



3rd May 2002

Ms. Anne Moloney,
Deputy Head of Economic Affairs,
36 Upper Mount Street,
Dublin 2.

Dear Ms. Moloney,

Re: Aer Rianta Response to Submissions on CP4 / 2002

Further to the submissions received in relation to CP4 / 2002 – *Consultation Paper on the implementation of the Levy* – which were issued on the Commission’s website. I am enclosing Aer Rianta’s comments in relation to same.

Yours sincerely,

Brian Hampson
Director Corporate Affairs
& Company Secretary

AR/CAR/05-02:

Aer Rianta Response
to Submissions to the
Commission for Aviation Regulation
on
Consultation on the Implementation of
the Levy Pursuant to Section 23 of the
Aviation Regulation Act, 2001
(CP4/2002)

3rd May 2002

AerRianta

TABLE OF CONTENTS

INTRODUCTION.....	3
ALLOCATION OF COSTS PROPERLY INCURRED BY THE COMMISSION.....	4
Litigation Costs	4
Professional Costs.....	5
UNDERTAKINGS LIABILITY TO PAY	6
Regulation of Airport Charges	6
Slot Allocation and Coordination	7
Ground Handling.....	8

Introduction

1. Aer Rianta and other parties made submissions to the Commission for Aviation Regulation on 26th April 2002, in accordance with the process outlined by the Commission in its consultation document CP4/2002. This document is Aer Rianta's response to the submissions of other parties as invited by the Commission.
2. As a preface, the key points put forward by Aer Rianta in its submission are summarised as follows:
 - The cost associated with the economic regulation of airports is a legitimate externally imposed expense over which the airport authority has no discretion and therefore should constitute part of the overall airport cost base that is ultimately passed through in full to users.
 - Aer Rianta does not accept the Commission's proposal that an element of the cost burden associated with airport regulation should be borne by the airport authority and not passed on to users. Such an approach is not authorised by Section 23 of the Act, deviates from standard international regulatory practice, is inconsistent with the position adopted by the Commission in its Determination on Airport Charges, and is based upon a false economic premise.
 - To impose the levy on Aer Rianta as set out in the Commission's consultation paper without an appropriate cost pass through mechanism would effectively double count for the impact of regulation on Aer Rianta's cost of capital.
 - The allocation of the Commission's costs and expenses in proportion to the time properly expended by it on various cost centres and costs directly related to that function should be applied, subject to full transparency on costs.
 - Aer Rianta has fundamental concerns as to the fairness in principle and propriety of the Commission recovering, and the manner in which it is proposed that it shall recover, costs associated with litigation.
 - The allocation of costs in CP4/2002 among the various functions of the Commission is disproportionate. The regulation of airport charges has been unfairly burdened with the bulk of the Commission's costs, despite the significant scope of the other five functions for which it has responsibility and the number of parties involved.
 - Aer Rianta is concerned that the Commission is proposing to impose upon the industry a very considerable financial burden, in circumstances where there is little or no accountability by the Commission to the industry in respect of its costs, and where there is no demonstration that the cost base is efficient.

Allocation of Costs Properly Incurred By the Commission

3. Aer Rianta is of the view that the costs set out by the Commission in CP4/2002 constitute a significant burden on the industry, are not transparent and do not represent value for money. At no point in the paper does the Commission give details of how it has ensured that its costs are kept to a minimum as required by statute. It is interesting to note how few of the submissions from other parties focused on this important issue.
4. Most respondents agree that the Commission's costs and expenses that are directly related to particular functions should be allocated to those cost centres and the remaining costs should be allocated in proportion to the time properly expended by it on various cost centres. Aer Rianta also agrees with this approach on the proviso that full transparency on all costs is provided and the Commission's time allocation records are available for independent audit prior to the annual finalisation of percentages used for the purpose of the calculation of the levy.

Litigation Costs

5. The treatment of litigation costs is a key concern for most respondents, as indeed it is for Aer Rianta.
6. It is interesting to note that respondents appear to make their comments only in the context of Aer Rianta taking a judicial review case against the Commission. If their submissions formed the basis of established principle, then any company taking an action in relation to any of the functions of the Commission would have to carry the Commission's litigation costs whether or not they were successful. This would restrict parties from taking an action against the Commission to the courts, regardless of the gravity of the perceived injustice. In this context, the Aer Lingus submission is notable in that it maintains that if it has to carry some of the Commission's litigation costs as a result of its being a joined party to the current High Court proceedings then it would reconsider its participation in the proceedings. This is a very serious matter in the context of regulation in Ireland and the Commission's accountability.
7. Where the Commission is found to have acted *ultra vires* in discharging its functions, then the costs incurred by the Commission in such proceedings should not be considered to be expenses "properly incurred" for the purpose of Section 23(1) and therefore should not be recoverable through the levy. Otherwise, the industry would unfairly have to bear the burden of costs incurred where the Commission did not discharge its functions properly.
8. Aer Rianta agrees with Aer Lingus that the Commission should seek to have costs awarded against the Commission and costs associated with unsuccessful Court engagements by the Commission underwritten by Government, as the Act does not preclude other sources of funding apart from the levy for recovering the Commission's costs and expenses. However, the suggestion that the Government as shareholder should fund these costs indirectly through the imposition of a levy on Aer Rianta, which is not recoverable through airport charges is unsustainable and contrary to the Air Navigation and Transport (Amendment) Act 1998 under which Aer Rianta operates.
9. If it is the case that the Commission's litigation costs are to be recouped through the levy, regardless of the outcome of the litigation, then the litigation costs incurred by regulated undertakings that challenge the Commission should also be allowed. Such costs should be spread equally across all classes of undertakings connected with the function to which the

proceedings relate. Any other model undermines fundamentally the entitlement of parties involved in the industry to litigate the validity of actions of the Commission, presents an improper barrier to the exercise by such parties to their right of access to Court and interferes with the power of the Court to grant orders for costs. It would, in essence, constitute a tax on litigating against the Commission.

10. There have been some comments from respondents regarding Aer Rianta's decision to pursue a judicial review of the Commission's Determination rather than take part in the Appeal Panel process, to the effect that this course of action increases costs to the industry. Aer Rianta rejects these submissions on two grounds
 - It is clear that an inaccurate or inappropriate Determination has the potential to cause significant financial damage to undertakings in the long term. Ensuring a correct Determination is in the best interests of all parties, even those parties who do not carry out long term assessments.
 - According to Section 40 of the Act the Commission may affirm or vary its Determination following a decision by an appeal panel. There is no obligation for the Commission to verify the Determination. Where there is a question of validity of the Determination there is no choice under the Act but judicial review. As the validity of the Determination as a whole is in question, Aer Rianta had only one route open to it under the Act, that of applying for judicial review to the High Court.

Professional Costs

11. The airlines have placed considerable emphasis on the contention that Aer Rianta benefited significantly from the analyses undertaken by IMG, to the extent that the related professional costs should not be recoverable under the maximum average revenue per passenger allowed by the Commission.
12. It should be noted that IMG were retained by the Commission to undertake studies in respect of both the regulation of aviation terminal services charges and airport charges. Due to the lack of transparency in CP4/2002 it is impossible to know what proportion of the professional fees incorporated in the Commission's estimates are allocable to each function.
13. Furthermore, the IMG Reports, far from being of any benefit to the airports, in fact damaged the airports significantly due to inaccuracies in the analyses resulting in ill-considered conclusions by IMG and the Commission.
14. The IMG benchmarking report, in particular contained some serious inaccuracies and methodological flaws, including:
 - No comparison of like for like activities across the various "peer" airports – so Aer Rianta figures were compared against airports that did not perform the same range of activities without adjustment
 - Incomplete and inaccurate data was used – for example, Aer Rianta has established that the figure used by IMG for WLUs at Dublin excluded cargo throughput.

15. When appropriate allowance is made for
- errors made by IMG (e.g. use of incorrect WLU figures);
 - adjustment to ensure a comparison of like for like activities; and
 - incorrect calculation of average results by IMG (use of simple average rather than more appropriately weighted average)

it is clear that IMG's conclusions are grossly in error and provide no basis for the efficiency factors arrived at by the Commission for Aer Rianta. In fact, the Aer Rianta airports are more efficient than their peers - Dublin airport's operating expense per WLU is 19% lower than the average of the 'best of peers' group and Shannon and Cork airports' operating expenses per WLU are 22% and 61% lower respectively than the average of their "peers"¹. The serious errors in IMG's benchmarking does not provide a basis for the contention that Aer Rianta should directly bear the costs associated with same. Indeed, it is difficult to see why anyone in the industry should be required to bear the cost of IMG's inaccurate benchmarking report.

Undertakings Liability to Pay

Regulation of Airport Charges

16. It is hardly surprising that many users support the Commission's novel suggestion that a proportion of the costs associated with airport regulation be borne by the airport operator as it "benefits" from regulation.
17. The ultimate objective of economic regulation is to protect consumers. Ryanair has acknowledged in its response that airport users benefit from the protection afforded by the Commission. It is only proper that those that benefit from regulation should be liable for the costs associated with it (a point which is accepted by DHL in its submission), therefore the cost associated with economic regulation should constitute part of the overall airport cost base that is ultimately passed through to users.
18. There are no "residual" benefits not already taken into account in determining Aer Rianta's allowable costs that could be "offset" against the cost of the Levy.
- The potential for cost efficiencies, which some airlines inaccurately claim has been surfaced as a result of IMG's incorrect analyses has already been factored into the Determination.
 - The empirical evidence does not support the Commission's assertion that Aer Rianta "benefits" from regulation in the form of a lower cost of capital. In any event, NERA² notes that the effects of regulation on the cost of capital, whether positive or negative, are already fully captured in the cost of capital that the Commission has applied in setting Aer Rianta's price cap.

¹ It should be noted that, when adjusted, Shannon and Cork are more comparable to the UK 'peers' in terms of activities carried out directly, than to Basel (the only non UK airport included by IMG in Shannon and Corks 'peer' group). Aer Rianta calculates Shannon and Cork's operating expense per WLU as being 32% and 65% lower respectively than the UK "peers".

² The Implementation of the Levy, A Report from NERA, Appendix to Aer Rianta Submission on CP4/2002, April 2002

- Aer Rianta will not achieve an increase in revenue from its regulated activities - charges at the three airports are required to decrease by more than 6% per annum in real terms for the first two years alone.

The Commission's proposal is therefore conceptually incorrect, unfair and should be withdrawn.

19. As set out in Aer Rianta's response to CP4/2002, best regulatory practice is to impose the levy on regulated activities only and to treat this cost as a pass through item. Regulators in the airports, rail, energy and water sectors in the UK adopt this approach. Neither the Commission nor the submissions from various interested parties have provided any compelling reason or solid economic analysis to support a move away from this established precedent.
20. Some of the respondents have accepted the Commission's suggestion that the costs of economic regulation of airport charges should be levied on non-aeronautical activities. This would result in a situation whereby the regulation of maximum airport charges would impact on other sections of the company's activities, as costs that are not relevant would be incorrectly loaded on the users of these activities. This would be neither fair nor equitable.
21. Such an approach would also be contrary to the requirement that the Commission should have due regard to promoting the efficient and effective use of all resources by the airport authority as set out in Section 33c of the Aviation Regulation Act 2001 and to the requirement that it impose the minimum restrictions on the airport authority consistent with its functions as set out in Section 33i of the Act. Section 23 of the Act does not permit the Commission to impose a levy on Aer Rianta's non-regulated activities.
22. In the Commission's Determination of airport charges, a number of parties submitted to the Commission that revenue from Great Southern Hotels and Aer Rianta International should properly be included in the regulatory till. The Commission rejected these submissions on the grounds that "*these activities do not have a sufficient nexus to the regulated activities.*"³ That being the case, it would be incorrect for the Commission to now take the view that the revenue from such activities should partially fund its operating costs.

Slot Allocation and Coordination

23. The comprehensive analysis provided by ACL demonstrates clearly that within the EU, the costs of this function are either shared between airports and airlines or funded entirely by the airlines.
24. In line with the current systems operating in Denmark, France, Italy and Sweden, Aer Rianta reiterates its proposal that it fund 50% of the costs associated with this function with the remaining 50% shared amongst the airlines in whatever manner the Commission deems appropriate.
25. Aer Rianta agrees with the suggestion made by the majority of respondents that the costs associated with this function be open and subject to review by the Executive of the Dublin Airport Coordination Committee.

³ CP9/2001, at page 139.

26. Aer Rianta rejects the suggestion made by Aer Lingus and Ryanair that the costs associated with this function should be borne solely by the airport operator. It should be noted in this context that at the first meeting of the Dublin Airport Executive Committee on Coordination on 5th December 2001, it was recommended that it was preferable that the costs associated with this function should be funded from a broad base of undertakings in order to ensure the independence of the coordinators.
27. Aer Rianta totally rejects the inaccurate claims made by Aer Lingus and Ryanair regarding the background to the assignment of an independent co-ordinator at Dublin Airport.
28. Contrary to their assertions, Aer Rianta did not appoint an independent co-ordinator at Dublin. In September 2000 the Minister for Public Enterprise designated Dublin Airport as a Coordinated airport (not Fully Coordinated as requested by Aer Rianta), appointed ACL as independent co-ordinator and, in accordance with the Council Regulation 95/93, commissioned a capacity assessment of Dublin Airport in order to assess the Aer Rianta's request for designation as a Fully Coordinated airport. The SH&E report⁴ stated that:

“The decision to designate Dublin airport as co-ordinated and to appoint ACL as the schedule co-ordinator is fully justified”
29. It is clear from the above that the designation of Dublin Airport as co-ordinated was correct as independently validated by consultants appointed by the Department of Public Enterprise. There are therefore no grounds to support the proposition by Ryanair and Aer Lingus that Aer Rianta alone should bear this element of the Commission's costs.

Ground Handling

30. Aer Rianta notes that respondents generally agree that approved handlers should fund the Commission's costs associated with this function.
31. Contrary to Aer Lingus claim that the costs associated with this function are generated equally by approved handlers, Aer Rianta is of the view that the handlers who are ultimately denied approval by the Commission also generate costs as the Commission must expend time and effort in reviewing the application before making its decision. Approved ground handling companies should not have to carry the costs associated with the screening of those companies that might ultimately be denied approval.
32. Therefore, Aer Rianta reiterates that each company that applies to the Commission for approval to carry out ground handling functions should be levied with a charge that reflects the costs associated with assessing applications.
33. The remaining costs associated with day-to-day administration of the ground handling cost centre should then be apportioned equally across all approved ground handling companies.
34. Aer Rianta rejects Ryanair's assertion that the ground handling administration fee should be withdrawn. It would be unfair and inequitable to allocate the costs involved across other users that do not engage in ground handling functions.

⁴ Assessment of Capacity at Dublin Airport, A Report for the Department of Public Enterprise, SH&E, February 2001