Joint Response by Forfás/Enterprise Ireland/IDA Ireland to CAR's Consultation on the Dublin Airport Charges Issues Paper

September 2013

Approximately three quarters of Ireland's exports of goods and services in 2011 were by development agency client companies in the internationally trading sectors. Agency-assisted companies operating in Ireland provide almost 300,000 direct jobs, a similar number of indirect jobs; 40 per cent of national GVA; €33 billion through payroll, materials and services purchases (which represents about 25 per cent of GNP); and three-quarters of all corporation tax.

The development agencies (Forfás, Enterprise Ireland and IDA Ireland) welcome the opportunity to input to the consultation by the Commission for Aviation Regulation (CAR) on its Dublin Airport charges issues paper.

Ireland's economic growth depends on the ability of businesses to trade successfully in increasingly competitive global markets. The availability of a competitively priced world class infrastructure (transport, energy, telecoms, waste and water) and related services is essential to support enterprise development, competitiveness and job creation.

As an island nation, excellent air connectivity is particularly important. Access to markets is one of the key factors for companies in deciding where to locate. Good international access (e.g. range of destinations, frequency, and cost) coupled with effective airport facilities and internal connectivity are key factors in mitigating the impact of Ireland's peripheral location in the eyes of potential investors, overseas customers and mobile employees.

Why good air access is increasingly important

The profile of Irish exports has changed significantly. Services exports are becoming increasingly important and in 2012 accounted for 49 per cent of total Irish exports, which means greater demand for air passenger services to a diverse range of destinations for meetings with client and overseas based colleagues. In addition, the composition of Irish merchandise exports has changed, particularly in key growth sectors like pharmaceuticals, medical technologies and ICT, where there has been a move from high volume, low value goods to low volume, high value goods. This has resulted in a change in the type of freight services demanded by these sectors, with an increasing demand for air freight services. While air freight represents about 16 per cent of the State's international merchandise trade in volume terms, it accounts for 38 per cent in value terms[1]. In addition to changes to the composition of Irish exports, the destination of Irish exports has become more diverse. This has implications for the international connectivity needs of businesses in Ireland.

The type of business activity that IDA and Enterprise Ireland client companies are engaged in is also changing – for example with more European headquarter and marketing functions locating in Ireland, executives need easy access to other office locations within the company and also to overseas clients; Irish companies are also setting up overseas offices to grow their business and are dealing with internationally based suppliers, clients and others (e.g. venture capitalists).

Continued access to a choice of competitively priced, frequent and direct services to a range of short haul and long haul destinations is critically important. Key to ensuring Ireland's direct connectivity needs are:

- policy and regulatory certainty to promote efficient and timely private sector infrastructure investment;
- adequate and efficient airport facilities and incentives to attract new air services;

1 The Competition Authority, Competition in the Irish Ports Sector, December 2012.

- good internal access to Irish airports to expand their natural hinterlands to drive demand of sufficient scale to support a diverse range of competitively priced direct services; and
- developing Dublin airport as a hub to increase demand to support the development of greater long-haul direct connectivity particularly to the Far East.

From an enterprise perspective, Dublin airport plays a critical role in providing businesses across the country with good international access, both in terms of passengers and freight – in 2011 (most recent data available), it handled 79 per cent of all passengers into and out of Ireland and 85 per cent of air freight. As Dublin airport dominates Irish air connectivity, ensuring efficient access to it from the main urban centres is critical. Recent investment in the motorway network to and from Dublin, the Dublin Port Tunnel and the upgrade of the M50 have significantly improved national and local access to Dublin airport.

Issues paper questions

The remainder of the paper will address the specific questions of relevance to enterprise in CAR's issues paper.

What changes, if any should be made to the approach to regulation that the Commission adopted in 2009?

The issues paper highlights a number of statutory developments since 2009, including the EC's Airport Charges Directive and the development of a new aviation policy.

One very important development that is not explicitly mentioned is the recently published Government policy statement on sectoral economic regulation[2]. Government has committed to undertaking a review of the aviation regulatory mandate by the end of 2013 and introducing legislation as required to revise mandates and provide for a hierarchy of objectives by mid-2014. In light of these commitments, the development agencies believe that the review of airport charges should be completed under the revised regulatory framework. This may require the temporary deferral of the comprehensive airport charges review until the new aviation regulatory mandate and the hierarchy of objectives are in place. Determining the maximum level of charges at Dublin Airport that will apply for at least four years (from 1st January 2015) under the existing regulatory framework would not be optimal.

Under the Action Plan for Jobs 2012, Forfás completed a study to identify changes to the operation of sectoral regulators to enhance cost competitiveness[3]. One of the sectors examined was aviation, specifically airport charges (see Chapter 5 of the Forfás sectoral regulation report).

2 Department of the Taoiseach, Regulating for a Better Future - A Government Policy Statement on Sectoral Economic Regulation, July 2013.

3 Forfás, Sectoral Regulation: study to identify changes to sectoral regulation to enhance cost competitiveness, April 2013.

As highlighted in the Government policy statement and the Forfás report, the existence of several (often) competing objectives can create tension. When setting the price cap CAR has three statutory objectives:

- The efficient and economic development of Dublin Airport;
- The ability of the Dublin Airport Authority (DAA) to operate in a financially viable manner; and
- The protection of the interests of users and potential users of the airport.

The lack of clarity on how to weight different functions could lead to suboptimal regulatory decisions. A simpler mandate, containing a single objective – or a mandate providing a hierarchy of objectives – would simplify the regulator's role and could lead to greater accountability. The UK recently published its aviation policy framework. It replaces the UK regulator's (the Civil Aviation Authority) previous four equal functions with a single primary duty to further the interests of the users (passengers and cargo owners) of air transport services[4].

Under the new Government policy statement, regulators will have a hierarchy of objectives to implement. The hierarchy of policy/regulatory objectives will be explicitly set out in sectoral legislation to provide greater clarity on how to weight the different priorities. As set out in the policy statement, Government views the promotion of consumer interest and national competitiveness as key national objectives that should be prioritised by sectoral departments when setting out their sectoral objectives in primary legislation. Consumer interest is defined as providing end users (business and residential) with competitively priced access to quality services while also providing a sustainable level of long term investment. The development agencies support this important development. That is why it is critical that the new price review should not take place until such time as the new regulatory framework and hierarchy is in place.

Airport charges (i.e. runway landing and take-off charges; aircraft parking charges; charges for the use of an air bridge; and passenger processing charges) at Dublin Airport have changed significantly in recent years - the price cap in Dublin has increased from €4.81 per passenger in 2005, to €6.20 in 2006, €7.39 in 2009, €9.31 in 2010, €10.42 in 2011 and €10.74 in 2012[5]. Airport charges are not easy to compare, since airports differ considerably in the facilities provided and they offer various incentives and reductions in charges to attract business. While limited comparable data on airport charges is publicly available, data presented at a recent aviation conference by the DAA indicates that the average revenue per passenger at Dublin Airport was lower than the average of 22 other European airports and Dublin was ranked mid table[6].

4 Department of Transport (UK), Aviation Policy Framework, March 2013.

5 http://www.aviationreg.ie/regulation-of-airport-charges-dublin-airport/compliance-papers.123.html

6 Based on data from the Airports Council International's key performance indicator project, which was included in the DAA presentation at the Conference on Aviation Policy for Ireland on the 3rd December 2012 – see: http://www.iaa.ie/media/O.Cussen-DAA-3rdDec20121.pdf

Given how critical Dublin airport is for Ireland's international connectivity, the development agencies believe that airport charges at Dublin airport should continue to be regulated with the goal of ensuring cost competitive airport charges at the airport and timely and efficient investment in new infrastructure and better utilisation of the existing infrastructure (e.g. incentives for new routes).

What level of charges should Dublin Airport users pay for quality of service and time of travel?

As outlined in the consultation paper, the average revenue per passenger from charges at Dublin Airport has increased significantly over the period 2005-2012. However, passengers' overall satisfaction with the airport has also improved. Improving satisfaction is likely to reflect a range of factors including recent investments in the airport facilities and improvements in operation efficiency. It may also reflect improvements in access infrastructure to the airports, the performance of the airlines and the impact of reduced congestion as demand has fallen. It will be important that the review of airport charges incorporates consumer research to assess consumers' views on trade-offs between price and quality, and the relationship between airport investment/operational efficiency and consumer satisfaction.

On the issue of differentiated pricing, some of the costs of T2 should be shared across both facilities as T2 will benefit users of both terminals (e.g. less congestion in T1 even if its facilities are not physically improved). We are not in a position to determine a formula for how these costs should be allocated. However, we believe that the case for differential pricing is strong. It is critical that administrative pricing is not used to remove the potential for competition between the facilities, which could have an adverse effect on the range/frequency of services offered by airlines.

Peak demand plays a key role in determining airport capacity and required investment. Therefore, peak users should bear some of the additional costs though the degree of loading should not be excessive. These charges should be benchmarked against costs in other countries that we compete with for trade, investment, and tourism.

Which airports should Dublin Airport be benchmarked against??

Dublin Airport's performance should be benchmarked against that of the main airports in key competitor countries for trade and investments as well as a selection of comparator countries – i.e. the selection of countries used in Forfás and NCC benchmarking studies.

In terms of what to benchmark, the definition of airport users needs to be clearly defined to include airlines and consumers (passengers and freight owners).

What is the appropriate approach to adopt for making passenger forecasts at Dublin Airport?

The development agencies accept that all projections carry a high degree of uncertainty. We believe that it is important that the regulator or others do not second-guess the DAA decisions. The DAA, in consultation with its customers, is best placed to assess the future needs of the airport. In this context, however, it is important that the DAA rather than final customers (i.e. air travellers) bear most of the risk of any future investment. Existing customers should not be expected to pay any emerging deficits if these projections prove too optimistic.

The DAA should also be incentivised through the price cap and perhaps the use of output triggers to aggressively seek to achieve the ambitious forecasts set out, through attracting new carriers to the market and widening the service base of existing operators.

What allowance should be made for operating costs at Dublin Airport after 2014?

What level of investment is needed at Dublin Airport in the future?

The regulator needs to continue to drive for efficiencies in opex and capex. Continuing to benchmark Dublin Airport's performance against other airports is critical. We acknowledge the challenges in accurately benchmarking airport performance on a comparative basis. The experience of other aviation regulators could be useful in this respect.

For example, the Australian Productivity Commission has undertaken significant benchmarking work in this area and has noted that "across airports, 'apples-to-apples' comparisons are difficult to engineer, and, in their absence, interpretations are challenging". This is often a result of location-, geographic- or configuration-specific reasons, unrelated to airport efficiency per se. The 'joint-product' problem also poses difficulties in airport benchmarking – it is often not possible to disentangle the impact of various functions on overall efficiency. Nevertheless, despite these complications, the Australian analysis has concluded that benchmarking three aspects of airport performance is necessary to evaluate the regulatory regime, namely:

- Productivity (whether services are being produced at minimum cost);
- Prices and profits (and whether the airports are making use of market power by allowing costs to rise while protecting their profit margins); and
- Quality.

The choice of airports to benchmark expenditure at Dublin Airport against in the new price review is important. The benchmarked airports should include comparator and competitor cities.

The development agencies are concerned that the issues paper talks about needing "*to decide whether and how to reimburse earlier investments by the DAA whose costs to date it has not been allowed to recover fully through airport charges*." Capital expenditure by the DAA on T2 between 2007 and 2012 was 20 per cent higher than what was allowed under the previous price review[7]. Only increases in costs that were outside the control of the DAA (e.g. increased cost of borrowing because of the increased cost of borrowing by the State) during that period should be recoverable.

One area of concern from an enterprise policy perspective is that although T2 was only completed in 2010, it cannot accommodate the new A380s as there are no double decker facilities at the new airport and runway capacity is also a challenge. If Irish airports cannot accommodate the new aircraft of the airlines serving the Irish market, the availability of direct access into and out of Ireland could be adversely affected.

It is important that regular reviews (every five years) are conducted to ensure that all of the main airports are well placed to accommodate passenger growth, changing passenger and freight needs and carrier needs. These reviews should take into account enterprise and tourism policy objectives and targets. Given the ever increasing importance of direct access to long haul destinations for enterprise development, the periodic review of capacity requirements at the main airports should carefully consider the implications of global developments in aircraft size and landing requirements.

From a competitiveness perspective, it is essential that the new price review strikes the right balance between ensuring adequate capacity to meet future needs and keeping costs as low as possible for users.

What is an appropriate cost of capital to allow?

There have been significant changes to the DAA's credit rating since 2009 which have implications for the cost of capital. While borrowing costs are relatively high currently, it is likely that they will decline over the period of the next price determination. The development agencies recommend that CAR introduces a mechanism similar to that used in electricity and gas by the CER which allows for interim reviews of the allowed cost of capital[8].

For example, in terms of electricity network investment, given the significant uncertainty prevailing when the cost of capital for the period 2011-2015 was set, it is to be reviewed midway through the review period. The cost of capital for gas network investment (2012-2017) is reviewed annually.

What assumptions should be made about commercial revenues at Dublin Airport after 2014?

As higher commercial revenues lead to lower airport charges under the single-till approach, consideration should be given to expanding incentives to increase commercial revenue.

7 The allowed capex for T2 between 2007 and 2012 was €771 million – the actual spend was €923 million.

8 CER, Decision on 2011 to 2015 Distribution Revenue for ESB Networks (CER/10/198), November 2010; Decision on TSO and TAO Transmission Revenue for 2011 to 2015 (CER/10/206), November 2010; and Decision on October 2012 to September 2017 Transmission Revenue for Bord Gáis Networks (CER/12/196), November 2012.

Under what circumstances, if any, should CAR make use of trigger allowances for capex?

There were three main triggers put in place under the current price determination:

- Runway investment when passenger numbers exceed 23.5 million;
- Apron investment when the number of contact stands exceeds 74; and
- T2 Box 2 investment when passenger numbers exceed 33 million[9].

The price review needs to consider if these triggers are still appropriate given developments since the last price review.

It is likely that a new runway will be required at Dublin airport in the medium term to facilitate future peak demand and aircraft requirements. Any new investment at the airport is likely to lead to an increase in airport charges. Therefore the decision on the timing of the rollout of the required infrastructure will need to balance cost competitiveness considerations with ensuring the timely availability of adequate facilities at the airport to accommodate future demand.

What is the appropriate approach to assess financial viability of the DAA?

As mentioned above, one of three objectives of CAR is to ensure the DAA operates in a financially viable manner. This creates a potential conflict with promoting consumer interests. The Government commitment to introduce a hierarchy of objectives, which prioritises consumer interests, should address this.

The role of the regulatory framework should be to provide certainty and transparency to reduce investor risks.

How should service quality be treated when making a determination for Dublin Airport?

When airport charges at Dublin airport were reviewed in 2009, the regulator introduced an explicit link between the level of the price cap and the quality of service provided[10]. The targets are set according to the average score achieved by Dublin airport on between Q1 2006 and Q2 2009.

In light of developments at the airport since 2009 and the fact that on most measures the DAA performs well above the target level, consideration needs to be given to setting targets informed by international best practice in the new price review, while doing so at minimum cost. Consideration should also be given to monitoring service levels at other Irish airports.

9 A two-box approach was introduced in 2007 for T2 costs – the Box 2 amount would only be added to the RAB when passenger numbers exceed 33 million.

10 Each quarter, the regulator publishes the quality of service monitoring at Dublin airport report. It includes thirteen service measures. The DAA provides information on the length of the security search queue and the availability of the inbound and outbound baggage system while the Airports Council International (ACI) carries out a customer survey on issues such as ease of finding your way through the airport, cleanliness of terminals, courtesy and helpfulness of airport/security staff and internet access/Wi-Fi. The reports are available at: http://www.aviationreg.ie/regulation-of-airport-charges-dublin-airport/compliance-papers.123.html

The passenger experience can have a significant on the business traveller's and the tourist's impression of Ireland and its attractiveness as a business/holiday location. It is also important for Dublin airport's attractiveness as a hub. From an enterprise development perspective, we are particularly interested in service quality from a business traveller and freight exporter/ importer perspective.

The agencies recently made a joint submission to the Department of Transport, Tourism and Sport's consultation on the new aviation policy. To inform our submission, we spoke to a selection of Enterprise Ireland and IDA client companies across different sectors and geographic locations to get their views on how their needs are currently being met and what will be required in the future. On the issue of quality, the key issues raised included:

- T2 facilities at Dublin airport are very well regarded as are facilities in Cork. T1 and Shannon airport need to be updated.
- Although Dublin offers more frequent and direct services, some business travellers prefer to use Cork and Shannon airports because of the ease of getting through the airports (time taken to clear the security; passport control). Of particular frustration to frequent business passengers are the often long queues on Friday evenings for passport control at Dublin airport. It also does not give a good first impression to tourists.
- Delays in customs clearance of inward time sensitive merchandise (e.g. life sciences, food and drink) is an issue.
- Dublin's attractiveness as a hub for transiting passengers could be improved.
- Availability of good and free Wi-Fi at the airports is important for business travellers who need to work while waiting for flights.