Maximum Levels of Aviation Terminal Services Charges

The Provisional Annual Compliance Statement for Regulatory Year 26th March 2005 to 25th March 2006 and Calculation of the Price Cap for Regulatory Year 26th March 2006 to 25th March 2007

Commission Paper CP1/2006

30th March 2006

TABLE OF CONTENTS

1.   PURPOSE OF THE PAPER

This Commission for Aviation Regulation ('Commission') paper serves two purposes. First, it assesses the Irish Aviation Authority's (IAA) provisional compliance with the Commission's price cap for the period 26 March 2005 to 25 March 2006. A definitive assessment of compliance for 2005/06 will be made when final figures for aviation terminal services charges' revenues and aircraft tonnages become available. Compliance with the price cap for the previous regulatory period (26 March 2004 to 25 March 2005), for which final data are now available, is also reported definitively in this paper.

Second, using final information (where it is available) and provisional information (otherwise), the paper calculates the price cap for the 2006/07 regulatory year.

The regulatory period commencing 25 March 2006 is the last year of the Commission's current price cap, which comes to the end of its five-year term in March 2007. The Commission will shortly announce the process by which it proposes, during the coming twelve months, to make a new determination of the price caps to apply to the IAA's terminal services charges for the period 2007 – 2012.

2. BACKGROUND

The Commission's Determinations are specified in such a way that, at the end of each regulatory year (which runs March to March) compliance with the price cap for that year is measured and a new price cap is derived for the next regulatory year. The calculation of the price cap is made by amending the previous year's cap for inflation; an X factor which represents the required annual real change in prices; the difference between the Commission's actual and budgeted costs and expenses per passenger, as recovered through the aviation terminal services charges; and, the degree of over- or under recovery of charges in the previous year.

A brief synopsis of the Commission's previous determinations and the associated price-cap compliance statements was provided in section 2 of last year's Compliance Statement (CP1/2005) and so is not repeated here.

3.   PRICE CAP DATA 2001 – 2006

Table 1	26/03/02 to 25/03/03	26/03/03 to 25/03/04	26/03/04 to 25/03/05	26/03/05 to 25/03/06	26/03/06 to 25/03/07
	Period 1	Period 2	Period 3	Period 4	Period 5
Unadjusted Max Yield (YU)	1.34	1.4974	1.6301	1.7804	1.9590
Adjusted Max Yield (Y)	1.34	1.79	2.01	1.98	1.94
CPI	4.75	1.86	2.22	3.03	
X	7.00	7.00	7.00	7.00	
Interest	2.96	1.92	1.88	2.02	
Total Revenue	7,750,845	10,829,552	14,163,059	17,364,657 *	
Total MTOW	7,264,444	7,680,531	7,846,766	8,682,328 *	
Actual Yield (Y*)	1.0670	1.4100	1.8050	2.0000	
K	-0.2811	0.3841	0.2055	-0.0225	
CAR's Budget Adjustment (W)	70,128	(66,373)	(72,734)**	9,125 ***	
MTOW for W calculation	8,376,250	8,773,750	9,172,750	9,568,281	
W per tonne	0.0084	-0.0076	-0.0079	0.0010	

♦ A technical change in the definition of the K-term (see CP4/2004, page 10) causes it to change from a negative value in the first period to positive values thereafter but in all of the first three regulatory periods it represents the amount by which per MTOW revenues were below the cap.

*These are actual figures up to December 2005 and estimates for 2006 provided by the IAA.

**This is based on actual figures up to 25 March 2005.

***This is based on draft financial statements from 26 March 2005 to 31 December 2005 and budgeted costs up to 25 March 2006.

Annex 1 provides a description of the calculation of the Period 5 price cap.

4. COMPLIANCE DURING THE THIRD REGULATORY PERIOD (26 MARCH 2004 TO 25 MARCH 2005)

For the third regulatory period (26 March 2004 to 25 March 2005), the price cap was €2.01. This took account of inflation, the formula's prescribed positive X value of 7%, the Commission's budget having been €66,373 below forecast[1], and the IAA's under-collection of revenues during the second regulatory period of €0.3841 per tonne (including interest).

Provisional compliance was posted in CP1/2005 using actual data for the period 26 March to 31 December 2004 and estimated data for the period 1 January to 25 March 2005. The Commission has since received actual data for the latter period. Although the total revenue and tonnage figures have changed slightly, average revenue per tonne did not change from the €1.80 calculated in CP1/2005, as can be seen below:

$$\frac{\text{Total Revenue}}{\text{Total MTOW}} = \frac{14,163,059}{7,846,766} = €1.80$$

Consequently, compliance with the price cap of €2.01 for the third regulatory period is confirmed.

---

[1] The sum differs from that reported in CP1/2005 (i.e., €66,402) due to the posting of audit adjustments.

5. COMPLIANCE DURING THE FOURTH REGULATORY PERIOD (26 MARCH 2005 TO 25 MARCH 2006)

For the fourth regulatory period (26 March 2005 to 25 March 2006), the price cap is confirmed at €1.98. This takes account of inflation during the twelve months to January 2006, the formula's prescribed positive X value of 7%, the Commission's budget having been €72,734 below forecast[2], and the IAA's under-collection of revenues over the third regulatory period of €0.2055 per tonne (including interest).

Following the Commission's request for information the Authority supplied the following information to allow the Commission to proceed with the monitoring of compliance:

i.   The total revenue yielded by way of aviation terminal services charges levied at Dublin, Cork and Shannon Airports during the fourth regulatory year of the Commission's determination;

ii.   The total number of MTOW tonnes for which aviation terminal services charges were levied during the fourth regulatory year of the Commission's determination.

In the year to 25 March 2006, the Authority's average revenue per tonne yielded by way of aviation terminal services charges levied per aircraft departing from Dublin, Shannon or Cork airports was €2.00. This was calculated using actual revenue and tonnage figures for the period 26 March 2005 to 31 December 2005 and estimated values for the period 1 January 2005 to 25 March 2006, as follows:

---

[2] The sum differs from that reported in CP1/2005 (i.e., €73,713) due to the posting of audit adjustments.

$$\frac{\text{Total Revenue}}{\text{Total MTOW}} = \frac{17,364,657}{8,682,328} = €2.00$$

Therefore, on a provisional basis, the average revenue per tonne yielded by way of aviation terminal services charges exceeded the cap of €1.98. The cap for the fifth year is correspondingly reduced to compensate users for the IAA's marginal over-recovery in the previous year.

Finalisation of the regulatory compliance assessment (along with any associated impact, likely to be extremely small, on the price cap for the fifth regulatory period) is pending, following the future receipt, on the agreed schedule, by the Commission of finalised revenue and tonnage data for 2005/06 from the IAA.

6. PROVISIONAL PRICE CAP FOR THE FIFTH REGULATORY PERIOD (26 MARCH 2006 TO 25 MARCH 2007)

This section of the paper updates the price cap from 2005/06 to 2006/07 in accordance with the amended formula set out in the Review, CP4/2004. In order to establish the price cap, the following information is required:

i.   The 2005/06 price cap;

ii.   Any difference between the Commission's actual and budgeted costs that is recoverable through aviation terminal services charges;

iii.   The percentage change in the Consumer Price Index between January 2005 and January 2006;

iv.   The X factor;

v.   Any correction arising from over- or under-recovery in previous years by the IAA of regulated aviation terminal services charge;

vi.   The average interest rate on three-month commercial paper issued between March 2005 and February 2006 by the National Treasury Management Agency.

The information necessary for the Determination is as follows:

i.   The unadjusted 2005/06 price cap of €1.7804.

ii.   The differences between the Commission's budgeted and most up to date actual financial information on cost that is recoverable through aviation terminal services charges. For the period March 2005 to March 2006, actual drafts costs were above the forecast costs by €9,125.

iii.   Between January 2005 and January 2006, the Consumer Price Index increased from 128.7 to 132.6, corresponding to an inflation rate of 3.03% over that 12-month period;

iv.   The X-factor for the fifth regulatory year of +7%;

v.   The average daily interest rate on three month commercial paper issued between March 2005 and February 2006 by the National Treasury Management Agency was 2.02%;

By substituting this information into the formula, the per-tonne price cap for aviation terminal services charges in the fifth regulatory year is found to be €1.94. The full calculation is presented in Annex 1 and Table 1 above.

The reason for the reduction in the level of the price cap, from €1.98 in the fourth regulatory period (2005/06) to €1.94 in the fifth (and final) regulatory period may be seen from careful inspection of Table 1. There was significant under collection of terminal services charges by the IAA (as a matter of policy) in the early years of the 2002 – 2007 price control. This in turn gave rise to a substantial carry-forward (i.e. the K term) of that under recovery into subsequent years, lifting the price above its underlying level. However the effect ceased to operate by the end of 2005/06, as by then the IAA had slightly over recovered the previous under-collection of charges. With the K term turning negative for 2006/07, the underlying adjustment in the price cap is limited to the application of the inflation and X terms. Although material, these changes are of a smaller magnitude than the elimination of the impact of the previous K factor, leaving the 2006/07 price cap some 4 cents lower than in 2005/06.

Using the above information, the Authority's regulatory requirements for the regulatory year 26 March 2006 to 25 March 2007 may be stated as follows:

The average revenue per MTOW tonne yielded by way of aviation terminal services charges levied per aircraft departing from Dublin, Shannon and Cork airports should not exceed €1.94.

ANNEX 1: PROVISIONAL REGULATORY PERIOD 5 PRICE CAP

For the regulatory year 2006/07, the average revenue per tonne yielded by the Authority by way of aviation terminal services charges levied per aircraft departing from Dublin, Shannon and Cork airports shall not exceed the amount calculated in accordance with the following formula:

$$Y_{06/07}^{Iaa} = \left(YU_{06/07}^{Iaa} + W_{05/06}^{Iaa} + K_{06/07}^{Iaa} \right)$$

where

$$YU_{06/07}^{Iaa} = YU_{05/06}^{Iaa} \left(1 + \frac{\Delta CPI_{05/06} + X^{Iaa}}{100} \right)$$

and where

$$K_{06/07}^{Iaa} = \left(Y_{05/06}^{Iaa} - Y_{05/06}^{\bullet Iaa} \right) \left(1 + \frac{I_{05/06}}{100} \right)$$

From Table 1, we know that

$$YU_{05/06}^{Iaa} = €1.7804$$

$$\Delta CPI_{05/06} = 3.03$$

$$X^{Iaa} = 7$$

and that

$$\Rightarrow YU_{06/07}^{Iaa} = 1.7804 \left(1 + \frac{3.03 + 7}{100} \right) = 1.959$$

We also know from Table 1 that:

$$W_{05/06}^{Iaa} = \frac{9,125}{9,568,281} = €0.001$$

The final step is to calculate the K-factor. From Table 1 again, we know that:

$$Y_{05/06}^{Iaa} = €1.98$$

$$Y_{05/06}^{\bullet Iaa} = €2.00$$

$$I_{05/06} = 2.02$$

and that

$$\Rightarrow K_{06/07}^{Iaa} = \left(€1.98 - €2.00\right)\left(1 + \frac{2.02}{100}\right) = -€0.0225$$

The three elements of the calculation of the price cap for the fifth regulatory year are as follows:

$$YU_{06/07}^{Iaa} = 1.959$$

$$W_{05/06}^{Iaa} = €0.001$$

$$K_{06/07}^{Iaa} = -€0.0225$$

and that implies that

$$Y_{06/07}^{Iaa} = \left(1.959 + 0.001 + (-0.0225)\right) = €1.94$$