

Ryanair's Submission to the Commission for Aviation Regulation

28th September 2006

Public Consultation on the Carrying Out of an Interim Review of the September 2005 Determination of Airport Charges at Dublin Airport

Commission Paper CP6/2006

Summary of Ryanair's Position

1. Ryanair totally rejects the arguments put forward by the Commission for Aviation Regulation for an Interim Review of airport charges at Dublin Airport. These arguments appear to be based on an unpublished Capital Investment Programme (CIP), which, by its own admission, the Commission has not seen, and on the Commission's mistaken understanding that airport users have revised their needs, which appears to be based on nothing more than presumption, hearsay, and media reporting.
2. Ryanair also believes that the Commission holds, by its own admission at the public meeting on 11th September 2005, a "presumption" in favour of a Review and that it has already taken action that pre-judges the outcome of the present consultation, by appointing consultants to assist it with matters that such a review might raise. The Commission stated that it has held several bilateral meetings with the regulated monopoly but has failed to verify any of the information received with airline users. Comments made by DAA Chairman, Garry McGann that the "*promised review of our full capital requirements has just commenced*" support the view that the Commission has already given a clear indication that a review will take place. This renders the present consultation meaningless and demonstrates bias and regulatory capture.
3. Before any regulatory review is considered, DAA should first have held meaningful consultations with its users over their requirements and the most cost-effective and efficient way of meeting those requirements. In this respect, the Commission should have attended the public "consultation" meetings of the DAA to witness first hand the lack of any real consultation on user requirements and costs. The Commission would also have been aware through those meetings that users have not revised their anticipated requirements such that the DAA has developed a substantially larger capital programme. Because the Commission failed to attend these meetings or to approach airlines separately, it has mistakenly come to a "presumption" of the need for a review. Users are therefore put in the unenviable position of having to overcome that presumption.

4. Following proper consultation with users on their requirements and traffic forecasts, the DAA should have made proposals that could then have been discussed in terms of costs and fitness for purpose. This has not happened. DAA announced their plans and simultaneously applied for planning permission without having even informed users of the costs. Indeed, the only indication as to costs was made in a statement by the DAA in September 2005:

“The new terminal, which will become operational in late 2010, will have a capacity for up to 15M passengers per year. It will cost between €170M and €200M to build depending on detailed design specification.”

DAA T2 announcement Sept 2005

However, in just 11 months, these costs have now increased to €609m., according to DAA’s website, for a total of €759 including the write off of Pier C:

Cost	€m
Terminal 2	395
Enabling works	6
Access & Roads	39
Utilities/Energy Centre	12
Pier E Apron Works	43
Pier E	114
Total	609
Pier C write off	150
T2 actual cost	759

5. It is Ryanair’s view that the current form of regulation at Dublin Airport is not working and that the interests of users of the Airport, which the legislation is intended to protect, are consistently being ignored, both in terms of the process by which regulatory decisions are arrived at, and in terms of the application of the regulatory mechanism itself. Indeed, this form of regulation actually encourages the regulated monopoly to waste money on unnecessary capex because the regulator applies a rate of return on this expenditure. It therefore makes sense, from the regulated monopoly’s point of view, to spend €760 million as opposed to €170 million, as long as it can convince the regulator to allow it a return on this inflated amount.
6. We also question the legality of forcing passengers to pay for facilities before they actually have an opportunity to use them, and also forcing passengers to cross subsidise a facility that they may never use.

7. Finally, given that Ryanair has offered to finance and build a low cost terminal, at a more sensible location in the airport (see Michael O’Leary’s letter to Cathal Guiomard dated 27th September 2007, see also Ryanair press briefing dated 26th September 2006), there is no justification for any increase in the airport charges. Alternatively, if the DAA insists on building this gold plated facility it should be forced to fund it from its own resources, e.g., the proceeds of the Great Southern Hotel group or its interests in foreign airports, which were originally financed through Dublin Airport charges.

Introduction and Background

8. On 29th September 2005, the Commission issued a determination on the maximum levels of airport charges that can be levied at Dublin Airport over the period January 2006 to December 2009. The Commission was required under the provisions of the State Airports Act 2004 to publish this decision by 1st October 2005.
9. This determination was based on the Commission’s own assessment of a CIP prepared by DAA in May 2005. Subsequently, a revised CIP was issued by DAA in September 2005, but this was too late for it to be taken into account in the determination. This flawed process completely failed to take account of the need for proper consultation with users, and for full independent verification that the proposed capital programme met the criteria of the efficient provision of facilities at the Airport to meet user needs in terms of both specification and cost. Users have not been consulted on this capital programme. Consultation should be a pre-requisite of any consideration of the legitimacy of the DAA’s capital programme.
10. The determination was appealed by DAA and an Appeals Panel was convened, which reported in April 2006. Ryanair objected in the strongest possible terms to the process followed by this Appeals Panel¹, which refused to provide details of documentation relating to the appeal or to allow Ryanair leave to intervene in the appeal. The decision of the Appeals Panel nevertheless led the Commission to amend in part its previous determination, to the detriment of users.
11. This background describes a catalogue of failure on the part of DAA and the Commission adequately to consult with the users of Dublin Airport. Not only was the original determination of September 2005 based on inadequate consultation (even if the Commission was right to reduce the allowed capex for Pier D and T2) but the deliberations of the Appeals Panel were confined to taking the DAA’s views at face value and excluding the views of users.

¹ See letter from Jim Callaghan to Cathal Guiomard dated 18th May 2006.

12. Now the users are faced with yet another proposed review, creating further uncertainty, and still no proper process of consultation with airport users over the DAA's proposed capital expenditure plans has taken place.

Response to Specific Questions

Q1 - Do you agree with the Commission's conclusion on the types of circumstances necessary to justify holding an interim review? Please provide reasons and, where appropriate, evidence.

13. Ryanair does not agree that circumstances have arisen which justify the holding of an interim regulatory review at this stage. The Commission itself states in the current consultation document:

*"There should be a presumption against holding interim reviews other than in exceptional circumstances, that are outside the control of the DAA, and where the financial or other effects of those circumstances are liable to be large enough to compromise the achievement of the Commission's statutory objectives unless the original decision were reviewed."*²

14. The Commission has also previously recognized, in CP3/2003, that:

*"it is a very desirable characteristic of economic regulation that it offer maximum price certainty, it follows that there should be a presumption against holding a mid-term review, unless events have occurred which significantly affect the objectives of the original decision."*³

15. It is difficult to reconcile these statements with the Commission's current presumption in favour of a review. The Commission appears to have come to this view because, in its opinion, there are "substantial grounds", under the terms of the legislation, for such a review to take place. It is important to trace the Commission's train of logic in arriving at this conclusion. First, it states, reasonably enough, that the interpretation of substantial grounds should be consistent with its statutory duties:

(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

² CP6/2006, page 13.

³ CP3/2003, pages 7 to 8.

(c) to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.

16. However, the Commission then proceeds to quote CP9/2004, in which it states that, in its view, *“the essence of its statutory mandate is to promote economic efficiency”*. This view ignores the second statutory objective, set out above, to protect the reasonable interests of users. The Commission appears to get round this obvious omission by stating that *“providing for the regulated firm to earn a reasonable rate of return on capital employed in the investment, thereby allowing the sustainable and financially viable operation of the airport is in the interests of users”*.⁴
17. This is a hopelessly narrow interpretation of the interests of users: whilst the ability of the regulated firm to earn a reasonable rate of return may be in the interests of users, it cannot be taken as synonymous with the interest of users. The interests of users are much wider than this and include, for example, the extent to which the investment proposed meets the users’ reasonable requirements or the extent to which reasonable consultation with users has taken place. Without properly considering such matters, which the Commission does not apparently consider to be part of the *“essence of its statutory mandate”*, the regulated firm could be earning a rate of return at the expense of user interests. We do not therefore accept this premise in the Commission’s argument.
18. Furthermore, it is important to recognize that ensuring that capital investment is incurred cost-effectively is part of any overall assessment of the economic efficiency of the regulated firm. Allowing the pass through of capital costs without full consideration of when and to what extent such investments are needed, and whether they are being procured at the lowest possible cost, is a dereliction of regulatory duty. This is exactly the current situation for so long as the current and revised CIP have not been subject to a thorough independent review to ensure that what is being proposed is actually required by users and is being provided in the most cost effective manner possible.
19. The Commission proceeds to set out reasons for not holding a review, based on its impact on incentives:

“An expectation that interim reviews could interrupt the period of a determination, for anything other than truly exceptional circumstances, would thus be liable to reduce the power of incentives to promote efficiency as required by the Commission’s statutory objectives.”
20. The Commission adds further reasons for not holding a review:

⁴ CP9/2004 pp 44-45, quoted in CP6/2006 page 11.

“A propensity for interim reviews would also have other detrimental effects on efficiency:

(i) confidence would be reduced in the stability and predictability of the economic regime, and uncertainty for the DAA, for providers of finance and for airport users could increase;

(ii) incentives on the DAA to provide the Commission with timely and properly justified information for price reviews could be weakened, possibly seriously; and

(iii) additional staffing and consultancy costs would be incurred by the Commission, the DAA and by other participants in consultation.

21. The Commission summarises its argument thus far as follows:

“Expressed alternatively: substantial grounds for a review would be held to exist only if not holding a review would be more harmful to efficiency (which in the Commission’s view is the essence of its statutory objectives) than holding a review, even allowing for the known detriments to efficiency of the latter.”

22. Because this argument is based on a misinterpretation of the Commission’s statutory objectives, without taking proper account of the reasonable interests of users, we do not accept its premise. Ryanair believes that initiating a review at this stage would have the result of further weakening such efficiency incentives as remain within the current regulatory determination by encouraging the DAA to invest inefficiently, without regard to the needs of users and at an excessive cost.

23. The question then arises, within the context of the Commission’s argument thus far, as to whether “*substantial grounds*” exist and what would constitute such grounds. A three stage test is proposed:

“(i) Are the circumstances exceptional?”

(ii) Are the circumstances generally outside the control of the regulated company?

(iii) Are the effects of those circumstances liable to be significant enough to compromise the objectives of the original decision without a review (taking into account the incentive and any other detriments that would in general also arise from a review)?”

24. The only basis on which it could be decided whether the circumstances referred to are exceptional or otherwise relate to the DAA's revised 2006 CIP, what it may contain, and how it might differ from the basis on which the previous determination was made. However, the Commission admits that it knows very little about what this document contains:

“The Commission understands the present position to be that the DAA has itself not finalized its 2006 CIP. In any case, the Commission has as yet seen no investment plan, nor has it been provided with the critical supporting justifications for a proposed set of investments at a particular set of costs over a given horizon.”⁵

25. It is difficult to see therefore how a decision on whether substantial grounds exist can be made on the basis of what might be contained in a document that no parties to the proposed review have seen! Nevertheless, the Commission is apparently willing to speculate on what might be in the revised CIP and what the implications of it might be, stating that it is “*open to possibilities*”. Amongst these possibilities are that the Aviation Action Plan has necessitated changes to the CIP, that users have changed their requirements, or that the DAA has brought forward investments in the short term which improve efficiency in the longer term.
26. None of these “*possibilities*” has been further explored by the Commission before its decision to consider undertaking a review. In particular, as we point out below, no attempt has been made to verify with the users whether their requirements have changed. It seems astounding therefore that the Commission is using a series of unfounded and unverified “*possibilities*” as a basis for considering an interim review.

Q2 - Do you consider the degree to which airline users of Dublin Airport have revised their anticipated requirements for airport facilities (such that the DAA has developed a substantially larger capital programme) to provide the basis for exceptional circumstances?

Q3 - Do you consider the degree to which airline users of Dublin Airport have revised their anticipated requirements for airport facilities to be liable to give rise to financial or other effects that are large enough to compromise the Commission's statutory objectives unless the September 2005 decision is reviewed?

⁵ Page 22.

27. The Commission puts forward no evidence of *"revised anticipated requirements"* on the part of users in its Consultation document, nor does it refer to any other source for its assumptions about these *"revised requirements"*. Indeed, as pointed out in a letter from Michael O'Leary to Cathal Guiomard of 26th September 2006, the Commission appears to have received this mistaken view through bilateral discussions with the regulated monopoly and media reports, some of which apparently emanate from the DAA⁶, without any attempt to verify these misstatements with the airline users. Moreover, statements made previously by Aer Rianta and the DAA demonstrate that the forecasts are in line with anticipated demand. The Commission's statements in para 10(II)(b) are therefore baseless.
28. Not only does the Commission admit that it has not even seen the DAA's revised CIP; it further takes the DAA at its word that the extent of the apparent revision is likely to warrant a review; it then fails to ensure that the DAA consulted properly with users on its revised CIP or that independent verification of costs takes place before any review is considered; it also fails even to verify with users that media reports about expansion are correct or warrant consideration of expanded airport facilities. Ryanair is appalled that the Commission can see fit to instigate a public consultation on the need for a regulatory review on this basis.

Q4 - Do you consider the circumstances surrounding the unavailability of a finalised CIP at the time of the 2005 Determination to have been exceptional? If you consider the circumstances exceptional, is this for any of the reasons suggested as possibilities in this paper or for some other reason?

Q5. Do you consider the circumstances to have been outside the control of the DAA?

29. Ryanair believes that, in the absence of having seen the revised 2006 CIP, the Commission cannot possibly be in a position to evaluate whether exceptional circumstances apply, or whether those circumstances lie outside the control of the DAA, or whether the effect of those circumstances is liable to be significant enough to compromise the objectives of the original decision without a review. This clearly makes the current consideration of a review premature.

⁶ For example the statement by Gary McGann, Chair of the DAA, on the announcement by the DAA of its planning application for T2, on the DAA website, which refers in general terms to Aer Lingus' and Ryanair's expansion plans.

30. In terms of whether exceptional circumstances applied at the time of the 2005 Determination, we would query why, if the Commission believes that this was the case, it made a determination at all at that time. Why did the Commission not challenge the Government's requirement to make a determination by 1st October 2005, in the absence of effective consultation with users over the 2005 CIP, if the circumstances applying at the time were truly exceptional? In a footnote on page 17 of the Consultation Document, the Commission states: *"In the UK, where regulatory timetables are both much longer and give more discretion to regulators, it has been customary to extend deadlines for receipt of information following a major change in circumstances, such as ownership. (This occurred recently in UK aviation, followed the change of ownership of the BAA.) Whereas a UK regulator has possessed the flexibility reasonably to extend deadlines, in the situation in which the Commission found itself in 2005, this was impossible, and thus the need for a review arises."* It is not clear why this was "impossible" or why it follows that an interim review should automatically be necessary.

31. The Commission goes on to state that:

"The final part of the three-part test relates to the scale of the effects. DAA has indicated to the Commission that the revised CIP will propose a substantially larger investment programme than the Commission allowed for in its 2005 Determination. The Commission accepts that the scale of the revised programme may be large enough for its viable implementation to be in doubt without a review of the 2005 Determination."

32. It is noteworthy that the Commission appears to blindly accept the DAA's claim that *"the CIP will propose a substantially larger investment programme"*. Such a claim should first be scrutinized and users should be consulted before consideration is given to any interim regulatory review. Given that DAA failed to provide any information to users regarding the cost of their proposed T2 and are proceeding with a plan to gold plate on an unprecedented scale, we have therefore advised the DAA that we do not intend to participate in their sham consultation process any further.

Q6. What do you consider should be the scope of any review? Do you consider that the scope of any review should be limited as far as possible to the matters directly affected by the circumstances justifying the review?

33. Ryanair does not accept that a review is necessary at this stage. However, even in circumstances where a review might be deemed to be necessary, it would not be possible, as the Commission seems to suggest on page 19 of its consultation document, to review the CIP in isolation of other factors.

34. The Commission in fact appears then to contradict its previous view by stating:

“It may therefore be necessary, in order to maintain the internal consistency of the review assumptions, to adopt revised traffic forecasts for the review and to recognise the consequential impacts on operating costs and retail revenues.”

35. We would agree that any interim review could not confine its deliberations to the CIP alone and that it would have to consider a range of associated issues, not least the views of the users, as to the need for the proposals. Such a review would also have to examine alternatives, such as the scheme proposed by Ryanair and the offer of Ryanair to fund this facility. It would also have to take into account the proceeds from the sale of the Great Southern Hotel chain and the DAA’s holdings in foreign airports, which were originally funded through Dublin Airport charges. The issues of pre-funding and cross subsidization would also need to be examined.
36. Ryanair is also concerned about the Commission’s presumption in favour of a review, before this consultation process has been completed.

“The Commission has initiated preparations for a possible review. It has engaged consultants to assist it in an ongoing analysis of certain issues and these consultants will be further requested to examine matters arising under a review.”

37. This would suggest that the outcome of the consultation is prejudged. This view is given further weight by remarks made by the Chairman of the DAA, Gary McGann, at the Announcement by the DAA of its Planning Application for T2 and Other Associated Infrastructure, in which it is stated:

“We acknowledge that due to pressure of time the Regulator was unable to conduct a full assessment of the capital programme submitted by the DAA last September and that a promised review of our full capital requirements has just commenced. We will continue to work proactively with the Regulator to carry out this review as swiftly as possible”⁷

38. The suggestion that a review was “promised” by the regulator, and the reference to the review having “just commenced” is further indication that the outcome of the current consultation process, and possibly the review itself, is a foregone conclusion.

⁷ DAA Website.

Conclusion

39. In conclusion, Ryanair re-iterates its view that the Commission has not presented any convincing arguments in favour of a review at this stage. Furthermore, in failing to ensure that proper consultation takes place with users over the detail of the proposed investment at Dublin Airport, the Commission has failed to meet its statutory objectives. This is further evidence of the consistent failure of the regulatory process at Dublin Airport to protect the reasonable interests of users.

40. Given that the DAA has failed to properly consult with users on the costs of its proposed development and has misled the Commission with regard to the anticipated requirements of users, a decision by the Commission to review the determination at this time would be challengeable in the courts.