

DECISION OF THE
AVIATION APPEALS PANEL

Established by Order of the Minister for Transport

29th September, 2009

APPEAL OF
RYANAIR LIMITED
AGAINST DETERMINATION OF
THE COMMISSION FOR AVIATION REGULATION CP6/2007

1. INTRODUCTION

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

“(2) The Minister shall, upon a request in writing from a person to whom this Section applies who is aggrieved by a Determination under Section 32(2) or 35(2), establish a panel (“Appeal Panel”) to consider an appeal by that person against the Determination.

(5) An Appeal Panel shall consider the Determination and, not later than three months from the date of its establishment, may confirm the Determination or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, refer the decision in relation to the Determination back to the Commission for review.

(6) An Appeal Panel shall notify the person who made the request under sub-section (2) of its decision under sub-section (5).”

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

“(1) In making a Determination the objectives of the Commission are as follows -

(a) to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport,

(b) to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport, and

- (c) *to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.*
- (2) *In making a determination the Commission shall have due regard to-*

 - (a) *the restructuring including the modified functions of Dublin Airport Authority,*
 - (b) *the level of investment in airport facilities at Dublin Airport, in line with safety requirements and commercial operations in order to meet the needs of current and prospective users of Dublin Airport.*
 - (c) *the level of operational income of Dublin Airport Authority from Dublin Airport, and the level of income of Dublin Airport Authority from any arrangements entered into by it for the purposes of the restructuring under the State Airports Act, 2004,*
 - (d) *costs or liabilities for which Dublin Airport Authority is responsible,*
 - (e) *the level and quality of services offered at Dublin Airport by Dublin Airport Authority and the reasonable interests of the current and prospective users of these services,*
 - (f) *policy statements, published by or on behalf of the Government or a Minister of the Government and notified to the Commission by the Minister in relation to the economic and social development of the State,*

- (g) *the cost competitiveness of airport services at Dublin Airport,*
- (h) *imposing the minimum restrictions on Dublin Airport Authority consistent with the functions of the Commission, and*
- (i) *such national and international obligations as are relevant to the functions of the Commission and Dublin Airport Authority.”*

Order of the Minister for Transport establishing the Appeal Panel

- 1.3 By Order of the Minister for Transport of 29th September, 2008 the Minister established an Appeal Panel to consider the Appeal of, inter alia, Ryanair Limited (“Ryanair”) against the Determination of the Commission for Aviation Regulation published on 30th July, 2007 “*Maximum levels of airport charges at Dublin Airport, Final Decision on interim review of 2005 Determination*”. This Determination is published as Commission Paper 6/2007 (CP6/2007).
- 1.4 The Appeal Panel members are Paul Gardiner S.C. (Chairman), Niall Greene and Alan Doherty.

2. POWERS OF THE APPEAL PANEL - SCOPE OF REVIEW

- 2.1 Section 40(4) of the 2001 Act provides that an Appeal Panel shall determine its own procedure.
- 2.2 As stated, the provisions of Section 40(5) require the Appeal Panel to consider the Determination and having so considered it, to either:

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

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

2.4 The Appeal Panel determined that:

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

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

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

2.5 The Panel took this view as it appeared futile to refer back to the Commission for consideration matters which the Commission had manifestly already considered, and where it had not erred in that consideration.

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

3. **THE DETERMINATION AS CLARIFIED**

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

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

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

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

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

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

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

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

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

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

4. **PROCEDURE**

- 4.1 The Appeals Panel adopted the following procedure:-

1. Ryanair was invited to set out its grounds of appeal and reasons therefor in writing.
2. The Commission was invited to respond.
3. Ryanair was invited to respond to the Commission’s response.
4. An oral hearing of the Appeal was held where:
 - (a) Ryanair presented its appeal.
 - (b) The Commission responded.
 - (c) Ryanair responded to the Commission’s response.

5. **COMMISSION APPROACH TO THE APPEAL PROCESS**

- 5.1 The Commission expressed itself to be concerned with the process proposed in light of the fact that it would have to consider any matter referred back to it for review. It decided that it would therefore confine its response to drawing the attention of the Panel to materials, statements, analysis and decisions which informed its

Determination and which were presented in the consultation on the interim review which ran from September, 2006 to July, 2007, together with materials which were placed before the High Court in the course of a judicial review instigated by Ryanair.

5.2 With respect to the Judicial Review, the Commission sought

“to draw the Panel’s attention to the fact that the points being made by Ryanair to the Panel were previously raised by Ryanair in the Judicial Review of CP6/2007 (JR 1246/2007). A copy of Mr. Justice Clarke’s Judgments of 11 April and 20 May 2008 in which he declared inter alia that:

“... all of the arguments put forward on behalf of Ryanair which concerned the merits of the decision taken by the CAR were rejected.”

and

“... It follows that Ryanair’s claim must be dismissed in its entirety”

5.3 The Commission particularly referred the Panel to paragraphs 4.7-4.11, 5.2-5.3, 9.3-9.9 and 9.11-9.12 of the judgment of 11 April 2008 and paragraphs 2.4 and 5.8 of the judgment of 20 May 2008.

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

6. **THE WRITTEN SUBMISSIONS**

6.1 In its submission Ryanair submitted that the Commission had fallen prey to regulatory gaming by Dublin Airport Authority (“DAA”). The specific elements of the

Determination which Ryanair contended should be referred back to the Commission were identified by it as follows:

- *The decision to allow €1,107 million to enter the Regulatory Asset Base (“RAB”) in future determinations and specifically that, in assessing the amount of capital expenditure to be allowed into the RAB:*
 - *The CAR failed to take proper account of available capacity in Terminal 1 (“T1”) in considering the incremental capacity which was required through the development of Terminal 2 (“T2”);*
 - *The CAR failed to take proper account of the fact that the capacity being provided in T2 cannot be used until the new runway is operational at the end of 2012 or later;*
 - *The CAR allowed excessive costs in to the RAB relating to T2 Phase 1, which is oversized by between 40% and 56% (as confirmed by the CAR’s own consultants) and Box 1 and Box 2 are incorrectly specified, so providing capacity in breach of the limit set on the Eastern Campus at Dublin Airport of 30 million passengers per annum (“mppa”) according to the Fingal Local Area Plan (“LAP”) and/or the passenger throughput limit of 32 mppa imposed by An Bord Pleanála (“the Bord”) on the T1 and T2 combined;*
 - *The CAR erred in allowing DAA to earn a return on capital on 100% of the costs of T2 Phase 1, including Box 2, as soon as such costs have been incurred, despite having found that T2 Phase 1 was substantially over sized, and despite the fact that the €101 placed in Box 2 by the CAR is only allowed to enter the RAB for the purpose of depreciation when passenger demand using T1 and T2 combined exceeds 33 mppa, a limit*

which cannot be achieved given the planning limits imposed on the Eastern Campus;

- *A downward adjustment to the RAB should have been made in relation to excess expenditure on Pier D and for the write off of the cost of Pier C, estimated by Ryanair as €150 million, which has effectively been demolished as part of the T2 development.*
- *The decision not to lower the cap on airport charges within the current regulatory period despite passenger traffic at Dublin Airport substantially exceeding that projected at the time of the 2005 Determination.*

6.2 In its submission Ryanair made reference to the Aviation Action Plan of 2005 and asserted that its Appeal was in respect of the failure of the third safeguard identified, it said, by the Minister in relation to the proposed development at Dublin Airport, being the failure of regulation to safeguard users to “*ensure that charges reflect costs appropriate to the building of an efficient terminal*”.

6.3 Ryanair identified the objectives which it said governed the Commission (and with which the Commission agrees) as:

- *“To facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport.*
- *To protect the reasonable interests of current and prospective users of Dublin Airport.*
- *To enable Dublin Airport Authority to operate Dublin Airport in a sustainable and financially viable manner.*

- 6.4 Ryanair asserted that the Commission failed to meet its statutory objectives by providing for grossly inefficient capital expenditure not required by current prospective users to enter the Regulatory Asset Base (RAB) with consequential implications for the level of airport charges at Dublin Airport.
- 6.5 It referred the Appeal Panel to the 2007 Determination and to the building blocks approach to the fixing of airport charges and asserted that *“A decision to allow increased capital costs into the RAB will, all other things being equal, lead to a higher airport charge”*.
- 6.6 It asserted that the problem caused by allowing substantial CAPEX into the RAB was compounded by evidence that cost pressure on the airlines at Dublin Airport is resulting in a material decline in traffic growth below levels assumed by the DAA in planning the development of T2 and other infrastructure improvements. It asserted that there would be a consequent vicious circle of higher charges and lower demand.
- 6.7 It made extensive reference to what it asserted were failures in the regulatory system which had been highlighted, it said, by the UK Competition Commission investigation of the British Airports Authority and asserted that *“there are many similarities between the UK and Irish situations and that much of the criticism expressed by the Competition Commission equally applies to the problems with the setting of airport charges in Ireland, in particular, the criticism of the RAB based approach to setting airport charges and the incentives on the regulated airport to over specify investment so as to maximise its return is inherent of the behaviours observed in relation to the planning and excessive cost of T2 at Dublin Airport.”*
- 6.8 It asserted that:
- “In many ways the performance of the CAR is worse than that of the CAA as it refused to attend consultation meetings between DAA and its users in relation to T2 and held bilateral meetings with DAA only. It went on to ignore the recommendations of its own consultants that T2 was 40-56% oversized and proceeded to allow excess capital expenditure into the RAB.”*

6.9 In its submissions Ryanair then went on to make the following assertions under the following headings which, for ease of reference, are set out here in bold type.

The Specific Failures of the Determination

6.10 Ryanair asserted that fundamentally, the Commission erred in its 2007 Determination in allowing higher and excessive capital costs (€1,107 million) into the RAB for the purpose of DAA earning a regulatory return on the totality of this investment in the current regulatory period and in pre-committing to the inclusion of the excessive costs of T2 Phase 1 into the RAB, subject to the flawed two box approach, from its operational date anticipated on or before the start of the next regulatory period.

Context – Planning and Sizing of T2

6.11.1 Ryanair contended that:-

“At the time when CAR made its Determination, T1 at Dublin Airport was processing 21.2 mppa in 2006. However, the CAR was aware that additional works, by way of Area 14 check-in, Pier D and T1X, were in progress to increase capacity available in T1 further. Ryanair assesses these developments as increasing the capacity of T1 to approximately 26 mppa by 2009, a fact (of) which the CAR was aware having accepted expenditure on these schemes into the RAB.”

6.11.2 Ryanair asserted that:-

“In fact, Dublin Airport is not expected to reach 26 mppa until 2011/12 at the earliest on the basis of DAA’s official forecasts and the timing when this level of passenger traffic is now expected to be reached has slipped significantly in the light of the slowing of growth at Dublin Airport.”

and further:

“At the time the Determination was made, considerable further infrastructural development at the airport was envisaged by way of planning applications to Fingal County Council (“FCC”) aimed at addressing increasing both passenger and aircraft capacity, which development includes inter alia the construction of the Northern Runway and T2, Phase 1 with a view to increasing throughput at the airport.

In anticipation of such development, FCC prepared and passed the Dublin Airport Local Area Plan (“LAP”) ... to provide a framework within which the development of the airport could proceed. This was prepared within the context of the Fingal Development Plan 2005-2011 ...”

6.11.3 Ryanair observed that:-

“The Government Aviation Action Plan 2005 provides that the DAA will develop T2 within the Eastern Campus of the airport. The LAP records that T2 is to be situated on the Eastern Campus and is for the purpose of addressing short term capacity needs of up to 30 mppa (in combination of both T1 and T2). Although the 30 mppa limit is later described in the LAP as an approximation, the LAP is very clear that long term passenger capacity in excess of that figure is to be located on the Western Campus and, by way of indication, it predicts that facilities for handling 40 mppa will be necessary by the late 2030’s requiring development in the Western Campus.

and asserted:

“This requirement for additional terminal development to be located in the Western Campus is consistent with the Aviation Action Plan, which notes that a third terminal will be delivered through “an open, transparent and competitive process”, which has implicit within it an assumption that the third terminal will be separate and independently

owned/operated from the existing two terminals owned by DAA within the Eastern Campus.”

6.11.4 Ryanair made reference to the grant by An Bord Pleanála of planning permission in relation to the different proposed developments for the Eastern Campus, including for T2 and its associated facilities by decision of the Bord dated 29th August, 2007, and to the Report of the Bord’s inspector

6.11.5 It referred to the fact that the planning permission granted by the Bord imposes a limit of 32 mppa on the throughput of T1 and T2, Phase 1 combined and asserted:

“It was important, therefore, in the light of the terms of the planning approval granted, that the CAR satisfied itself that the design hour capacity and physical scale of the development proposed was consistent with the overarching capacity limits imposed by the Bord.”

6.11.6 The Panel has already recorded that it considers that it is appropriate to review matters which were before the Commission at the time of the Determination and cannot have regard to the subsequently produced planning documents. Nevertheless the assertion of Ryanair that:

“T2 Phase 1 is being planned, according to DAA, for a design capacity of 11.4 mppa, although DAA claimed that it may be required to handle in excess of this design throughput prior to the construction of a second phase. However, it is clear that the effect of a cap on the throughput of the Eastern Campus to either 30 mppa (LAP) or 32 mppa makes consideration of a second phase redundant as the combined capacity of T1 and T2 Phase 1 will already exceed the specified limit on the throughput of the Eastern Campus even on the lowest estimates of the combined capacity of T1 and T2.”

may be made (whether valid or not) by reference to the LAP without reference to the permission actually granted.

6.11.7 Ryanair stated that:-

“Ryanair is strongly of the view that the DAA presented flawed evidence as regards a peak hour demand of 4,200 passengers as the basis for designing T2 Phase 1 in order to justify an oversized building with excessive capacity. The CAR’s own consultants, Rogerson Reddan & Vector (“RR&V”), raised substantial concerns about the methodology used by DAA to assess the design hour capacity required, concluding that “the DAA forecast design passenger hours appear to be very high and do not conform to any values that Vector has experienced, even allowing for peak congestion or unconstrained growth”. DAA’s behaviour in this regard is consistent with regulatory gaming by way of over specifying capital development in order to increase the cost of the facilities and thereby the returns to the regulated entity. This has a second important effect of preventing or delaying competition from third parties on the Western Campus by providing excess capacity in the Eastern Campus, so delaying the time when a competitive third terminal would be required in frustration of Government objectives.”

6.11.8 Ryanair asserted that delays in the Planning process affecting the planned second runway meant that:

“T2 is therefore being built approximately 3 years too early, given that there is sufficient passenger capacity on T1 now to fully utilise available runway capacity in the peak period, and the lack of additional runway capacity is the major constraint on growth. DAA has, therefore, provided these facilities prematurely and, therefore, should have to bear the risk of this premature expenditure.”

Regulatory History

6.12.1 Ryanair referred the Panel to the regulatory history of the inclusion of capital expenditure in the RAB since 2001. With respect to the Determination under appeal it stated:

"In making the Determination in 2007, the CAR assessed the costs of DAA's CIP 2006 and reduced it from €1,178 million to €1,138 million; representing a reduction of just €40 million for inefficient development. The capital programme sum was broken down as "T2 Main Projects" valued by the CAR at €582 million, and "Other Projects" valued at €556 million.

Having carried out this exercise, the CAR assessed whether and how these costs should be recovered and decided to permit for inclusion certain infrastructure expenditure (and as a consequence related expenditure) valued at €1,107 million in to the RAB (i.e. €1,138 million less €31 million relating to an overspend for Pier D, which has been postponed for consideration at the next determination)."

6.12.2 Ryanair stated:-

"Whilst Ryanair accepts that the CAR is entitled to allow capital expenditure into the RAB for the purpose of future determinations following the judgment of Mr. Justice Clarke, of the €1,107 million allowed by the CAR to enter the RAB in future determinations, €101 million (relating to the excessive size of T2, Phase 2) was deferred until the throughput of the "airport" or the "Eastern Campus" (it is unclear which) exceeds 33 mppa. The €31 million of excessive spending on Pier D was also deferred for consideration at the next review. This represents an increase in the additions to the RAB of around 2.5 times its level at the start of the regulatory period in 2006. By virtue of the CAR's 2007 Determination, the RAB will be 65% higher at the start of the next review period than it otherwise would have been had the terms of the 2005 Determination stood. This substantial, and Ryanair would argue largely unnecessary and excessive increase in the RAB will obviously lead to substantial increases in airport charges under the building block approach ... and therefore a further decrease in passenger demand.

Following the review, and in the 2007 Determination, the CAR decided not to change the 2005 Determination, i.e. not to change the level of airport charges, which were therefore to remain at the level determined until the period end, being 31 December, 2009. This, despite the fact that passenger numbers and commercial revenues far exceeded the original estimates at the time of the 2005 Determination, which would have necessitated a reduction in the charges. It did, however, set out how this additional capital expenditure would be treated in future reviews and effectively allowed the total capital expenditure, as adjusted by it and including that in T2 Box 2, in the RAB with immediate effect for the purpose of DAA earning a return on the capital by way of pre-financing costs."

The Size and Cost of T2

6.13 Ryanair contended that:

"It is self evident that before the costs of development can be included into the RAB, it must be demonstrated that such development is "efficient and economic" and meets "the requirements of current and prospective users of Dublin Airport". ... the T2 development is neither economic nor efficient. Ryanair firmly believes that DAA has purposely inflated the size, and therefore the cost, of T2 in order to achieve a higher return under the flawed regulatory system, now exposed by the UK Competition Commission."

At the time when the original Determination was finalised in 2006, the T2 proposal comprised a building of 47,164m², to handle a passenger throughput of 10 mppa, at a cost of just €165.2 million as consulted upon with users in CIP 2005. In addition, Pier E was proposed at a cost of €79.3 million, of which only €7 million was expected to be spent during the current regulatory period. Ryanair had no objection to the provision of T2 on the basis then proposed by DAA and, in fact, actively supported those plans.

However, within the space of 11 months, these costs had ballooned to a total of €609 million (an increase of over 250%) and Ryanair believes the overall costs to be much higher when all of the associated costs and projects are included. Moreover, the costs should include a write off of the residual cost of Pier C, which has had to be entirely demolished as a result of the flawed T2 design and location.”

Consultation

6.14.1 Ryanair contended that there was no meaningful consultation with users regarding DAA’s revised plans for the T2 development and that DAA had consistently engaged in a process of what can only be described as a “sham” consultation as part of its strategy to game the regulatory process in order to inflate the size of the RAB.

6.14.2 It referred the Panel to correspondence which it contended confirmed “*that Ryanair was at no time consulted on the massive increase in the original cost estimate (some fourfold, when the write off of Pier C is included)*”, and referred to Ryanair’s complaint to the Competition Authority “*highlighting DAA’s abusive conduct in relation to T2.*”

6.14.3 It asserted:

“As a consequence, the terminal as proposed, and now being constructed, does not meet the needs of current and prospective users; specifically in being excessively large and costly leading to increased prices and a loss of profitable route opportunities at Dublin. ...

The fact that DAA engaged in a process of sham consultation, designed to game the regulatory regime, which resulted in a facility which is approximately 50% larger and four times more expensive than their original proposals, is something that the CAR should have dealt with robustly and excluded any costs associated with the excessive size of the building from the RAB. However, the CAR failed to do so. In fact, the CAR contributed to this regulatory gaming by

failing to attend any of the user consultation meetings, despite repeated requests by users, who repeatedly complained that the DAA was ignoring users' requirements and planning facilities that did not meet their needs. Instead, the CAR engaged in a number of meetings (some seven according to the CAR) with the regulated monopoly alone."

The Available Capacity in T1

6.15.1 Ryanair considered that:-

"The CAR's Determination is wrong in that it fails to take any proper account of the capacity of T1 when assessing the size of and expenditure on T2 Phase 1 or when allowing such expenditure into the RAB. At page 107 of the Draft Decision, the CAR stated that T1 had a "comfortable capacity" of 18.5 mppa. In this respect, the CAR has acted inconsistently with its previous decision in 2001 regarding the regulation of charges up to and including 2005 and 2006, wherein it provided for capital expenditure and a level of charges necessary to enable DAA to handle 19.7 mppa in T1 by 2006. Therefore, as a result of paying charges relating to the 2001 determination, users have already funded developments to achieve a capacity of approximately 20 mppa in the previous regulatory period. This view is supported by the DAA's Annual Report of 1999 (at Tab B.24), which records the capacity of T1 to be assessed at 20 mppa upon completion of Pier C and the earlier terminal extension. For the record, such capacity assessment was prior to construction of Area 14, Pier D and the proposed T1X. In 2006, 21.2 mppa were processed through T1 ..."

6.15.2 Ryanair asserted:

"Whilst the capacity of T1 ultimately assumed by the CAR is not entirely clear from the Determination, it would appear, wrongly, to have been approximately 20 mppa. The CAR appears to have based its assessment of the level of expenditure in relation to T1 Phase 1

contained in "Box 1" on the floor area required for T2 Phase 1 to handle 13.2 mppa, based on their consultant's assessment of capacity which, when combined with 20 mppa in T1, equates to the 33 mppa limit against which the Box 2 expenditure threshold has been set. ...

Ryanair believes that once the planned works were carried out to T1, the capacity of T1 will be of the order of 26 mppa. Ryanair is supported in this belief because, according to Mr. Robert Hilliard on behalf of DAA at a consultation meeting with airline users held on 2 March 2007, for which the Minutes are attached ... it was accepted by DAA that T1 would have a capacity of 4,800 departing passengers per hour (once the works to Area 14, Pier D and T1X were completed), which is equivalent to 26 mppa (capacity of departing passengers being the limiting factor in passenger handling capacity at Dublin Airport)."

6.15.3 Ryanair asserted that: -

"The hourly passenger capacity of a terminal can be converted to estimated annual capacity by taking into account the relationship of passenger demand in a busy hour to annual passenger volumes. In 2007, T1 at Dublin Airport handled 23.3 million passengers within a departure hourly capacity limit of 4,050 passengers. This gives a multiplier of annual demand to busy hour capacity of 5,570. (In 2006, on the basis of 21.2 mppa as the annual passenger throughput, the hourly constraint would give a multiplier of 5,382). Taking the 2007 multiplier would mean that the annual capacity of T1 at a busy hour departure throughput of 4,800 can be assessed as approximately 27.6 mppa and, at the 2006 multiplier, the annual passenger capacity would be 25.1 mppa.

Whilst DAA has contended that T1 is currently operating at unacceptable levels of congestion, which it is seeking to alleviate through reducing demand using T1 once T2 opens, on the other hand,

as airports get busier, demand at an airport tends to become more spread out over the day and over the year, i.e. less peaky.”

6.15.4 On that basis it asserted that the capacity of T1 once extended would be of the order of 26 million passengers per annum and that:

“This is the correct basis upon which to assess what scale of T2 development would constitute an efficient addition to capacity at Dublin Airport.”

6.15.5 Ryanair asserted:-

“Given the capacity limit within the LAP, or as determined by the Bord in relation to the T2 development, the additional capacity required at Dublin Airport in order to handle growth up to the limit of the Eastern Campus is 6 mppa. However, the development of T2 Phase 1 will in practice result in terminal capacity within the Eastern Campus of up to:

- 37.4 mppa, if DAA is correct regarding the capacity being provided by T2 Phase 1;*
- 39.2 mppa, on the basis of the CAR’s assumed capacity relating to Box 1;*
- 42-43 mppa, if the CAR’s consultants are correct that the scale of the building is 40-56% too large (as we discuss below) relative to the annual throughput projected to use it.”*

6.15.6 Ryanair contended that:-

“In assessing the need for T2 Phase 1, the CAR should have had regard to the incremental capacity available in T1: namely 26 mppa following completion of T1X, the expenditure for which the CAR has

already allowed into the RAB. In failing to do so, the CAR has allowed the DAA to recover through the RAB for capacity in T2 Phase 1 that is entirely superfluous to user requirements, and in excess of that permitted under the LAP and the Bord's decision on T2 Phase 1. On the basis that the 33 mppa relates to the Eastern Campus, and given that the LAP only allows for "approximately" 30 mppa in the Eastern Campus, and the capacity of T1 will be 26 mppa when extended, the CAR should only have allowed for expenditure to generate additional capacity of 4 mppa (or 6 mppa according to the Bord's limit of 32 mppa).

It is clear that, on any measure, the capacity being provided by T2 Phase 1 will result in terminal capacity on the Eastern Campus of Dublin Airport substantially in excess of the capacity that can be used without breaching the LAP or planning cap. As such, in the context of the available capacity provided already by T1, the scale of T2 development cannot be considered as either efficient or economic, and a significant proportion of these costs should be permanently excluded from the RAB."

Box 1 and Box 2

6.16.1 Ryanair asserted that there was:

"clear evidence that the development being carried out by DAA is over sized relative to the annual throughput which it is claimed that it is being designed to handle. This was confirmed by the CAR's own consultants, RR&V, and which the CAR sought to deal with in the two box approach."

6.16.2 Having referred to the busy hour departing capacity with reference to the cap on numbers by virtue of the planning constraint, Ryanair asserted that:

"split across two terminals, effective capacity would be required for around 7,120 departing passengers per hour to match a total airport

capacity of 32 mppa. Taking into account the available capacity in T1, the required hourly capacity in T2 is no more than 2,320 departing passengers, consistent with the overall throughput limits of the LAP and the planning conditions in force.

DAA has, however, designed T2 Phase 1 to handle a busy hour departing passenger volume of 4,200, which equates to a terminal with a capacity of the order of 22 to 24 mppa, approximately double the size which DAA claims and sufficient to provide an overall terminal capacity in the Eastern Campus of up to 50 mppa assuming perfect efficiency in the use of the two terminals or around 40 mppa, taking into account some natural loss of efficiency from operations being split across two terminals. Ryanair's view of the extent to which T2 Phase 1 is oversized is broadly consistent with the position adopted by the CAR's own consultants.

The origin of this requirement for T2 Phase 1 to handle 4,200 departing passengers per hour is claimed by DAA to be a requirement by the anchor tenant, Aer Lingus, to depart all its aircraft with a single morning peak hour. ...

6.16.3 Ryanair stated that:

"As a consequence of sharing Ryanair's belief that DAA was seeking to build an oversized T2 Phase 1, the CAR engaged experts being RR&V for the purpose of assessing the said "peak hour demand". RR&V confirmed that T2 Phase 1 is oversized relative to demand in an accompanying report to the consultation document CP5/2007. Furthermore, it is clear that the CAR, on advice from RR&V, shared many of Ryanair's concerns as regards the DAA's claim that T2 Phase 1 needed to be for a development of 75,000m² based on a peak hour passenger demand of 4,200. The CAR stated (at page 14 of CP6/2007) that:

“The Commission does not currently believe that such demand exists for a T2 project designed to cope with 4,200 passengers per hour in the busy hour of the day – the proposed scale of T2 as outlined by the DAA in CIP2006 ... (at page 15) ... The DAA has chosen to build a large terminal in one go with considerable excess capacity, rather than building a smaller facility and adding an extension at a later date if the traffic growth mandated further capacity expansion.”

RR&V assessed the area proposed for T2 Phase 1 of 75,000m², based on an hourly departure capacity of 4,200 passengers per hour, as being 40-56% too large for the annual passenger throughput of 11.4 million advanced by the DAA. This is broadly consistent with Ryanair’s view.”

6.16.4 Ryanair complained that:

“Despite having clear evidence that T2 Phase 1 was substantially oversized relative to demand and having regard to the available capacity of T1, the CAR then proceeded to allow a sum of €278 million into Box 1 on an erroneous basis. The CAR adopted a figure of approximately 3,000 departing passengers per hour as its allowable capacity, equivalent (according to RR&V) of 13.2 mppa, which DAA had indicated might be the maximum throughput which T2 Phase 1 might have to accommodate prior to the construction of a second phase. On this basis, the CAR concluded that this justified a mid-point design for T2 Phase 1 of approximately 54,000m², significantly greater than the area assessed by its consultants as that required to accommodate predicted demand. The area allowed by the CAR, hence represents approximately 73% of the total area of T2 Phase 1 as being constructed by DAA.”

6.16.5 Ryanair referred to the Commission's reasoning at pages 97 and 98 of CP6/2007, and asserted that:-

"Having purported to carry out an objective analysis of the DAA figure of 4,200 peak hour passengers presented for the purpose of determining the size of the T2 Phase 1, the CAR then purported to safeguard the users of the airport from inflated charges by having €101 million of the cost placed in Box 2 of the RAB, which cannot be relied upon by the DAA until the annual passenger capacity exceeds 33 mppa. Such restriction does not stand up to scrutiny and certainly fails to give any comfort to airport users. Firstly, whilst the CAR includes €101 million of the T2 Facility Costs in Box 2 so that the DAA cannot rely on such expenditure until capacity exceeds 33 mppa, it fails to properly state whether the cap of 33 mppa relates to capacity in Dublin Airport (as a whole) or within the Eastern Campus. In fact, it is clear from its Draft Decision and the Determination that it does not know whether such cap is for the entire airport or the Eastern Campus. In its Draft Decision, it refers to such cap at pages 9, 15, 17, 39, 107, 108, 110 and 118 in the context of the airport as a whole, which is consistent with pages 1, 38, 40 and 49 of the Determination. At page 40 of the Determination, however, the CAR states that the figure of 33 mppa relates to the capacity of T1 and T2 Phase 1 (i.e. the Eastern Campus)."

6.16.6 Ryanair contended that:

"This distinction is fundamental as the LAP and the planning permission confines the Eastern Campus capacity to 30 mppa and 32 mppa respectively. If the 33 mppa relates to the Eastern Campus, Box 2 can never become operative although the DAA will be permitted to enjoy a return on the capital nonetheless. If the 33 mppa cap relates to Dublin Airport as a whole, DAA will be entitled to claim both the return on and return of (depreciation) related to such expenditure of €101 million, despite the fact that the increased passenger throughput

will occur on the Western Campus (at further expense) and may be delivered by an entity other than the DAA such that the expenditure was unnecessary.”

and

“In the light of the binding capacity limit imposed on the passenger throughput of the Eastern Campus at Dublin Airport as a result of the conditions imposed on the planning approval granted to the development of T2 (albeit postdating the CAR’s Decision), Ryanair is firmly of the view that any capacity provided to handle demand above 32 mppa cannot be utilised. It must, therefore, constitute uneconomic and inefficient development such that, as stated above, Ryanair believes that the CAR’s Box 2 should be treated as Ryanair’s proposed Box 3, i.e. development undertaken at DAA’s own risk and which can never enter the RAB to be remunerated by users who will not get any benefit by way of the scope for growth in business which the terminal is designed to cater for. The fact that the CAR adopted a threshold of 33 mppa for its Box 2 cannot be correct in the light of the planning condition imposed, nor can it be right that DAA is allowed to earn a return with immediate effect on the costs of development to meet demand above a 32 mppa threshold as this expenditure is entirely redundant.”

6.16.7 Ryanair complained that:

“On the basis of its analysis, the CAR allowed 73% of the cost of the T2 as sought by the DAA to enter the RAB (for the purpose of depreciation) on operation of the facility, despite its own consultants having found the facility to have been 40-56% too large. Moreover, the total cost of T2 Phase 1 (i.e., 100% of 75,000m²) was allowed into the RAB for the purpose of calculating a return on capital employed from when the costs were incurred. This allows DAA to finance the building of a terminal, including the Box 2 area, larger than can ever

be used given the limits on the Eastern Campus, and certainly larger than any requirement of users. This clearly represents grossly inefficient and uneconomic development as the annual capacity being provided substantially exceeds the planning limits on development and the scale of the terminal is too large relative to the annual capacity being planned for.”

and asserted that:

“no more than 55% of the costs of T2 should have been allowed into the RAB and that the timing of this should have been deferred until the date when the throughput of Dublin Airport exceeds 26 mppa. The other 45% should have been permanently excluded from the RAB and entirely at DAA’s own risk.”

6.16.8 Ryanair also complained that:

“The CAR allowed all of the remainder of T2 costs, under the headings “Pier E and Apron Remodelling” (€107 million) and “Other Works in T2 Main Projects” (€96 million) to enter the RAB on the same basis as the Box 1 costs, notwithstanding that the same issues of scale of development apply to these facilities as to the main T2 Facilities themselves.”

and asserted:

“These costs should equally be reduced and the excess permanently excluded from the RAB.”

6.16.9 Ryanair made reference to the 3 Box approach which it had advocated in response to CP5/2007 being:-

- *No cost should be allowed into the RAB in relation to T2 until such time as throughput of Dublin Airport exceeds 25 mppa (the minimum capacity of T1 as extended);*
- *Box 2 should comprise of costs relating to development to handle in excess of 30 mppa, up to the putative upper bound allowed under the LAP of 35 mppa as emerged at the Bord hearing into the T2 development, which should not be allowed into the RAB until such time as the trigger passenger throughput was reached;*
- *Box 3 should comprise of all costs associated with providing capacity for in excess of 35 mppa on the Eastern Campus at Dublin Airport, which capacity could never be used in the light of the limitations on the total passenger throughput of the Eastern Campus.*

and concluded:

“However, given the final confirmation by the Bord decision on the T2 Planning Conditions, the final limit on capacity allowed under the LAP has been confirmed as 32 mppa. Hence, Ryanair accepts that its suggested 3 box approach can be condensed to a 2 box approach, with efficient costs up to 32 mppa allowable in Box 1 (32 mppa – 26 mppa in T1) once additional runway capacity is in place and or the throughput of T1 exceeds 26 mppa, whichever is the later, and the remaining costs in Box 2 permanently excluded from the RAB and undertaken entirely at DAA's own risk.”

6.17 In its response to this aspect of the Appeal, and subject to the overall constraints upon which the Commission participated in the Appeal process recorded above, the Commission stated:

“9. In CP5/2007, the Commission’s draft determination of the interim review of the 2005 Determination ... the Commission took the view that the capacity of T1 was approximately 18.5 mppa and proposed

that Box 1 for the purposes of T2 remuneration would be based on passenger throughput from 18.5 mppa to 30 mppa. For reference see page 107 of the CP5/2007.

10. *One of the main difficulties faced by the Commission during the Interim Review was the lack of an agreed approach or formula to convert busy hour flow rate to annual capacity.*
11. *Even if one accepted Ryanair's conversion of hourly to annual capacity, the current hourly capacity of T1 relates to the current level of service, which has been much criticised. An improved level of service would imply a lower annual capacity of T1. In that regard, during the interim review several parties made strong representations to the Commission regarding the inadequacy of existing facilities at the airport.*
12. *Having considered respondents' views submitted following the Draft Determination the Commission increased the threshold for Box 2 to enter the RAB to 33 mppa. Page 38 of the Final Determination presents the reasoning for this as follows: "This is because box two is smaller, reducing financing concerns, and the Commission's estimate of T1's capacity was based on studies conducted prior to recent capacity-enhancing projects in the terminal referred to by Ryanair."*

6.18.1 In its written response to these submissions of the Commission, Ryanair referenced its own submission in response to CP5/2007 and asserted that:

"The CAR erroneously considered the size of T2 in isolation without properly considering the scale of the economic and efficient next increment of capacity at Dublin Airport to meet user needs and within the limits set by the LAP. In considering only whether T2 Phase 1 was appropriately sized to meet the requirements of Aer Lingus and its partner airlines, expected to be the users of T2, the CAR has allowed inefficient development to proceed in terms of the airport as a whole and for which all users of Dublin Airport will have to pay but for

which the majority will never receive benefit. The question which should have been addressed was not what is the appropriate size for T2 to meet the requirements of Aer Lingus in 2013? But what is the appropriate size for the next increment of terminal capacity at Dublin airport having regard to existing capacity, any limits on the overall capacity of the site and the needs of users overall?"

6.18.2 Ryanair suggested that the Commission had made a serious error by working backwards from the size of building proposed by DAA to accommodate the potential need of Aer Lingus in 2013, instead of considering the actual capacity at Dublin Airport and whether it was an efficient solution, other than for Aer Lingus, to assume that the new terminal had to be large enough to accommodate the entirety of Aer Lingus' operations. Ryanair contended that there was no lack of agreed methodology for assessing the hourly capacity of a terminal. Indeed Ryanair asserted that *"The methodology adopted by RR&V for the CAR and York Aviation for Ryanair was remarkably similar ..."*

6.18.3 Ryanair illustrated its assertion of the appropriate sizing of T2 and asserted:

"At no point in CP6/2007 did the CAR set out transparently what capacity it had assumed in relation to T1, following representations. Readers were left to infer that, as the CAR had taken a proportion of 73% of the total costs as the basis for assessing the amount of the T2 terminal development costs to include in box 1, relating to a capacity of 13.2 mppa according to the RR&V report, it had assumed a capacity of T1 of just under 20 mppa (33 – 13.2). The CAR has not addressed, in its response, the fact as set out in paragraph 49 of Ryanair's submission of 3rd November, that users were already paying, by way of return on and return of the RAB for assets, including PRC, which had been justified on the basis of being able to handle 20 mppa before consideration of area 14, Pier D and T1X and the capacity being provided by those developments, specifically the stand capacity being provided by Pier D."

6.19.1 In its written submission the Commission observed that:

“In its submission to the Panel Ryanair have questioned the size and thresholds of box 1 and box 2 as well as the way in which the costs associated with “Pier E and apron remodelling and other works in T2 main projects” will be remunerated.”

and stated:

“The size of the boxes and their respective thresholds are discussed above. In the Draft Determination the specific costs mentioned by Ryanair – Pier E, Apron Works, and other works in T2 Main Projects – were originally proposed to be treated in a two box manner. Following the Draft Determination, we received comments on the proposed approach from all interested stakeholders. The DAA made specific submissions arguing for the exclusion of the above projects from the two-box approach (see page 53 of DAA response to Draft Determination on the Interim Review attached to this document and marked as Exhibit 3).”

6.19.2 The DAA in the submission referred to by the Commission in response to the interim review had argued that the T2 enabling works, access and roads, utilities/energy centre and Pier E should not have been included in Box 1. They argued:

- That the Pier E gates were required on foot of the airport Gating study due to the acute shortage of gates so that €147 million relating to Pier E should be extracted from Box 1/Box 2 methodology.
- The enabling works (€6 million) would have been required regardless of the size of T2 and involved a structured services trench.
- Kerbs (€39 million) would have been required regardless of the size of T2. The DAA asserted that the kerbs/roads are sized for peak hour passenger demands.

- Energy centre (€12 million). The DAA argued that the energy centre had been sized to provide space for plant to serve the “total T2 requirement”.

6.19.3 The Commission submitted that in its Determination it agreed with the DAA and allowed for the full remuneration of these costs subject to the trigger that T2 must be operational. The Commission took the view in its Determination that these costs would be incurred regardless of the size of T2. It stated “*The Commission’s views on these costs are set out on page 38 of its Final Determination (and those of its consultants on page 8 of RR&V Report No. 4).*”

6.19.4 The Commission submitted:-

Ryanair state in its submission that the limit imposed by An Bord Pleanála of 32 mppa effectively means that the DAA cannot use Box 2 and that it should be excluded from the RAB. The Commission’s Final Determination states that Box 2 will not enter the RAB unless passenger throughput exceeds 33 mppa. Therefore if An Bord Pleanála’s constraint is binding, the full amount of Box 2 will never enter the RAB.

Cathal Guiomard, the Commissioner for Aviation Regulation, discussed the issue of planning constraints in an Affidavit to the Commercial Court in November 2007 in the course of an unsuccessful Judicial Review 1236/2007 referred to earlier (see Exhibit 4). The Panel are referred to paragraphs 142 to 145 of that document.

Ryanair query in its submission whether the Box 2 threshold relates to the entire airport or the Eastern Campus. The issue was specifically clarified to the Court in Cathal Guiomard’s Affidavit of November, 2007 (see Exhibit 4). In paragraph 132 Cathal Guiomard states

“At paragraph 43 [of Mr. Callaghan’s Affidavit, Company Secretary, Ryanair], Mr. Callaghan states that in the Draft Determination and the Determination,

the Commission failed to properly state whether the cap of 33 mppa relates to capacity in Dublin Airport (as a whole) or within the eastern campus. This point is irrelevant as there is no distinction between the eastern campus and the airport itself for the purposes of considering passenger capacity. This is because both the airport's existing terminal (Terminal 1, including Piers A to D) and the proposed terminal (T2) are within the "eastern" part of the airport campus, i.e., the "eastern campus". The western campus is where future terminal development might take place at the other side of the cross-wind runway, and includes where the control tower and emergency services are located but where no terminal facilities are located at present or currently intended to be located. Therefore, there was no need to draw a distinction between the airport and the eastern campus."

6.19.5 The Panel observes that in his said Affidavit Commissioner Guiomard stated:

- At paragraph 138, that the Commission subsequently revised the capacity of Terminal 1 to 21.5 million passengers per annum (up from 18 million passengers per annum).
- At paragraph 139, that the Commission concluded that it should permit the funding of a second terminal and it needed to be big enough to have an airline of Aer Lingus' size assuming a normal daily schedule.
- At paragraph 140, that the Commission made a decision that the DAA was meeting the needs of all users if it built a second terminal capable of handling 13.2 million passengers per annum, given the assumptions about likely hourly utilisation of the facility and that reasonably incurred costs of providing such capacity should be remunerated.

6.19.6 The Commission further submitted:-

In considering Ryanair's contention that the Commission ignored the views of its consultants the Commission would firstly like to state that it was on the basis of the views of a range of consultants including Rogerson Reddan and Vector ("RR&V") in their report on T2 sizing that the Commission introduced a two box methodology for remunerating the costs associated with T2.

Contrary to Ryanair's submission the Commission explicitly took RR&V's views into account in determining the size of the boxes. The Panel are referred to page 38 of CP6/2007, the Commission's Final Determination on the Interim Review, which demonstrates how RR&V's analysis informed the Commission's conclusions on the size of the boxes. The following extracts are particularly informative

"RRV's conclusion remains that T2 is large, and it stands by its alternative sizing estimates for a facility of between 50,980 sq/m and 58,262 sq/m"

"The mid-point of the two RRV estimates of T2-sizing (50,980 sq/m and 58,262 sq/m divided by the DAA's proposed sizing (74,555 sq/m) is 73%. This is the proportion of T2 costs that the Commission will include in box one."

Notwithstanding the Commission's reliance on RR&V's analysis in determining the size of the boxes it seems to the Commission that Ryanair have adopted the erroneous view that a decision maker (this holds for any occupant of public office) is obliged to always agree with a consultant report. Apart from the error of this view, it is quite clearly provided in section 14 of the 2001 Act that the Commission may engage consultants or advisers to "assist it in the discharge of its functions".

It should be noted from paragraph 90 of Ryanair's submission that Ryanair supports both the Commission's use of a two box approach to remuneration and a unitised approach to depreciation. Its objections appear to be related to the size of the boxes and the costs that were included. The box and the costs were determined by the Commission after a lengthy consultation process and after considering the submissions of ten separate parties. In making its decisions on the allowed costs and the size of the boxes the Commission is of the strong view that it has come to a balanced conclusion in light of the submissions put to it and its three statutory objectives under the Aviation Act 2001, as amended by the State Airports Act 2004.

6.19.7 The Commission further submitted with respect to Ryanair's assertion that the Commission erred in allowing DAA to earn a return on capital on 100% of the cost of T2 Phase 1

The Commission has stated both in the Determination and before the Commercial Court that the DAA will receive the €101 million costs related to Box 2 if and only if the threshold for Box 2 is met in 2018. The Commission refers the Panel to the Affidavit of Cathal Guiomard of November 2007, mentioned above and attached as Exhibit 4, which deals with this exact point. In paragraphs 134 it is stated "[t]he size of Box 2 is €101 million. The Commission has clearly stated that this is at risk if annual passenger numbers do not rise above 33 mppa". It is further stated in paragraph 135 "[t]he DAA will not recover the costs in Box 2 if passenger numbers do not exceed 33 mppa in a year".

In a subsequent Affidavit of December 2007 in the same case Cathal Guiomard further clarifies this point. For the avoidance of doubt on this issue the statement in full is outlined herein. In paragraph 33 it is stated that "[t]he Commission's proposed treatment of Box 2, which is outlined in both the Draft Determination and Determination, as well as in my first Affidavit is that all of the capital costs relating to Box 2 – i.e. depreciation plus the cost of capital – are subject to the 33 mppa

threshold". It is quite clear that users will not pay for any costs relating to box 2 unless the 33 mppa threshold is satisfied.

The Panel are referred to page 40 of the Commission's Final Determination on the Interim Review which states "the DAA will not receive financing costs for box one after 2009 should T2 not be operationally ready; nor will the DAA receive financing costs for box two after 2018 should demand not have exceeded 33 mppa by then" (see Ryanair Tab 1).

6.19.8 In the Affidavit referred to of December, 2007 Commissioner Guiomard stated as follows:-

"To summarise the outcome of the interim review, the Commission concluded that the price cap would not need to be changed and the existing regime could remain in place until the end of 2009. This is despite the fact that the Commission acknowledged the DAA revised CIP, was roughly twice the size of CIP presented to it at the time of the 2005 Determination. The Commission cited three principal reasons in support of the decision not to alter the price cap:-

- 1. Due to the nature of the per passenger price cap, the DAA was already benefiting financially from a significant increase in passenger numbers compared with projections made at the time of the 2005 decision;*
- 2. For this reason, combined with other improvements in the group balance sheet, even with the financing obligations of an enlarged capex programme, the DAA would remain financially buoyant up to the end of the current price control period; and*
- 3. Subject to the capital expenditure actually taking place in line with the plans reviewed by the Commission, the DAA could begin to recover the costs of these investments either from the*

beginning of the next price control period or when the assets themselves were operational. The motivation for this derives from the "user pays principle" – which essentially means that customers should only pay for services that they actually receive."

6.20.1 In its response to the said submission from the Commission, Ryanair maintained its position:-

"That the CAR erred in setting the threshold for costs entering box 1, the scale of box 1 and the threshold for costs entering Box 2. This applies whether the thresholds are applied to all T2 related costs, as in CP5/2007, or the terminal related costs only, as in CP6/2007."

6.20.2 It asserted that the vast majority of the costs of Pier E and various T2 ancillary developments would suffer from the same overspecification as T2. *"Hence the CAR was correct in its consultation document CP5/2000 to include these facilities in its two box approach and wrong in the Determination in allowing DAA to recover these excessive costs within box 1."*

6.20.3 Ryanair referred the Panel to a RR&V Report considering the requirement for Pier E (which is attached as Annex 1 to its submission) and asserted that

"the logical consequence of the CAR adopting a significantly lower design hour passenger flow as the basis for sizing the terminal building for inclusion with Box 1 would be that this would apply equally to the Pier as well if it was considered that there would be fewer peak hour departures than originally assumed by DAA. This should have been dealt with by placing excess expenditure into Box 2 for Pier E and other capacity related elements."

6.20.4 Ryanair asserted that it was *"perverse that when new facilities are provided in the western campus to allow demand over 32 mppa to be accommodated, this will shortly afterwards trigger DAA being able to earn a return on and recover the costs of its*

excessively sized T2, even though throughput will still be capped by planning conditions on the eastern campus. The CAR is wrong that the distinction is irrelevant as, if the Box 2 threshold was specifically conditioned to the eastern campus, DAA would never be allowed to earn a return on its excessive investment as the threshold cannot legally be reached, while if the threshold applies to the whole airport DAA will be able to earn a return on the investment, although the incremental passengers will be handled in the western campus”

6.20.5 Ryanair asserted that the costs included in Box 1 should have been limited to at most €320 to €363 million, with the remaining costs of €219 to €262 million placed into box 2, dependent on the precise assumptions made about Pier E and other terminal related infrastructure.

6.20.6 Ryanair complained that the Commission had been inconsistent both in its approach to the sizing of Terminal 1 (by reference to a ready reckoner produced by the Commission to assist those responding to CP6/2008 which demonstrated a T1 capacity of 21.5 mppa), and in its approach to the work of its consultants (by virtue of its departure from recommendations of RR&V, without being transparent as to why it was departing from those views, (while at the same time invoking the views of RR&V in other aspects of the Determination)).

6.20.7 With respect to the Commission’s response to the Ryanair submission that the Determination permitted the DAA to earn a return on capital on 100% of the costs of T2 Phase 1 including Box 2, Ryanair maintained its position that the DAA was being allowed to earn such return and asserted that the Commission did not understand its own Determination. Ryanair asserted that any doubt about the treatment of expenditure on Box 2 had been clarified by the publication of the ready reckoner and that this confirmed that the DAA would earn a return on capital from the date when the costs were incurred.

Effect of Runway Capacity Constraint

6.21 In its submissions Ryanair asserted:

“Even once the correct scale of T2 Phase 1 development has been determined, there remains a question of the timing of the development. Whilst the passenger capacity of T1 has been constrained prior to recent and imminent developments, including T1X, overall capacity at Dublin Airport is constrained by a busy period departure capacity of 31 departing aircraft movements in the peak hour. This constraint will remain in place until the new runway is open, currently scheduled for the end of 2012 but which may be delayed in consequence of a DAA challenge to certain of the planning conditions.

As recognised in the RR&V report for the CAR (page 23), the T2 Phase 1 development was predicated on an increase in busy hour departure movements to 36 in 2009 and 38 in 2010, although the opening of T2 is now deferred to 2010. It is absolutely clear that these levels of departing aircraft movements cannot be accommodated within the capacity of the existing runways. In practical terms, this means that the additional capacity being provided by T2 Phase 1 cannot be taken up until such time as additional runway capacity is in place. Whilst airlines may relocate their operations to T2, this will leave the capacity in T1 underutilised and result in uneconomic operations at Dublin Airport in breach of the CAR’s statutory objectives. Ryanair argues that the CAR should have taken this further factor into account in determining when any of the costs associated with T2 should enter the RAB for the purpose of either return on or return of capital. Ryanair contends that no element of T2 should have been allowed to enter the RAB in advance of the opening of the new runway.

6.22 In its response the Commission stated:

“It is the Commission’s view that the proposals in the Final Determination, in particular in relation to the two-box approach, are consistent with proposals for a new runway that were available to it at the time of the Interim Review. The issue of terminal capacity and a

new runway was considered by RR&V in its report on T2 sizing (see page 24 of RR&V report number 4 ...), RR&V note that depending on outturns there may or may not be a binding constraint on capacity in 2013 if a second runway has not been delivered.

In February, 2007 the Commission published a cost benefit model produced by its consultant Cambridge Economic Policy Associates ("CEPA"). The model which accompanied the report looked at the costs and benefits of the second terminal and the proposed new parallel runway. The model allowed parties to model when the benefits will outweigh the costs for three scenarios; a new terminal, a new runway and, a new terminal and runway. The Panel are referred to CEPA's report "Cost benefit analysis (CBA) of Terminal 2 and Runway 2 at Dublin Airport (CEPA)" and its accompanying excel model "Excel CBA Model".

The Panel will appreciate that a key question in this context is whether it is ever feasible for an airport operator in any jurisdiction to perfectly synchronise the provision of terminal and runway capacity given the timescales involved in the provision of a capital programme, and the attending issue of the varying timetables for planning and regulatory decisions. Since the Commission's 2007 Determination there have been several separate High Court judicial reviews as well as the current Appeal relating to terminal or runway issues.

Ryanair at paragraph 4 of their Appeal state that the background to the Appeal lies in the objectives for Dublin Airport set out in the Governments Aviation Action Plan of 2005 and in that regard conclude that "... expansion of capacity at Dublin Airport is not an end in itself but is in order to facilitate airlines offering an increasing range of air service connections ...". The Commission notes that Ryanair commenced and then withdrew in 2005 its legal challenge to the Government Decision which resulted in the Aviation Action Plan, and furthermore this Plan was the basis of a subsequent Ministerial

Direction to the Commission, compliance with which is mandatory in accordance with Section 10 of the Aviation Regulation Act, 2001.

6.23.1 In its response to this submission Ryanair contended that the DAA had misquoted the RR&V Report and rather that the RR&V Report made it clear both in the original Report and in the phase 2 Report (annexed as Annex 1 to its responding submission) that

“Given the possibility of a delay to the delivery of a new parallel runway at DUB the magnitude of additional terminal capacity being provided by the DAA could result in both T1 and T2 being substantially under-utilised as a result of runway capacity constraints.”

6.23.2 Ryanair asserted that:

“The CAR had clearly been advised by its consultants that the terminal capacity being provided could not be efficiently used prior to the new parallel runway becoming operational. The CAR clearly erred in providing for such expenditure to enter the RAB and to be paid for by users when there was no scope for such capacity to be efficiently used before 2012 at the earliest.

6.23.3 Ryanair submitted that the CEPA analysis relied upon by the Commission suffered from a fundamental flaw, namely that the benefits deriving from the development of the new runway and/or the second terminal were both assessed against the same passenger forecast.

6.23.4 Ryanair had re-worked the CEPA analysis using Exhibit 2 to the Commission’s response to show the benefits arising from the provision of T2 only, using the costs and all base assumptions supplied in the model (equivalent to the high costs/high benefits scenario), as set out in the CEPA Report at Exhibit 1 to the Commission’s response. It asserted that the Commission could not rely on CEPA analysis in support of its contention that the constraint imposed by the capacity of the existing runway

was not material to its consideration of the regulatory treatment on the expenditure of T2.

6.23.5 Ryanair accepted that it was not always possible to synchronise the provision of additional runway and terminal capacity at an airport. It contended, however, that the binding constraint was runway capacity and that therefore the Commission was wrong to determine the inclusion of costs relating to incremental terminal development into the RAB when sufficient runway capacity did not exist to allow the terminal capacity to be used efficiently.

6.23.6 Ryanair asserted that the DAA had attempted to use the reference to 2009 in the Government's 2005 Aviation Action Plan as a deadline for providing T2. It asserted that the reference to a target date should not be taken as overriding sensible and timely terminal development at Dublin Airport.

6.23.7 Ryanair also referred to the 2005 legal challenge (which appears to the Panel to be irrelevant to the matters which the Panel has to consider).

Pier C and Pier D

6.24.1 With respect to Pier C Ryanair submitted that:

"A further consideration is that the construction of T2 has necessitated the substantial demolition of Pier C, to be incorporated into the new building structure. Yet this asset is still within the RAB and for which airline users are paying. The CAR erred in failing to deduct the costs of Pier C from the RAB before calculating the cost of any additional elements to be added to the RAB. Ryanair estimates the original cost of Pier C to have been approximately €150 million (based on total capex figures from DAA's Annual Accounts from the period in which Pier C was delivered). Ryanair has repeatedly requested details of the cost of the facility but DAA has refused to provide them. Ryanair submits that the written down cost of Pier C should be permanently excluded from the RAB."

6.24.2 With respect to Pier D Ryanair submitted:-

Although the CAR excluded €31 million of additional cost relating to Pier D and the link bridge to the terminal building from the RAB in the short term on the grounds of lack of consultation, pending consideration during the forthcoming review for the period 2010-2014, Ryanair contends that other aspects of the costs of this facility are excessive and arise solely from the decision of DAA to demolish Pier C and, hence, needed to be in a position to provide capacity for long haul airline operations pending development of T2. Ryanair considers that the CAR erred in failing to properly consider whether the high costs of Pier D were warranted in the circumstances where such traffic is proposed by DAA to be relocated to T2.

6.25 In its response the Commission stated:-

The Commission's views on the apparent Pier D overspend are set out in its draft and Final Determination on the Interim Review. It has chosen to treat the overspend as it would any overspend by requiring the DAA to bear the risk of overspend for the duration of the regulatory period. The treatment of the overspend for the next Determination is currently the subject of consultation. Consistent with CPI-X regulation (i.e. price cap regulation) the Commission believes that the DAA should enjoy the benefits (bear the costs) of completing an investment project at a lower (higher) cost than was forecast by the Commission following consultation in making a Determination. Its views in this regard are set out on page 113 of the Draft Determination of the Interim Review. For the benefit of the Panel the Commission has prepared a brief note on CPI-X regulation, appended as Annex 1 to this document.

On page 39 of its Final Determination on the Interim Review, the Commission stated that the €31 million overspend will be considered as part of the consultation for the 2010-2014 price control. This

process commenced in October 2008 with the publication of an Issues Paper on charges for the next price control period (marked as Exhibit 6). The Panel are referred to paragraph 7.9 of that document.

In relation to Pier C the Commission is currently consulting on the size and methodology for estimating the opening RAB for the beginning of the next price control. While the Commission did not consider it appropriate to make an adjustment to the RAB during the current regulatory period, especially given that it has already made one adjustment to the RAB in respect of Pier C following a referral from the 2006 Aviation Appeal Panel, it will consider representations from interested parties in (sic) what the opening RAB should be in 2010, in the context of making the next airport charges Determination for Dublin Airport next year. Statements to this effect were made at the time of the Final Determination on the Interim Review [see, for example, page 44].

6.26.1 In its response to the Commission submission Ryanair in reference to CPI-X stated that the fundamentals of such regulation require that the Regulator is in a position to assess efficient costs. It asserted that if inefficient costs are allowed into the RAB, *“as is the case in relation to the capital costs which are the subject of this Appeal, the incentive properties of CPI-X regulation are lost.”* It cautioned that the UK Competition Commission had recognised that CPI-X Regulation provides incentives to the Regulator’s Report to over-specify capital expenditure in order to lock in higher returns within the price cap. It suggested that the Commission had failed to recognise this incentive to overinflate costs.

6.26.2 With respect to Pier C it asserted that by failing to take into account the write off of Pier C *“the CAR erred in not reducing the price cap for the remainder of the current regulatory period to 2010.”*

Consequences of the CAR’s Decision

6.27.1 Ryanair summed up its submissions at paragraph 90 and following of its submissions. In particular at paragraph 90 it stated:-

As set out above, the Determination allows the majority of the costs associated with T2 Phase 1 to be allowed into the RAB once T2 Phase 1 becomes operational under a two box approach, as set out above. As stated, Box 1 represents those costs which the CAR considers reasonable in relation to the planned capacity of T2 Phase 1, whilst Box 2 contains those costs which the CAR ascribes to T2 Phase 1 having been designed too large, relative to the annual passenger demand. It is stated at pages 32 and 38 of the Determination that the two-box approach is adopted to address concerns that the size and consequent cost of T2 Phase 1 might otherwise be too large relative to the benefit accruing (thereby necessitating the DAA to bear some of the risk). The DAA is allowed to recover the full cost of depreciation on the Box 1 amount from the date T2 Phase 1 is operational, but cannot recover the depreciation regarding Box 2 costs until the throughput of T1 and T2 Phase 1 combined exceeds 33 mppa (although the Draft Determination and Determination are inconsistent throughout the reports in this respect). Ryanair considers that, in principle, the approach adopted by the CAR is correct but that it erred, inter alia, in failing to take proper account of the capacity of T1 and failed to correctly take into account the advice of its own consultants in terms of the required scale and timing of development to provide the required terminal capacity at Dublin Airport, consistent with LAP limits.

6.27.2 Ryanair also asserted:-

100. *Alongside its errors in allowing the excessive costs of T2 Phase 1 into the RAB, the CAR postponed any substantive decision on "trigger pricing", which would have tied the time when costs of projects enter the RAB to the need for such facilities, but stated (at page 22 of the Determination) that it would consider introducing trigger prices at the next determination for major investment projects including T2 Phase 1 if it was not complete by 2010.*

101. *Furthermore, in relation to “peak pricing” (i.e. pricing according to the demand for the time of day) and “differential pricing” (i.e. pricing that differentiates between facilities afforded to passengers), the CAR specifically stated (at page 22 of the Determination) that it did not envisage introducing these in the next determination (despite reserving its right to do so on the basis that both options have merit). It would appear, therefore, that the CAR has allowed the asset cost of T2 Phase 1 into the RAB and has further indicated that Ryanair’s passengers (using the lower cost T1) will be forced to pay for it by way of increased airport charges (and are, in fact, already paying higher charges as a result of the return on monies being spent), despite T2 being a larger and more costly facility than is necessary. Ryanair’s passengers will not gain any benefit from the construction of T2 as Ryanair will never use this facility, but is instead using the less costly facilities in T1.*
102. *On this basis, it would appear that T2 Phase 1 is to be financed by all airport users despite the fact that it is being built to excessive specifications on the basis of Aer Lingus’ requirements as interpreted by DAA. If the CAR deviates from its Determination and allows price differentiation, Aer Lingus have said they will not pay higher charges for T2 Phase 1, which means that T2 Phase 1 will be in any event financed by depreciation of the asset and/or RAB. Therefore, the CAR has guaranteed the regulated monopoly a return on this excessive asset, regardless of the fact that the CAR has clearly stated that the facility is massively oversized.*
103. *Effectively, the CAR has put in place a Determination that actually incentivises and indeed rewards DAA for building an excessively large and costly T2 Phase 1 development as it will earn a guaranteed return immediately on the full cost and that the depreciation element of the development will be allowed into the RAB in future regulatory settlements, regardless of whether the passenger triggers are reached*

in view of the commitment to address any financing difficulties which DAA may have. This latter criterion will act to over-rule any assumption as the merits of unitising the recovery of depreciation on a per passenger basis in the short term.

104. *This clearly erroneous and biased treatment of what constitutes a blatant example of regulatory gaming by DAA (similar to that criticised by the UK Competition Commission in the case of BAA) cannot be accepted. The CAR's abject failure to take the regulated monopoly to task over this blatant regulatory gaming is a breach of the CAR's statutory objectives "to facilitate efficient and economic development and operation of Dublin Airport to meet the requirements of current and prospective users of Dublin Airport" (emphasis added).*

6.27.3 Ryanair concluded its submissions by identifying the specific matters which Ryanair said should be amended, in line with its modified two box approach:

- No recovery of any depreciation costs associated with T2 until the capacity can be used following the opening of the new runway;
- Box 1 costs to be confined to those costs associated with providing capacity to handle demand in excess of 26 mppa, i.e., the maximum capacity of T1, and up to the limit set by the planning conditions for the Eastern Campus of 32 mppa;
- Box 1 to comprise pro-rata costs only for "Pier E and Apron Remodelling" (€107 million) and "Other Works in T2 Main Projects", consistent with the required additional capacity of 6 mppa;
- All other costs to be placed into Box 2 and funded entirely at DAA's own risk as these facilities can never be used given the planning condition in force.
- The financing costs associated with Box 2 to be stripped out of the RAB;

- The written down cost of Pier C to be stripped out of the RAB;
- The excess costs of Pier D, over and above user requirements, and the terminal link bridge to be stripped out of the RAB;
- A downward adjustment be made to the cap to reflect higher passenger volumes in total during the current regulatory period.

6.28 In its responding submission the Commission referred to the decision not to lower the cap on airport charges within the current regulatory period, and stated:

“The purpose of the Interim Review was to determine if the Commission needed to change the prevailing cap set in 2005 as a result of the DAA’s revised capital investment programme which it received in 2006. In relation to other aspects of DAA’s performance the Commission sought to maintain its established approach to CPI-X incentive regulation by allowing the regulated company to enjoy the benefits (bear the costs) of efficiency (inefficiency) against the forecasts made by the Commission in its 2005 Determination.

If it were to have “clawed-back” or expropriated any profits above the assumptions in the 2005 Determination the Commission would have undermined the power and credibility of incentive regulation going forward. For the same reason the Commission did not increase the cap to account for additional operational costs incurred by the DAA during the Determination which the DAA had sought from the Commission.

The scope of the Interim Review focused only on the revised CIP2006 (and the underlying reasons for the CIP) (i.e. revised passenger forecasts). The decision to limit the scope of the review to CIP2006 was made after a consultation initiated by CP6/2006 (attached to this

document as Exhibit 7). In particular the Panel are referred to consultation question 6 on page 22 of that document. The Commission's decision to hold an Interim Review and the scope of the review were set out in CP9/2006 (attached to the Ryanair submissions as Tab 18) and had regard to seven submissions received. Some submissions, including Ryanair's sought a broader scope, while others including the DAA, Aer Lingus and Cityjet sought a narrow scope, while other parties including BMI opposed the undertaking of an Interim Review.

The Commission sought to balance the range of views received while also preserving the efficiency incentive properties of its 2005 Determination. As stated in CP9/2006 "it is clearly important to retain the incentives from the original determination. Whilst ensuring a narrow focus for an Interim Review prompted by so large a 'building bloc' as a (greatly increased) CIP is likely to prove challenging, the Commission will strive for this objective, given the impact on incentives of an Interim Review, as set out at some length in CP6/2006."

6.29.1 In its response to the Commission's submission Ryanair asserted that the views of the Commission on the incentive properties of Regulation had been discredited.

6.29.2 It asserted that:

"Ryanair has argued from the outset that increased passenger numbers were a relevant consideration for the interim review but the CAR determined that the scope of the interim review would be limited solely to the revised capital investment programme. Despite so limiting itself, the CAR nevertheless did have regard to increased passenger numbers in reaching its determination that the price cap should not change. Ryanair considers that had the correct assessment in the capital programme taken place, as outlined above and in its original submission, then the effect of allowing for the increased

passenger numbers would have been for a reduction in the price cap. Ryanair considers that the CAR erred in not making such downward adjustment.

At paragraph 35 of its response CAR purports that it sought to balance the range of views in coming to its determination. However it did not transparently set out its reasoning in coming to its final decision. Ryanair considers that it is reasonable to expect the CAR to set out clearly its reasoning and how it has fulfilled the objectives laid down for the regulation of airport charges under Section 33 of the Aviation Regulation Act 2001 ... in particular Ryanair considers that the determination fails to make clear how the CAR has addressed two of its key duties under the Act, specifically to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport and to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport.

7. THE APPEAL HEARING

- 7.1 Ryanair was represented at the Appeal hearing which was held on 15th December, 2008 by Martin Hayden, Senior Counsel, Frank Beatty, Barrister at Law, Janet Li and Muireann Reidy, both Solicitors of A & L Goodbody, Solicitors, and by Louise Congdon of York Aviation and Jim Callaghan of Ryanair.
- 7.2 The Commission was represented by Commissioner Guiomard, John Spicer, Head of Economics and Patricia Lamb, Head of Legal.
- 7.3 Mr. Hayden S.C. opened the Appeal by making a legal submission on the powers of the Appeal Panel. He urged that the Appeal Panel should not approach the Appeal from the perspective of manifest error and referenced the Judgment of Clarke J. in *Ryanair Limited v. Commission for Aviation Regulation* (Unreported, High Court, 11th April, 2008) where Mr. Justice Clarke stated:

“As is clear from the provisions of Section 40 of the 2001 Act, ... an interested party has a right of Appeal from a determination of the CAR to an Appeal Panel constituted in accordance with the terms of that section. It is clear that the CAR is not bound by the decision of an Appeal Panel, but must have regard to a view expressed by an Appeal Panel where the Appeal Panel considers that there are sufficient grounds for referring the original decision of the CAR back for review.”

- 7.4 He urged by reference to jurisprudence of the High Court and the Supreme Court, the detail of which it is not necessary to set out here, that the Appeal Panel was an expert body and that it would be entitled to approach the Appeal from that perspective and to “substitute” its view for the view of the Commission. It should be said, however, that the contention that the Appeal Panel should substitute its view was, and was taken by the Panel to be, more in the context of urging that the Appeal Panel’s review should not be of a manifest error standard but rather that if it disagreed with the Commission, the Panel was entitled (and obliged) to so state.
- 7.5 Indeed Mr. Hayden accepted that the height of what the Panel can do is express its views on what needs to be addressed or not addressed. In light of that position, it seems to the Panel that it is not necessary to embark upon a review of the authorities opened by Mr. Hayden nor to review the approach enunciated by the Panel prior to the Appeal as the Panel is of the view that it is not appropriate to uphold the decision of the Commission but rather that there are sufficient grounds to refer matters back to the Commission for review and it does so as appears hereafter.
- 7.6 Mr. Hayden submitted that Ryanair’s primary complaint was that the Commission had failed adequately to address its mind to the sizing of Terminal 2. He urged that in order to properly assess the size of Terminal 2 one had to first ascertain the capacity of Terminal 1. He contended, as Ryanair had in its written submissions, that the capacity of Terminal 1 was 26 million passengers per annum and he cited in support the statement of Mr. Hilliard of the Dublin Airport Authority to the effect that Terminal 1 could deal with 4,050 passengers in the busy hour.

- 7.7 He suggested a terminal the size of Terminal 2 was not required on the eastern campus of the airport and urged that the trigger for Box 2 could never happen in the context of the Planning Permission granted for Terminal 2 which put a cap of 32 million passengers per annum on the eastern campus.
- 7.8 He stated that Ryanair was concerned that this might mean that the 33 million passengers per annum trigger for Box 2 of Terminal 2 might be triggered by developments on the western campus of the airport and it wished to have clarity on that matter.
- 7.9 He suggested that the Commission had been contradictory in its approach and emphasised in particular that there was a difference between a return on capital and a return of capital. He urged that the Box 2 approach was only disallowing depreciation (until the 33 mppa trigger) but was otherwise promoting a return on capital.
- 7.10 On the basis of the contention as to the size of Terminal 1, he argued that the return on capital was premature by reference to the fact that Terminal 2, it was alleged, could not be used by reason of a constraint on capacity at the airport caused by the absence of a second runway.
- 7.11 He stated that in the circumstances Ryanair contended that the DAA was guilty of regulatory gaming: that the object of the DAA was to include as much capital expenditure as possible in the RAB upon which it would receive a guaranteed return of capital without regard to cost efficient development at the airport.
- 7.12 He submitted that the allowance of capital expenditure in respect of Pier C and Area D should be stripped from the RAB, and contended that there was a bewildering sequence of decisions by Aer Rianta and its successor, the DAA which resulted in significant expenditure being incurred (and going into the RAB) and then being written off. Mr. Hayden submitted that it was critical that there be significant scrutiny of any proposals by the DAA given the stated position of the Commission that the Commission had to maintain the solvency of the DAA.

- 7.13 In the remainder of his submission Mr. Hayden, helpfully, stuck closely to the written submissions and it is not proposed here, therefore, to reiterate those arguments as same have been fully set out above.
- 7.14 He opened in some detail the UK Competition Authority provisional findings with respect to the three airports in London and urged that the problems identified in the UK were replicated here by reason of the conduct of the Commission in failing to prevent regulatory gaming by the DAA.
- 7.15 He submitted and Miss Congdon elaborated upon his submission that what the Commission had done was play around with the DAA assessment of what T2 needed to handle in isolation. The DAA assessment was a bottom up assessment when the appropriate assessment was a top down assessment or a working backwards from an overall throughput at the airport of 30 or 32 million passengers per annum. They suggested the Commission should have taken comfort from the fact that the RR&V analysis, although approaching the problem from a different direction, came to a view broadly similar to that of Ryanair that the capacity that should have been allowed for Terminal 2 would stay at around 2,500 passengers per hour. It should not have then proceeded from there to take a figure of 3,000 passengers per hour on an unidentified and impenetrable basis.
- 7.16 In his response Commissioner Guiomard asked that if the Panel was going to refer matters back to the Commission, that it do so with clarity as to what was expected of the Commission.
- 7.17 Commissioner Guiomard referred to the written submissions, which have already been referred to by the Panel above and are not repeated here. With respect to the capacity of Terminal 1 he submitted that the capacity of Terminal 1 affects the implementation of the unitisation treatment of the depreciation costs of T2. It reflected the cost recovery schedule of the DAA from its investments in the investment plan. It affected the period and the manner and the time period in which those costs were recovered but it did not directly affect the decision to approve those assets to put them into the RAB.

- 7.18 Commissioner Guiomard stated *“So it will be helpful to be clear on what change is being asked of the Commission in terms of the price cap and their own decision.”*
- 7.19 With respect to runway constraint, he referenced in particular the fact that the Commission had been required by Ministerial Direction to facilitate the development of Terminal 2. He emphasised that the Commission had looked at the size of Terminal 2 and had concluded that it was oversized. Having reached that conclusion he identified two options open to the Commission. The first was to refuse to permit the investment proposed to enter the RAB which would have the effect of requiring the DAA to come back with a new proposal with new costs and other such matters. He urged that it was not at all clear that such a response would have been compatible with user interests or with the ministerial direction which the Commission was bound to follow.
- 7.20 The second option identified was to devise a two box treatment of the proposed expenditure and he pointed out that this is what had been done. He urged that this was in accordance with the objectives set down by statute which were to facilitate the development of Dublin Airport, accommodate the reasonable expectation of users and enable the DAA to operate in a sustainable and financially viable manner.
- 7.21 He pointed out that at paragraph 90 of its written submissions Ryanair had supported the two box approach and unitisation. He noted that neither a two box approach nor unitisation were used in the United Kingdom and urged therefore that reliance upon the observations of the UK Competition Authority was not relevant.
- 7.22 With respect to financing costs he suggested that the Commission had said in its draft decision that it would allow full pre-funding costs and urged that there was still €100 million at risk relating to Box 2.
- 7.23 He stated that the issues arising with Piers C and D would be decided in the next consultation period and in the next Determination.

- 7.24 With respect to the issue of the reduction in price caps, he urged that incentive regulation required that the Regulator not claw back gains made by increased numbers since this would have the effect of dis-incentivising the regulated body.
- 7.25 He urged that the issue of differential pricing was merely an aspect of cost recovery mechanism and that it did not speak to the assets which should be placed in the Regulatory Asset Base. He observed that Aer Lingus expressed full support for Terminal 2.
- 7.26 He urged that the statutory objectives had been met and that users were protected by the use of (1) triggers; (2) unitisation; and (3) the specifics of Box 1 and Box 2.
- 7.27 In response Mr. Hayden S.C. submitted that the Commission response was consistent with the non-engagement practice of the Commission. He urged that it was not sufficient to allow a return on Box 2 where a conclusion had been reached that the Terminal was oversized.
- 7.28 He urged that there was a failure by the Commission to look at the Airport as a whole and that the Commission had erred by looking at the requirements of Aer Lingus only.
- 7.29 He urged that the DAA had not increased passenger numbers, but rather the airlines had and that there was no reason that there should not be a reduction in charges in light of that fact. The failure to reduce charges, he urged, allowed a remuneration of capital expenditure without changing the cap.
- 7.30 He urged that the Regulator had adopted a judicial review type approach to the issue of differential pricing and that this was in error.
- 7.31 He accepted that while there was nothing wrong with a Box 1 or Box 2 approach, the approach adopted by the Commission was wrong because it had not engaged with the size argument even at the Appeal hearing. Rather, it had looked only at the capacity of Terminal 2 by reference to Aer Lingus schedules.

- 7.32 He referred the Panel to the written response of Ryanair of 19th November, 2008 and briefly went through it. Ms. Congdon emphasised that the Commission had not suggested that it had made an assessment of the capacity of Terminal 1, in other words it had not rebutted the submission of Ryanair that the entire process had not started from an overarching capacity requirement at the airport.
- 7.33 Mr. Hayden emphasised that the Commission had not addressed the argument of Ryanair with respect to the increase in capacity in Terminal 1 as a result of Area 14, Area D and T1X.
- 7.34 He and Ms. Congdon suggested that matters would not come into balance until 2020 and referenced in that regard the recalibration of the CEPA analysis which had been relied upon by the Commission.
- 7.35 Ms. Congdon stressed that if the conclusion was that T2 was oversized, which it was, then it followed that the Pier was too large because there would not be so many aircraft departing in a single peak hour. She rejected the “persuasive argument” of the DAA, as found by the Commission, since she characterised that argument as simply stating that all costs should be in Box 1.
- 7.36 Mr. Hayden stressed that it remained unclear as to whether or not the Commission was saying that the 33 million trigger would occur with traffic at the airport in its entirety, i.e. after the building of the western campus, or only on the eastern campus.
- 7.37 The Appeal Panel then posed a question to the Commission as to whether or not it believed that the 33 million trigger could be triggered by passengers on the western campus. The Commission in response seemed to suggest that the third terminal could be considered as triggering Box 2.
- 7.38 He concluded by stating that Ministerial Direction does not override regulation.

8. THE DECISION OF THE APPEAL PANEL

- 8.1 The Panel accepts the view of the Commission that when presented with the proposal for Terminal 2 by the DAA which the Commission considered to be considerably

oversized, the choices identified by the Commission were indeed those with which it was faced. The Panel agrees that it would not have been compatible with user interests and most particularly with the ministerial direction to have refused to permit the investment proposed to enter the RAB.

- 8.2 In those circumstances it was appropriate for the Commission to devise a two box treatment.
- 8.3 The Panel is concerned that the Commission considered the size of T2 in isolation without properly considering the scale of the economic and efficient next increment of capacity at Dublin Airport to meet user needs within the limits set by (a) the Local Area Plan, including the provision therein for the further development of the airport on the western campus, and (b) runway constraint.
- 8.4 The Panel is of the view that in order to properly assess the proper size of Terminal 2 (and accordingly the appropriate parameter for Box 2) the Commission must first establish and identify clearly the capacity of Terminal 1.
- 8.5 Only having identified the capacity of Terminal 1 can a view be taken as to the appropriate size of Terminal 2 by reference to the needs of the airport and airport users. It is not clear to the Panel either from the Determination under Appeal nor from the Appeal process as to what precisely the Commission regarded as the capacity of Terminal 1 (which is to be taken to include Terminal 1 extension (T1X) and Pier D and Area 14 all of which were known to the Commission in July, 2007).
- 8.6 Having ascertained the existing capacity of Terminal 1 and by extrapolation the required capacity of Terminal 2, the Commission must have regard to, and clearly identify the regard which it does have to, the constraints imposed upon the utilisation of that capacity by:
- (a) The delay in the provision of a second runway, and
 - (b) The Local Area Plan of Fingal County Council which suggested a limit to the airport campus at the eastern campus to 30 million passengers per annum.

- 8.7 The Panel is also of the view that the Commission should have regard to the ministerial direction which proposes a third terminal on the western campus
- 8.8 The Panel observes that it is aware that An Bord Pleanála has put a ceiling on passenger numbers at 32 million at the eastern campus but notes that this decision came after the Determination which is under appeal and consequently is a matter which could not have been known by the Commission at the time of the Determination. Nevertheless, the Commission was aware of a ceiling under the Local Area Plan which also referred to further development above the ceiling being on the western campus and ought to have taken this clearly into account.
- 8.9 The Panel is not itself in a position to carry out the analysis of the appropriate capacity of T1 but observes that the Commission did not challenge the calculation put forward by Ryanair in its original submissions nor in its subsequent response to the Commission's submissions. The matter was simply not dealt with by the Commission at the oral hearing.
- 8.10 In those circumstances the Panel tends to the view that Ryanair's calculation may well be correct. If that is so the capacity of Terminal 1 could be up to 26 million passengers per annum with significant consequential effects for the size of Terminal 2 with reference to the Local Area Plan (or An Bord Pleanála Decision).
- 8.11 It is vital that the Commission in reviewing its Determination on foot of the referral back to it by this Panel carries out a detailed and transparent analysis of the capacity of Terminal 1 and clearly states its conclusions in that regard.
- 8.12 The Panel is of the view that the Commission might well be best advised to carry out that analysis by reference to the competing contentions of the DAA (which manifestly contends for a large Terminal 2) and Ryanair, by way of a joint meeting/hearing with Ryanair's consultants, the DAA's consultants and the Commission's own consultants, rather than by way of passive regulation, as appears to have occurred to date.
- 8.13 Whichever way the Commission decides to assess the matter, it seems to this Panel that the first step must be a comprehensive assessment of the capacity of Terminal 1.

- 8.14 The next step is to assess the size requirement of T2, having regard to the effective cap of 30 mppa on the eastern campus (per the Local Area Plan). The Panel is of the view that the Commission must clearly express its conclusions arising from that assessment and the reason for those conclusions, identifying clearly the busy hour rate and the annual capacity to which it has had regard. The Panel observes that Ryanair contended that there was a similarity between the methodology employed by it and that employed by RR&V. This was not rebutted by the Commission at the oral hearing. If Ryanair is correct, and on the submissions and oral hearing it would appear to be correct, T2 as proposed may well be oversized in an amount significantly in excess of that allowed for by the Commission.
- 8.15 The Commission must transparently state the amount by which T2 is, in its opinion, oversized. Once it has done so it must proceed to appropriate the relevant cost to Box 1 and Box 2.
- 8.16 The Panel is of the view that in considering the projects which should be included in Box 1 of the two box approach, the Commission should consider afresh whether the facilities proposed for Pier E suffer from the same over sizing (assuming same to exist) as Terminal 2. The Panel tends to the view that the decision in the Consultation Document CP5/2007 to include these facilities in Box 1 of the two box approach was correct and should be reinstated. The Panel does not share the view of the Commission that the DAA's response to the interim decision was persuasive.
- 8.17 Accordingly the Panel refers back to the Commission for its review:
- (a) the assessment of the capacity of T1,
 - (b) the consequential assessment of the required capacity of T2
 - (c) the expression of the result of those assessments
 - (d) the consideration of the appropriate T2 associated projects capex which should be included in Box 1 or Box 2
 - (e) the consequential appropriation of capex into Box 1 and Box 2

- 8.18 The Panel is concerned that permitting what may be a greatly oversized Terminal 2 does not facilitate the efficient and economic development of Dublin Airport and might give rise to a risk to the financial viability of the DAA, contrary to Section 33(1) (a) and (c) of the 2001 Act.
- 8.19 The latter is so because the Panel believes that it is not appropriate to provide any remuneration whatever in respect of Box 2 until the trigger of 33 mppa is achieved. Insofar as the Determination of the Commission is unclear as to the remuneration of Box 2, the Panel refers back to the Commission for reconsideration the remuneration of Box 2. It is the view of the Panel that there should be neither remuneration on capital, as explained by Ryanair, nor remuneration of capital in respect of Box 2, until the trigger is achieved.
- 8.20 The Panel is of this view because the Panel is of the view that the risk of oversizing is one which should be borne by the DAA, and not by current or prospective users. Insofar as the remuneration of Box 2 pending the trigger of 33 mppa imposes costs upon users of Dublin Airport, it is contrary to Section 33(1)(b) of the 2001 Act.
- 8.21 Having regard in particular to the ministerial direction, the Panel is of the view that it is not inappropriate for Box 1 to be triggered by reference to the operational use of Terminal 2 rather than by reference to the operational use of the second runway. Once Terminal 2 is operational it is appropriate that the appropriate capital cost of providing same be remunerated through Box 1. Whether the appropriate amount has been allowed into Box 1 and thus is permitted to be remunerated is something that will need to be assessed by the Commission.
- 8.22 Insofar as the trigger for Box 2 is concerned, the Panel is of the view that it would be wholly inappropriate, in assessing whether the 33 million passengers per annum for Box 2 has been triggered, to take into account any passenger numbers at any to be constructed western campus. To permit such passenger numbers to be taken into account would be to permit the DAA to benefit from having oversized Terminal 2. This is contrary to the interests of users, and thus contrary to Section 33(1)(b) of the 2001 Act.

8.23 The Panel does not consider that the cap on airport charges should have been reduced (or increased) in the interim review. In truth the Appeal has been directed not to that issue, but rather to the consequence for the next review of the inclusion of excess expenditure in the RAB at the time of the next review.

8.24 In reaching its conclusions, as set out above, the Panel has had regard to the terms of the ministerial direction of 20th May, 2005 and in particular that of 3rd April, 2007 which directed the Commission to take due and manifest account of:

- (a) The importance the Government has attached to implementation of its policies on infrastructure development at Dublin Airport and the restructuring of the State airports;
- (b) The Government policy, in the public interest, that there be a second terminal fully operational in 2009 so as to serve passenger growth needs and the requirements of a growing economy; and
- (c) The need to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner having regard to Government policy that the Dublin Airport Authority should operate on a commercial basis without recourse to exchequer funding or an equity injection by the State.

8.25 The Panel recognises the difficulty which such a direction causes for the Commission, but believes that the direction does not override the statutory requirement to regulate.

Signed: 

PAUL GARDINER
Chairman


NIALL GREENE



ALAN DOHERTY

Dated the 23rd day of December 2008.