



27<sup>th</sup> August 2001

**Commission Determines that Aer Rianta should cut planned capex, improve efficiency and consult users to facilitate cost-effective airports that meet demands of users**

The Commission for Aviation Regulation has published its Determination of maximum airport charges at Dublin, Shannon and Cork Airports and associated Reports. The Determination applies to Aer Rianta and covers the five-year period beginning 24<sup>th</sup> September 2001.

**The Maximum Yields**

The maximum permissible yields are as follows:

- For Aer Rianta's three Irish airports taken together, the maximum yield from airport charges for the first year is £5.29 (€6.71) per passenger.
- Dublin Airport's yield from airport charges in the first year must respect a separate maximum yield of £4.41 (€5.60) per passenger.
- Charges for take-off and landing at Dublin Airport at off-peak periods are subject to a further set of limits, depending on the type of aircraft.
- A maximum charge of £10.00 (€12.69) per tonne for cargo has been set.

The Commission estimates that Aer Rianta's aeronautical revenue yield (at Dublin airport and at the company level) will be approximately £4.65 in 2001 but may be higher. Therefore the maximum yield for the three airports taken together is at most 14% higher than the estimated 2001 yield. The maximum Dublin yield is 5% lower than the estimated 2001 yield. The maximum charges are to be adjusted annually using an equation which takes into account inflation and airport efficiencies.

In separating Dublin from Cork and Shannon, the Commission has attempted to ensure that Dublin has sufficient resources to relieve congestion and bottlenecks while also providing Shannon and Cork with the necessary resources to develop as counter-balances to Dublin.

**Recoverable Capital Expenditure reduced from £998m to £272m**

The Commission set maximum yields to allow for sufficient capital expenditure to meet the future demands of the users, but at a level substantially below that which Aer Rianta had set out in representations to the Commission. Aer Rianta proposed a capex programme to the Commission of £998m covering the period between 2001 and 2006. The Commission determined that only £272m of the Aer Rianta programme had been adequately justified in terms of contributing to the operation and development of cost-effective airports that meet the requirements of users. The Commission's Recoverable capex programme covers all safety and compliance projects in the Aer Rianta capex, together with all projects to increase needed capacity (aeronautical and commercial) at the airports, including a new terminal at Cork Airport and additional facilities to relieve congestion at Piers A and B at Dublin



Airport. The Commission cited the following weaknesses in relation to both previous, as well as current CAPEX, for the Aer Rianta airports:

- poor consultation with users of the airport;
- lack of transparency in quality of information provided to users of the airport, particularly as to planned costs of proposed projects;
- construction (both past and planned) of facilities that are inefficient and/or do not meet the requirements of users of the airports in line with best international practice;
- inadequate or non-existent cost-benefit-analysis or business cases undertaken to justify specific CAPEX projects;
- internal inconsistencies in information supplied by Aer Rianta to the Commission on the CAPEX Programme.

### **Lower cost of capital and X-factor of 5-7% a year**

In making the Determination the Commission considered the appropriate cost of capital for a semi-state, sole provider entity. After reviewing submissions, including those from Aer Rianta, and receiving advice from Colm Kearney, Professor of Finance at DCU, it concluded the rate of 6% was appropriate.

The Commission applied a **CPI-X** formula for the level of the maximum yield in the four following years, whereby yields will be adjusted upwards to reflect the annual inflation rate (CPI) over the twelve months before the commencement of each regulatory year, **minus** a factor known colloquially as the "X" factor. For the three Aer Rianta airports taken together, the annual "X" factor has been set at 5%. For Dublin Airport, it has been set at 7%. The value of "X" is the same for all subsequent regulatory years (please see appendix 2 of CP7 for further detail).

### **Ministerial Direction**

As well as addressing the statutory factors (see notes to editors below) the Commissioner took other inputs into consideration. These included the Ministerial direction under Section 10 of the Act to take the government's position on regional development (as set out in the National Development and National Spatial Strategy) into account.

### **The Commissioner's conclusion**

Bill Prasifka, the Commissioner pointed to the Section 33 of the Aviation Act, 2001 as the Commission's guiding principle: "Section 33 of the Act is our lodestar. As our guiding legislation, it instructs us to facilitate the development and operation of cost-effective airports which meet the requirements of users, having due regard to 10 factors. From the various representations we received and from our own efforts, it was clear that Aer Rianta current plans would not meet the needs of the users. In addition, there is substantial scope for operating efficiencies at two of the three airports. Our Determination sets a challenging, but achievable framework for Aer Rianta to service the needs of its users now, the next five years and beyond."



The Commissioner thanked each of the parties who made representations and declared the consultation process a success. "The report follows a robust and transparent consultation process initiated and directed by the Commission. The representations assisted the Commission greatly in discharging its statutory functions" said Mr Prasifka.

### **FURTHER INFORMATION**

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The full text of the Determination and associated Reports can be accessed on the Commission's website, [www.aviationreg.ie](http://www.aviationreg.ie)

### **NOTES TO EDITORS**

The Commission for Aviation Regulation was established on the 27th February 2001. Its primary function is the economic regulation of airport charges at Dublin, Cork and Shannon airports and certain aeronautical charges levied by the Irish Aviation Authority on air traffic arriving at or departing from those airports. The Commission published its draft determination, Proposed Maximum Levels of Airport Charges, CP6/2001, on the 26th June 2001.

32 interested parties made representations to the Commission. The representations were made to the Commission in both oral and written form. The oral representations were made at public hearings held by the Commission on the 17th and 18th July 2001. The written submissions were made to the Commission on or before 26 July 2001 and then posted by the Commission on its website.

The Aviation Regulation Act, 2001 provides that, after five years, the Commission for Aviation Regulation will set new maximum charges for a further period of five years. A review of the Determination can be initiated by the Commission after two years, or if a third party provides the Commission sufficient grounds to begin a review.

### **Contents of Determination and Reports**

The Commission published the following three documents

- CP7/2001: *Determination in respect of maximum levels of airport*
- CP8/2001: *Report on the Reasons for the Determination*, (split into Part 1 and Part 2)
- CP9/2002: *Response to Representations*



**CP7/2001**, 34-page document contains the Determination (pages 1 to 18) and an Explanatory Memorandum (page 19 onwards). The Explanatory Memorandum covers the following issues:

- Definitions (pg19)
- Maximum airport charges (pg20) including CPI-X formula
- Regulatory Tills (pg 21)
- Regulatory Asset Base (pg22, 28)
- The calculation of Maximum Yields (pgs 23, 24, 25)
- Passenger forecasts (pg 26)
- Cargo sub-cap (pg 27)
- Dublin off-peak subcap (pg 27)
- Efficiency (pg 28)
- Capex (pg29)
- Quality of Service (pg 30)
- Cost of Capital (pg 30)
- Procedure for under- and over-recovery of the maximum yield (pg 30)
- Appendix 1: the calculation of a per-passenger yield (pg 32)
- Appendix 2: The X factor (pg 33)

**CP8/2001**, a 306-page document in two parts, discusses the overall statutory objectives, the Ministerial Direction of the 16<sup>th</sup> August and the Commission's review of the ten factors set out in Section 33 which sets out the regulatory objectives in respect of airport charges. It states: "In making a determination the Commission shall aim to facilitate the development and operation of cost-effective airports which meet the requirements of users and shall have due regard to:

1. the level of investment in airport facilities at an airport to which the determination relates, in line with safety requirements and commercial operations in order to meet current and prospective needs of those on whom the airport charges may be levied;
2. a reasonable rate of return on capital employed in that investment, in the context of the sustainable and profit-able operation of the airport;
3. the efficient and effective use of all resources by the airport authority;
4. the contribution of the airport to the region in which it is located;
5. the level of income of the airport authority from airport charges at the airport and other revenue earned by the authority at the regulated airports or elsewhere;
6. operating and other costs incurred by the airport authority at the airport;
7. the level and quality of services offered at the airport by the airport authority and the reasonable interests of the users of these services;
8. the cost competitiveness and operational efficiency of air-port services at the airport with respect to international practice;
9. imposing the minimum restrictions on the airport authority consistent with the functions of the Commission, and
10. such national and international obligations as are relevant to its functions."



Part 1 of CP8/2001 also includes the following appendices:

- Appendix I – The assumptions underlying the Commission’s Financial Model of Aer Rianta
- Appendix II – Ministerial Direction under Section 10 of the Aviation Regulation Act, 2001
- Appendix III - Bibliography of the Commission’s review of the National Development Programme and the National Spatial Plan
- Appendix IV - IMG Capital Investment Programme
- Appendix V- IMG Capacity Analysis
- Appendix VI- Aer Rianta’s Cost of Capital

Part 2 of CP8/2001 covers:

- Appendix VII- IMG Benchmarking Report
- Appendix VIII- Off-peak charges in respect of the landing and take off of aircraft at Dublin Airport - report on the associated marginal costs.

**CP9/2001**, a 196-page document, sets out the Commission’s response to the various submissions received during the consultation process. It includes the following appendices:

- Appendix I – Comment on the report by NERA on Aer Rianta’s cost of capital.
- Appendix II – IMG comments on “Report on regulatory asset valuation prepared on behalf of Aer Rianta”, dated 31 May 2001 by Arthur Andersen (the “Andersen Report”).

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