



Decision of the Commission further to Referral by the 2012 Aviation Appeals Panel

Commission Paper 1/2013

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1. Introduction

- 1.1 This document sets out our final decision following the referral from the 2012 Aviation Appeals Panel of the 2011 Determination on the maximum levels of aviation terminal service charges that the Irish Aviation Authority (the IAA) may levy at Cork, Dublin and Shannon airport. We also set out the reasoning for our decision.
- 1.2 We published the 2011 Determination on 24 October 2011 as CP2/2011. This document is available, along with an associated spread sheet, on our website at www.aviationreg.ie.
- 1.3 Following the 2011 Determination, the IAA requested that the Minister for Transport, Tourism and Sport establish an appeal panel pursuant to section 40 of the Aviation Regulation Act 2001. The Minister acceded to the request and on 27 August 2012 an appeal panel (the Panel) was established to hear the appeal.
- 1.4 On 16 November 2012, the Panel issued its decision. It referred the 2011 Determination back to us for review in respect of a single ground:
 - Pension costs – the Panel was not satisfied that we had due regard to pension costs in our determination.
- 1.5 In the case of the remaining grounds raised in the appeal, the Panel rejected the case made by IAA. The decision of the Panel is also available on our website.
- 1.6 Following the referral we have undertaken a review to decide whether to affirm or vary the 2011 Determination. Upon receipt of the Panel's report, we issued Commission Paper CP2/2012 notifying interested parties of the review and inviting submissions in respect of the matter referred back to us by the Panel. CP2/2012 listed the matter referred back and described the scope of our review. This document is available on our website.
- 1.7 Section 2 of this paper describes the review process. Section 3 sets out our decision. Section 4 sets out the reasons for the decision and summarises the responses from parties to CP2/2012.

2. Review Carried Out by the Commission

- 2.1 The scope of the review was set out in CP2/2012. The review was limited to the single matter identified by the Panel as constituting sufficient grounds for referring the determination back to us. In conducting the review, we have considered the decision of the Panel and the reasons given by the Panel for the referral.
- 2.2 CP2/2012 was the first opportunity for parties other than the IAA to comment on the appeal. The Panel had not invited third parties to comment on the appeal.
- 2.3 Two parties responded to CP2/2012 by the deadline: Aer Lingus and the IAA.
- 2.4 In conducting the review and making our decision, we have considered the representations of both parties. We have also had regard to the statutory objective and the statutory factors set out in section 36 of the Aviation Regulation Act 2001 (as amended by the State Airports Act 2004).

3. Decision of the Commission

3.1 We have decided to affirm our Determination.

3.2 The following section explains why we have reached this conclusion.

4. Reasons for the Commission’s Decision

- 4.1 The Panel asked us to re-consider our treatment of pension costs. It concluded that we did not have due regard to these costs, and that applicable European regulations allowed the IAA to recoup its forecast pension costs through aviation terminal service charges for staff involved in providing these services at Dublin, Cork and Shannon Airports.

Responses to CP2/2012

- 4.2 We summarise below, without comment, the observations and arguments that parties made in their responses to CP2/2012. Their full responses are available on our website (www.aviationreg.ie).

Aer Lingus

- 4.3 Aer Lingus agreed with the approach we adopted in the Determination. It believed it was consistent with the requirements of Article 6.2 of Commission Regulation (EC) No 1794/2006 and necessary to ensure cost efficient terminal services. Aer Lingus did not think that increases in pension costs should automatically be passed through into the price cap.

IAA

- 4.4 The IAA underlined that there is limited scope for changes to be made to the pension costs under the IAA’s defined benefit scheme because of the provisions in the Irish Aviation Act 1993.
- 4.5 It argued that Article 6.2 of Regulation (EC) No 1794/2006 allows the IAA to recoup its pension costs through aviation terminal service charges for staff involved in providing terminal services at Cork, Dublin and Shannon airports. It stated that the National Performance plan of the National Supervisory Authority fully allowed the inclusion of pension costs in the IAA’s en route cost base. Further it cited the decisions in the UK which allow the allocation of NATS’ cash contributions to the pension fund to the cost base.
- 4.6 The IAA claimed that it reasonably reduced its liability to the pension fund and its future risk exposure. As a result, the main defined pension scheme had been closed to new entrants by the end of 2011 and a new 2012 hybrid pension plan has been created. The IAA also undertook other measures to reduce its pension fund deficit.
- 4.7 Finally, the IAA argued that it does not have recourse to the State or any other funding sources to recover its costs. Therefore these costs have to be met from its operational activities. It argued that pension costs are different to operating costs and therefore should be treated differently within the price cap, with the full cost of pensions being allowed. The IAA suggested that pension costs from 2007 to 2011 that exceeded the level of pension costs allowed in the 2007 determination should also be carried forward into the 2011 Determination.

Commission’s Decision

4.8 In deciding to affirm our original Determination, there are two points that lead us to conclude that the Panel’s referral does not warrant a change.

- We had due regard to the IAA’s operating costs, including pension costs, when making our 2011 Determination. Our approach to these costs is simply different to that advocated by the IAA.
- The relevant European regulations do not oblige us to provide for a full pass through of forecast pension costs when making a determination.

4.9 We develop these points in turn.

Treatment of Pension Costs

4.10 We are required to have due regard to operating and other costs incurred by the IAA in providing aviation terminal services, pursuant to section 36(e) of the Aviation Regulation Act 2001.

4.11 In this regard, we identified pension costs as an issue from the start of the process leading to the 2011 Determination. The Issues Paper published in October 2011 had a chapter on operating costs, and identified there pension costs as a subset of staff costs.¹ That paper started a consultation process with interested parties, and invited their comments on how we should proceed given our statutory objective and the various factors to which we have to have due regard.

4.12 In its response to this paper, the IAA argued that the full value of the pension costs paid out in the determination period should be included in the cost base. It claimed that such an approach would be consistent with practices in other regulatory environments and that the “SES II amended Charging Regulation” looks to protect pension contributions as a “pass through cost”. The IAA quoted articles 6(2) and 11a(2)(c) to support its viewpoint.

4.13 In May 2011 we published our Draft Determination.² Prior to making this Draft Determination, we had sought and received from the IAA its forecast operating costs for the period of the determination. The IAA’s forecasts included forecast pension costs. The Draft Determination devoted an entire chapter to the IAA’s operating costs and how forecast operating costs might be treated in relation to the calculation on maximum levels of charges allowed. It identified staff costs as an important element of operating costs, and discussed pension costs as a subset of staff costs.

4.14 The IAA was one of four parties that responded to the Draft Determination. Its response included a number of arguments in relation to the proposed treatment of pension costs. Having considered the

¹ See Commission for Aviation Regulation (2010) *CP3/2010 Maximum Level of Aviation Terminal Service Charges that may be imposed by the Irish Aviation Authority ISSUES PAPER*, www.aviationreg.ie

² See Commission for Aviation Regulation (2011) *CP1/2011 Maximum Level of Aviation Terminal Service Charges that may be imposed by the Irish Aviation Authority DRAFT DETERMINATION*, www.aviationreg.ie

representations made by all interest parties, we published our Determination on aviation terminal services charges. In relation to operating costs, the treatment of pension costs was not that advocated by the IAA.

- 4.15 Instead, we set an efficiency target for overall operating costs with reference to traffic levels and operating costs in 2006 and forecast traffic levels in 2015. With traffic levels in 2006 similar to those forecasted for 2015, we concluded that the IAA should be incentivised to realise similar levels of operating costs in 2015 as it had incurred in 2006 (controlling for the effects of inflation). We were not persuaded that an efficient level of operating costs in 2015 would exceed the level required in 2006. For the years 2012 through to 2014, our calculations included allowances for operating costs consistent with a transition from the existing levels to our target 2015 level. The IAA was expected to realise operating cost savings of approximately 6 per cent per annum. In this manner, we had regard to operating and other costs in providing aviation terminal services, as required by statute, when determining the maximum level of charges.
- 4.16 The IAA argues that our approach to operating costs should not apply to pension costs. Instead it states that these costs, as forecasted, should be included in full in the calculations underlying the Determination. To support its argument for a cost pass through in relation to pension costs, it refers to Commission Regulation (EC) No 1794/2006.
- 4.17 As described above, the IAA made a similar argument in representations to us prior to the 2011 Determination. We rejected the idea then of a cost pass through for pensions in our final Determination.³ In doing so, we were aware of European regulatory requirements.

Compliance with European Regulations

- 4.18 European regulations and our determinations both constrain the IAA's discretion when levying aviation terminal service charges. Although the IAA may fund the operation and management of aviation terminal service charges in whole or in part from such charges, its power to set these charges is not an absolute power. Our 2011 Determination caps the level of aviation terminal service charges the IAA may levy for the years 2012 to 2015 inclusive. In 2015, the IAA will have to comply with the provisions of Regulation (EC) No 1794/2006 as amended by Regulation (EU) No 1191/2010; in the years 2012-2014 Ireland chose not to apply those provisions and the unamended Regulation (EC) No 1794/2006 instead applies.
- 4.19 The Panel's referral gives rise to the question of whether and how European regulations constrain our discretion when making a determination. Specifically, are we required to include in our calculations the entirety of the IAA's forecast pension costs for the duration of the 2011 Determination? We do not think so.

³ See paragraph 5.22, Commission for Aviation Regulation (2011) *CP2/2011 Determination on Maximum Level of Aviation Terminal Service Charges*, www.aviationreg.ie

- 4.20 We accept that our Determination should permit the IAA to comply with relevant European regulations. However, we reject the idea that our 2011 Determination prevents the IAA from complying with those regulations. Moreover, to implement the pass through of pension costs sought by the IAA would potentially be at odds with the approach to regulation that we have adopted in all of our determinations governing aviation terminal service charges (and also airport charges), including the 2007 Determination which also covered a period when Regulation (EC) No 1794/2006 applied.
- 4.21 Our statutory objective in relation to aviation terminal service charges is to facilitate the development and operation of safe and cost effective terminal services. To achieve this goal, we have employed incentive regulation, an approach commonly used by economic regulators. A fundamental element of this approach is that the regulated entity is incentivised to realise efficiency savings. Cost pass through is not automatic. Instead, the cap on charges is set with reference to costs that the regulator thinks are achievable. The regulated entity then has an incentive to identify and implement operating efficiencies, with the prospect of profits (losses) if it is able to realise a cost base lower (higher) than the regulator assumed when setting the price cap.
- 4.22 Such an incentive scheme is consistent with Commission Regulation (EC) No 1794/2006. Article 12 states that Member States may establish incentive schemes to support improvements in the provision of air navigation services. The unit rate may be adjusted to provide for a bonus or penalty according to the actual performance level of the air navigation service provider against the relevant target. Article 12(2) sets out in detail what is foreseen. Member States which have established or approved incentive schemes shall monitor the proper implementation by air navigation service providers of these incentive schemes. As foreseen by Article 12 the form of price regulation we have adopted under the Aviation Regulation Act 2001 is incentive regulation, whereby the costs of the IAA are subject to an analysis as to whether or not they are cost effective and represent the efficient and effective use of all resources by the IAA.
- 4.23 A number of other articles in Commission Regulation (EC) No 1794/2006 are relevant in considering the appeal by the IAA. Article 5 sets out eligible services, facilities and activities to be taken into account by the IAA when establishing the costs of air navigation service provision. We use a similar approach in relation to the costs considered when making a determination.
- 4.24 Article 6 discusses the calculation of costs, including how they shall be broken down. It prescribes that the costs should be established in accordance with the accounting requirements laid down in an earlier regulation.⁴ That provision is mainly concerned with separation of costs and income from different aspects of the business of the service provider so that one can identify the costs and income from the provision of air navigation services – Commission Regulation (EC) No 1794/2006 seeks to contribute to achieving greater transparency with respect to the determination, imposition and enforcement of charges to airspace users. Article 7 deals with the allocation of costs, including a detailed description

⁴ See Article 12 of Commission Regulation (EC) No 550/2004.

of the eligible terminal service costs and the subtraction of terminal services costs from en route costs. There is nothing in our Determination that prevents the IAA from calculating and reporting costs in the manner required by these regulations: our Determination constrains the charges that the IAA may levy, rather than the costs that the IAA may report.

- 4.25 Article 11 deals with the calculation of terminal charges. However, the approach outlined is without prejudice to the possibility of a Member State applying an incentive scheme described in Article 12. As discussed above, Ireland does have an incentive scheme. Our Determination, rather than Article 11, governs the level of aviation terminal service charges that the IAA may collect. In collecting this sum, the IAA will have to set charges with reference to the definition of terminal service units referred to in this Article and defined in Annex V. Our 2011 Determination has been expressed in a manner that aligns the price cap with the charging unit that the IAA has indicated it intends to use to comply with this European requirement. This contrasts with the 2007 Determination, when our price cap was with reference to maximum take-off weight and it was left to the IAA to ensure that in setting charges per terminal service unit (as required by the European regulations) it complied with our price cap.

Conclusion

- 4.26 In conclusion, we are satisfied that our Determination does not need to be amended given European regulations. We note that in the recitals to Commission Regulation (EC) No 1794/2006, paragraph 4 states that

"in accordance with the overall objective of improving the overall cost efficiency of air navigation services, the charging scheme should promote the enhancement of cost and operational efficiencies."

It would be strange if a regulation with this stated objective could be used to justify charges in 2015 higher than the charges in 2006 when traffic was at a corresponding level. We do not think that it does. This stated objective echoes the statutory objective we have when making a determination under Section 36 of the Aviation Regulation Act 2001 –

"...the Commission shall aim to facilitate the development and operation of safe, cost effective terminal services which meet international standards..."

The challenge for the IAA is to achieve operating costs comparable with those incurred in 2006; the extent to which savings in pensions costs contribute to realising this goal is for the IAA to determine.