IATA response to the Irish Commission for Aviation Regulation Draft Determination on the Maximum Levels of Aviation Terminal Services Charges of the Irish Aviation Authority (IAA) – CP10/2006 of 21 December 2006

1. Introduction

1.1 We fully support the aim to motivate air navigation service providers to achieve the lowest possible charges consistent with a high standard of safety, capacity and service, while protecting the users' against any abuse from the relatively strong market power of the provider.

1.2 Airlines are operating in an increasingly competitive and deregulated business that is driving cost reduction and improved efficiency. Our members have reduced non-fuel unit costs some 14% over the last five years, with a 33% improvement in labour productivity. While the recent drop in fuel price is welcome we are still paying more than twice as much as we were in 2001 and is now some 26% of our total costs.

1.3 Competition has driven down our real yields some 30% over the last 10 years. Airlines are continuously reducing costs in line with consumers' demands. Unfortunately we are seeing nowhere near this improvement in efficiency from our ANSP partners within the supply chain who enjoy a relatively stable and growing revenue. More than ever we need regulatory support to ensure the lowest possible costs and charges consistent with the provision of the agreed necessary capacity and service.

1.4 IAA is a key supplier of an essential service that has a significant impact on our operations and service quality. We wish to see a strong and successful IAA but with the capacity and service delivered at the best possible price and cost-efficiency. We therefore welcome the opportunity to respond to the CAR Draft Determination on the IAA terminal navigation charges (TNC) for 2007-11.

2 Scope of regulation

The Commission appears to be assured by application of the average 25/75% EUROCONTROL split cost allocation between en route and TNC. We would be more comfortable if this was backed by proper activity based costing or justified cost-allocation to ensure that users are only paying for costs of capacity, services and facilities that they need and use.

3 Design and scope of the price control

3.1 We generally support the current control and form, recognizing that in practice the price control is a hybrid of price cap and cost pass-through

methodologies. Our concern however is that pass-through costs, unless vigorously scrutinized and controlled, can weaken the incentive properties of the regulation.

3.2 We would like to see consideration of site-specific charging for TNC that is more reflective of cost-relatedness and minimizes the opportunities for cross-subsidy. Such a system can be regarded as less discriminatory and anti-competitive. In this respect it would also be helpful to know the Commission's intentions with regard to the impact and implementation of the EC Charging Regulation.

4 Over and under recovery of charges

4.1 We can support the adjustment mechanism to ensure the average price recovered over the period is consistent with the determination, and that the actual recovery of the last year is factored into the next price determination, providing the incentive effects are sufficiently robust and challenging. If not, the system is virtually a full-cost recovery.

5 Determination period

5.1 We recognize that a period of four to five years is appropriate to enable the efficiency incentives to be effective in addition to providing the necessary stability to facilitate longer-term planning. This allows a reasonable trade-off between the time needed for the efficiency incentives to be realized while minimizing the time lag before users can benefit from the efficiency gains. We support the proposal for the regulatory years to be aligned with the IAA financial year.

6 Regulatory till

6.1 We support continuing with a regulatory till that only includes revenue earned by the IAA from aviation terminal services. It would be inappropriate if users were expected to bear any costs or risks that relate to the unregulated business. This points to the basing of regulated charges on the separate costs of those activities.

7 Traffic forecasts

7.1 We have confidence in the EUROCONTROL Statistics and Forecast Service (STATFOR). Nevertheless, we believe that if possible the forecasts should be discussed and agreed with based and local operators who are better aware of their operational plans.

8 Volume risk

8.1 We recognize that there has to be a balance between risk and reward in any regulatory settlement. However, in this regard an ANSP has a relatively low risk in general with a continuous revenue stream. It can be claimed that airlines have a higher risk on traffic. In the event of traffic downfall or shocks airlines are invariably obliged to reduce fares and yields, but still pay the same (and in many cases increased) charges or price caps. In our view IAA is as well placed as the users to mitigate volume shock.

8.2 Against this background captive airline customers are doing business in an increasingly competitive business where all risks have to be faced and dealt with. We trust the Regulator will bear this situation in mind when considering a balanced solution that protects the interests of the users.

8.3 If there were to be any consideration of trade-off for users between the risk placed on IAA and the prices we face, the charges would have to be significantly lower to justify any such consideration.

9 Capital expenditure (capex)

9.1 The proposed or planned capex of EUR 103m for the next control period is significantly higher than the current EUR 23m (in 2006 prices). We note that EUR 54.5m of this is for construction of new control towers at Dublin and Cork for EUR 44m and EUR 10.5m respectively.

9.2 We assume that the necessity for the towers together with issues such as location and height are matters for the Irish safety regulator to establish. However, we do expect the regulator to closely scrutinise any costs, as well as the IAA contracting, tendering and project management processes and capability to ensure cost-efficiency and best possible value for money.

9.3 In general terms we would also expect the capex plans to be consulted and coordinated with the users to obtain “buy-in” as part of the IAA’s service and investment plan. Every significant investment should be justified with a robust business case or positive cost benefit analysis. The Commission needs to ensure that the regulatory framework has not encouraged IAA to over-forecast on capital expenditure and under-spend on delivery.

9.4 In view the significantly increased capex proposals, and to minimize the situation outlined above, the Commission should consider introduction of agreed milestones or “triggers” to incentivise timely and cost-efficient investment in major projects such as the control towers. Charges should be reduced in the event that that agreed target process or delivery dates are not reached.

10 Operating expenditure (opex)

10.1 We much appreciated the IAA efforts post "9/11" which maintained 2002 charges at 2001 levels and indicated the attempt to provide a cost-effective service during a very difficult trading time. This also indicated that operating costs are a major source of potential efficiency savings.

10.2 We therefore welcome the Commission's attention and analysis on efficiency in general and productivity in particular. Against the airline industry situation outlined in 1 (above) we are concerned to note that the consultant's studies indicate IAA productivity is slightly lower than the national average.

10.3 The proposed total operational cost increases, and in particular the 73% increase in training costs between 2006 and 2011 as well as the 46% increase in personnel costs, warrant special attention and efficiency targets or incentives. We are not aware of what is included in the "Administration etc" costs but believe these also requires scrutiny as they represent 22% of the total opex increasing by 37% over the same period.

11 MET costs

11.1 For the last price cap period we supported the correct allocation of MET costs between the en route and TNC cost bases on the basis that all costs should be fairly allocated to ensure that no users are burdened with costs not properly allocable to them.

11.2 While the current 80/20 split may be in line with the European average we would like assurance this is more appropriately based on where the MET services and facilities are actually needed and used. We would also like assurance from the regulator that MET costs allocated to civil aviation are being properly contested and challenged and not treated merely as a pass-through cost to users.

12 Cost-effectiveness and benchmarking

12.1 We are aware IAA is a relatively good performer in Europe. The latest EUROCONTROL PRR 2006 report indicates they are 5th best of 34 in terms of "gate to gate" cost-effectiveness, which includes TNC as well as en route. Also that they are slightly above average in terms of "gate to gate" ATCO-hour productivity and employment costs per ATCO-hour.

12.2 We also note that the 2005 PRC study indicates that of the top 25 European airports Dublin was 15th highest for larger aircraft and 19th for B737/A320. Our own November 2005 TNC study indicated that Irish Airports were 39th of the 92 European airports that were analysed.

12.3 Nevertheless, while such comparisons are interesting they should be treated with care. Other factors such as pricing parities also need to be considered. The PRC reports also indicate that IAA is only ranked 27th in terms of complexity and density of airspace. It should also be considered that the en route activity has benefited from the significant windfall of additional revenue-producing service units (CSUs) from the inclusion of NOTA within the Irish charging area. The regulatory regime must incentivise continuous improvement in productivity and cost-effectiveness.

13. Cost of capital

13.1 The Commission proposes to allow the IAA a real, pre-tax rate of return of 6.7%. However, we note that in his initial proposals for the London Airport price caps the UK regulator has recently proposed a rate of 6.2% for Heathrow, where our own analysis indicates that a rate closer to 5.6% would be sufficient. In addition to the changes to justify a lower rate for this control period outlined in CP10/2006, we believe the relatively low-risks referred to under "Volume risk" (8 above) should also be taken into consideration for the allowed cost of capital.

14 Service quality

14.1 Delay performance is clearly the most important service quality element for the airlines. Any delay terms on ANSPs could not be expected to compensate airlines for the significant cost of delays, but they do serve to focus the provider's attention on what is important for the airlines. We believe consideration should be given to inclusion of a financial incentive to improve service quality.

14.2 Our preference is for an asymmetric penalty with IAA only being accountable and subject to penalties on delays they can directly control. Such a regime however should not perversely increase cost through unnecessary complexity. We recognize that such a scheme should only proceed if the majority of based and local operators support the idea and are willing to discuss and agree the terms together with the CAR and IAA.

Geneva 22 February 2007