**IATA response to the Irish Commission for Aviation Regulation (CAR) response to the Draft Determination of 27 May 2011 on the maximum level of Irish Aviation Authority (IAA) Aviation Terminal Service Charges (ATSC) for 2012-15**

1 In our 14 December 2010 response to the CAR Issues Paper of 29 October 2010 we said that in our view that the current economic regulation regime was not sufficiently bearing down on Irish ATSC costs and charges. We had suggested that the 33% charges increase from 1 July 2010 together with the 14.6% increase from 1 January 2011 indicated that the current system was not fit for purpose.

2 We therefore welcome the CAR's robust approach to the economic regulation of ATSC with a proposed draft determination for a starting cap that represents a reduction of some 28% on the 2011 cap with a further reduction of about 5% per annum in real terms for the following three years.

3 The CAR detailed analysis for the determination illustrates that while the IAA considerably under spent on capital expenditure allowed in the 2007 determination the current levels of operational expenditure exceed the forecasts and targets set in the Determination. In the meantime IAA has continued to price up to the maximum allowable cap.

4 We recognize that traffic was adversely impacted due to the economic downturn during the last determination. Nevertheless over the last ten years, including the recent economic and traffic downturn, the airlines have been obliged to take robust efforts to reduce costs and increase efficiency against the background of increasing competition and changes to business models. Worldwide this has enabled a 15% average reduction in airline fares over the same period, while in comparison ANSP costs and charges have steadily increased.

5 We therefore urged the CAR, as the independent regulator, to ensure IAA is managing its business as efficiently as possible and to set operational expenditure projections on the basis of equally stretching efficiency improvements.

6 In particular we suggested that IAA should be incentivised to be more flexible and efficient at managing changing workloads. Intuitively, and particularly when compared to the airlines achievements, there is an opportunity for significantly more challenging operational expenditure efficiency. Non-regulated businesses, including airlines, operating in competitive industries, are obliged to successfully manage all such risks.

7 We commented that we rely on the CAR's robust scrutiny on key potential areas for further improvement and efficiency savings. Staff costs, representing some 46% of total IAA TNC costs, are clearly a major area for such scrutiny. As the IAA is a monopoly provider of essential service to the airlines we rely on the CAR to ensure they are not immune from these disciplines and pressures.

8 We therefore fully support the CAR proposal for IAA to achieve operating efficiencies of around 6% per annum in real terms, an area where we note their costs have evolved in a manner that appears to compare unfavorably with other sectors in the Irish economy. .

9 In our Issues paper response we stated that along with flight efficiency, delay performance is the most important component of service quality for the airlines. Not surprisingly we therefore fully support the proposal for introduction of a service quality term with a financial incentive for IAA to avoid delays due to industrial action, equipment failure and other factors within its control. We welcome the proposal for the price cap to be reduced by 0.33% for each day there is an ATFM regulation delay in excess of 15 minutes, but note that the total penalty in a year is capped at 10% and would apply if the IAA was responsible for significant disruption on 30 days or more.

10 We can understand the CAR reasons for not introducing a rolling incentive mechanism (RIM) scheme in this determination period. While we appreciate the potential incentive benefit of the RIM and the ability to ensure that customers share the benefits earlier than they would otherwise, we are also concerned at the potential for such a mechanism to be gamed, including the restating of costs, and the lack of transparency on which benefits have been identified.

11 With regard to capital expenditure we welcome the proposal for the forthcoming Determination to "claw back" those revenues that the IAA was allowed to collect on the basis of investments that it subsequently did not make. We note this is achieved through revising down the RAB with future depreciation charges and depreciation returns on capital consequently being lower in the next period.

12 As stated in our response to the Issues paper we fully support the principal of milestone capital allowances but given the relatively large investment costs for major projects such as airport control towers we believed consideration should also be given for a more symmetrical system including trigger penalties with reductions in charges.

13 We can therefore support the proposal for IAA to be able to collect additional revenues if passenger numbers exceed 23.5m at Dublin airport, so as to fund a control tower or other option to permit use of a parallel runway at Dublin. We note this will allow IAA to collect EUR 4.1m for subsequent years of the regulatory period, or about a 20% increase in the cap. We appreciate that

this will reduce the risk of users being asked to pay for a tower when there is no runway or vice versa.

14 We are pleased the CAR has not reached a final conclusion on how much to allow for such a project given uncertainty about viable technologies. Such new technologies as remote and virtual tower possibilities should also be considered against the increasing trend for tower and approach service to be out-sourced or put out to tender (currently happening in at least four European States). We welcome these initiatives to assist provide more cost-effective tower service.

15 We generally support the proposal for continuation of a volume-risk sharing regime with price caps adjusted to partially compensate IAA if traffic was lower than expected or to partially reimburse airlines if traffic exceeds forecast. With regard to volume risk in our Issues Paper response we said it should be considered that airlines have a higher risk on traffic and that ANSPs are better placed to take this risk. In the intensely competitive airline business airlines are inevitably forced to reduce fares and yields in the event of traffic shocks or downturns while generally still being obliged to pay the same or even increased charges to ANSPs.

16 We can therefore support the proposal for IAA to reimburse users within 45 days should it over-collect in a year and for future caps to only be adjusted to allow recovery of at most 5% of the allowed revenues in the year of any under-collection. Our support for this proposal is also against the background that IAA has generally always priced up to the maximum allowable cap.

17 We could accept the proposed cost of capital rate of 5.6% pre-tax real rate of return providing the CAR draft proposals remain robust and challenging and not reduced or watered-down below the current proposed price controls. Our views on the relatively low-risk enjoyed by ANSPs are clearly detailed in 8.23 of the CAR Draft Determination paper. This is against the background not only of the relatively low risk of ANSPs but because we are aware that some ANSPs have used the cost of capital to build up reserves or profits.

18 We recognize that many ANSPs have a tendency to be overcapitalized with assets and cash, with the result that a small weighted average cost of capital (WACC) on a very large asset base can have a higher cost impact than a big WACC rate on a leaner balance sheet.

19 In our view ANSPs have no requirement to build-up any reserves to finance investments, which are already covered by depreciation and interest costs. Any such reserves could be regarded as pre-financing that can be considered as a “double-hit” for the users who finance the build-up as well as the normal investment costs. This should also be considered against the possible privatization of IAA and potential loss of contributing profitable revenues from the regulatory service role and the possible desire to generate compensating returns.

20 In theory we can understand the benefit of the rolling investment mechanism that should incentivise IAA to continue to pursue continued improvements throughout the Determination period and ensure that customers share the benefits earlier than they would otherwise. We are however also concerned at the possibility this mechanism can be gamed, including the restating of costs, and the lack of transparency on which benefits have been identified. We therefore welcome the CAR intention to fully consider the appropriateness of the RIM for the next Determination.

21 We note from 8.10 of the CAR Draft determination that IAA presented its investment plans to airline users at a meeting in April 2011. In view our interest as evidenced by our response of 14 December 2010 to the CAR Issues Paper of October 2010 as well as the previous determination, it is disappointing that IATA was not involved in this process.

22 We support the continued treatment of inflation and deflation in a symmetrical manner and agree that the proposed volume risk-sharing arrangements already reflect a judgment about the extent to which the IAA and the airlines respectively should assume the risks of any downturn or upturn in IAA traffic.

23 We are content with the proposals to continue with a four-year determination period.

24 We are disappointed with the decision to continue with an airport system of ATSC for charging purposes rather than a fairer and much more cost-related separate cap for each airport. While we recognize this is ultimately a Department for Transport decision, it is clearly intuitive that the users of the larger Dublin Airport are significantly cross-subsidising the much smaller Shannon and Cork users. In this regard the argument that a number of EC-Member States also charge on an airport system basis is a weak and inappropriate defense for the continuation of a discriminatory and anti-competitive system.

25 It should also be noted that such States are increasingly taking top-down measures to improve the cost-effectiveness and reduce the charges for ATSC through initiatives such as out-sourcing and automation in addition to evaluation of remote or virtual tower service provision. We would urge the CAR to consider support for such initiatives that can reduce our ATSC costs and charges.

26 We are of course happy to provide the CAR with any further information regarding our views and requirements.

Geneva 24 July 2011