed Pier E and other projects from the two-box approach in its final decision.*
>
> - *The Commission's approach to regulation as set out in CP6/2007, Section 3.5 pages 40-45.*
>
> - *In addition, the Commission would like to point out that during the mid-term review of the first (2001) Determination, the Commission allowed for upwards adjustments to the price-cap*

to reflect changes in demand projections and security costs in the wake of the September 11th events.

Thus, the Commission believes that there is no factual basis for an assertion of any policy of downward adjustment in its approach to setting the DAA price cap."

6.20 In its written response to the Commission's response, DAA asserted that its position was consistent with the position it had adopted in the Judicial Review, and stated that it had been advised that it could not appeal the decision which is why it had not attempted to do so.

6.21 It asserted that insofar as the Commission's response could be read as suggesting that its decision was immune from review, that was obviously wrong and that the applicable standard against which the Commission's decisions should be tested in Judicial Review proceedings was entirely different to the standard to be applied by the Appeal Panel.

6.22 It rejected the assertion of the Commission that the fact that DAA had proceeded with its investment meant that the Determination was necessarily correct and had not prevented DAA from carrying out the investment. It asserted that such argument ignored the statutory obligation on the DAA and the government mandate.

6.23 DAA suggested that the Commission's reference in its submissions to the attendance of Commissioner Guiomard at the Board meeting of DAA in June, 2007 was ambiguous and it clarified the terms of that attendance.

6.24 In respect of the introduction of triggers and the two box approach, DAA asserted that the Commission's response did not in any way explain the way in which the Commission had fulfilled its statutory duties in relation to the introduction of triggers and the two box approach; or the inappropriate use of external consultants and its assessment of the evidence put forward by DAA in relation to terminal sizing.

6.25 It rejected the Commission's assertion that the use of triggers in respect of air traffic control towers at Dublin and Cork could support the Commission's assertion that the introduction of triggers was not a policy departure. Further, it pointed out that the triggers used in those instances had been significantly detailed. This was in comparison to the decision which merely stated *"the guiding principle in defining such a trigger will be that it allows the DAA to start collecting revenues once T2 achieves operational readiness."* And a statement that the final structure for the two box approach will be determined in the next consultation process.

6.26 DAA provided a table of the discussion papers which the Commission had referenced as discussing triggers and rejected the suggestion that there had been adequate consultation in respect of same. Such documents as did discuss triggers did not allow adequate time for consideration of same by DAA (and others).

6.27 With respect to the sizing of T2, DAA complained that the decision was inconsistent with the obligation upon the Commission to ensure that its Determinations are objectively justified, non-discriminatory, proportionate and transparent as required by Section 5(4) of the Aviation Regulation Act, 2001. It asserted:

> *"In the decision the Commission fails to assess its assumption on sizing against the assertions put forward by DAA on the need to ensure sufficient headroom when building a facility such as a new terminal."*

6.28 It referenced its responses to CP1/2007 and CP5/2007 where it had argued that it was more expensive to engage in modular provision of capacity.

6.29 DAA rejected the Commission's attempt to defend itself against the claim that it had engaged in unjustified second guessing of the government appointed independent verifier. It pointed out that Boyd Creed & Sweet in its final Report concluded *"The approach to sizing of the Terminal and key systems follows very closely the guidance contained in the IATA Airport Development Reference Manual. The approach is supported by the interrogation of key operational elements of the terminal against agreed criteria and benchmarks. Moreover the project team has developed and*

refined the methodology to understand the likely impact of passenger growth and the relationship between demand and the need for future capital investment." DAA asserted that Section 6.2 of the BCS Report was devoted to the approach to sizing by DAA and its expert consultants. According to BCS *"through development of the brief and design, the size of the facility has been optimised by refinement of planning data and development of user and stakeholder requirements."*

6.30 It asserted that the Commission response had not addressed the detailed evidence submitted by DAA which underpinned the contention that the Commission's assessment of the size of T2 was based on flawed assumptions. It asserted that the reliance of the Commission on the submission of Ryanair with respect to sizing highlighted the inability of the Commission to point to adequate reasoning for its conclusions on terminal sizing. It referenced Aer Lingus' rejection of the Commission's draft decision with respect to sizing.

6.31 DAA instanced examples of what it said was the Commission's policy of downward adjustment in its approach to setting DAA's price cap. Among the matters instanced were the adoption of the unitisation principle based, so DAA said, on *"questionable logic"* and the penalisation of DAA for higher than forecast traffic *"in the first years of the current price cap period by being required to use the extra revenue from the extra volume to fund extra capex rather than obtaining a price increase at the interim review."*

6.32 DAA rejected the assertion that its appeal was inconsistent with statements made by it in the Ryanair Judicial Review. In particular, DAA did not support the use of a two box approach.

Reductions in Allowed Capital Expenditure

6.33 DAA asserted that the Commission should not have reduced the capital expenditure programme in respect of

- T2 Project Contingency allowance - €25 million;

- T2 customs and border protection project - €9 million; and

- Airfield projects - €4 million.

6.34 It asserted that this approach provided another example of the Commission's willingness to accept the findings of its consultants, even where these were based on brief, high level analyses.

6.35 DAA asserted that

- the Commission disallowed contingency costs on the basis of unreliable evidence produced by its own consultants (who themselves acknowledged that they were under-qualified to undertake risk assessment);

- the Commission ignored the robust risk assessment analysis undertaken by DAA's consultants without providing reasons; and

- the Commission made unreasoned deductions from project costs without conducting a full consideration of all cost elements or the appropriate basis on which costs are calculated.

T2 Project Contingency allowance

6.36.1 DAA asserted that in its Decision, the Commission reduced the allowed project contingency costs for T2 by €25 million on the basis that if DAA's full projected contingency costs were allowed this would result in contingency costs in excess of 20% of construction costs, an amount considered too high.

6.36.2 It asserted that the Commission's opinion in this regard was informed by work commissioned from the firm of consultants RR&V. RR&V concluded that the T2 contingency cost provision projected by the DAA *"appears to be relatively high"*. RR&V suggested that a typical level of cost contingency would be a 15% margin in the early design stage falling to 10% for the construction phase. DAA contended that this view was not substantiated with reference to airport or other relevant examples of

an appropriate scale, and

> *It should be noted that in their original report (RR&V Review of T2 Non-Construction Costs, p.12) RR&V prefaced their findings with the assertion that they were not competent to critique risk analysis and that the Commission should seek an appropriate independent expert to carry out a risk review:*
>
> > *"RR&V are not risk analysis experts and to fully and scientifically review this procedure and calculation, it may be useful to undertake an independent risk review by an independent expert".*
>
> *In its follow-up report commenting on issues raised during the public consultation process, RR&V reiterated that an independent review of DAA's risk analysis methodology would be appropriate. This independent review did not take place.*

6.36.3 DAA asserted that as a consequence *"RR&V did not provide the Commission with an appropriate basis on which to reject the detailed analysis provided by Dublin Airport Authority and its experts that fully supported the level of contingency allocated to the T2 project."*

6.36.4 DAA stated that it had outlined this position to the Commission in response to its draft decision CP5/2007.

> *"As previously outlined to the Commission in response to its draft decision CP5/2007 DAA upholds the view that its consultants employed a best in class scientific approach to enable them to establish a meaningful, quantitative risk based contingency to underpin the cost estimates for the T2 project. This project budget was then presented to the DAA Board and submitted for external*

scrutiny by the Government appointed Independent Verification team. In this context, DAA's consultants conducted a range of risk workshops, attended by a multidisciplinary team of project management, design, operations and construction experts and chaired by an expert in the use of statistical methods for quantification of project related risks. The project contingency was computed based on the 80th percentile derived from the application of a Monte-Carlo simulation model. The assessment was independently reviewed and assessed by DAA's Programme Management Team — Turner and Townsend. DAA supplied full facts about the process undergone in addition to the project's detailed risk register to RRV. DAA received no queries in respect of the material presented."

6.36.5 DAA pointed out that

"it requires its consultants to continuously review and update the risk register, as part of their standard project management procedures, and the profile is expected to change relative to time. The review undertaken prior to the Commission's decision and advised to it in DAA's response to the Draft Decision confirmed that the risk based contingency allowance as provided for in the cost plan still constituted the best estimate of a prudent and appropriate provision for project contingency."

and stated:

Furthermore, following the completion of the cost plan, DAA carried out its assessment of the procurement strategy and decided to procure the works on a multi-package basis with upwards of 20 packages of work involving multiple interfaces to be delivered in an aggressive timescale within an extremely challenging operational environment. The complex nature of the procurement was further evidence of the necessity of allowing for an appropriate contingency.

6.36.6 DAA asserted that:-

> *The notion of discounting / disallowing an element of the T2 cost plan, which is the product of a proposition that:*
>
> - *has been developed to planning stage following 8 months of detailed assessment and value engineering;*
> - *comprises a range of inter-related major projects which have been the subject of detailed constructability studies which reflect the unique nature of the site, the critical path requirements, project interdependencies and operational impact assessment; and*
> - *has been subjected to a comprehensive quantitative risk assessment which reflects the unique and specific attributes of the development environment at Dublin Airport.*
>
> *is unreasonable and inappropriate, and totally ignores the challenges and complexities of the programme in question.*

6.36.7 DAA also asserted that its contingency provision for T2 was in line with international precedent, citing the regulatory review of the BAA London airports by the UK Competition Commission (a 25% contingency) and the UK Office of Rail Regulation 2008 review (a contingency allowance of 20%).

6.36.8 DAA concluded by contending:-

> *"Given that the DAA's project contingency provision is based on and supported by experts in Risk Analysis, it was therefore unreasonable for the Commission to have disallowed €25 million of the costs of T2*

on the basis of the conclusions of consultants, which, by their own admission, are not experts in this area."

T2 Customs and Border Protection €9 million

6.36.9 DAA noted that in its Decision, the Commission retained the view, cited in its draft decision, that the DAA projected costs for its Customs and Border Protection (CBP) project as set out in the October 2006 CIP (of €30m) were €9 million too high.

6.36.10 It noted that this view was based on the findings of the Commission's consultants RR&V (to be found in Annex 9 of CP5/2007):

"... it is our view, based on the information provided that the costs for this facility would be in the region of €20.8m to €23.6m"

6.36.11 DAA stated that:-

"The Commission claimed that a reduction of €9 million in the project allowance would bring the projected cost for the CBP project more in-line with the DAA's own cost benchmarks as presented in the DAA T2 cost plan."

6.36.12 It asserted that

"this T2 benchmark figure as referred to by the Commission was exclusive of the fees, planning contributions and project contingency associated with this project. When allowance for these is made, the cost for the CBP facility is in line with the higher range of the RR&V estimate (approx. €24 million)".

and went on to say:

"Further allowances must then be made for the necessary works to connect to the T2 baggage system, for the construction of sterile

corridors connecting to Pier E and alterations to the existing Pier C building to provide vertical escape routes. All of these elements taken together underpin the total project budget of €30 million as included in the October 2006 DAA/ClP04."

6.36.13 DAA asserted that in light of the foregoing there was no basis or justification for the Commission's Decision to deduct €9m from this project allowance.

Airfield projects €4 million

6.36.14 DAA noted that in its Decision, the Commission chose to deduct €4 million from the capital expenditure allowance for DAA airfield projects and that this was a revision of its earlier proposal contained in the draft decision CP5/2007 where the Commission included a reduction of €17 million to the allowance for airfield projects.

6.36.15 It stated that the apparent basis for this original reduction was the Commission's consultants RR&V's conclusion that there appeared to be significantly greater value to be obtained at the tender stage for certain airfield projects, and in particular the fact that the P2 bypass had been tendered and the tender costs returned were below the benchmark average for other projects.

6.36.16 DAA concluded that the assumption was therefore made that this trend would continue for all other airfield projects in the 2006 Capital Investment Programme and that this was a complete over simplification.

"given that there is potentially a wide variance of costs for taxiways and aprons there is no methodological basis for extrapolating the cost per square metre for an individual project such as the P2 bypass project across the remaining airfield projects."

6.36.17 DAA noted that

"In its Decision, the Commission referred to tender receipts for six additional projects provided by DAA and concluded that it was better

to base its Decision on this additional evidence rather than relying solely on the overall estimated cost savings derived from one particular airfield project."

6.36.18 It asserted:-

"However, it offered no clarity as to the basis upon which it was continuing to reduce its allowable capital expenditure for airfield projects by €4million in its final Decision."

6.36.19 As a consequence of the foregoing DAA submitted:-

"that the Commission acted inconsistently with its statutory objectives in disallowing expenditure for the relevant projects."

"that the Panel should conclude that the Commission's failure to allow the expenditure for the projects was based on erroneous assumptions and information."

"[That] The Decision is therefore inconsistent with the Commission's statutory objectives in particular that of facilitating the efficient and economic development and operation of Dublin Airport to meet the requirements of current and prospective users while also enabling DAA to operate and develop Dublin Airport in a sustainable and financially viable manner."

6.36.20 DAA invited the Appeals Panel to direct that:

"In reviewing the Decision the Commission ... make appropriate use of the expert reports prepared by DAA's consultants and other information submitted by DAA so as to ensure a correct factual basis for all its findings. In particular the Commission should be directed to reverse its decision to exclude €38m relating to these projects and to

include them in the RAB for the future."

6.37.1 In its response to these various grounds the Commission stated:-

For the convenience of the Panel the Commission has listed the relevant documents and extracts that set out the Commission's thinking that led to the exclusion of these costs. These documents are as follows:

- *CP5/2007 (May 2007, Exhibit 10) Section 7, pages 87-95, 115.*
- *RR&V Report 3 (attached as Exhibit 21) – Review of DAA CIP which deals with the customs and border protection and airfield projects.*
- *RR&V Report 2 (attached as Exhibit 22) – Review of T2 non-construction costs pages 11 & 12, which deal with T2 contingency costs.*
- *CP6/2007 (Exhibit 11) Section 3.4, pages 24-40 in particular pages 35 and 36.*
- *RR&V response to DAA comments on RR&V Reports which discuss all three projects (Exhibit 13).*

6.37.2 The Commission stated:-

"One must recall that, unlike the DAA and its consultants, the Commission (and its consultants) were able to consider completed project plans, which might be expected to account for the difference in the relative time taken to carry out the various reviews.

The Commission is entitled to make decisions on what capital

expenditure to take into account when setting airport charges. In this context, the Commission again refers the Panel to the views of the Court in the 2003 High Court (Mr. Justice O'Sullivan) Judgment in relation to the Commission's role and powers in examining capex proposals (Exhibit 20)."

6.38 In its response to the Commission response, DAA asserted that the Commission's response made clear that its decision to exclude these costs was based on erroneous assumptions and information deriving from misplaced reliance on work carried out by the Commission's consultants. It asserted that *"the Commission's response to DAA's submission does not contain any further information that would allow the appeal Panel to conclude that the Commission acted in accordance with its statutory objectives in relation to these costs."*

6.39 It rejected the assertion that the Commission's consultants had looked only at completed projects and asserted that the evidence showed that they had re-run work which had been carried out by the experts appointed by DAA. It pointed out that the time frame for work allocated to RR&V was far too short to enable a proper analysis be carried out, and referenced in that respect a statement from John Hughes of RR&V which suggested that as deadlines were approaching no further information could be considered by RR&V. It maintained that there was no robust evidence to justify the exclusion of the capital which had been excluded.

Unitisation of Depreciation Charges

6.40.1 DAA observed that in its Determination the Commission introduced a unitisation approach to regulatory depreciation in respect of the capital costs for T2 and T2 associated projects when estimating future price caps. It suggested that this would allow costs for T2 to be recovered equally across all forecast airport users thereby ensuring a relatively small increase in charges upon commencement of T2 operations and a smooth progression of airport charges thereafter.

6.40.2 DAA asserted that the adoption of the unitised method of depreciation for certain assets:

- represented a significant departure from the approach previously adopted to depreciation ;

- would not necessarily deliver the profile in airport charges increases envisaged by the Commission;

- entailed a backloading of remuneration of capital costs which in turn, has significant implications for DAA's finance risk and overall financability;

- introduced unwarranted complexity in the regulation process;

- was implemented by the Commission without consideration of the way in which it would impact on DAA's remuneration; and

- was implemented without any clear assessment of how it would impact on rates paid by passengers.

6.40.3 DAA asserted that when compared with the current straight line approach to depreciation the unitisation approach would result in lower airport charges in the short term. DAA considered that this was counterintuitive given that it coincided with the introduction of new infrastructure.

6.40.4 DAA asserted that:-

> *"The consequence of this for DAA is that (all things being equal), the level of returns that DAA will receive in the short term will potentially be much lower than would have been the case if the straight line depreciation policy implemented since the Commission's inception in 2001 was retained. Given the relative scale and extent of the T2 project, the unitisation approach has significant implications for the company's levels of finance risk and overall financability."*

It is recognised that backloading remuneration implies increased risk because it entails a greater proportion of remuneration occurring at future points. Since uncertainty increases with the time horizon, risk increases the further in the future remuneration is expected. Under regulation, as the number of regulatory reviews occurring within the asset lifetime increases there is a greater chance of a change in fundamental factors affecting remuneration. These factors include changes in regulatory methods, a change in user type and preferences, and changes in the methodology for calculating key regulatory components.

Where a regulator backloads the remuneration of capital costs, the company must commit to undertaking capital expenditure with a greater degree of uncertainty as to whether it will receive remuneration, how much it will receive and when it will receive it. Under the Commission's proposals therefore, the DAA faces greater risk as a result of the backloading of remuneration. This risk is enhanced by the Commission's approach to unit cost depreciation which will allow for the possibility of even greater backloading occurring than anticipated at the time of asset investment, depending on the change in demand forecasts at each consecutive price review relative to the original forecasts.

The implementation of the unitised approach to depreciation also means that two conflicting depreciation policies are operating at the same time over different parts of DAA's asset base. This brings greater complexity to the regulatory model and is not in keeping with the Commission's obligations to impose the minimum restrictions on DAA.

6.40.5 DAA asserted that the use of the unitised method of depreciation was not properly reasoned. It observed that the Commission suggested that this approach would allow costs for T2 to be recovered equally across all forecast airport users thereby ensuring

a relatively small increase in charges upon commencement of T2 operations and a smooth progression of airport charges thereafter, and, further, that the Commission stated the intention of avoiding step-change increases in charges as further capacity expansion occurred. The Commission suggested that a unit-cost approach to depreciation would better align the costs and benefits to passengers of long-lived assets.

6.40.6 DAA asserted that

> *"this objective does not take account of how current users are now benefitting from the write down of past investment under the existing straight line approach to depreciation. If the T2 project is viewed as part of a cycle of investment over the long term, it is much less clear that conventional RAB-based remuneration would place an unfair cost burden on existing users, indeed current users are favoured over both past and future users."*

6.40.7 DAA complained that:

> *"Apart from its broad policy aspirations, the Commission gave no details or specific proposals in its Decision as to how it envisaged this significant change in depreciation policy was to be applied and its likely impact in practice. It did not elaborate on how it perceived the implementation of this regulatory policy would improve economic efficiency or assist in fulfilling its statutory objectives. The Commission acknowledged that theoretically this regulatory policy change could impact negatively on a company revenue returns but it did not provide any assessment of its likely effect on DAA's financability going forward despite its statutory obligation in this regard."*

6.40.8 DAA asserted that in its response to the draft decision CP5/2007, it had raised a number of specific concerns and recommendations in relation to the proposed

unitisation of T2 depreciation costs but these matters were not addressed in the final Decision by the Commission. It listed those concerns as :

- *... passengers will not pay the same rate for the whole period of the asset life.*

  Because the calculation appears to be based on an estimate of the incremental passengers above the assumed "comfortable capacity" level for T1, costs per total passenger will, in fact increase over time, to the point where total capacity estimated by the Commission is reached, and reduce thereafter. DAA believes that the Commission's proposals produce a peaked charge per passenger rather than a flat profile. The opening of T2 will deliver benefits to all passengers at the airport, providing both additional capacity in T2 and an alleviation of congestion in T1. Notwithstanding its opposition to the adoption of a unitised depreciation, DAA believes that it would be more reasonable, if the Commission retains this approach, to base its calculation on the total passenger numbers at the airport. This approach would deliver a more smoothed effect on the total cap. Furthermore, this approach would also possibly reduce the near-term possibility of financial difficulties and regulatory risk, while still applying an unitisation model.

- *A key rationale for adopting the unitised approach appears to be the assumption that the current capital expenditure programme represents the most significant step change in investment that will be required within the life of the assets provided. ... It is not apparent that the Commission examined whether the application of unitised depreciation charges would be appropriate going forward given the likely impact of future additional infrastructure requirements.*

- *The unitisation approach to depreciation has been applied by the Commission to two project groupings - T2 Main Projects and T2*