Ryanair Dublin Office
Airside Business Park
Swords
County Dublin
Ireland
Telephone: +353 1 945 1212
Website: www.ryanair.com

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FAO Dr Adrian Corcoran
Director of Economic Regulation
Commission for Aviation Regulation
3rd Floor
Alexandra House
Earlsfort Terrace
Dublin 2
D02 W773
Email: info@aviationreg.ie

By email

Re: Ryanair Response to DAA Submission on Regulatory Model Strategic Considerations

Dear Adrian,

1. To accompany its consultation as to whether there should be a Second Interim Review of the 2019 Determination (CP1/2021), CAR published a submission by DAA that proposes changes to the regulatory model adopted for Dublin Airport (the 'Submission'). In CP1/2021, CAR asked for stakeholder views on the proposals made by DAA and how these proposals could work within the current regulatory framework as defined under the Aviation Regulation Act 2001 and/or what changes would be required to implement any of the proposals.

Summary of Key Issues Raised by Dublin Airport

2. The Submission is wide-ranging and it is difficult to discern precisely what is being requested from CAR, but it starts from the fundamental principle that the existing form of regulation is too inflexible, being based on defined projections and *"tightly specified outputs"* to set a price cap which may not be realistic during the current period of uncertainty following Covid-19. In addition, DAA also cites the extent to which there have been appeals and interim reviews over the years as evidence that the current regulatory model is no longer appropriate more generally.

3. DAA believes that there is a need, at the very least, to adjust the allocation of risk within the regulatory settlement but more fundamentally DAA proposes to move towards a regime based on seeking agreement with users. DAA argues that such a regime is more likely to enable it to react flexibly and to meet the future requirements of users and of Irish society more generally, including delivering a net zero carbon outcome. However, it is not clear why or how this would be so given that DAA provides no detail as to why the current regulatory regime presents any barrier to the achievement of net zero.

4. In the first instance, the Submission argues for a change to the regulatory approach in Sections 2 and 3 and, in the alternative, argues for specific changes to the way in which the building blocks are specified in Section 4.

5. We now address these two issues in turn, commenting also on the initial views expressed by CAR as set out in Section 8 and paragraphs 7.11-7.16 of CP1/2021 respectively.

6. Paragraph references throughout this document are to the Submission unless otherwise clearly stated.

Market Power

7. In the first instance, DAA claims that the regulatory model being applied is disproportionate to the market power held by Dublin Airport (paragraph 1.2.2). DAA has made a number of claims in relation to the existence or otherwise of market power at Dublin and in relation to the assessment of market power previously undertaken by Indecon for DTTAS of March 2016 and its appropriateness moving forward. These are summarised at paragraph 2.2.9:

    - "Indecon considered concentration measures based on three airports in the Republic of Ireland, which does not reflect the existence and strength of competitive constraints faced by Dublin Airport from airports beyond those in the immediate catchment area.
    - The analysis did not reflect the extent of the bargaining position held by the airlines at the airport—e.g. it only considered actual switching over a limited time period, and did not take account of the threat of switching or airlines allocating new capacity to other airports.
    - Indecon also did not assess whether, even if the airport had market power, it would be able to exercise this market power.
    - Furthermore, never has the competition between European airports been so profound, with airlines demonstrating no loyalty to any particular airport or region, where they are ultimately seeking the most competitively priced airports for bases.
    - Importantly, this assessment was also undertaken five years ago. There have been a number of significant changes in the market since this time."

8. Essentially, DAA is suggesting that the following issues were not sufficiently examined:

    - that the definition of the relevant market for the market power assessment should have included European airports as they are a competitive constraint on Dublin Airport (Bullets 1 and 4 above);
    - that the assessment did not adequately consider the effect of countervailing buyer power from airlines and the potential impact of switching as a competitive constraint (Bullet 2);

- that DAA would be able to abuse its market power (Bullet 3).

9. We assume that DAA raised these points with Indecon at the time of the drafting of its report and that these were considered and given appropriate weight by Indecon in its final report.

10. Furthermore, DAA claims that the market assessment undertaken by Indecon is out of date and no longer relevant. DAA also appears to assert that the <u>extent</u> of market power is a relevant consideration in relation to the form of regulation adopted. While this is primarily an issue in relation to the form of regulation following a determination of an entity having significant market power (SMP), which is discussed below, there is also clearly relevance to the process of assessment of SMP.

11. DAA goes onto argue (paragraph 1.2.8) that it is not sufficient for the entity to have market power, cross referring to the Indecon Study, but for there also to be evidence of market abuse. DAA claims that there is no evidence that it has abused its market power at Dublin Airport but, of course, this claimed absence of abuse is contemporaneous with an ex-ante regulatory regime expressly aimed at ensuring such abuse could not take place. Hence, DAA's reliance on this point is misplaced. As noted by the Thessaloniki Forum, reliance on ex-post regulation through remedies after the event or general competition law is less well suited to addressing the risk of excessive pricing or reductions in service quality where market power exists[1]. The question of the extent of market power held by Dublin Airport is, thus, a key issue in determining the appropriate level of regulation and we now examine Dublin Airport's market power in some detail below.

<u>Market Definition – Competition with European Airports</u>

12. Determining the correct definition of the market is clearly essential in undertaking any assessment of market power. The primary point of issue in relation to this process is the correct definition of the geographic market. For the reasons set out below, the Republic of Ireland is the correct geographic market definition for conducting a market power assessment of Dublin Airport.

13. DAA seeks to argue that the market that Dublin Airport operates in is highly competitive and that the airport's main competitors are international European airports. However, this line of argument has been previously considered by Indecon in the context of defining the 'market' to determine the extent of market power held by Dublin Airport. Indecon stated the following:

    "The issue of competition from European airports is, however, relevant for hub related traffic but is not, in general, applicable for most Irish origin or Irish destination traffic. Even in the case of hub traffic, it is only where European airports impact on the pricing levels of Irish airports that a non-domestic market definition

[1] Thessaloniki forum of Airport Charges Regulators: Remedies Available to ISAs to Address Potential Misuse of Significant Market Power by Airports, December 2019, paragraph 3.3.

would be appropriate. The key issue for market definition is whether other airports would be viewed as reasonable alternatives."[2]

14. The argument that the competition is intense amongst airports in Europe is not new and a number of points should be made in relation to the situation in Dublin.

15. Given the overall proportion of hub related transfer traffic at Dublin Airport, which only accounted for around 6% of total passenger volumes in 2019, the issue of hub competition from European airports is only possibly applicable to 6% of passengers. It is highly unlikely that competition for this very limited proportion of the overall traffic would act as a competitive constraint on DAA. This does not justify a change to the market definition beyond the Republic of Ireland. In relation to origin and destination passengers travelling to or from Ireland, it is clearly nonsensical to argue that any airport away from the island of Ireland could act as a reasonable alternative to Dublin. The airports in Northern Ireland are now outside of the EU, of a different scale, and operate under different fiscal and regulatory regimes such that they cannot be considered direct competitors.

16. We also note that this issue has been consulted on and has been summarised by the UK CAA in its Market Power Determination for Gatwick Airport, where Gatwick Airport made similar claims, and also in relation to Heathrow, where the UK CAA considered the European hub competition aspect for Heathrow[3]. The UK CAA came to several relevant conclusions.

17. Firstly, the UK CAA confirmed the fact that airports serve their own catchment areas. This means that airlines switching to an airport outside Ireland but within Europe cannot be taken to imply that the European airport serves the same catchment area or market. This can be summarised in the text below:

    "As noted above, the CAA's statements on European markets gave limited consideration to air transport markets, where passengers make their decision on which London airport to use, which, in turn is a result of their decision to fly to or from London. The evidence to date shows generally that airlines flying from airports in the south east of England operate primarily to serve the outbound demand generated by the local catchment area and/or the inbound demand of those that wish to travel to London and the South East. Case law also indicates that competition in air transport markets is based on city pair routes. As shown in the airline evidence below, airlines do not consider that UK regional airports compete with Gatwick. Therefore, by extension, operating flights from an airport in Europe would not serve the local catchment area either.

    The CAA considers that passenger demand for air transport services is fixed to a particular location, so a London airport is needed to serve passenger demand to and from London. This line of reason appears to be non-contentious and was the view of the CC:

[2] Indecon, page 12.
[3] CAP1133 Appendix D – Evidence and analysis on market definition, D.263-265.

...if Ryanair has a customer who wants to fly from the UK to Spain, the customer will not think that an airport in Italy is a close and effective substitute for Stansted from which to fly. It seems to us that airlines care about access to particular locations precisely because the passengers who will choose to fly from a UK airport will not be the same as those who are based close to, for example, an Italian one."[4]

18. The argument applies in the context of Dublin Airport too. For example, if Ryanair has a customer who wants to fly from Ireland to Spain, the customer will certainly not think that an airport in France is a close and effective substitute for Dublin Airport from which to fly.

19. The UK CAA also rejected the assumption made by the airports that airlines are very limited in their ability to procure aircraft, such that, in order for an airline to operate a new route, it would only be possible if they switch from another route at another airport. The implication put forward by airports being that they are competing against each other for finite aircraft capacity. The UK CAA has pointed out that this is incorrect and states that airlines are in a position to procure new aircraft for new services relatively easily if required:

"The CAA does not consider that airlines are, in general, constrained in their choice of airport by either the number of aircraft or bases that they can operate, as MAG has suggested. The CAA considers that airlines are able to procure aircrafts (sic) *through purchasing from manufacturers, or from other airlines and/or engaging in leasing agreements. This being the case, the CAA also considers that the decision to open up new bases or deploy aircraft on particular routes would be driven by individual route or base profitability. The CAA notes that a route has to be profitable (not more profitable than an existing route) to be operated; if a route is unprofitable it would close."*[5]

20. The concept of route 'stickiness' has also been outlined by the UK CAA, where the assumption that airlines purely seek the most profitable routes has been addressed. The UK CAA used an example from easyJet's investor presentation which outlines that easyJet, in some cases, maintains a network of routes with varied levels of profitability, in some cases including negative returns, as the routes may be kept operational to serve the overall airline's strategy to benefit the airline's network. Given Dublin Airport is Ryanair's second largest base, it is inevitable that there is some 'stickiness' in the route network meaning and that Ryanair or, indeed, other airlines will not simply relocate significant aircraft capacity because there is a better opportunity elsewhere in Europe.

[4] CAP 1134 Appendix D – Evidence and analysis on market definition, D.200-201.
[5] Ibid, D.209.

21. In relation to hub competition and its market definition for Heathrow, the UK CAA considered that, despite Heathrow having a significant proportion of transfer passengers (34% in 2019[6]), the level of competition was still not sufficient to justify widening the market definition, given the overall connectivity offered at Heathrow by British Airways, IAG and all other airlines to each other's passengers, the wealth of the catchment area, the loss of valuable slots as a result of route switching, the overall brand and the evidence of airlines switching routes from Gatwick to Heathrow.[7] The UK CAA noted that the costs of switching away from such an airport would not outweigh the benefits to airlines of remaining[8]. We highlight again that the proportion of transfer traffic at Dublin is low and, even if other European hubs were to be considered within the market definition, they could not be considered an effective competitive constraint on DAA.

22. Finally, the UK CAA concluded that, given the difference in catchment areas between European airport 'competitors', any route switching is in fact a market exit, so there was no competition in the first place. Exit in such circumstances is entirely consistent with the existence of SMP. This is summarised in the excerpt below:

    "The CAA recognises that network yield optimisation of LCCs involves a degree of switching assets between differing markets across Europe. This ability to yield manage across a range of markets is likely to provide some degree of constraint on airport operator pricing. However, when moving capacity from Gatwick to a European airport, more so than to a neighbouring UK airport, the airline will be giving up on its competitive position at Gatwick and the customers it serves. The CAA considers that this is not so much switching as market exit, which is a valid response to a SSNIP. "[9]

[6] UK CAA Departing Passenger Survey 2019.
[7] CAA CAP1133, CAP1134.
[8] CAA CAP1133, CAP1134.
[9] Ibid, D.213

23. Given all the evidence highlighted above, the UK CAA concluded that it did not consider that the market definition should be geographically widened to include European airports[10] in the case of Heathrow or Gatwick for which it carried out market power assessments. This applies equally in relation to Dublin Airport. When properly considered, the evidence suggests that the ability of airlines, particularly those based at Dublin Airport, to exit the Irish market and seek to serve other markets would not provide an effective competitive constraint on the pricing at Dublin Airport. By way of comparison, in relation to Gatwick, which is probably the closest comparator to Dublin, it is clear that the CAA considered a much narrower market, concluding that for low cost carriers and charter airlines, the market was largely one south of London, given distinct catchment areas from Luton and Stansted in the north, but that for full service carriers, there was some overlap with Heathrow[11]. Similar considerations would clearly constrain the relevant market for Dublin Airport to the Republic of Ireland at its widest extent. This is the same conclusion reached by Indecon in 2016.

Countervailing Airline Buyer Power and the Threat of Switching at Dublin Airport

24. One of the claims made by DAA is that the market power analysis in the Indecon study does not take into account the bargaining position held by airlines at Dublin Airport (paragraph 2.2.9). We do not accept this view. Firstly, the issue was considered by Indecon. Indecon state:

"Indecon's analysis does, however, suggest that one of the major airlines, Ryanair, is likely to have credible options to move aircraft to other airports and that in the case of Aer Lingus, the recent acquisition by IAG is likely to enhance its ability to move its fleet to other airports. In spite of this, other factors including sunk costs and capacity constraints indicate that these possibilities are insufficient to warrant a removal of price regulation at Dublin Airport at this time because significant market power still remains."[12]

25. More pertinently, whilst airlines may have choices as to whether they wish to serve the Irish market, for those airlines that wish to serve Ireland, there is little to no choice in terms of which airport to use, particularly in the light of the concentration of population around Dublin and the fact that DAA also owns Cork Airport. Those airports in Northern Ireland serving Belfast are simply too far away from the main market centred around to Dublin to provide an effective competitive constraint. It is also questionable as to the extent to which airlines do have significant choice in serving Dublin in terms of markets of a comparable size and strength.

[10] Ibid, D.214.
[11] CAP1134, paragraph 4.19.
[12] Indecon, page 30

26. Whilst it is true that Ryanair and Aer Lingus each have high shares of the number of seats offered by airlines at Dublin Airport, this does not automatically convey high buyer power. In 2019, Ryanair provided 46% of the seat capacity scheduled at Dublin Airport and accounted for 43% of passengers actually using the Airport in the year. This is very similar to BA's share of capacity at Heathrow Airport (46% in 2019), lower than the IAG share (50% in 2019), and substantially below the overall oneworld alliance share of 57%. Hence, Ryanair's and Aer Lingus's market shares at Dublin are clearly no barrier to a finding of the existence of SMP based on the Heathrow precedent.

27. Again, in the context of DAA's comments in relation to countervailing buyer power, it is important to note the analysis undertaken and the conclusions reached by the UK CAA in relation to this issue. In respect of Gatwick, the UK CAA stated:

"With respect to countervailing buyer power, some airlines have a sufficient share of GAL's business to suggest that they might have buyer power. However, the evidence suggests that these airlines have limited ability to credibly threaten to switch sufficient capacity away from Gatwick that would give them buyer power in their negotiation of terms with GAL. This is the result of a number of factors including the capacity constraints, presence of backfill and the credibility and effectiveness of alternative switching options."[13]

28. It is clear that, in this respect, that the UK CAA primarily considered switching within the local market (i.e. London) rather than the broader ability to switch aircraft capacity between alternative airports across Europe as asserted by DAA:

"Viable switching opportunities for airlines at Gatwick are limited. While there is capacity at the north London airports, these airports are clearly a less preferred option for airlines than operations from Gatwick, either because they do not have the necessary facilities, runway length, feeder traffic or (wealthy) catchment area. With respect to switching to Heathrow, the evidence suggests that it is a preferred airport to Gatwick. However, the evidence also shows that there are a number of high barriers to entry, including the cost and availability of slots, which prevent effective switching to Heathrow as a reasonable response to a price increase"[14]

[13] CAP 1134 Market power determination in relation to Gatwick Airport: statement of reasons, 2013, paragraph 5.29.
[14] Ibid

29. Furthermore, there is evidence that, pre-Covid-19, the overall concentration of airlines at Dublin Airport has been falling. **Figure 1** below shows the Herfindahl-Hirschman Index (HHI), a commonly used measure of market concentration, for all the airlines operating at Dublin Airport. The HHI has been dropping since 2012, with the decline accelerating since 2015, falling to around 1,633 in 2020. This suggests strongly that the overall airline market at Dublin Airport has become more competitive with an increasing share of other airlines growing capacity and new entrants. This again clearly points towards a fall in the bargaining power held by existing airlines, including Ryanair. Hence, if regulation was required in 2016 because of the existence of SMP and a lack of effective countervailing buyer power, the same would be even more the case in 2019 and as the market recovers from Covid-19.

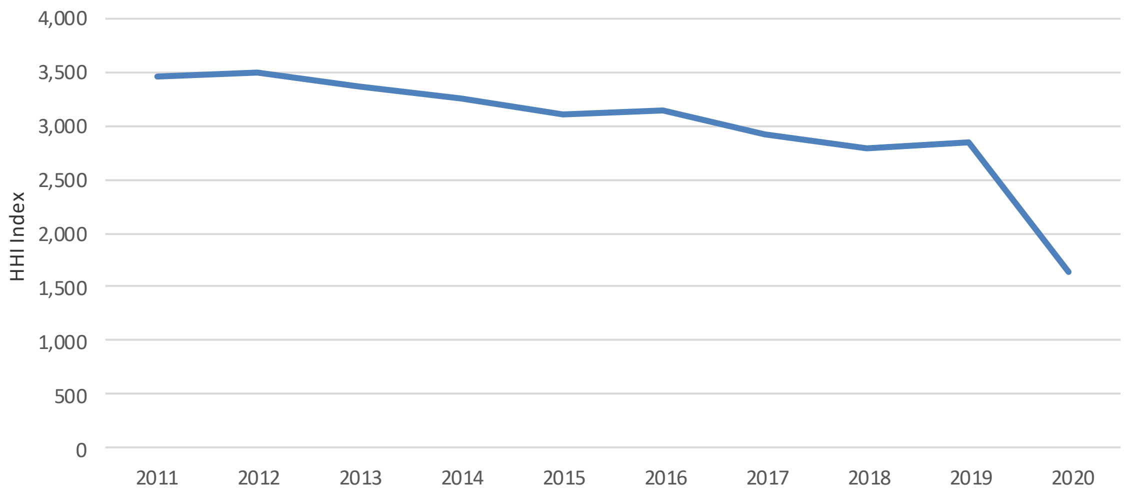


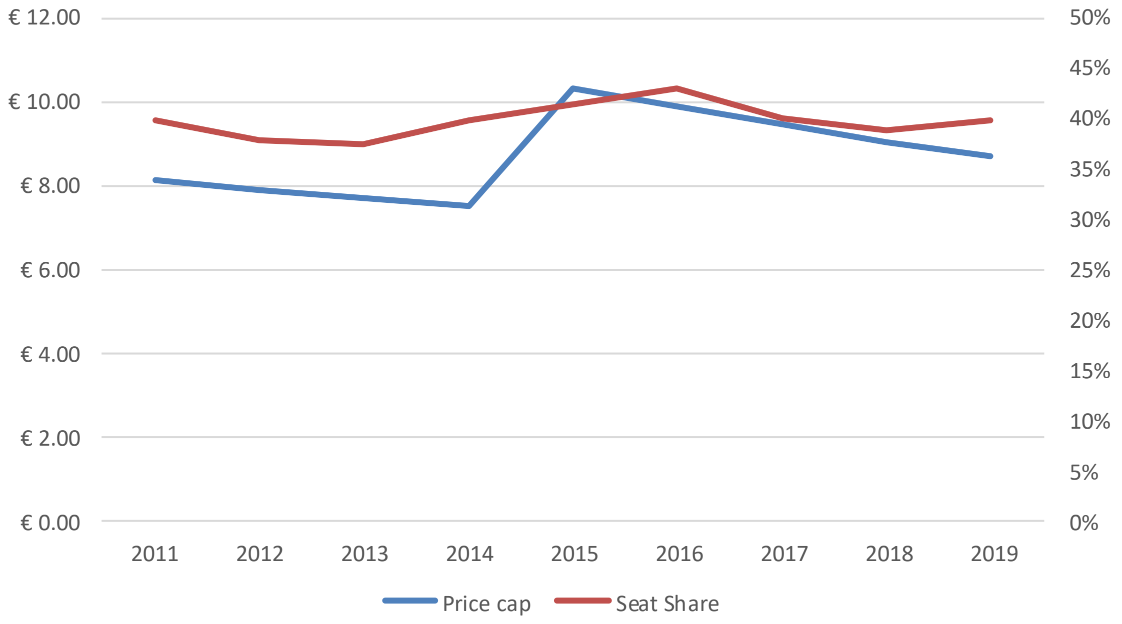
Figure 1: HHI Index of Airline Market share at Dublin Airport since 2011

Source: York Aviation Analysis of OAG Seat Capacity Data.

30. DAA asserts (paragraph 2.2.9) that the threat of airlines switching to other cheaper airports or allocating new capacity preferentially to airports offering lower prices acts as a competitive constraint on its behaviour. However, this is misleading. Where two airports serve the same market and offer the same potential yield, airlines may contemplate switching capacity but, given the unique nature of each airport, it is not always the most competitively priced airport alone that the airlines look out for. It is a combination of the underlying demand, the capacity potential, the infrastructure offering, yield, operational flexibility and the airport charges. If the underlying demand is insufficient to achieve any profit targets, then there is no significant advantage in purely opting for an airport offering the lowest airport charges. It is, therefore, the combination of the above factors that helps contribute to larger profits and a deciding factor, especially if an airline is considering making changes at its base.

31. This is also clearly evident in **Figure 2** below, where despite the airport charges at Dublin Airport remaining high, Ryanair's seat capacity share has remained consistent at around 40%, indicating that Ryanair has a very limited bargaining power in its ability to switch away from Dublin Airport. This is because, in large part, it has spent decades investing in the development of its network of services from the airport such that the costs of switching would be very high. This sunk investment means that there will by necessity always be a substantial base of aircraft at Dublin.

Figure 2: Price cap in previous determinations and Ryanair's seat capacity share, 2011-2019

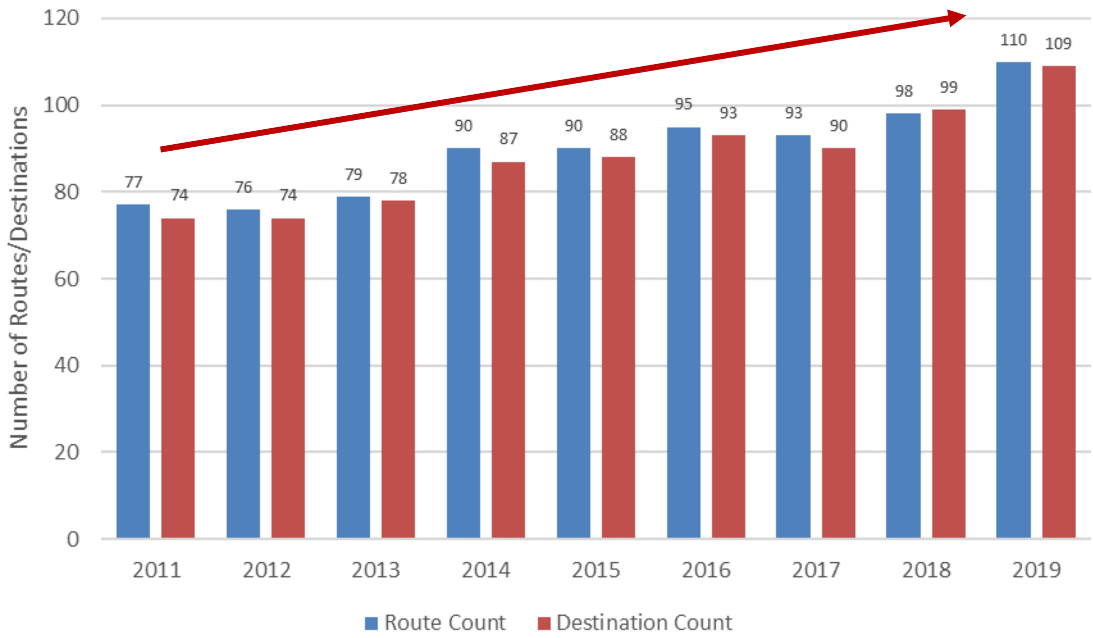


Source: OAG & Previous determinations.

32. Nor are DAA correct to assert that airlines demonstrate no loyalty to any particular airport or region. It is evident that, whilst there may be switching between routes or changes in capacity provided dependent on broader economic circumstances (recession, tax changes, etc.), this does not demonstrate a lack of loyalty to a particular market. **Figure 3** below outlines Ryanair's route and destination count at Dublin Airport since 2011. As can be seen, the overall number of routes and destinations served out of Dublin Airport by Ryanair has significantly grown from 77 routes and 74 destinations in 2011 to 110 routes and 109 destinations in 2019. The growth has been stronger since 2015-16 and especially in 2019, when Ryanair added over 10 routes and 10 destinations.

33. This long-term trend alone suggests that Ryanair has maintained its loyalty to Dublin Airport as its second largest base and has been growing at the airport since 2012, offering new routes and destinations despite the supposed claimed competition amongst European airports for based aircraft.

Figure 3: Ryanair Route and Destination Count at Dublin Airport, 2011-2019



Source: OAG.

34. There are other reasons why airlines will not readily choose to switch away from Dublin. Dublin is one of Europe's leading capital cities and, compared to other capital cities, such as Stockholm, Brussels, Zurich, Copenhagen and Vienna (all highlighted purple in **Table 1**), which share similar overall GDP, population, Globalisation and World Cities (GaWC) ranking and one way seat capacities, Dublin has a very high GDP per capita, suggesting a strong market and a strong propensity to fly. This is a powerful reason why airlines will not switch away from the Dublin market, as the economic conditions are such that routes to and from Dublin are likely to command higher yields on average. The performance of the Dublin economy contributes substantially to the market power held by the airport and will substantially outweigh any countervailing buyer power held by airlines.

Table 1: Dublin Airport's International Competitiveness

City	GDP Metropolitan Area (18/19)	Population (18/19)	GDP per capita	GaWC Ranking[15]	2019 One Way Seat Capacity	Existing Ryanair Base
Paris	€ 724,980	12,282,000	€ 59,028	Alpha+	62,760,090	✓
London	€ 585,577	9,046,000	€ 64,733	Alpha++	107,727,424	✓
Madrid	€ 231,134	6,587,000	€ 35,089	Alpha	36,316,187	✓
Milan	€ 213,811	4,337,800	€ 49,290	Alpha	30,912,856	✓
Munich	€ 194,880	2,896,030	€ 67,292	Alpha-	31,866,355	
Berlin	€ 193,344	5,281,610	€ 36,607	Beta+	20,340,948	✓

[15] Global and World Cities Index Ranking

Amsterdam	€ 182,699	3,257,000	€ 56,094	Alpha	41,361,506	
Barcelona	€ 171,350	5,537,000	€ 30,946	Beta+	31,344,089	✓
Rome	€ 165,265	4,350,000	€ 37,992	Beta+	31,249,284	✓
Hamburg	€ 162,722	3,318,510	€ 49,035	Beta+	11,246,808	
Dublin	**€ 159,233**	**2,086,350**	**€ 76,321**	**Alpha-**	**18,820,207**	✓
Frankfurt	€ 152,232	2,701,630	€ 56,348	Alpha	45,956,044	✓
Stockholm	€ 147,848	2,326,050	€ 63,562	Alpha-	20,677,996	✓
Brussels	€ 147,670	2,558,700	€ 57,713	Alpha	21,021,717	✓
Zurich	€ 144,287	1,521,000	€ 94,863	Alpha-	20,806,828	
Copenhagen	€ 134,872	2,052,000	€ 65,727	Beta+	19,597,271	
Vienna	€ 132,208	2,845,040	€ 46,470	Alpha-	20,343,511	✓
Oslo	€ 98,929	1,296,480	€ 76,305	Beta	20,655,626	
Manchester	€ 97,783	2,690,000	€ 36,351	Beta-	17,218,538	✓
Helsinki	€ 91,656	1,663,530	€ 55,097	Beta	14,120,300	
Duesseldorf	€ 88,809	1,554,050	€ 57,147	Beta+	17,362,744	✓
Athens	€ 81,891	3,596,160	€ 22,772	Beta	14,378,412	✓
Lisbon	€ 73,603	2,840,000	€ 25,916	Alpha-	18,764,139	✓
Geneva	€ 49,717	504,128	€ 98,620	Beta-	11,626,260	
Nice	€ 39,321	1,086,000	€ 36,207	Sufficiency	9,007,613	

Source: Eurostat, GaWC, OAG, UN – The Worlds Cities in 2018, ONS, Switzerland Federal Statistical Office.

35. Given these economic fundamentals, it would be highly imprudent to rely on a concept of the ability for airlines to switch capacity away from Dublin as a mechanism to control any risk of abuse of market power by DAA. This would simply not make economic sense for the airlines given the strength of the underlying market. We would expect these relative advantages to remain as economies recover from the Covid-19 crisis. It must be concluded that airlines do not have countervailing buyer power at Dublin Airport such that it would act as a competitive constraint on DAA.

Need to Demonstrate Evidence of Market Abuse

36. As noted earlier in this submission, the existence of economic regulation is precisely aimed at ensuring there is no market abuse. This is also confirmed in the Indecon report, where it was stated that the absence of economic regulation may not have an incentive to reduce charges:

"As part of our analysis we also considered if it is likely that DAA in the absence of regulation would have an incentive to over time reduce charges to the extent required by regulation. This depends on a number of assumptions, among the most important of which is the charges elasticity of demand, in other words how passenger numbers are likely to move as a result of changes in airport charges. While it is difficult to be definitive on the likely impacts our analysis suggests that in the absence of regulation DAA may not have an incentive to reduce charges to the levels which may exist in competitive markets." [16]

37. We would also challenge the statement that there is no evidence of abuse of market power by DAA. As, even under economic regulation, DAA has been able to secure a higher price cap through embarking on capex development and failing to address excessive opex in a manner that would not have occurred at an airport operating in a truly competitive market. This is a form of market abuse that would only worsen should the discipline of economic regulation be relaxed. It is in this context that we go onto comment on the alternative regulatory models put forward by DAA below.

The Market Assessment is Outdated and there are Changed Circumstances

38. While it is clearly a statement of fact that the market power assessment undertaken by Indecon is now 5 years old, we strongly disagree that this is evidence that either the approach adopted is outdated or that the simple passage of time constitutes changed circumstances sufficient to suggest that the findings would be likely to change. In relation to the Covid-19 pandemic, it is important to recognise that this is a short-term market phenomenon. It does not change the fundamental competitive drivers that give DAA market power. Dublin Airport will continue to have an exceptionally high market share in the relevant geographic market (the Republic of Ireland), Dublin will remain a market sufficiently large, strategically important and affluential that airlines will wish to serve the market, and airlines at Dublin will still have limited options in switching away from Dublin.

Extent of Market Power

39. In Section 2.2 of the Submission, DAA sets out a position which seems to suggest that market power assessment is about determining the *extent* of market power and points to the UK CAA's assessments of market power at Heathrow, Gatwick and Stansted, suggesting that these assessments have used the extent of market power found to justify different forms of regulation. This is not the case. Market power assessments are binary in their findings, in contradiction to the statement made by DAA at paragraph 2.2.8. An airport either has significant market power (SMP) or it does not. All firms in a market, however competitive that market, have some degree of market power. The purpose of market power assessment is to determine whether or not a firm has SMP. The form and extent of regulation required is then subject to a separate process.

[16] Indecon International Economic Consultants Review of the Regulatory Regime for Airport Charges in Ireland

40. The UK CAA's process in considering the correct approach to regulation is set out in CAP1433 'Market Power Test Guidance' of August 2016:

- does the airport have SMP?
- if it does, is competition law sufficient to protect users?
- if not, would the benefits of economic regulation outweigh the costs?

41. The first stage is a binary test of SMP. In this context, DAA is wrong to state that the UK CAA found Gatwick only to have *"some market power".* There is a clear finding of SMP set out in CAP1134[17] where the UK CAA states the following:

"In light of the CAA's findings on market definition, competitive constraints and indicators of market power, the CAA concludes that GAL currently has SMP in the relevant market and that its market power is unlikely to be eroded over the Q6 period."[18]

42. Similarly, the UK CAA provided a clear and unambiguous finding of SMP in relation to Heathrow:

"Having analysed the above market, and taken due account of the competition law notices and guidance as well as the responses to the CAA's Heathrow: Market Power Assessment, the CAA's Initial Views - February 2012 (the Initial Views) and the Consultation, the CAA has decided that HAL has SMP in this market, which is expected to persist over the period April 2014 – December 2018 (Q6). This decision is unchanged from that proposed in the Consultation."[19]

43. We would also highlight our previous comments in relation to DAA's market power in response to CAR's Issues Paper (CP7/2018) as follows:

"The requirement for economic regulation of Dublin Airport is due to the fact that Dublin Airport enjoys significant market power. This has been confirmed on numerous occasions, notably by CAR in its submission to the Consultation on the Review of Airport Charges Regulation in Ireland, where it stated that "the dominant position of Dublin Airport is evident using any sensible measure of market power and any reasonable definition of the market. This market power, if left unchecked and unregulated, would result in a significant loss of consumer welfare."

44. We consider that it is fundamental that any assessment of SMP is kept separate from considerations around the form of regulation, which is discussed further below.

[17] CAP 1134, paragraph 7.4.
[18] CAP 1134, paragraph 5.31
[19] CAP1133, paragraph 2.3

Updated Market Power Assessment Indicators

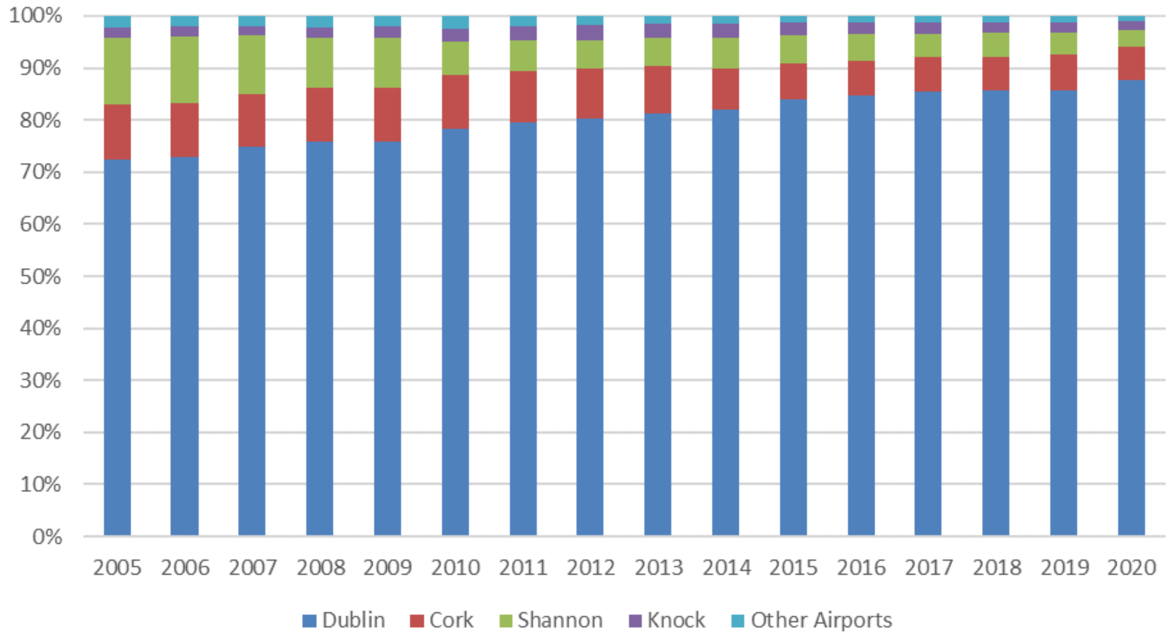
45. Further to DAA's statements (paragraphs 2.2.9, 2.2.10) that the market power assessment undertaken is out of date and that there are changed circumstances, an updated analysis of a number of key indicators of DAA's market power are set out below. This includes considering the position over time to demonstrate that, in fact, rather than DAA's monopoly position weakening, it has in fact strengthened since the time of the Indecon assessment, and that, as a result, there is no reasonable basis for requiring a further market power assessment.

46. The analysis presented here draws on the approach adopted by Indecon and the approach adopted by the UK CAA in its assessment of market power at Heathrow and at Gatwick, as cited by DAA. This provides a benchmark against which to assess the market power held by DAA at Dublin Airport. It should be noted that, in line with the discussion above, the analysis focusses on the correct definition of the geographic market, the Republic of Ireland.

47. It is also important to highlight again that the UK CAA adopted a two-stage process; firstly, to establish whether an airport had SMP and then secondly to consider the appropriate form of economic regulation. Again, DAA appears to be concatenating two separate stages of consideration in its approach.

48. **Figure 3** shows Dublin Airport's market share of total passengers compared to the other main airports in the Republic of Ireland between 2005 and 2020. At this most simple level of assessment, it is quite clear that Dublin Airport has significant market power, and even the next largest airport by market share in the Republic of Ireland (Cork) is operated by DAA. It is evident that upward changes in prices have had no impact on Dublin's inexorable rise in market share, indicating the extent of its market power. It also shows that Dublin's monopoly position is strengthening and has done since 2014, the calendar year on which the Indecon assessment was based.

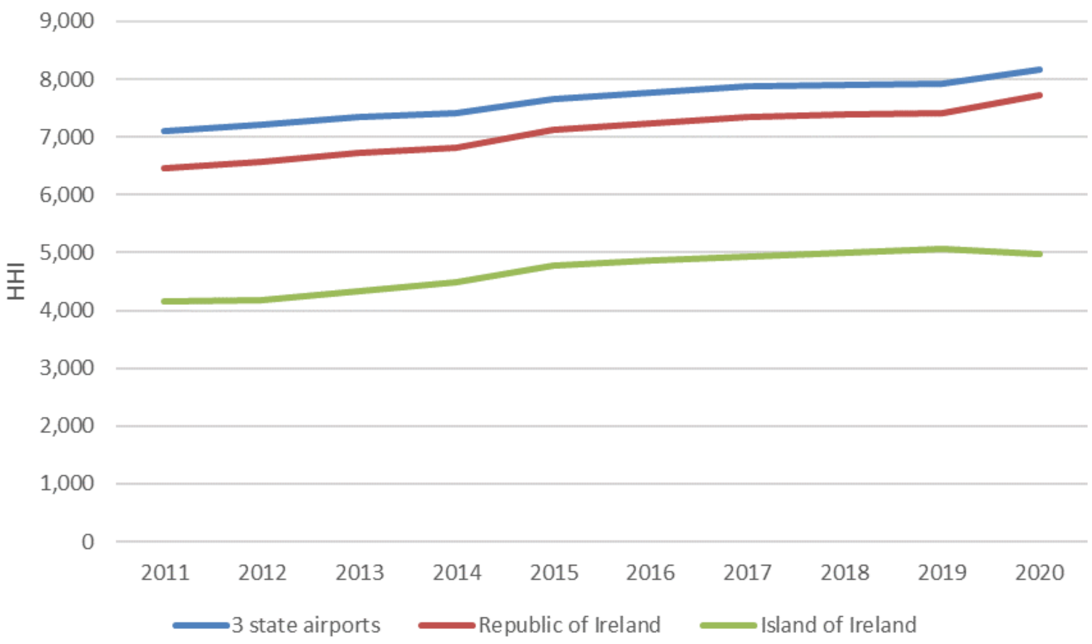
Figure 3: Airport Market Shares in the Republic of Ireland



Source: Irish CSO.

49. **Figure 4** shows the HHI for the three state owned airports in Ireland, all airports in the Republic of Ireland, and all airports on the island of Ireland (i.e. including the two Belfast airports and City of Derry Airport). An HHI of greater than 2,500 is generally considered to be a highly concentrated market. It is clear that, whatever the geography considered, the air transport market in which Dublin operates and is by far the largest player, is highly concentrated. Furthermore, we note that the situation has actually worsened markedly since 2014, the final calendar year on which the Indecon assessment was based. It is not possible to reach any other conclusion on this basis other than that Dublin Airport and DAA holds SMP.

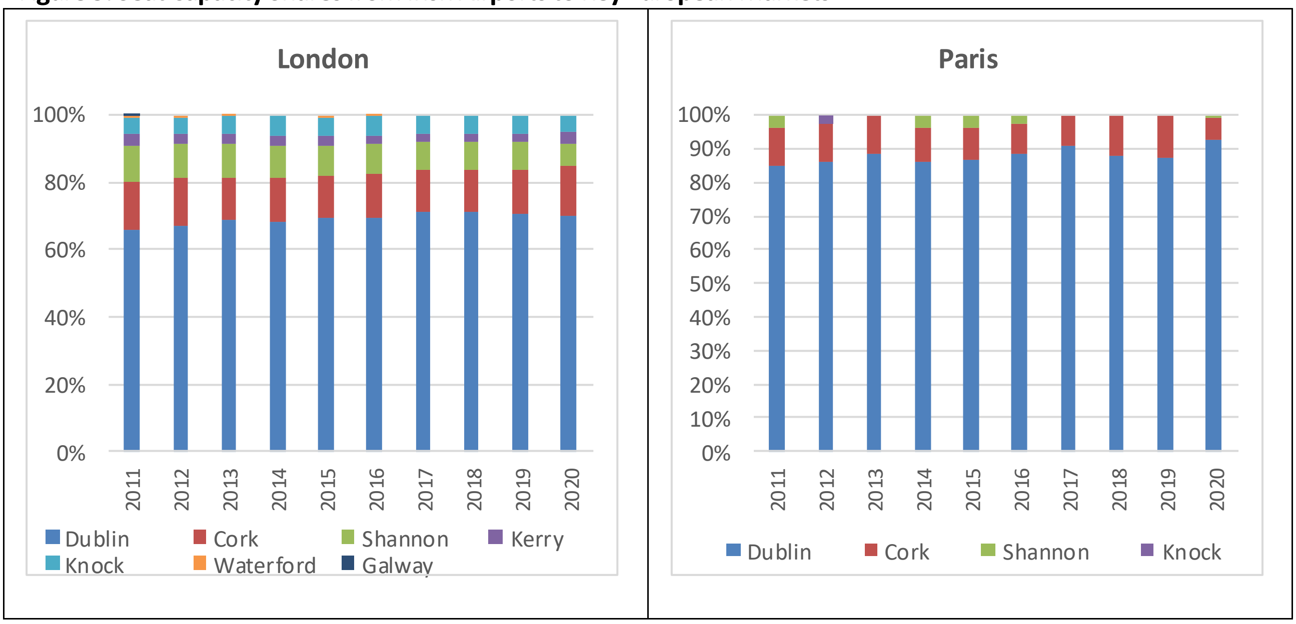
Figure 4: HHI Estimates of Irish Airport Market for Passengers using Different Geographical Markets

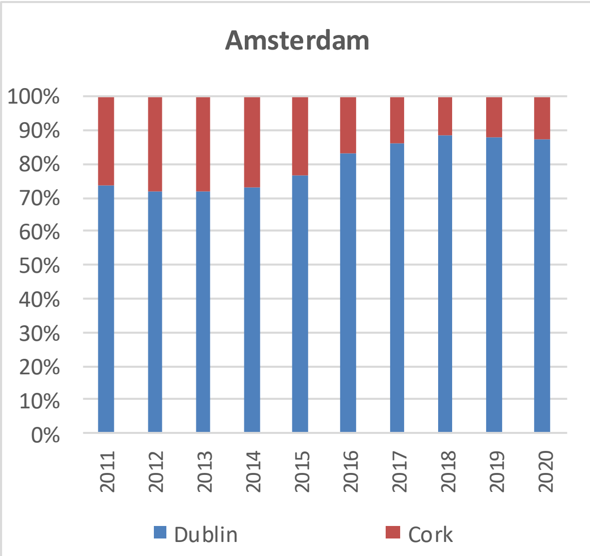


Source: York Aviation Analysis of Irish CSO Data and CAA Statistics.

50. **Figure 5** considers Dublin's monopoly position at a more micro-level, examining its share of seat capacity on a number of key European cities, including key connections to regional UK cities, which are traditionally strong markets for other airports in Ireland. This analysis clearly demonstrates Dublin Airport's dominance at a city pair level as well. In all cases, Dublin's market share is in excess of 60% of seat capacity and in many cases it is substantially higher. This is on routes where it would be reasonable to expect relatively strong local markets around the other airports in the Republic of Ireland. There are no cases where its market share has declined significantly. Again, this strongly supports a finding that Dublin Airport has SMP.

Figure 5: Seat Capacity Shares from Irish Airports to Key European Markets

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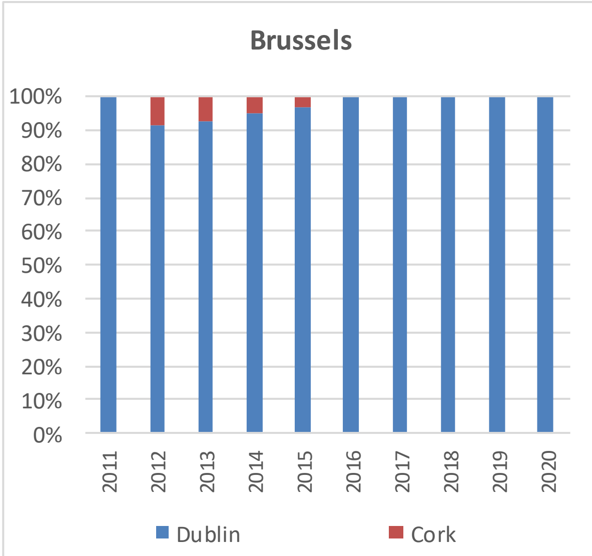
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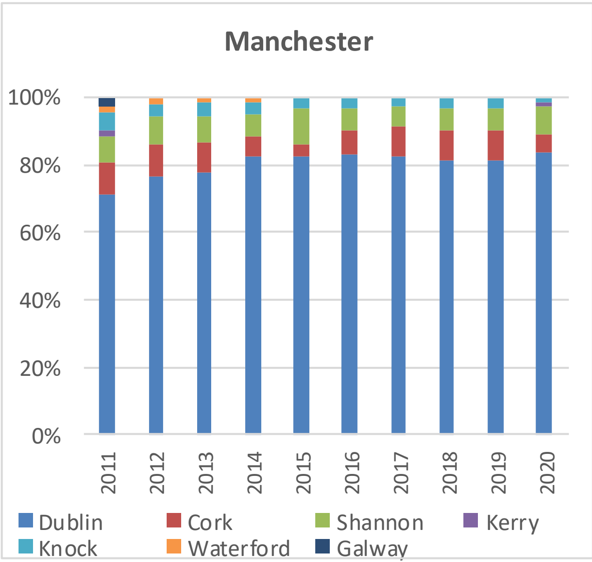
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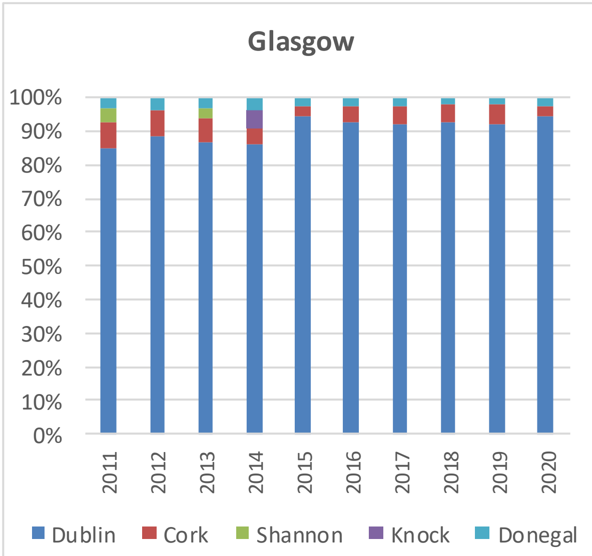
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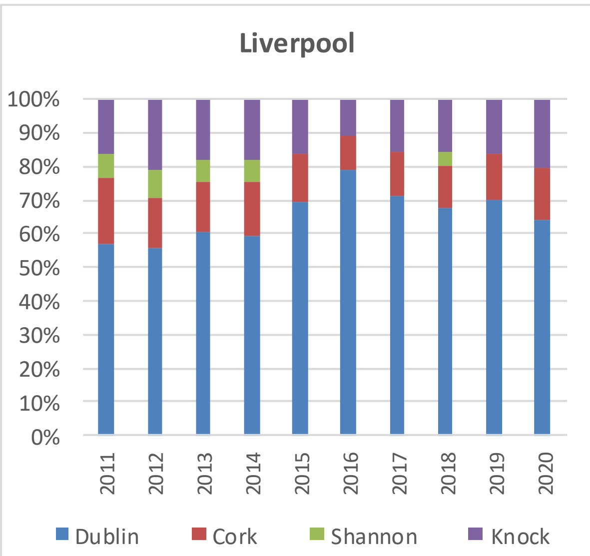
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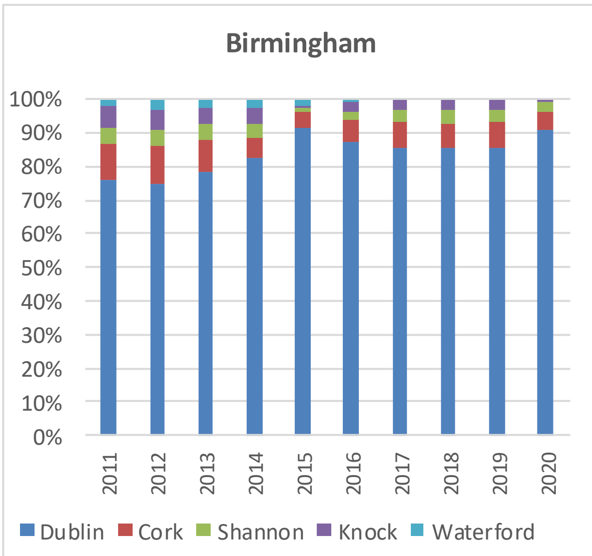
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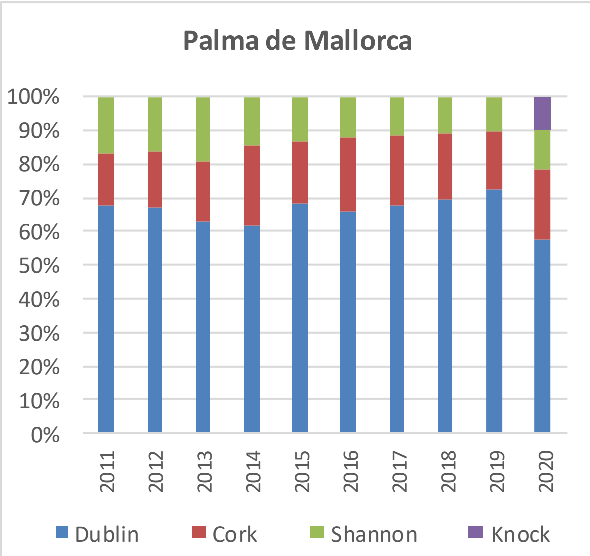
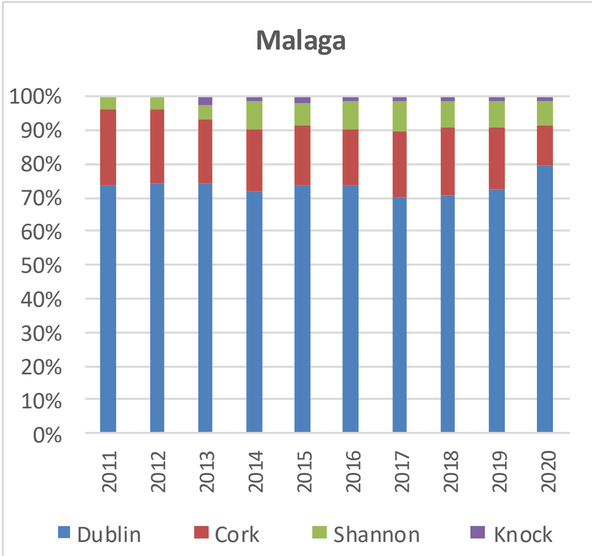
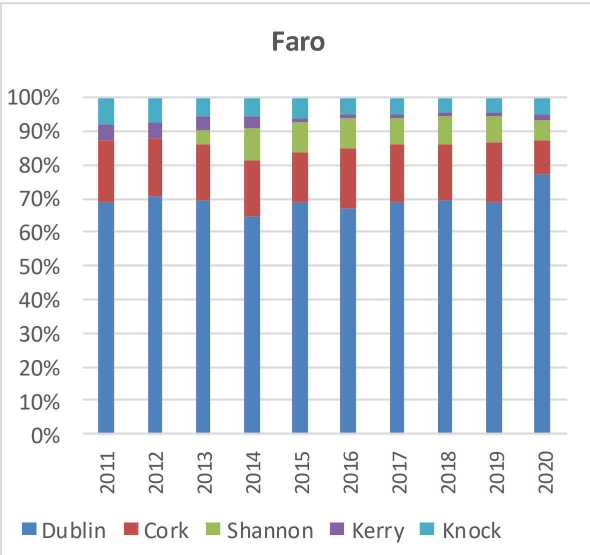
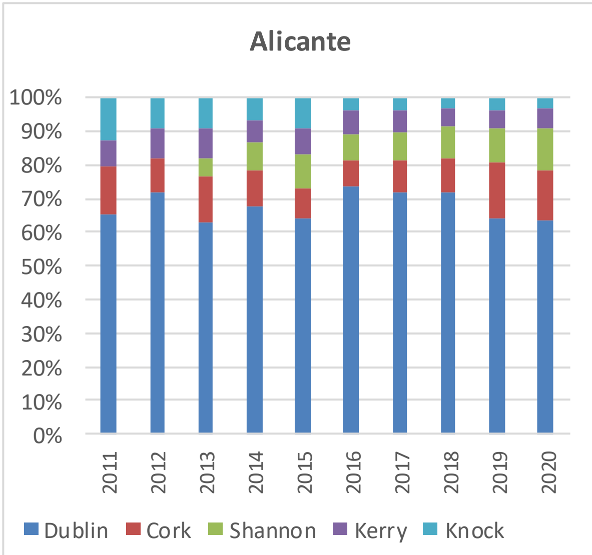








Source: OAG.

51. It is, of course, worth noting that market share is only one indicator of market power, other factors such as the airlines' ability to switch routes, availability of better alternatives and the airline's tolerance to bear higher airport charges are also relevant. It is noted that switching costs to larger based airlines are far greater than smaller airlines with less dependency. The additional loss of network effects from the connectivity at Dublin too is likely to contribute to additional switching costs to some airlines. Other costs such as excess fuel costs too could be incurred, as Dublin is a gateway to North America due to its location in the periphery of Europe, the fuel saving offering provided by Dublin, especially on journeys to North America, can be considerable.

52. Given the appropriate definition of the geographic market is the Republic of Ireland, there is no credible alternative to Dublin Airport for airlines to switch to. There is no other airport that has the capacity to deal with significant exiting from Dublin, and given the costs of maintaining airline bases, it is not credible to consider that airlines would switch piecemeal. No other airport is appropriately located to serve the key Dublin market in a credible fashion. Both Cork and Shannon are over two hours' drive from Dublin and in excess of 200km. There is no ability to switch.

53. DAA also relies on reports by Copenhagen Economics[20] and Oxera[21]both for ACI EUROPE to assert that there is greater competition between airports to attract airlines. However, it is informative to examine the criteria by which these organisations describe such competition, including the proximity of airports with overlapping catchment areas within 2 hours, competition for transfer passengers and 'route churn'. Given Dublin Airport's dominance within Ireland, low proportion of transfer passengers and continued growth in its network, none of these factors are present in relation to Dublin Airport.

54. We conclude that there can be no argument with the proposition that Dublin Airport holds significant market power. The question then becomes what is the appropriate form of regulatory response.

Alternative Regulatory Models

55. Based on its assertion that Dublin Airport does not possess SMP, which the above analysis demonstrates to be false, DAA, in the first instance (Section 3), proposes two alternative regulatory models:

- Shadow Price Cap with Negotiated Settlements
- Price Monitoring

56. However, it is important to note that the Thessaloniki Forum makes clear that, although the proportionality of regulation is relevant: "*An assessment of proportionality may address specific (sub)questions. One of the possible (sub)questions is whether competition law is sufficient to address the risk of abuse of that significant market power in that specific instance*"[22]. The key principle is that that *"any regulatory measure that is to be imposed should be proportionate to the dominance/ risk of abuse of that dominance that the regulation is trying to address."*[23] Although the Thessaloniki Forum stated, in its paper on Remedies[24], that *"trigger regulation and shadow pricing can be an adequate solution where SMP exists and the risk of misuse is moderate",* this is not the case at Dublin given the high risk of abuse of dominance by DAA and the low countervailing power from the airlines (particularly given the high level of sunk costs by the based airlines and the lack of alternatives within Ireland) coupled with DAA's evident wish to always push for higher prices at each regulatory review.

[20] Copenhagen Economics, Airport Competition in Europe 2012.
[21] Oxera, The continuing development of airport competition in Europe
[22] Thessaloniki Forum, First Report Working Group Market Power Assessments

57. We now go onto comment on the specific propositions put forward by DAA.

Shadow Price and Negotiated Settlements

58. DAA has suggested that it would like to see a shadow price cap with negotiated settlement with airlines either on a bilateral or multilateral basis, noting that it believes that this would be possible without a change to the Aviation Regulation Act 2001. This is, in essence, the model adopted at Gatwick Airport.

59. It is not clear to us from the limited detail provided in the Submission how the proposed shadow price cap regime would differ in substance from the existing price cap regime.

60. We would like to make it clear that bilaterals/multilaterals are possible without changes to the Aviation Regulation Act 2001 or the existing regulatory regime. It appears to us that this is similar to the current de facto regime at Dublin Airport, as bilateral agreements have always been possible between DAA and airlines and the DAA published prices, based on the price cap regime, are essentially the fall-back if a bilateral does not exist. Previous efforts to reach a bilateral with DAA have been unsuccessful due to DAA's limited engagement. The failure of previous discussions on bilaterals tells us that the current price cap regime appears to be a satisfactory outcome for DAA.

61. Whilst we would welcome engagement by DAA in seeking bilateral agreements on pricing and service with its customer airlines, this would, in any event, be possible without changing the current regulatory regime and would not contravene Irish legislation, nor any of the principles of the Airport Charges Directive (the 'ACD'). However, as noted above, DAA's track record in engagement and effective consultation with its customers would strongly suggest that this would not be effective absent a firm backstop of regulation set in the conventional manner.

Price Monitoring

62. Alternatively, DAA puts forward a Price Monitoring regime similar to the above where prices are negotiated, agreed, and published, with CAR only intervening if there is failure to agree or in the event of a complaint. However, the adoption of such an approach would probably require new legislation and so could not be implemented in the near term. Realistically, with the Air Navigation and Transport Bill 2020 due to pass into law later in 2021, it will likely be at least 5 – 10 years before there are any further substantive changes to the legislation underpinning the regulatory regime.

Recommendations on market power assessments to ensure that economic regulation of airports in the EU is appropriately targeted, November 2017, paragraph 33.

[23] Ibid, paragraph 34.

[24] Thessaloniki Forum, Remedies Available to ISAs to Address Potential Misuse of Significant Market Power by Airports, December 2019, paragraph 5.12.

63. Fundamentally, this approach relies on the airport and the airlines being able to reach agreement, with the role of the regulator reduced to monitoring outcomes in terms of price, service quality and investment. This is a very light touch form of regulation and, in essence, is a form of ex-post regulation which would not be appropriate given the existence of SMP at Dublin Airport and DAA's record of lack of engagement with its airline customers.

64. CAR's role in the determination of charges at Dublin airport would be weakened to the extent that Ireland would certainly not be in a position to rely on the Article 6(5)(a) of the ACD exemption for disapplication of Articles 6(3) and 6(4) of the ACD. The fundamental shift in CAR's role under the regulatory regime would need to be considered and captured in this new legislation and such a move is both unrealistic and undesirable at this time.

Modifications to the Building Blocks Approach

65. In the event that supposedly lighter touch regulatory approaches are rejected, DAA sets out (paragraph 4.1.4) a number of considerations that it believes should inform the application of a building blocks regime in future:

- How to ensure the regulatory framework allows Dublin Airport to adopt whole life cost principles, by trading off between operational and capital solutions?
- How to ensure that the investment appraisal process appropriately captures external costs (e.g. carbon)[25] and benefits (e.g. economic growth)?
- How should the regulatory framework take account of a broader set of issues than purely financial (efficiency) considerations, including social, human and environmental capital?
- Linked to the above, whether an approach based on ex ante 'rules' and 'incentives' encourages the right behaviours and is likely to address long-term challenges?
- The extent to which a greater level of collaboration is possible and would be of benefit to all parties?

66. This leads onto a number of propositions from DAA as to how the regulatory framework should be adapted.

- Risk Sharing Mechanisms - the current regulatory framework assigns all volume risk to Dublin Airport through the per passenger price cap, but DAA claims the impact of Covid-19 has made this unfair;
- Cost Assessment – with DAA claiming that the CIP review takes up too much time and meetings and expressing a preference to focus on the largest projects of most concern to airlines;

[25] It is noted that there is a Bill currently within the legislative process that would add government policy on aviation, sustainability and climate change to CAR's objectives in future.

- The Regulatory Till – DAA stating a preference for a hybrid till in order to give it flexibility to embark upon higher risk commercial ventures and innovations that might not have the support of the airlines;
- Price Cap Compliance – focussing on the yield concentration issues that have arisen as a result of Covid-19 due to declines in passenger numbers being greater than declines in aircraft movements;
- Price Control Duration – DAA seeks a longer period of 6 to 7 years;
- Regulated Entity Recapitalisation – DAA seeks an adjustment to the RAB to compensate it for the continued deduction of regulatory depreciation during a period when revenues are depressed.

67. We now go on to comment on each of these proposed adjustments to the building blocks approach in turn.

Risk Sharing Mechanisms

68. DAA states that the current regulatory framework assigns all volume risk to Dublin Airport through the per passenger price cap but that, due to Covid-19, it is no longer able to manage and/or control these risks (paragraph 4.2.1). DAA cites a number of examples, including Rome Airports where the airport's liability for the volume risk is capped at +/-5%.

69. It is important to recognise that, given the strong monopoly position and market power held by Dublin Airport, the volume risk is minimal other than in circumstances as currently due to a global pandemic or other external shock to aviation market demand. In this eventuality, as currently, the risk to the volume of demand cannot be controlled or managed by the airlines either. Hence any transfer of the volume risk to the airlines would be totally unfair and unacceptable. In these circumstances, there is no-one to whom the airlines could transfer the risk.

70. It is important to note that volume risk is inherent in an airline's operations already, i.e., lower passenger numbers mean lower revenues and higher unit costs per passenger. Transferring further volume risk from Dublin Airport to airlines would be imbalanced and would mean minimal risk attaching to the airport, which, as discussed below, is in the best position to manage it in normal circumstances.

71. As CAR has always accepted, any risk should be allocated to the party that can best manage it:

"The combined effect of different elements of risk results in high powered incentives, not only to beat the various targets we set, but also to respond appropriately to changing circumstance."[26]

and:

[26] Issues Paper CP7/2018, paragraph 4.14

"A guiding principle in past determinations has been that the DAA should bear those risks that it is best able to control. For example, it bears the risks associated with cost outturns deviating from those forecast at the time of a determination."[27]

72. Ryanair has previously pointed out, in its response to CAR's Issues Paper (CP7/2018), that CAR has previously stated that:

"This remains the case, and Dublin Airport should assume all the risks that outturns deviate from the numbers assumed in the building-block calculations, as this is the principle on which incentive-based regulation is founded.

Responsibility for volume risk should remain with DAA as it has ability to stimulate growth through reductions in airport charges and / or the introduction and long-term retention of appropriate incentives. When external shocks occur, airlines can reduce fares to stimulate passenger throughput, which mitigates the risk to airports but may require airports to reduce airport charges temporarily. To the extent that residual risk remains with the airport, it can be compensated for by the airport reducing opex. In any event, airports are better placed to bear volume risk than airlines, given the nature of their business. Risk is also factored into the regulatory model through the choice of an appropriate WACC.

In the event of a shortfall in traffic vis-à-vis passenger forecasts, it would be counterproductive for the airlines to take on the risk through higher charges as this would create a perverse incentive to reduce traffic still further. If the reason for the shortfall is general economic conditions, it is likely that airfares will have been reduced in an attempt to stimulate demand, making any increase in charges in such circumstances doubly unfair. If traffic grows more than expected, airlines would expect that any excess returns to the regulated entity be returned to customers at the next determination."[28]

73. To the extent that DAA is required to accept the normal volume risk, this is, in any event, factored into the WACC and is, thus, reflected in the price that users pay.

74. The UK CAA is giving some consideration to whether volume risk sharing might be an appropriate response to traffic uncertainty following Covid-19 at Heathrow. However, the airlines have made clear that there are a number of factors that would need to be carefully balanced including:

- the need to consider the wider context, including both the likely impact on HAL's cost of capital and the operational measures HAL would be likely to take in response to different traffic scenarios;
- a lack of support for the use of the RAB as a mechanism to defer increases in charges; and
- the need for any specific proposals would need to clearly demonstrate real consumer benefits and should only be considered once HAL had exhausted all opportunities within its control.

[27] Maximum Level of Airport Charges at Dublin Airport, CP/2013, page 12
[28] Ryanair Response to CP/7 2018.

75. Based on this, the UK CAA concluded:

"Reflecting the current and ongoing difficulties associated with traffic forecasting, we are confirming our intention to introduce new arrangements for traffic or revenue risk sharing. More work is required over the coming months on the design and calibration of these arrangements, as well as on the interaction with other elements of the regulatory framework (including how such arrangements would prevent undue upward pressure on HAL's cost of capital and level of allowed returns)."[29]

76. It is clear that risk sharing is not seen as a permanent regulatory mechanism but a possible short-term response to the difficulties in forecasting demand due to Covid-19. It can never be appropriate over the longer term in circumstances where an airport has SMP.

77. However, for the reasons pointed out above, introducing a volume risk sharing mechanism at this time would constitute an unfair transfer of risk to the airlines who are no better placed to manage that risk than the airport operator. It would need to be clearly demonstrated that adopting a different approach to risk sharing would result in lower prices, to stimulate recovery, than would otherwise be the case. The introduction of such a mechanism would need to be on the basis of clear agreement to the forecasts upon which the mechanism is based between the airport and its user airlines.

Cost Assessment

78. DAA has expressed a view that that the CIP review takes up too much time and meetings (paragraph 4.3.4) and they would prefer a focus on just the largest projects of most concern to airlines. Whilst we commend DAA's concern for efficiency and reducing the burden of unnecessary consultation, the quid pro quo to such an approach is that there would need to be significantly greater sharing of information regarding the justification for each project in terms of the benefits to users from each scheme. Presently, users are unable, from the information provided, to understand the business case for each project and whether the benefits to users outweigh the costs in terms of the increments to the price cap.

79. DAA proposes that a set amount of annual CAPEX could be undertaken without the need for consultations, particularly in the case of REPEX (routine and maintenance CAPEX), where costs are typically lower and certain. The user consultations would, instead, be based on the major capital items impacting on capacity for growth, ensuring the focus is on the key aspects which have the potential to benefit users and/or the greatest implication for the RAB.

[29] UK CAA, CAP 2139: Economic regulation of Heathrow Airport Limited: Consultation on the Way Forward, April 2021, paragraph 25

80. Regardless of any change to the consultation provisions, there would still need to be ongoing regulatory scrutiny of all elements of the capital programme to ensure that expenditure on maintenance, safety and security was essential and being undertaken in the most cost-efficient manner. This would not reduce the need for scrutiny of the programme as a whole by CAR. In particular, it would be important to benchmark the costs for such works, particularly any set annual allowances for REPEX, against those at other airports operating within a competitive environment as there is a real risk that DAA would overstate such requirements. Such elements would lend themselves to a StageGate type process, focussed on cost efficiency, leaving the main consultation requirements focussed on the business case for capacity, growth and commercial schemes. This would necessarily require a change in approach by DAA to a more constructive engagement, whereby it is open to projects being re-scoped in response to airline concerns and if the business case to the airlines was not robust. Based on DAA's current consultation performance, we would not be confident that DAA would be willing to engage appropriately and that this would still leave a large burden of regulatory scrutiny to CAR.

<u>The Regulatory Till</u>

81. DAA seeks to move away from the current single till form of regulation and for CAR to adopt a hybrid till. Its stated rationale is that this would give it more flexibility to innovate and embark on projects with a higher risk profile and that may not be supported by the airlines (paragraph 4.4.9).

82. Although this is its stated intent, it is clear that the main purpose is to allow DAA to retain a greater proportion of the commercial income and to reduce the extent to which this cross subsidises charges to users (paragraph. 4.4.8). DAA's real intent is to use a hybrid till so as to justify a higher price cap and the remainder of the arguments made by DAA are no more than 'smoke and mirrors'.

83. In practice, DAA's arguments for a hybrid till are weak, suggesting that there would be some unspecified sharing of profits from commercial activities (paragraph 4.4.4). The benefits cited by DAA (paragraph 4.4.5) either flow to the airport operator or are illusory:

    a. Effect on charges – DAA suggests that it could use some revenue from commercial activities to subsidise airport charges but there is no guarantee or requirement for it to do so under a hybrid or dual till regime. Hence, charges would be likely to rise absent other adjustments;

    b. Economic efficiency – DAA appears to argue that the complementarity between commercial and aeronautical revenues has been overstated. It is difficult to see how this can be argued given that these commercial revenues derive from the passengers using the airport to access the services provided by the airlines and/or are earned from activities supporting the operation of air services;

c. Market power in commercial activities – DAA seeks to argue that it has less market power in relation to certain commercial activities as it lacks space to expand. In practice, this would increase rather than decrease their pricing power due to scarcity rents. It would not diminish market power per se;

d. Financial viability – DAA argues that retention of revenues outside the till could be used to build up capital reserves enabling capital works to be funded and the cost of capital lowered. However, if this was the case, the price cap would need to be adjusted downwards in any event and the impact would be neutral compared to a single till approach.

84. The issue was previously consulted on by CAR in 2010[30]. In response, IATA provided a summary of why retention of the single till should remain the regulatory approach:

- The single till is an acknowledgement of the symbiotic and essential relationship between airports and the airline users.
- Airlines bring passengers to the airport and, as the primary users, they should share the benefits from the non-core activities.
- Lower fares as a result of lower charges increases the attractiveness and competitiveness of the airports.
- Airports are built specifically for aviation purposes and priority must be given to airlines activity and passenger facilitation.
- The single till eliminates the need for difficult detailed cost and asset allocation between aeronautical and commercial tills.
- There is no evidence that dual till provides better incentives for airports to make more timely investments than under the single till.
- A dual till can incentivise airports to invest in potentially higher-return commercial activity rather than essential aeronautical infrastructure.
- The single till incentivises and allows airports to increase retail and commercial revenues while decreasing charges to airline users.
- A single till is supported by ICAO Charges Policies[31].

85. Following this consultation, in 2012, CAR concluded that it was minded to retain the single till approach not least because of the difficulty in defining the boundaries under a dual till system, but was open to excluding some commercial activity from the till. This resulted in the separation out of the land for the Airport City Development, which is fundamentally about DAA using part of the site for non-airport related property development. As such, airlines rightly considered that they were not willing to absorb the risk of such non-aviation related development so long as appropriate adjustments were made to the RAB for the value of the land.

86. CAR, at the time, correctly characterised the issues:

[30] Defining the Regulatory Till, Commission Paper 4/2010
[31] ICAO Document 9082/8 paragraph 30 i)

"Moving to a regulatory environment where some activities generating commercial revenues are within the regulatory till and others outside may create some perverse incentives. It may distort future investment incentives. For example, if car parks are outside the regulatory till the DAA's incentives to invest in other transport modes may be reduced if such investments might reduce demand for its car parks."[32]

87. Indecon also considered this issue in their report on the regulatory regime for DTTAS:

"A single till approach is commonly used in many EU airports. The potential benefits of a single till approach is that it reflects the reality of the interaction between airport operational activities and other income derived as a result of passengers visiting the airport. It also removes the need to attempt to separate all costs which are related to airport operational requirements and those costs attributable to other sources of airport revenues within the airport. In many ways it could be argued that effective regulation under both options should result in the same level of price caps although this would depend on how costs are allocated and it is sometimes thought that dual till regulation could result in higher airport charges."[33]

88. Consequently, Indecon recommended that a single till approach to the determination of airport charges be retained.

89. There is other research evidence which shows the dangers of adopting dual or hybrid tills in terms of allowing airport operators to earn substantially in excess of their cost of capital. For example, York Aviation's study for A4E[34] found that:

"Generally, airport companies make greater returns overall where a Dual Till is in force, as commercial revenues are not used to underpin the cost of core aviation activities; the Single Till mechanism and full economic regulation are more effective in restraining returns…Dual Till airports tend to be achieve returns on capital employed greater than the WACC and these represent supernormal returns to shareholders, which would be competed away over time in a fully competitive market."

90. Hence, operation of dual or hybrid till regulation would need to be coupled by measures to ensure that airport operators are not earning such supernormal profits, such as adopting a lower WACC for the regulated till, to ensure that users are not overpaying for the use of airport assets and in relation to the passengers that they deliver to the airport from which such supernormal profits can be earned. Hence, any benefits from moving to a hybrid till are illusory and, to the extent that benefits are cited by DAA, these would be earned at the expense of the users of the airport and so breach fundamental regulatory principles.

[32] Future Investments and the Regulatory Till, Commission Paper 1/2012, April 2012, paragraph 3.31.
[33] Indecon, page 67
[34] The Profitability and Regulation of European Airports 2017.

Price Cap Compliance

91. DAA cites the current issue of price cap compliance due to Covid-19 as a reason to change the compliance mechanism (paragraph 4.5.1). Although acknowledging that this was due in large part to falls in load factor on passenger flights, it also cites the increase in cargo flights as a factor. In practice, cargo flights at Dublin Airport increased by less than 20% in 2020 compared to 2019 and still made up only 6% of total flights despite the dramatic downturn in passenger flying during the pandemic.

92. It would be wrong to make long term adjustments to the structure of the price control formula based solely on short term conditions during a pandemic. Nonetheless, we would be open to considering the case for either removing cargo flights from the per passenger-based price cap or accounting for cargo operations on a workload unit basis, including cargo carried on passenger flights. The implications of this would need to be carefully modelled, consulted upon, and safeguards put in place to ensure that cargo operators were neither under or over-charged relative to passenger operations.

Price Control Duration

93. DAA has suggested that it would wish to see a longer regulatory period of 6 to 7 years so as to reduce the regulatory burden, allow it to retain the benefits of innovation for longer and to provide tariff certainty (paragraph 4.6.3). However, it links its request for a longer regulatory period to the concept of regular mid-period reviews under the current regime. Ryanair cannot see the merits in such an approach as it would increase rather than decrease the number of reviews. Furthermore, to the extent that there are reasons for the duration of a price cap to be extended in particular circumstances, the Air Navigation and Transport Bill 2020 allows for the period to be extended by up to 2 years in any event.

94. It is possible that such an extension might be an appropriate response to the Covid-19 pandemic dependent on the pace of recovery and any subsequent interim review undertaken by CAR pursuant to CP1/2021. However, we are strongly of the opinion that this should not set a precedent for the duration of the regulatory period to be routinely extended. DAA have not provided any evidence that a longer regulatory term would allow them to achieve innovation and dynamic efficiency in a manner where the benefits would be shared with users. Indeed, precedent would suggest that, even when given a longer period to achieve a ‘glidepath’ to efficient opex, DAA has failed to deliver.

Regulated Entity Recapitalisation

95. Finally, DAA argues that it is wrong that regulatory depreciation will continue to be deducted from the RAB at a time when Dublin Airport is unable to earn revenues commensurate with this depreciation. DAA proposes that this should be addressed by an upward adjustment to the RAB over time so that it can continue to earn the same revenues (paragraph 4.7.4). However, such an adjustment would also need to remove from the RAB returns earned by DAA as a consequence of the decision made by CAR not to adjust the RAB relative to unspent capex during 2020 and 2021.[35]

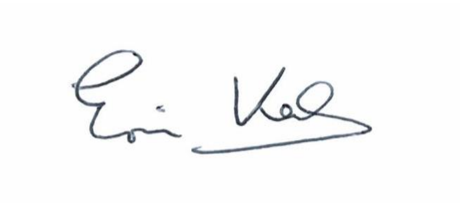
96. In essence, what DAA is seeking here is another form of risk sharing mechanism whereby it would be compensated by users for the fall in revenues as a consequence of the Covid-19 pandemic. It is fundamentally unfair that the burden of risk should be passed to users as we have noted above.

Conclusion

97. Fundamentally, virtually all of the changes to the building blocks proposed by DAA are for the benefit of DAA and would be to the detriment of users as they are aimed solely at increasing DAA's returns and achieving a higher price cap.

98. This would be contrary to the objectives of the Aviation Regulation Act 2001 and contrary to the objectives of National Aviation Policy, aimed at creating the conditions where airlines can maximise connectivity for the benefit of the economy of Ireland.

Yours sincerely,



Eoin Kealy
Head of Competition & Regulatory

[35] CP12/2020