

22nd June 2010



**DAA Response to Commission for Aviation Regulation's
Consultation on the Decisions of the 2010 Aviation Appeal
Panel**

Table of Contents

Introduction	3
The Appeal Process.....	4
Executive Summary	8
1. DAA Appeal: Matters Referred to the Commission	11
2. Aer Lingus Appeal: Matters Referred to the Commission.....	19
3. Ryanair Appeal: Matters Referred to the Commission	24
Appendix I - Pier D Material Previously Submitted to the Commission	46
Appendix II– Summary of Retail Operating Costs as per Booz Report 27th Nov	53
Appendix III– 2009 Airport Charges at Dublin Airport	54
Appendix IV – Examples of Differential Terminal Charges	55
Appendix V - Ryanair Response to Consultation re Service Quality	58
Appendix VI - Establishing A Differential Charge for Terminal Services	60

Introduction

DAA would like to take this opportunity to participate in the Commission's consultation on the decisions of the 2010 Aviation Appeal Panel (Appeal Panel) dated 1 June 2010 in relation to the appeals brought by DAA, Aer Lingus and Ryanair . The format of DAA's submission is as follows:

- In Chapter 1, DAA explains its concerns in relation to the Appeal Process and in this context emphasises the Commission's duties and responsibilities in relation to its reconsideration of its Determination of December 2009.
- Chapter 2 contains a summary of DAA's position in relation to the matters being referred to the Commission in each of the three appeals.
- Chapter 3 considers the matters referred to the Commission arising from DAA's Appeal.
- Chapter 4 considers the matters referred to CAR in the Aer Lingus Appeal.
- Chapter 5 considers the matters referred back to the Commission in the Ryanair Appeal.

As requested by the Commission, DAA has limited itself to providing cogent arguments in response to each of the grounds of appeal referred to the Commission by the Appeal Panel.

The Appeal Process

The decisions of the Appeal Panel in the appeals brought by Ryanair and Aer Lingus against the Commission's Determination of 4 December 2009 were made on 1 June 2010 and published on CAR's website on 8 June 2010 together with the Commission's Consultation Paper CP1/2010 calling for submissions on the matters referred back by the Appeal Panel to the Commission. As the Commission would be aware, in view of the procedures chosen by the Appeal Panel, this is the first opportunity provided to DAA to comment on the grounds relied upon by Ryanair and Aer Lingus in their appeals against the Determination. DAA had no knowledge of those grounds prior to the publication of the Decision of the Appeal Panel on the Commission's website other than from the press release of Ryanair dated 1 June 2010.

The findings of the Appeal Panel, in particular in the Ryanair Appeal, confirm DAA's concerns that the procedures adopted by the Panel, which refused to grant DAA any role or means of participating in the process, could lead to findings which are adverse to DAA's interests, without DAA being aware of such matters and without DAA having been heard¹. DAA would like to express its regret that it was not granted an opportunity to deal with these matters when they were before the Appeal Panel as this would have allowed DAA to have clarified certain issues and it may have in fact avoided the need for the referral of these matters back to the Commission.

Against this background, DAA submits that it is of the utmost importance that careful attention be given by the Commission to the present submissions, at the risk otherwise of further depriving DAA of its right to fair procedures. As set out in more detail below, DAA submits that the grounds advanced by Ryanair are based on an incorrect or incomplete presentation of the facts and are biased and should not have warranted a referral by the Appeal Panel.

In this context, DAA notes the invitation by the Commission in the Consultation Paper to make comments in writing in relation "only to those matters where the panel concluded that sufficient grounds existed for referring its decision in relation to the Determination back to the Commission" and its clarification that it "will not have regard to submissions that introduce

¹ DAA notes that the first Appeal Panel, in 2001, took the view that its decision would directly affect the interests of Aer Rianta (as the airport authority) and that Aer Rianta should accordingly be given an opportunity to make observations and submissions to the Panel

any issues not referred back to it by the Panel” (p. 4). There are two issues which arise in this respect. First, it is not entirely clear to DAA what materials, in addition to the submissions to the present consultation, the Commission intends to rely upon in considering the matters referred back to it and deciding whether to vary its determination or not, and in particular whether it will rely on any submissions made by Ryanair or Aer Lingus to the Appeal Panel. If that is the case, then DAA requires that it be provided with a copy of these materials and with the opportunity to comment and make any further submissions as may be necessary.

Second, while the submissions below are limited to the matters which have been referred back to the Commission, in view of the public nature of the Decisions of the Appeal Panel, DAA wishes to object to the recommendation of the Appeal Panel at para. 9.2 of the Decision in the Ryanair Appeal that “*regulated entity accounts with detailed divisional analysis should be prepared by DAA and that variance analysis be carried out by the Commission for future Determinations*” in circumstances where, on its own admission, the Appeal Panel did not find that sufficient grounds had been established in this respect for the purpose of the review of the Determination of December 2009. It is DAA’s view that in making this recommendation, the Appeal Panel has very clearly exceeded its jurisdiction which is confined to “*consider[ing] the determination*” under appeal. It is not open to the Appeal Panel to make recommendations in relation to future determinations. It is relevant in this regard that under section 40 of the 2001 Act, the Appeal Panel, once it has made its recommendation in relation to the determination under appeal, stands dissolved. It is also particularly inappropriate for the Appeal Panel to make such recommendations in circumstances where it chose not to hear the position of all parties concerned, including in particular DAA. For the avoidance of doubt, DAA believes that the recommendation is without merit and notes that it has been and continues to be DAA’s practice to provide substantial analysis and information in response to requests from the Commission. DAA will continue to cooperate with the Commission in addressing their information requirements. The Commission accordingly should not consider, including for the purpose of future determinations, the recommendation of the Appeal Panel at para. 9.2 of the Decision in the Ryanair Appeal.

As explained fully in our submission, DAA believes that the Appeal Panel has been unwittingly misled in relation to certain appeal matters brought before it but expects that the Commission in examining the matters referred back to it by the Appeal Panel will have the benefit of its extensive regulatory knowledge and expertise and that it will therefore be in a

position to employ a more balanced approach to assessing the merits of any conflicting arguments.

DAA notes further however that in considering the matters brought before it by the Appeal Panel, the Commission retains its statutory responsibility to ensure that Dublin Airport is developed to meet the requirements of current and prospective users in an economically efficient way and that DAA is able to operate and develop Dublin Airport in a sustainable and financially viable manner. In order to fulfil these objectives it is necessary that the Commission continues to allow:

- An adequate return on existing assets employed in the operation of the airport that is sufficient to attract the necessary funds to maintain and develop infrastructure
- The recovery of efficiently incurred operating costs
- Sufficient levels of capital expenditure to ensure that the airport is appropriately developed to meet current and future users needs
- Realistic and achievable assumptions in relation to all elements of the price cap derivation

It is also imperative in the interests of regulatory consistency that the Commission does not, in responding to the matters referred back by the Appeal Panel has renege on previous regulatory commitments and that any change that is made has adequate justification.

It is the case that the present consultation process has potentially serious implications for the future viability of DAA. In particular, DAA is concerned that certain matters which have now been brought before the Commission have the potential to postpone further or threaten DAA's ability to recover costs relating to its mandated investment in T2. There is no justification for this development given that T2 has been the subject of two regulatory reviews, two regulatory appeals, an independent verification process initiated by the Government and two specific ministerial directions. If the potential to strand investment relating to T2 is realised, then this will undoubtedly have the most serious implications for the financial stability of DAA. This consultation process should not be allowed to hamper the impending opening of T2. T2 is a critical piece of airport and national infrastructure which has been designed to and will facilitate the expansion of Dublin Airport in accordance with customer requirements, passenger needs, business demands and the overall national interest. Indeed, it has been specifically pointed out by the Appeal Panel that *"if the concerns expressed by the Panel in relation to some of the grounds above regarding the disallowance*

of prudently incurred past capex are not addressed, capital markets may come to require a higher debt premium to compensate for perceived asymmetries in regulatory risk².

² Decision of the Aviation Appeals Panel 2010 – DAA paragraph 9.4

Executive Summary

Set out below is a summary of DAA's submissions to the Commission in relation to the matters referred to the Commission by the Appeal Panel in each of the three appeals:

The DAA Appeal

The matters referred by the Appeal Panel related to factual errors or omissions and it is imperative that such errors and omissions be corrected by the Commission.

In calculating its aeronautical revenue allowance for the regulatory period 2010-2014, the Commission double counted PRM revenues as both commercial income and aeronautical revenue. This error should now be corrected either by reducing the 'Other Commercial Operations' category of the Commission's commercial revenue forecast by the equivalent PRM revenue amount or alternatively properly exclude PRM revenues from the price cap.

The Commission should amend its capital expenditure reconciliation for DAA's CIP 2006-2009 using the correct outturn costs for each year as provided by DAA. This will also allow for a reconciliation and roll forward of the RAB in 2014 on the basis of an accurate cost assessment of capital expenditure for the period 2006-2009.

The 2009 Determination should be amended to allow for the inclusion of €15.3m additional capital cost relating to the Pier D project into the Regulatory Asset Base (RAB) as an efficiently incurred element of capital infrastructure.

The 2009 Determination should be amended to allow for the inclusion in the RAB of an additional €7.7m capital expenditure relating to the Temporary Forward Lounge (TFL) and Pier D fit – out projects as they were excluded on the incorrect assumption that they formed part of the allowed investment in Pier D.

The Aer Lingus Appeal

DAA submits that there is no basis for the assertion made by Aer Lingus that T2 has been overspecified in terms of the space allocation for retail. It was in any event demonstrated in the analysis conducted on behalf of the Commission that the level of overheads driven specifically by the provision of retail space in T2 is negligible. Therefore there is no requirement for any adjustment to the 2009 Determination to postpone the recovery of any alleged increased overheads associated with this retail space.

The Ryanair Appeal

DAA submits that the grounds advanced by Ryanair which have formed the basis of the Appeal Panel's recommendations are flawed and reflect an incorrect assessment of the airport charges at Dublin Airport. The Appeal Panel appears to have disregarded or misinterpreted the manner in which this issue was comprehensively addressed by the Commission in the consultation process preceding the current (and previous) determination and in the determination itself. DAA submits accordingly that the Commission should maintain its approach to date and not vary its Determination in the manner recommended by the Panel. DAA notes as follows:

Contrary to the contention of Ryanair, the introduction of differential pricing is not necessary to ensure that the interests of users including low cost airline are met at Dublin Airport, which are already met through the current pricing structure. In fact differential pricing would hurt the interests of all users as it is more likely to seriously distort the allocation of capacity, the management of demand, and competition between airlines at the airport.

The mandated introduction of differential terminal pricing is likely to give rise to a number of complex legal and technical difficulties that may ultimately have the consequence of frustrating the implementation of the Ministerial Directive concerning the opening of T2 and the achievement of the statutory objectives pursued by the Commission.

The Appeal Panel appears to have overlooked the very serious practical and legal difficulties, including under the European Airport Charges Directive which would arise from the implementation of its recommendation.

It is wholly inappropriate that the Commission has been asked by an appeal panel to consider the initiation of such a radical new change in policy such as differential pricing at this late stage, given the potential significance of such a new initiative for the regulated sector. This issue differs materially from the other appeal grounds referred by the Panel as it does not represent the correction of an error or a reinterpretation of facts but would involve a fundamental change to the nature of the regulatory model that applies at Dublin Airport. The Panel's decision to refer the issue of differential pricing is not founded on evidence or practical economic logic, and does not offer the Commission sufficient time within the two-month window to adequately address the myriad issues to which differential pricing gives rise. The short time-frame available to CAR is likely to amplify the risk of unintended consequences arising from an imposed system of differentiated charging.

The recommendation of the Appeal Panel is further undermined by the suggestion that differential pricing might be applied in an arbitrary or token fashion to establish a principle.

The available evidence in fact indicates that any differential pricing computation would operate in the opposite direction to that suggested by Ryanair.

In relation to the second referral arising from the Ryanair appeal, there is no justification for the Commission to carry out a further analysis of the extent of incremental retail revenue attributable to T1X given that this facility is included in the RAB on the basis that it is to have a neutral impact on airport charges. Furthermore the Commission has already undertaken to conduct an ex post examination of the actual return on this project over the period 2010-2014 and compared with the €5 million per annum revenue assumption for the regulatory period.

1. DAA Appeal: Matters Referred to the Commission

1.1 Error in the Treatment of PRM Revenues in the Calculation of the Price Cap

In its decision in relation to the DAA appeal of the 2009 Determination, the Appeal Panel recommends that the Commission should review whether there has been an error resulting in a double counting for PRM charges by it being included under both aeronautical revenues and 'other commercial revenues'.

DAA submits that in calculating its aeronautical revenue allowance for the regulatory period 2010-2014, this error has in fact occurred, and that the Commission double counted PRM revenues as both commercial income and aeronautical revenue.

This error arose as a result of the Commission considering PRM revenues as an aeronautical revenue, when in fact a certain portion of these revenues were also included in its commercial revenue forecasts under the heading 'other commercial operations'. The annual value for the projected PRM revenues included in the 'Other Commercial Operations' category is set out in the table below.

€ millions	2010	2011	2012	2013	2014
Projected PRM Revenues	1,175,808	1,193,445	1,217,314	1,241,660	1,266,493

DAA proposes that this error should now be corrected by reducing the 'Other Commercial Operations' category of the Commission's commercial revenue forecast by this PRM revenue amount and adjusting upwards the annual price cap formulae. DAA estimates that based on a circa €6 million double count in PRM revenues correction of this error would require that the average price cap should be increased €0.06 over the period 2010-2104. Alternatively as previously proposed, DAA recommends that PRM revenues be removed from the aeronautical price cap and treated separately from aeronautical revenues with the appropriate adjustment being made for the double count.

1.2 Error in the Treatment of Inflation in the Reconciliation of CIP 2006-2009

In its decision in relation to the DAA appeal of the 2009 Determination, the Appeal Panel has recommended that the Commission consider the effect of its application of deflation of -6.6% for 2009 to DAA's submitted figures for reconciliation of project outturn costs for the 2006 - 09 CIP (which had allowed for an estimated inflation figure of 4% in 2009)

The Appeal Panel referred the Determination back on the grounds that there has been a mathematical error in the Commission's calculation which was a sufficient ground to refer the Decision to the Commission..

This fundamental error was arrived at as follows

- DAA submitted a reconciliation of project outturn costs for the 2006 – 09 CIP in May 2009. This CIP was originally assessed by the Commission in 2006 prices. The reconciliation therefore deflated outturn costs to 2006 prices using actual inflation for 2006-2008 and an estimate of 4% for 2009.
- In the Final Determination, the Commission erroneously re-inflated this 2006 total figure using actual inflation for 2006-2008 and -6.6% for 2009. The 2009 index used for deflation and subsequent inflation are therefore misaligned. This has had the effect of substantially understating DAA capital expenditure for the period 2006-2009 as the 2009 expenditure is understated by over 10%.

Correcting for this error requires the Commission to amend its capital expenditure reconciliation for DAA's CIP 2006-2009 using the correct outturn costs for each year as provided by DAA. This will allow for those assets included in the opening RAB to be correctly valued and a reconciliation and roll forward of the RAB in 2014 on the basis of an accurate cost assessment of capital expenditure for the period 2006-2009, in respect of those assets for which a review has been deferred.

In order to do so, project outturn costs with spend broken down by year have been provided in the table set out below. This data will allow the Commission to apply its indices for the years 2006 – 2009 in a consistent manner in order to inflate or deflate as required.

Column A contains the original CIP values inflated to 2009 prices using the Commission's indices.

Column B represents the Commission’s miscalculated figure as outlined above. These figures, which exclude Capitalised Interest and Labour, were then used by CAR in its project-by-project reconciliation of the CIP 2006 – 09.

Columns C – F contain the outturn values by year, which are summed in Column G.

Column H represents the total outturn value (contained in Column G) inflated to 2009 prices using the indices adopted by the Commission in its Final Determination.

These revised 2009 prices should be used by the Commission to carry out a new project-by-project reconciliation of the CIP 2006 – 09.

DAA will be happy to provide further detail and discuss the mechanics of the indexation exercise in more detail if so required by the Commission.

DAA estimates that the correction of this error will result in an average €0.05 initial increase in the price cap over the period 2010-2014. This will require an adjustment in the annual price caps formulae as set out in the 2009 Determination. However, the primary impact of the correction of this error will be that it will ensure an appropriate basis for calculation of the opening RAB for the next regulatory period once these assets fall to be reviewed in line with the treatment set out in the 2009 Determination.

	A	B	C	D	E	F	G	H	I	J	K
	Original CIP 09 Prices	DAA O/T as per CAR Final Det	2006 O/T	2007 O/T	2008 O/T	2009 O/T	Total O/T	Total 09P	Less Cap Int 09P	Less Cap Lab 09P	Revised 09P for CAR
Airfield	103	86	6	56	26	5	93	90	1	3	86
General	43	27	7	4	9	10	30	29	-	1	28
Runway	8	4	1	0	1	4	5	5	-	0	5
New	-	32	-	6	11	19	36	35	-	1	34
T1X	56	51	2	6	32	18	58	56	1	2	53
Pier D	88	117	35	74	12	2	124	121	2	2	117
TFL and Pier D Fit out	7	7	6	0	1	1	8	8	-	0	8
Other	94	99	31	34	17	22	104	102	0	1	101
T2 Projects (main & associated)	738	775	33	78	263	501	875	856	16	14	826
Total	1,136	1,199	120	259	371	582	1,332	1,303	20	26	1,257

1.3 Disallowance of Pier D Costs

In its decision in relation to the DAA appeal of the 2009 Determination, the Appeal Panel recommended that the Commission review its decision to disallow €15.3m Pier D overrun costs.

While it cited a number of DAA's points in its Decision, the Panel was particularly concerned that capital markets would react negatively to the Commission's disallowance of large tranches of past investment as a result of the inevitable regulatory uncertainty created.

DAA welcomes the Panel's decision to refer the Pier D project back to the Commission. Pier D has already proven itself to be an asset of significant value to Dublin Airport users, forming a central component of low cost carrier operations in particular, via the facilitation of the 'quick turnaround' requirement.

DAA has also demonstrated through a benchmarking exercise that Pier D has been delivered extremely efficiently and competitively. There is therefore no question that users are being asked to pay for inefficiently incurred capital investment. Pier D is an excellent facility which is being used intensively by airlines to sustain and develop their businesses. The facilities within provide a solid level of service quality to passengers. The facility itself was provided within an extremely tight timescale, and has been delivered efficiently.

DAA highlighted to the Commission the preliminary nature of the initial Pier D estimates during the 2007 interim review process. As outlined in DAA's response to the Commission's Issues Paper³, DAA was mandated by the Government to design and build a new pier within a very tight timeframe. The timeframe required the construction of Pier D prior to the completion of its design. While this approach is necessary in such a scenario, cost estimates are unavoidably less reliable than would otherwise be the case. Unfortunately, the Commission's determination process had begun in parallel, requiring a cost estimate for the project at a stage where the final design of the project was not complete.

The Commission was obliged to mandate a price cap for the next determination, and so it incorporated the preliminary estimate in the price cap. However in the 2009 Determination insufficient consideration was given to Pier D's outturn costs or to the detailed rationale for these costs provided by DAA. As a result the current allowance into the RAB for this project is not a reflection of the actual cost of providing the facility.

³ DAA Response to CP6/2008, Appendix 3, December 2008.

DAA has provided the Commission with a detailed breakdown of the cost outturns of Pier D, including individual cost drivers. Individual drivers were either out of the control of DAA, or in the interests of all users of Pier D. Users gained both directly, via additional services such as extra contact stands, and indirectly via increased efficiencies such as an improved life cycle.

DAA therefore requests that the Commission to allow for the inclusion of the full cost of Pier D into the RAB on the basis of the evidence presented to the Commission which shows that Pier D was delivered to users in an efficient manner, and in light of the evident significant benefits that users are deriving from the facility on an ongoing basis.

DAA submits that the remuneration of all such efficient and effective capital investment is key to maintaining a functioning regulatory system for both regulated entities and their customers and it welcomes the Appeal Panel's clear support for this principle

A summary of DAA's original submissions to the Commission is set out in Appendix I, this details the context of the Pier D project, the individual components of the additional which includes this additional €15.3m and the international benchmarking exercise undertaken. DAA recommends that an adjustment to include the additional €15.3m in the opening value of the regulatory asset base (RAB) as set out in the capital costs section of the ready reckoner (published alongside CP4/2009) is required plus an appropriate upward adjustment in the annual price cap formulae. DAA estimates that a correction of this capital expenditure disallowance will require an average increase of €0.15 in the price cap for the regulatory period 2010-2014.

1.4 TFL and Pier D Fit-Out costs

In its decision in relation to the DAA appeal of the 2009 Determination, the Appeal Panel has recommended that the Commission review its disallowance of €6.2 million TFL costs and €1.5 million Pier D fit-out costs.

The central point is the Commission's incorrect inclusion of these costs in its assessment of the Pier D outturn cost. DAA has consistently highlighted that these were separate projects and as such were not included in the Pier D costs. The Appeal Panel has sensibly concluded that "this would appear to be a matter of fact which can be objectively ascertained". It goes on to say that "if the expenditure was incurred and cannot be said to be imprudent, allowance should be made for it. This makes for regulatory consistency."

1.4.1 TFL Context

In DAA's 2005 CIP the TFL project was not listed either as an individual project nor as an element of the Pier D project, as it was not envisaged as necessary. Between the 2005 Determination and the 2007 Interim Decision, passenger numbers rose considerably more than had been anticipated. The Commission will be aware of this fact, as it was the justification used to defer a required increase in passenger charges, despite an acceptance of the need for a major capital investment programme.

The unanticipated increase in passenger numbers also placed considerable strain on Dublin Airport's capacity, not least concerning the provision of contact stands. In the absence of a completed Pier D DAA provided a temporary forward lounge (TFL) to facilitate users as an interim solution. While the TFL did facilitate the construction of Pier D by substituting for some contact stands which had been taken out of service, this project should be seen as separate from Pier D, as it was primarily driven by a short term sudden increase in passenger numbers which could not be facilitated by the construction of a long term piece of infrastructure. This capacity shortage was exacerbated by the delays associated with the required decision to proceed with Pier D.

Such was the benefit that users derived from the TFL facility that DAA agreed to extend its lifespan past the opening of Pier D. This incurred costs of circa €0.5m as contractors had to amend their works on the surrounding apron – a fact that was articulated to the Commission in DAA's response to CP6/2008, in the appendix detailing the drivers of the true outturn cost of Pier D. This additional development should not be confused with the drivers of the original TFL project. Airline users clearly valued the TFL project. The Commission will be aware of recent communication between DAA and users, under the auspices of the DACC,

concerning the continued use of the facility, and of its own communication to DACC on the matter⁴. The correspondence no doubt impressed upon the Commission the importance which users attach to this facility. DAA considers it unjust, therefore, that following the Commission's 2009 Determination, users are not required to pay for the cost incurred by DAA in providing this facility.

1.4.2 Pier D Fit-Out context

The requirement for separate Fit-Out costs for Pier D stems from the following:

The Pier D project was originally tendered on a "shell and core" basis (i.e. excluding fit-outs to Ramp Accommodation).

During negotiations to secure a tenant for the new Pier D Ramp Accommodation, it became apparent that there was a requirement for a Pier D fit out in order to achieve a higher rental income for these areas and an additional €1.5 million was allocated.

Pier D fit-out costs have been inappropriately deducted given that no compensating downward adjustment was made for the incremental rental income that has accrued from the investment.

Simultaneously, in its treatment of Hangar maintenance, the Commission accepts the principle that reducing DAA's ability to invest in revenue generating projects reduces its ability to generate commercial revenues.

Therefore, the Commission should allow the cost associated with fitting out Pier D for its tenants. Failing this, and at a minimum, it should revise downwards property rental targets for the lifetime of the accommodation fit out.

1.4.3 Possible Source of the Commission's Misunderstanding

In its 2009 Determination (paragraph 8.20), the Commission reiterates incorrectly that Pier D included the costs of both the TFL and Pier D fit-out projects – "The commission has rejected DAA's arguments that its reconciliation excluded projects CIP4.019 and CIP7.020 relating to temporary forward lounge and pier D fit out. The reported outturn capex amount (€124.9m) for pier D included the costs of both these projects".

⁴ Cathal Guiomard to Geoffrey O'Byrne White, April 19th 2010

DAA has never suggested to the Commission that the costs for these projects were included in the Pier D costs and therefore is unsure as to how the Commission came to this conclusion.

The Commission adjusted DAA's final outturn cost €132.6m (submitted in December 2008 in DAA's Response to CAR's Issues Paper) by subtracting €7.6m for pre-2006 spend to arrive at this €124.9m figure.

However, the Commission appears to have made a series of incorrect assumptions, as alluded to in Table 8.2, in order to form the mistaken view that these separate projects were included in the Pier D outturn cost

The Commission started with DAA's Pier D 2006 – 09 spend deflated to 2006 prices (as submitted in May 2009) of €114.9m.

The Commission then incorrectly added €6.0m for TFL and €1.3m for Pier D Fit-Out, to arrive at a total assumed spend of €122.2m.

The Commission appear to have assumed that because this total spend was less than the DAA €124.9m outturn, that the TFL and Pier D Fit-Out costs were included in the Pier D budget.

	DAA outturn spend (€m)	
	2006 prices	2009 prices
Pier D	114.9	118.5
Pier D fit out for tenants	1.3	6.1
TFL	6.0	6.1
Pier D capex remunerated pre-06		-7.2
Total	122.2	117.9

Table 8.2: Pier D outturn costs

DAA would be happy to provide further clarification of the above by means of direct discussion with the Commission if so required.

The inclusion of this €7.7m capital investment will necessitate an adjustment to the opening value of the regulatory asset base (RAB) as set out in the capital costs section of the ready reckoner plus an appropriate adjustment in the annual price cap formulae. DAA estimates that the addition of this capital expenditure to the RAB will result in an average increase of €0.20 in the price cap over the period 2010-2014.

2. Aer Lingus Appeal: Matters Referred to the Commission

2.1 Over Specification of T2

In its decision in relation to the Aer Lingus appeal of the 2009 Determination, the Appeal Panel has recommended that the Commission should consider how the recovery of T2 retail overheads could be postponed until they are commercially justified.

It appears that the basis for this referral is the view put forward by Aer Lingus that

- there is potentially excess retail space in T2 given that the Commission estimated that this area was some 40% greater than the international and European averages
- this retail space will not be efficiently used for the foreseeable future because traffic numbers are insufficient with the result that the cost of this excess retail space will be passed onto airport users.

DAA is somewhat surprised that Aer Lingus has adopted this position in regard to the sizing of T2 retail. This appears in marked contrast to earlier statements made by the airline relating to this matter.

The following quotes have been taken from Aer Lingus's response to CP5/2007 – the draft Determination which considered the optimal sizing of T2:

- “Aer Lingus wishes to reiterate its support for Arup’s design schedule for T2 as reflected in DAA’s CIP”
- “this (T2’s) specification has been the result of a detailed consultation with the airport users which was fair and balanced. We believe this process is exactly what airports should go through in determining the level of future facilities which should be provided”
- “in our view the Commission would be wrong to alter the specification of T2 as part of its determination as this would fail to provide airport facilities with the facilities they need”

At that time, Aer Lingus did not express any concerns regarding the amount of space devoted to retail in T2, nor the impact this would have upon associated overheads/operating costs.

Concerns relating to the sizing of T2 have been dealt with extensively to date given that it has been the subject of two regulatory reviews, an independent verification process initiated by the Government and two subsequent regulatory appeals. DAA therefore does not believe that it is appropriate that this matter should be raised again albeit in the limited guise of retail space.

DAA is of the view that there is no basis to support the requirement that the Commission should consider the postponement of remuneration of T2 operating costs. DAA rejects both the assertion that T2 has excess retail space and the suggestion that airline users as a result of the 2009 Determination could be required to cover costs which are attributable to this alleged excess retail space.

DAA submits that the grounds advanced by Aer Lingus do not justify a variation of the Commission's Determination because, first, T2 in fact does not include excessive retail space and second, in any event, the operating costs associated with this alleged excess would have an immaterial effect on the Determination.

2.1.1 T2 Retail Specification

Retail operations form a central component of most airport operations. In the case of Dublin Airport it is particularly critical for both the airport operator and airline users, as DAA heavily subsidises airport charges with associated commercial revenues through the operation of the single till. This is central to its strategy of providing a reasonable level of service across facilities while still retaining comparatively low airport charges.

T2 offered an important opportunity for DAA to continue with this strategy and to ensure that commercial revenues continue to subsidise airport users for the foreseeable future. Therefore one of the key objectives in the design for a second terminal at Dublin Airport was that it should include a highly successful retail component. To achieve this, the design to meet the operational requirements for efficient passenger movements and ease of way finding had to be balanced with the commercial requirements for a successful retail layout. In line with the wider T2 project, considerable discussion and consultation informed the final design of the terminal's retail & catering facilities. Considerations on retail & catering facilities were made within the context of wider T2 consultation process, which the government's Independent Verifier concluded '*accords with best practice*⁵'. Aer Lingus positive comments on the process have already been recounted above.

⁵ Boyd Creed Sweet, '*Independent Verifier's Report*' September 2006, page 3

This has resulted in a T2 retail area which extends over 8,500sq metres and which is set to contain 20 retail concessions units, 10 food and beverage concession units and 3 direct retail units. Based on the negotiations which are currently ongoing, it is expected that this retail space will be virtually fully occupied when operations in T2 commence.

In contrast, the Appeal Panel's consideration of the T2 floor space devoted to retail were limited, and seemed to hang on the Commission's observation that retail space was 40% higher than the average of the referenced 'Airport Commercial Revenues Study 2008/2009'. This figure was considered in isolation from any of the detailed design work which drove the retail offering in T2. This also ignores the fact that at 8,500 sq metres the retail area for T2 is in fact considerably smaller than the 13,700 sq metre retail area currently in place in T1.

- The provision of retail space is based upon space requirement of 750 sq metres per million passengers at a busy hour rate (BHR) of 4,200 passenger. This is in line with the average amount of commercial floor space specified in The Airport Retail Study⁶
- Retail space in T2 is to be concentrated on the airside (80:20) with landside offers mainly on the arrivals level, in line with international trends⁷
- The airside departure lounge is based on a shopping centre model with the anchor tenant (DAA) providing core products together with specialist retail units. This ensures that adjacencies and passenger flows maximise the success of the retail offer
- The retail mix is to be tailored for target passengers at the time of day (long haul – mid morning, low cost, short haul - early morning, mid afternoon and evening)
- The Primary Food and Beverage offers are integrated into the departure lounge on the mezzanine level with a secondary F&B offer contained in the Bar on the main shopping or departures level.

Like all elements of the terminal, the retail facilities were designed to a declared capacity of 15 million passengers per annum. As previously outlined, T2's capacity is not likely to be reached for some time. However, in the interim period, the floor space devoted to retail will

⁶ The Moodie Report & RDG Solutions 'The Airport Commercial Revenues Study 2008/2009' para 10.1

⁷ The Moodie Report & RDG Solutions 'The Airport Commercial Revenues Study 2008/2009' para 10.1 'the results highlight the worldwide trend to shifting more commercial operations airside for security reasons (and to maximise commercial dwell time)' & para 8.5 'Globally, more and more airports are accentuating their focus on airside activities in an effort to maximise available dwell time with time-conscious consumers'

generate substantial commercial revenues which are essential if the DAA is to reach the Commission's targets for retail revenues which are built into the 2009 Determination.

2.1.2 T2 Retail Operations

Aer Lingus has suggested that airport users will somehow be penalised for DAA's alleged excess retail space due to the requirement to cover the operating costs associated with this area.

DAA believes that the size of retail facilities in T2, while contributing to commercial revenue generation, will have an immaterial impact upon overall operational expenditure for T2.

The reality is that the vast bulk of retail space in T2 will be concessionaire based. As DAA has articulated to the Commission before, it is moving towards a new business model where DAA will be directly involved in the retail of only a few core commodities⁸. Currently in T1 82% of retail is concession based with the remaining 18% directly operated. It is intended that the proportion in T2 will be weighted slightly more towards concession operations (84%-16%). The overheads associated with concession operations are negligible, as it is written into contracts that concessionaires are to be recharged for all costs incurred.

The treatment of retail operating costs was dealt with comprehensively by BOOZ & Co in its report to the Commission on 27th Nov 2009. For convenience the relevant information relating to retail from this report has been sourced and is presented in the Appendix II set out below.

As is clear from this table, very few of the cost drivers even partially relate to floor space, indicating that these costs would be incurred regardless of the size of the T2 retail facilities and therefore cannot be attributed to excess retail size as alleged in the Aer Lingus appeal.

Therefore, DAA believes that there is no basis to the assertion that users will be required to pay for excess retail size given that DAA anticipates that

- direct retailing operations will earn a sufficient return to cover all operating expenditure
- concessionaires will be required to cover any operating expenditure associated with their occupied space

⁸ DAA's 'Regulatory Proposition Document', April 2009, Supporting Document V

- Overall retail space is expected to be virtually fully occupied when operations commence in T2.

3. Ryanair Appeal: Matters Referred to the Commission

3.1 Differential Pricing

The Appeal Panel has recommended that CAR considers “*how best differential pricing might be initiated*”. The recommendation of the Appeal Panel is set out in more detail at paragraph 8.4.8 which states as follows:

“while it is open to DAA to charge on a differential basis the Panel believes that the DAA will only do so if it is mandated by the Commission, either in the form of different charge caps for each terminal or alternatively, by introducing incentives into the price cap to encourage DAA to employ differential pricing”.

The Panel adds that “*A start could be made with a small nominal difference in the price cap between T1 and T2 once T2 is operational. This would establish the principle.*”

As set out in detail below, DAA submits that the grounds advanced by Ryanair which have formed the basis for the Appeal Panel’s recommendation are flawed and reflect an incorrect analysis of airport charges at Dublin Airport. The Commission should not accordingly vary its Determination on this ground. It appears to DAA that CAR has examined and debated thoroughly the possible use of differential charging for terminal services at Dublin Airport and the issues and concerns arising during both its 2007 and 2009 regulatory reviews. In this regard, it is DAA’s submission that CAR should not follow the Appeal Panel’s recommendation. DAA considers that the Commission came to the considered and correct conclusion in deciding not to require differential pricing in one form or another and concurs with the Commission’s position in relation to differential pricing as set out in its 2009 Determination:

“the Commission is also concerned that to impose sub-caps requiring some kind of differentiation risks denying DAA the necessary ability to respond to changing conditions at the airport in a way that meets the reasonable interests of users. If the Commission made a determination that required a particular structure of charges there is a risk that all airlines would want to use a particular pier (for example). In this case, the appropriate response would be for the DAA to increase the charge for the pier relative to the charge for using other piers until such time as the structure of the charges meant that demand for any given pier did not exceed the capacity of the pier.

If the Determination set a sub-cap on the charges that could be levied for using the more popular pier, the DAA would not have the option of changing charges”⁹

DAA explains in further detail below the reasons why the basis for the recommendation is flawed and the considerable practical and legal issues which appear to have been overlooked by the Panel in making its recommendation to introduce differential pricing.

3.1.1 The basis for the recommendation of the Appeal Panel is flawed

The basis for the recommendation of the Appeal Panel that differential pricing be introduced in respect of the two terminals at Dublin Airport, set out in section 8.4 of the Decision, can be summarised as follows: Providing a dedicated low cost terminal is critical to addressing the needs of present and future airport users. Differential pricing is required because as an operator in a ‘monopoly position’, DAA should cater for different airline business models and its failure to do so means that it is favouring certain business models with potentially anticompetitive effects on competition between airlines. Catering for different business models requires differential pricing which DAA will not introduce unless it is mandated to do so by CAR.

DAA believes that these reasons relied upon by the Appeal Panel are flawed and that this has resulted in large part because the Appeal Panel has in effect only heard Ryanair’s position which DAA does not believe presents a full and accurate picture of the issue.

(i) DAA is not in a monopoly position

- First DAA does not accept that it can be appropriately characterised as a “*monopoly*” or that it is in a “*monopoly position*”. Constant repetition by Ryanair of a supposed DAA monopoly does not make such statements true. DAA notes in this regard that no definition of the market concerned or assessment of market power on that market has been carried out either by CAR or the Appeal Panel and these statements are accordingly entirely unsubstantiated and groundless. DAA rejects in the strongest terms the statements of the Appeal Panel which associate with DAA, without any evidence, certain potentially anticompetitive behaviours, in particular the contention that DAA has favoured certain business models over other, which would imply “a *potential restriction or distortion of competition in airline markets*”. The Appeal Panel

⁹ CP4/2009 P.146

should not operate on this assumption unless there is clear evidence to justify its approach.

- DAA would like to point out that it actively competes within the European aviation market as a venue for the location of airline services and any market power that DAA could hold is subject to the countervailing monopsony power of the airline carriers operating out of Dublin Airport, in particular Aer Lingus and Ryanair. DAA believes accordingly that the view of the Panel that DAA would not introduce differential pricing if not mandated is based on a flawed premise. It is in the interests of DAA to meet the requirements of all the users and that within its aeronautical facilities DAA continuously aims to provide a range of services that can be adapted to meet the requirements of the different airline business models.

(ii) DAA does not serve only one airline business model

- Second, the Appeal Panel's recommendation appears to be based on the belief that a low cost terminal is indispensable to the operation of a low cost carrier and that in the absence of a low cost terminal, different pricing between terminals must be established to serve the needs of low cost carriers. Appendix III illustrates a small number of examples of low cost terminals which are based on a clear distinction in service levels. However the Appeal Panel has suggested the fact that both T1 and T2 are designed at the same IATA level of service is "meaningless". DAA considers that this is not correct. DAA notes as follows:
- First, it is not the case that a dedicated low cost terminal is necessary to the operation of a low cost airline business. There are other ways in which the various business requirements of airlines can be met through one terminal including through the introduction of the differential pricing of certain services where required and justified. This is how Dublin Airport operates. DAA thus offers a range of differential prices for certain aeronautical services (as set out in Appendix IV). Different charges are levied in respect of different types of product and service: for example, different charges are levied for contact stand and remote parking and runway usage, which varies both in relation to the season (winter/summer) and according to the weight of the aircrafts used. Other charges are levied on a per usage basis in relation to a range of facilities such as check-in desks, airbridges, use of INS(CBP), and lounges. Airlines have a choice as to whether to use those facilities or not depending on their business models. In this context it is worth noting that the example used by the Appeal Panel of services that Ryanair does not require (check-in desks) as a justification for introducing

differential pricing is not relevant as check-in desks are charged separately on a per usage basis.

- Once T2's operations commence, the same approach will be used across the two terminals, which, following extensive consultation with airport users and at the direction of the Minister, are built to a common level of services. From the outset of the planning process for a second terminal at Dublin Airport, DAA received the support of key stakeholders in relation to the proposition that a common level of service would apply in the two terminals:
 - IATA submitted that "Our understanding is that T2 is planned to provide the same standard of service as T1."
 - The IDA stated that it was in its view "imperative that Dublin Airport does not develop a two tier standard between the existing terminal and the proposed new terminal. The development of the new terminal should complement developments at the existing terminal, as the complete infrastructure and service offering of Dublin Airport is a critical element in attracting and retaining FDI in Ireland".¹⁰
 - Aer Lingus made it clear that "T1 and T2 must be viewed as substitutes in the same way that the eastern and western halves of one very large terminal of uniform quality would be substitutes. The inevitable consequence of this is that T1 and T2 must be treated as homogenous terminal capacity and priced identically."¹¹
- As with all other airlines and stakeholders, Ryanair was invited to and attended all the major consultation events from the beginning of the process in 2002. It was given every opportunity to contribute and participate fully in the discussions with the DAA. However, Ryanair refused to participate meaningfully stating that "*it was meaningless to be asking Ryanair planning questions on a facility that they wouldn't be using*". Ryanair's apparent complaint to the Appeal Panel that "*providing a dedicated low cost terminal was critical to addressing the needs of present and future users and this has not been addressed by the DAA or the Commission*" is unsustainable in this context.

¹⁰ IDA response to CP1/2007

¹¹ Aer Lingus Response to CP5/2007

- However it should also be borne in mind that a dedicated low cost terminal was not built and the construction of T2 does not retrospectively make T1 a low cost terminal regardless of Ryanair's desire for one. In this regard, Ryanair's claim that the newness and cost of the T2 facilities implies that there should be differential in charges relative to T1 is wrong. DAA would point out that to have some facilities which are newer than others is part and parcel of airport development. This does not mean that the level of service provided in those facilities is different and/or sufficiently different to justify a different price. In addition, Ryanair is wrong to assume that because T1 is older than T2, differential charges based on the respective costs of T1 and T2 should, and would, result in a lower charge for T1 than for T2. These issues are considered in further detail in section iv below.

(iii) The level of service at Dublin Airport is common to T1 and T2

- DAA does not agree with the suggestion that the newness of T2 is sufficient to validate a finding that the level of service in T1 and T2 is different. Furthermore, DAA does not accept that Ryanair can suggest, and the Appeal Panel agree, that *"DAA's reliance on IATA service standard C to justify the size of T2 and to support the argument that T1 and T2 are equivalent in terms of services provided is meaningless"*. There are two aspects to this.
- First, the IATA service standards are not meaningless. IATA standards are in fact the standards relied upon globally in the aviation industry. Indeed, IATA is the main representative body for the airline industry, representing some 230 airlines and 93% of the world's international scheduled traffic¹² and as such it is uniquely placed to articulate the different levels of service the airline industry requires of supporting airport infrastructure (Ryanair is one of the few Dublin Airport airlines who are not members). When in contact with prospective airlines it is via this tool that service standards are discussed. These standards actively inform Dublin Airport scheduling and capital investment plans. IATA Service Levels have been referenced or used by multiple parties at various times, including the Government's Independent Verifier Team, CAR and its consultants, ARUPs-T2 design consultants, CAA's consultants (Scott Wilson, Supporting Paper X of Initial Proposals for Heathrow Gatwick & Stansted December 2006) and Aer Lingus (response to CP1/2007).

¹² http://www.iata.org/pressroom/facts_figures/fact_sheets/Pages/iata.aspx

- Ryanair’s position in relation to IATA service standards raises the question as to what it then considers to be the key indicators of service quality. The Commission recently concluded an extensive consultation process to inform the implementation of a new service quality regime at Dublin Airport. In this process airlines were specifically asked what metrics best describe service quality. A review of Ryanair’s responses, as set out in Appendix IV, shows that the terminal services which Ryanair considers to be the best indicators of service quality will be to an equivalent standard in both T1 and T2.
- A review of other airline responses, including those of DACC and IATA itself, reveals a similar picture. When asked for the metrics which best represent service quality at Dublin Airport, their preference is for objective measures, the body of which will be to a standard level in both T1 and T2. A small minority of suggested metrics-such as the availability of fixed ground power-will be available exclusively in T2; however such services are charged for separately. The use of certain facilities in T2 such as the Customs Border Protection facility (CBP) or specific executive lounges will be voluntary and the charges relating to these additional options will similarly be recovered separately. In effect, general service standards in both T1 and T2 are the same on all key dimensions.
- In circumstances where the level of service, howsoever measured, is the same in T1 and T2, there is no logic for differentiating the level of airport charges on the basis of the terminal used.

(iv) Ryanair is wrong to assume that because T1 is older and T2 is newer, differential charges based on the respective costs of T1 and T2 should, and would, result in a lower charge for T1 than for T2.

- Generally, the age of a facility is not determinative for the purpose of pricing, especially not in a RAB/WACC environment. Using cost-causality principles to set charges would suggest that, if differentiation is to be introduced, it should be related to user categories and the costs to which those users give rise, rather than the book value of the assets these users happen to use. The need for a careful understanding of the drivers of cost must take into account the role played by commercial revenue at airports, which can have the effect of reducing net regulated yields relating to assets that may have a strictly higher book value.

High level analysis of a cost-based differential

- DAA has carried out a very high level analysis based on the Commission's financial model for 2011, on the following preliminary basis:
 - Passenger forecast split between T1 and T2 as applied by the Commission in its analysis of T2 costs.¹³
 - Using the allowed payroll and non-payroll opex for T2 as set out in the 2009 Determination
 - Using the Commission's allowed capital costs for T2.
- In order to establish a comparator set of values for T1, DAA has separately looked at existing facilities costs between direct T1 related, Campus-wide (non-terminal) and shared services costs.¹⁴ Payroll and non-payroll costs have been split between T1 and Campus/shared services costs on the basis of a number of high level assumptions. Overall operating costs in T1 have been estimated for the purposes of this analysis at c38% of the total existing facilities. (A more comprehensive allocation exercise is likely to increase the proportion attributable to T1 rather than reduce it.) Capital costs have been split between T1 and Campus on the basis of the DAA fixed asset register for existing assets and the Commission's treatment in the determination for CIP2010-14.
- The results of this high level analysis summarised in the table below, show that it cannot be assumed that any allocation of costs on the basis of the key building blocks would result in a situation where any differentiated price for T1 would exceed T2 by a wide margin (T2 costs are 2/3rds of T1 in the above analysis). This stems from the lower operating cost per passenger targets set by the Commission for T2 on the basis of its operating model and the more than 5:1 ratio of remuneration of capital costs in T1 versus T2. DAA has not been in a position to conduct a similar high level analysis of the commercial revenues associated with each terminal in view of the particular complexities that relate to these activities but would concur with the premise outlined

¹³ Changes in the relative market shares of airlines in Dublin Airport would suggest that the proportion of total passengers using T2 in 2011 would be somewhat higher than assumed in the Commission/Booz analysis.

¹⁴ It is not clear how the Commission would approach the treatment of non-terminal related costs such as Campus and Shared costs (referred to by the Commission as Head Office costs) (for example as components of separate charge or allocated to each terminal on some quantified basis). DAA has excluded such costs from both T1 and T2 to ensure a like for like comparison between terminals

by the Commission that net commercial revenues are likely to be higher in a facility such as T2.

€ m's	T1	T2	Campus / HO	Total
Opex: Payroll & Non Payroll	62	43	100	206
Capital costs	57	9	53	119
Total	119	52	154	325
Passengers	11.7	7.8		
Cost per Pax	10.18	6.68		
<i>T2 % of T1 costs</i>		66%		
T1 % of Existing Facilities				
Opex: Payroll & Non Payroll	38%			
Capital costs	52%			

- It should be noted that this analysis was undertaken in the very limited time period allowed for this submission. It does not purport to include the level of analysis that would be necessary to conduct a thorough review of the each of areas of cost and the potential methods of treatment outlined elsewhere in this submission. For example, the T2 amounts above include the costs and activities related to Pier E consistent with the Commission's financial analysis. DAA believes that a decision would need to be made regarding the precise boundaries of terminal operations, which may or may not include Piers. In addition, and in the interests of expediency, we have restricted this review to 2011, the first full year of operation of T2. Any detailed review would need to consider each of the years of the determination. However, despite these limitations, this high level analysis shows the dangers in the Appeal Panel's suggested approach to establish a small difference between the charges for T1 and T2 as a matter of principle. The establishing of an incorrect principle would be wholly unwarranted.

Pricing of under-utilised assets

- DAA further notes that a computation of charges that would result in a lower level for T2 than T1 would be consistent with the economics of pricing for less utilised assets. Indeed, in the circumstances of T1 and T2, economic theory would clearly point away from requiring lower charges for T1 than T2 in order to encourage 'efficient' capacity utilisation and the switching of airlines. This is because it would be somewhat perverse

to levy higher charges for a little-used asset than for one which is congested: if prices are not set so that they adjust to demand, or cannot do so, congestion at the more-utilised asset is likely to be exacerbated. In these circumstances, it would be reasonable to have higher charges for T1. This approach would also be consistent with established economic principles, and is well understood in the airports sector. For example, Vickers and Yarrow (1988)¹⁵ describe the problem of inefficient resource allocation in the case of BAA as follows:

➤ *'The first problem with the regulation of BAA pricing is that it perpetuates the inefficiencies in resource allocation that have prevailed in the past [...] Traffic charges are generally too low (for example there is heavy rationing at peak times at Heathrow and Gatwick).'*

- While this is not specifically referring to terminal charging, it reflects the need to relate prices to the demand for infrastructure rather than simply costs in order to secure efficiency in resource allocation. A regulated charge that reduced the cost of a busy terminal (T1) below that of a less busy terminal (T2) would contradict this.
- For example, a plausible scenario could be that capacity utilisation is lower initially at T2 than at T1, as airlines take time to switch to the new terminal. In this case, assuming an obligation to set differentiated charges, and modest initial utilisation of the new terminal, one possible charging basis for T2 would be to price on an incremental basis, which refers to measures that capture the costs that can be avoided in the short run by reducing output marginally (i.e., excluding capital costs) while the more congested T1 could be priced at a level allowing full cost recovery. (In practice, any implementation of incremental costing would need to ensure that the airport could finance itself, and could earn its cost of capital overall.)
- This suggests that one interpretation of a 'reasonable' differentiated charge for the two terminals—based on the economists' notion of efficient resource allocation—would be lower prices at the terminal used less intensively, with the charge adjusting over time to reflect changes in capacity utilisation. In this context also, the notion of T1 being or becoming a cheaper 'low cost terminal' is meaningless.

¹⁵ Vickers, J. and Yarrow, G (1988), 'Privatization An Economic Analysis', MIT Press, p. 364

Pricing in a RAB/WACC environment

- It should be noted that DAA is not advocating differential pricing on this basis. Nonetheless, this shows that the premise on which Ryanair initiated this appeal and the basis on which the Appeal Panel considered this issue was fundamentally at odds with the financial realities over this determination period. It is also starkly clear from the treatment of capital costs that the principles underlying unitisation and differential pricing are mutually exclusive. DAA notes that as part of its 2007 regulatory review the Commission undertook a full review of regulatory policy where it examined a variety of issues including unitisation of capital costs, peak and differential pricing. In its decision, the Commission opted to introduce a unitised approach to the remuneration of capital costs for T2 where the recovery of costs associated with T2 was spread over a longer time horizon in order to balance the relative capital costs between the two alternative terminals. This appears to have been adopted by the Commission as an alternative to differential pricing. It would therefore be completely inconsistent at this juncture for the Commission to impose a differential terminal charge to this unitised cost base. It would not be possible for both principles to co-exist in a regulatory model. Adopting a differential pricing approach would necessarily involve an unwinding of the Commission's entire approach to unitisation if it was to retain any economic rationale.
- DAA notes further in this context that cross-subsidies are to a certain extent inherent to a RAB/WACC regulatory environment. In particular, the use of a RAB-based approach spreads remuneration of capital assets over a number of time periods, leading to the possibility that there may be some form of 'cross-subsidy' between users in different time periods, as well as between users of different terminals. Two points are relevant in this context. The first is that the (complicated) depreciation profiles applied by CAR to remunerate various airport assets are motivated, in part, by a desire not to have current users pay 'too much' for assets that may be more heavily used by future users. As such, there is a deliberate cross-subsidy between time periods created by regulatory preferences.
- The second is that intergenerational cross-subsidies are inherent to a RAB-based regulatory system. Although predating the current regulatory structure, the construction of T1 has benefited users (such as Ryanair) that did not contribute to all of its construction cost. Backing out the benefits enjoyed by different users of different assets at the airport would be unwieldy and would result in a complicated regulatory system that would potentially not be in the interests of users, creating price spikes and troughs. In particular, there would be potential to create a system where the highest

prices are set when new facilities open (and so congestion is at its lowest), and the lowest prices when facilities are very congested.

- In addition, there are a number of reasons why T1 passengers will directly benefit from the opening of T2, not least in respect of the reduced levels of congestion in T1. Passengers at T1 may also benefit from the increased attractiveness of the airport as a whole, which, in combination with the new capacity associated with the terminal, could attract new carriers offering new routes and flight schedules—this could create positive network externalities for users of T1 services. (It is possible that some carriers may not welcome the development of additional capacity for precisely this reason, since it represents a competitive challenge to entrenched incumbency advantages.)
- DAA showed above there is no reason in fact to distinguish between T1 and T2 and that Dublin Airport’s pricing structure for airport charges allows DAA to support the various business models of airlines. In this regard and in a context where neither a high level analysis of costs, nor economic theory or the regulatory system in place support the introduction of differential pricing at Dublin Airport, it is difficult to see how the recommendation of the Appeal Panel could enhance the current regulatory policy of the Commission and “facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users” as required by section 33(a) of the 2001 Act. DAA notes that it is not quite clear from the Decision in the Ryanair appeal which of the statutory objectives the Appeal Panel considered relevant to the issue of the introduction of differential pricing. DAA submits accordingly that the grounds raised by Ryanair and referred back by the Panel to the Commission are without merit on the facts and do not justify a variation of the Determination.
- As explained in detail below, in the absence of a valid economic justification, the introduction of differential pricing is bound to have adverse effects on economic welfare including by threatening to strand T2 and with it the financial viability of DAA, contrary to the regulatory objectives pursued in the 2001 Act. In addition, DAA believes that the implementation of the recommendation of the Appeal Panel would result in the effective reshaping of the regulation of airport charges in Dublin. DAA suggests not only that this simply cannot be achieved in the time allotted by the 2001 Act but also that it would be unwise to do so in a timeframe which does not allow a proper consideration of the implications of the proposal and of the serious legal uncertainties which would arise. DAA believes in this regard that the Appeal Panel has overlooked the considerable practical difficulties which would arise in implementing differential

pricing and the consequent impact on the Commission which would effectively be required to micro-manage the airport. No such power or function has been vested on the Commission. On the contrary, the 2001 Act requires that the Commission seeks to “*impos[e] the minimum restrictions on the airport authority consistent with the function of the Commission*”.

3.1.2 The recommendation of the Appeal Panel raises practical and legal issues

(i) Statutory objectives and requirements

- Having regard to pricing structure used at Dublin Airport, DAA further submits that the introduction of differential pricing in the manner suggested by the Appeal Panel will not, contrary to the suggestion in the Appeal Panel’s Decision, in fact allow DAA to serve the interests of users in Dublin Airport including the low cost carriers but rather, will act to their detriment by leading to the stranding of assets. This would be contrary to the statutory objectives set out in section 33(a) of the 2001 Act including
 - To facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users;
 - To protect the reasonable interests of current and prospective users; and
 - To enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.
- The following criteria which the Commission must have regard to are particularly relevant here: the level of investment in airport facilities; the level and quality of services offered at Dublin Airport and the reasonable interests of the current and prospective users of these services; the cost competitiveness of airport services at Dublin Airport; and imposing the minimum restrictions on Dublin Airport Authority.
- The Commission in the context of the 2007 Determination found that T2 was required for the efficient and economic development of Dublin Airport and to meet requirements of current and prospective users. The introduction of differential pricing would work, however, to frustrate this objective. In particular, the recommendation of the Appeal Panel does not consider the risks of “perverse effects” arising out of the introduction of differential pricing, including the stranding of assets and/or the sub-optimal utilisation

of the capacity available at Dublin Airport. Such effects would impede and run contrary to the achievement of each of the three objectives referred to above.

- DAA must emphasise that these risks are not theoretical but very real. Aer Lingus as the potential anchor tenant in T2 has stated its strong objection to the introduction of a differential terminal charge in the following terms:
 - “Aer Lingus is strongly opposed to differential pricing”
 - “T2 is specified to offer the same standard of service as T1.In our response (response to CP1/2007) we stated that for that reason alone there is no justification whatsoever for making separate charges for T1 and T2.”
 - “T1 and T2 must be viewed as substitutes in the same way that the eastern and western halves of one very large terminal of uniform quality would be substitutes. The inevitable consequence of this is that T1 and T2 must be treated as homogenous terminal capacity and priced identically”
 - “If DAA were to attempt to charge a different price it would in our view be in severe danger of falling foul of existing competition rules”
- Aer Lingus has publicly stated that it will refuse to move to T2 in the event that a differential charge is implemented. In its response to CP1/2007, Aer Lingus said that it *“will have no option but to remain in T1 should differential pricing be imposed as to do otherwise would be to place it at a significant competitive disadvantage with regard to users of T1”*. DAA believes that other potential airline tenants (for example Delta Airlines) will also refuse to occupy T2 if a differential terminal charge is introduced. This of course is not surprising in view of the fact that both terminals offer the same level of service. Users therefore have no incentive to pay more for the same level of service and indeed only have disincentives as this raises their costs as compared to their competitors, with no increase in the benefits.
- Obviously, were airlines to refuse to move to T2 because of a higher price in T2, then DAA will not be able to balance demand between the two terminals, resulting in a lack of demand for T2 combined with excess demand for T1. This risk has been identified by the Commission paragraph 146 of the 2009 Determination when it acknowledged the potential negative consequences which could arise from the introduction of a differential charge.

- If no airlines move to T2, then DAA will not be in the position to open T2 and there will be a significant risk that T2 will become a stranded asset. This has significant implications for the ability of DAA to be remunerated for T2 given that the Commission has decided that remuneration will only commence when the terminal is operationally ready. This would not enable DAA to operate Dublin Airport in a sustainable and financially viable manner, as there would be serious consequences for the financial position of the airport, including with respect to raising finance on capital markets in the future. In addition, if T2 were stranded, the interests of prospective users – in particular for the provision of long haul services – would be undermined. The potential market implications arising from a mandatory introduction of a differential terminal charge have not been addressed by the Appeal Panel.
- DAA also believes for these reasons that it is not possible for CAR to introduce differential pricing and at the same time comply with the direction issued by the Minister for Transport under section 10 of the Aviation Regulation Act for the purpose of the 2009 Determination. Under this direction, the Minister directed the Commission (inter alia) to ensure that DAA's financial viability is protected in order to implement Government policy on:
 - The desirability that Dublin Airport should have the terminal and runway facilities to promote direct international air links to key world markets, such as new and fast-developing markets in the Far East and the importance of ongoing and planned infrastructure development in that context;
 - The development of Terminal 2 as quickly as possible as set out in the Government decision of May 2005.
- In the direction the Minister also noted “that the Commission indicated its compliance with [previous] direction on the basis that it had satisfied itself that DAA would be able to add capacity in an efficient and timely manner and that DAA would be able to fund the allowed investment programme.”

(ii) Issues arising in relation to the assessment of costs

- The Panel suggests in its Decision that a differential charging could be introduced either in the form of “different price caps for each terminal” or “by introducing incentives into the price cap to encourage DAA to employ differential pricing”. It is unclear what is meant by the latter. In order to introduce separate caps the Commission would need to determine the cost differential between the two terminals in

the most careful detail. This has already been referred to in the earlier discussion on the high level financial analysis prepared by DAA.

- In order to determine the cost differential between the two terminals, the Commission would need to fully allocate all direct and indirect costs associated with the two terminals as well as conduct an analysis of the single till contribution in each terminal in order to determine appropriate regulated yields. This would require a series of complex steps in order to:
 - Establish the exact boundaries of “terminal operations”. While this may on the face of it seem a trivial issue given the designation of T1 and T2, decisions would need to be made in relation to, for example, the inclusion or not of specific Piers within each terminal, given their interconnectivity between terminals or whether to include or exclude specific elements of infrastructure that are separately charged such as CBP;
 - Separately isolate and distinguish the services provided in the two terminals to establish separate charges for T1 and T2;
 - Establish, quantify and allocate all the direct costs associated with the alternative terminals including both capital costs and operating expenditure;
 - Establish, quantify and allocate any common costs or shared services between the two alternative terminals including both capital and operating costs;
 - Establish and fully estimate the contribution of all of the single till revenues derived from the two terminals in order to determine the regulated yield under the prevailing single till model. A decision would need to be made on an objective basis regarding whether to include commercial revenues earned outside the confines of each terminal. Consideration should be given in doing so to the fact that their contribution might be disproportionately driven by the passengers using one or other terminal (e.g., revenues related to car hire concessions or car parking).

In Appendix V, DAA has set out a preliminary list of key questions that would have to be addressed in any analysis undertaken to establish a potential differential charge. These matters would have to be comprehensively addressed and updated at regular intervals to support any potential differentiated charge.

- An example of the complexity to which price differentiation would give rise is provided by the allocation of the cost of capital between the two terminals. Differentiation involves differences in the per-passenger charge levied to recover the costs of the terminal and seems likely, as a consequence, to lead to changes in the composition of passengers and carriers using each terminal. This could happen through conscious decisions and effort on the part of either or both of the airport and its airline users, or may happen naturally over time as different types of airline decide to continue at T1 or transfer their operations to T2.
- An important implication of introducing differences between the terminals' price caps, and potentially also in the composition of users, is that the exposure to systematic risk of the two terminals is likely to differ. In turn, this means that the two terminals would require a different allowed return on capital to reflect this exposure. This exposure will affect both revenue and cost volatility.
 - Revenue volatility will be affected in a direct way by differentiating charges between the terminals, since the basis for remuneration is different by construction. In turn, the two terminals will face different revenue risks under differentiated prices, which is likely to affect both level and variance of 'profit' of each terminal. (This was explicitly recognised in the most recent round of price determinations by the CAA in the UK, which took account of Stansted Airport's higher systematic risk exposure relative to Heathrow and Gatwick airports. This higher risk exposure was stated to be attributable to the higher proportion of total passenger volumes served by low-cost carriers at the former airport than at Heathrow and Gatwick airports.)
 - Competition and regulation also drive revenue volatility. In principle, the two terminals should be subject to similar pressures from competition and regulation, although it remains to be seen whether this will be the case in practice. To the extent that the terminals compete for passengers who have alternative modes of transport available to complete their journeys, then competition between modes of transport could become a relevant consideration in terminal-specific risk. For example, if one of the terminals serves primarily short-haul destinations, it may face more competition from ferry services on some routes than a terminal focused on long-haul traffic would.
 - Cost volatility will be affected by the operational gearing of the two terminals, and their different operating costs and capital requirements. The capital and

operating costs of the two terminals will differ because of their age, their configuration, and their methods of operation. For example, a potential cause of operating cost differences are divergences in wage costs (and, potentially, average wages paid) between the two terminals. Put differently, the cost drivers of the two terminals will be different, and this will influence exposure to systematic risk.

- Identifying the separate influence of all of these variables driving revenue and cost volatility at the level of the individual terminals would, in effect, require a separate cost of capital to be calculated. This will increase the complexity of the regulation to which the airport is subject. In addition to the allocation of capital costs, there are a battery of other practical complexities that would require considered implementation, including, but not limited to, the need to calculate the subcaps to apply to the terminals (a complexity alluded to in the Commission's price determination), the need to capture the required cost information from costing systems that were not designed for that specific purpose.
- It is also highly unlikely that the relative cost of the two terminals would remain static over time given that inputs such as passenger throughput and mix, input costs and commercial revenues would be subject to constant fluctuation. Therefore the various elements of the differential charge would have to be constantly reassessed if the validity for the charge was to be maintained. Indeed, as discussed further below, the differential charge itself would tend to lead to different demand profiles at both terminals, which itself would have consequences for cost (including the cost of capital, for the reasons outlined above). This dynamic interaction between the differential, demand, capacity utilisation and the cost of the terminals would confound regulatory efforts to mandate a particular structure, or, at best, would require frequent and expensive revisions that will increase the complexity and reduce the transparency of the regulatory regime.

(iii) The approach proposed by the Appeal Panel is contrary to EU Law and statute

- DAA does not believe that these issues could be dealt with in the short term for the purpose of the 2009 Determination by accepting the recommendation of the Appeal Panel to introduce a “*small nominal difference*”. This is, by any other name, recommending the introduction of an arbitrary element in the determination of the airport charges. In doing so, the Commission would be exercising its powers in an

irrational and unjustifiable manner contrary to the requirements of the 2001 Act. In addition DAA believes that the mandatory application of differential pricing between terminals is not permissible, whether by way of a small nominal difference, or otherwise, under both EU law and statute.

The requirements of the Airport Charge Directive

- The conditions under which differential pricing can be applied in accordance with European Union law are now set out in the Airports Charges Directive¹⁶ which entered into force on 15 March 2009 and must be transposed in Irish law by 15 March 2011 (that is during the currency of the Commission's Determination of 4 December 2009). As an emanation of the State, the Commission is itself under an obligation to ensure that it does not act in a way that would be contrary to the obligations of the State under European Union law.
- The Directive sets out a number of requirements in relation to the determination of airport charges. In particular, in the system put in place by the Directive, Member States must ensure that airport managing bodies set airport charges on a transparent and non-discriminatory basis. The Directive also requires that were the managing bodies consider that it is appropriate to introduce a differentiation in service levels. the level of charges must be set "*according to the quality and scope of [the] services and their costs or any other objective and transparent justification*".
- DAA submits following the recommendation of the Appeal Panel First would result in a breach of all those requirements. DAA believes that the introduction of an arbitrary difference between T1 and T2 would clearly fail the requirement of transparency and could not be considered to be justified by reference to any objective criteria. It is also the case in any event that the principle set out in the Directive do not support the introduction of differential pricing at Dublin Airport in view of the fact that there is no distinction in the level of services between T1 and T2. In these circumstances, differential pricing would also breach the requirement that airport charges must be non-discriminatory. DAA further notes, without prejudice to the question whether it holds a dominant position or not, that in requiring the imposition of differentiated charges where this is not justified, the Commission could be in breach of Article 106 TFEU in conjunction with Article 102 TFEU.

¹⁶ Directive 2009/12/EC of the European Parliament and of the Council of 11 March 2009 on airport charges.

The scope of the Commission's powers under the 2001 Act

- Finally, DAA submits that the Commission in fact is not legally entitled to mandate differential pricing between the two terminals at Dublin Airport, as recommended by the Appeal Panel. The function of the Commission is, in accordance with section 32 of the Aviation Regulation Act, 2001 as amended, to “*make a determination specifying the maximum levels of airport charges that may be levied by Dublin Airport Authority in respect of Dublin Airport*”. Such airport charges are defined in turn as “(a) *charges levied in respect of the landing, parking or taking off of an aircraft at an aerodrome including charges for airbridge usage...; (b) charges levied in respect of the arrival at or departure from an airport by air of passengers, or (c) charges levied in respect of the transportation by air of cargo, to or from an airport, as may be appropriate*”. Section 32 (6) enumerates the possibilities which are open to the Commission for the purpose of specifying the maximum levels of airport charges that may be levied by DAA in respect of Dublin Airport including the following (the list is exhaustive):
 - An overall limit on the level of airport charges;
 - Limits to apply to particular categories of such charges;
 - A combination of any such limits;
 - Restrictions on increases in any such charges or requirements of reductions in them whether by reference to a formula or otherwise;
 - The provision for different limits to apply in different periods of time falling within the period to which the determination relates.
- While the Act thus provides the Commission with many options to choose from in term of specifying the maximum levels of charges that can be levied in relation to Dublin Airport, the possibility of setting different limits for charges depending on the terminals used by the passengers at the airport is not amongst them. In particular, the possibility that limits be set for particular categories of airport charges does not, in view of the definition of airport charges, include the possibility that different limits may be set for the two terminals. Indeed it is clear that the term “categories” refers to the set of services contained in the definition of airport charges, i.e., the services related to landing, parking or taking off of aircrafts, to the arrival or departure of passengers and to the transportation of cargos, but not the terminal used by the passengers.

- In addition, following the recommendation of the Appeal Panel would, in any event, require the Commission to set more than two different price caps. The Panel has in fact recommended that the Commission ensures through the price cap mechanism that DAA charges a lower rate for the use of T1 than for the use of T2. This effectively would require CAR to set the difference that must be applied by DAA between the charges for the two terminals. DAA does not believe that the Commission is entitled to do this as this would be tantamount to setting the airport charges to be applied by DAA, and not the *maximum* levels of airport charges, as the Commission is mandated to do under the 2001 Act.
- DAA notes that this interpretation is consistent with the provisions of the Airport Charges Directive which provides that “*airport managing bodies shall remain free to set any such differentiated airport charges*”. DAA submits that if the Commission were to mandate differential pricing, it would be interfering with the system envisaged in the Airport Charges Directive in breach of its obligations. DAA notes that the above is consistent with the position of the Commission who has (correctly) recognised in the Final Determination for 2010-2014 that DAA is better placed than the regulator to judge whether the conditions under which differentiation could be applied exist: “*the Commission is also concerned that to impose subcaps requiring some kind of differentiation risks denying DAA the necessary ability to respond to changing conditions at the airport.*”

3.2 T1X Incremental Revenues and Remuneration

- In its decision in relation to the Ryanair appeal of the 2009 Determination, the Appeal Panel recommends that the Commission should carry out an analysis of the extent of incremental retail revenue attributable to T1X before allowing the capital expenditure associated with this project in the RAB.
- The Commission's approach to the remuneration of the T1X asset was clearly set out in sections 7.27 and 8.28 of the 2009 Determination. "*The Commission has assumed an up-lift in retailing revenues equal to €5m each year associated with T1X opening*", its approach was said to be "*consistent with what was proposed in the 2007 review*" and demonstrated that this was "*charges neutral such that a higher or lower forecast for these incremental revenues would not affect the allowed airport charges.*". It is also worth noting that this specific treatment was designed to address requests from users that the facility would be charges neutral.
- Furthermore the Commission gave the commitment that it would "look at the evidence in 2014 with the benefit of the five year –plus years of data, of the extent to which the T1X appears to have generated the incremental revenues assumed in the Determination and make an adjustment accordingly"
- Therefore, given the Commission's current approach to the T1X project, DAA does not believe that there is a requirement for any further analysis of commercial revenue projections for T1X at this juncture.
- DAA believes that the Appeal Panel may have misinterpreted the treatment adopted by Commission for this investment, stating that it is not sufficient for the Commission to simply "assume" an increase in revenue and assert that it is charges neutral. This ignores the principles under which commercial revenue targets are set for the DAA by the Commission. By setting a higher target including the uplift for T1X the Commission has ensured that the project is charges neutral, regardless of whether or not the revenue target is achieved by DAA.
- As it happens, DAA can confirm that the T1X area has outperformed the expectations set for this business. As the Commission has stated in CP1/2010 that its analysis will be based on the information it had before it at the time of making the 2009 Determination, DAA has not provided updated financial information regarding the more recent performance of T1X. DAA will be happy to share this information with the

Commission if requested. In addition, DAA can confirm that it will be in a position to provide detailed evidence of the performance of T1X to facilitate the Commission in its review of the roll-forward of the T1X asset in the RAB in 2014.

Appendix I - Pier D Material Previously Submitted to CAR

The need for additional pier and stand capacity at Dublin Airport became increasingly apparent throughout the 1990s. This peaked in 2002 when demand for contact stands began to exceed supply, particularly at peak hours. The capacity restraints resulted in severe congestion in Pier A and the modified Old Central Terminal Building (OCTB), with subsequent knock-on effects on service standards, in particular in the areas of toilets, queuing and circulation space. The absence of segregation in either facility resulted in further disruption and was contrary to Department of Transport requirements.

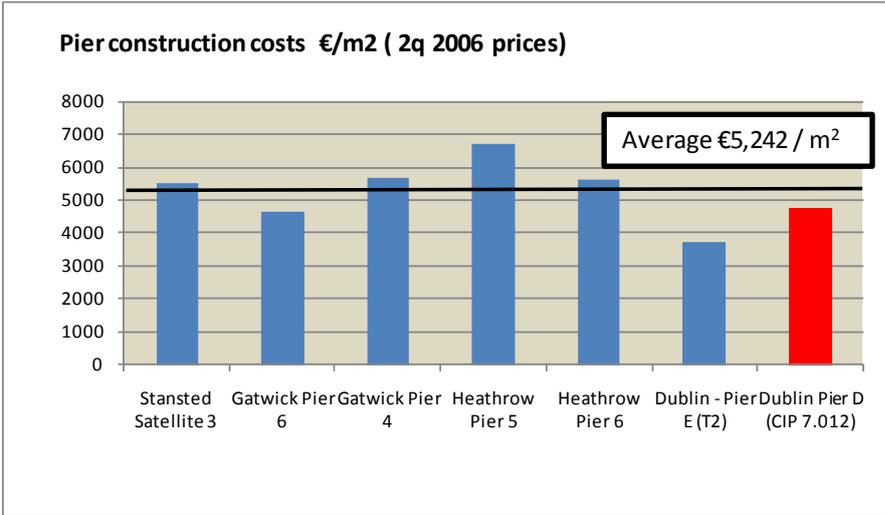
The original designs for Pier D were completed, and the project tendered by late 2003, with a tender recommendation received in April 2004. However the project was put on hold pending the publication of the government's Aviation Action Plan in May 2005. This plan imposed a challenging deadline of end of 2007 for full delivery of the additional pier capacity.

Construction commenced in May 2006 and the pier was commissioned and open for operations from October 2007. Pier D is now a central component of T1 operations. It is used intensively by airlines, and consistently rated highly by passengers in customer surveys.

An international benchmarking exercise has confirmed that, despite the challenging timeframe, Pier D remains an efficiently-delivered piece of infrastructure.

The key cost elements which can be benchmarked against industry standards are pier construction and design and project management costs.

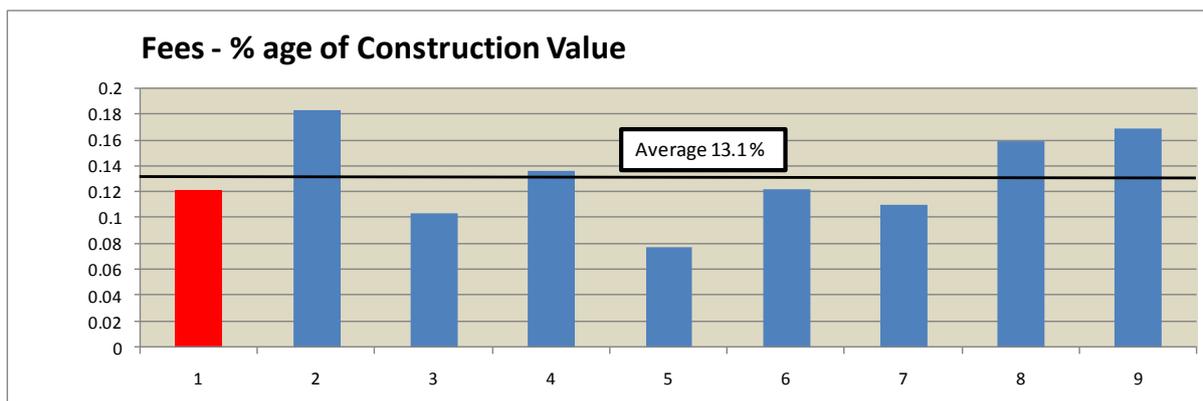
As the graph below illustrates, the cost per square metre is 10% lower than the equivalent at other airports.



Facility	€/m ² - 2q 2006
Stansted Satellite 3	5,527
Gatwick Pier 6	4,674
Gatwick Pier 4	5,669
Heathrow Pier 5	6,718
Heathrow Pier 6	5,623
Dublin - Pier E (T2)	3,743
Dublin Pier D (CIP 7.012)	4,738

DAA's efficiency is also reflected in the projected costs for the delivery of Pier E, although it must be noted that Pier E benefits from efficiency gains associated with its three-storey structure, as well as general economies of scale associated with T2.

In addition, design and project management fees compare favourably against international equivalents. In spite of the inherent complications of such a project, in particular the management of a construction site which spans both landside and airside, average fees spend as a percentage of construction value is below the average.



Reference	1	2	3	4	5	6	7	8	9
CLIENT	Pier D	MAFF	Oxford	STAL	PACE	KCL	UK Gov.	Imperial College	Treasury Holdings
	Pier D	Laboratories	Research Laboratories	Airport Terminal	Offices	Research Laboratories	Various	Various	Commercial Office 30,000sqm
Value (Construction only)	€115m	£66	£41	£48	£40	£23.90	Framework	Framework	€93m
Status		Complete	Complete	Complete	Complete	Complete	Ongoing	Ongoing	Construction
Total Fees	12%	18%	10%	14%	8%	12%	11%	16%	17%

This benchmark data demonstrates that DAA delivered a crucial piece of airport infrastructure to users in very challenging circumstances at an extremely competitive cost. Accordingly, DAA should be remunerated in full for its investment.

Basis for Appeal

DAA believes that the additional cost incurred by the company in connection with the Pier D project should be included in the Opening RAB for 2010 under Scenario 2 of CAR's RAB roll forward principles where the investment delivers the expected outputs but at a higher cost than allowed.

In its response to CAR's Issues Paper (CP6/2008), the DAA provided a detailed explanation for the various cost components of the Pier D project which exceeded CAR's original allowance. Each component was individually costed, and supported with explanatory text, this detailed information is contained in appendix 1.

It is clear that Pier D cost overruns have been caused by either (i) circumstances beyond the control of DAA, (ii) the provision of additional required facilities and services to users or (iii) amendments to suit user requirements. In such circumstances these additional capital costs should be included in the Opening RAB and DAA should not be penalized for such incurring this cost.

Detailed Rationale for Additional Cost Pier D

Increase in contact stands for 12 to 14 - €2.8m

Changes to airport regulations meant that a reduction in the mandatory clearance between the wing tips of adjacent airplanes parked on stands is now permitted. This change presented DAA with an opportunity to increase the number of planes that could be parked around the Pier from 12 to 14 (increase from 6 to 7 on each side), without any increase to the Pier dimensions. The contract was tendered on the basis of the original 12 stand design, and this change was made post-award. Relatively modest extra costs were incurred in the construction of the apron and in M&E services due to the increase in the number of parking zones and associated upgrades to the apron slope tolerances.

Amendment to walkway at Pier A - €1.8m

The original design concept for Pier D provided for dedicated immigration facilities at the end of the arrivals concourse. In the period between the original tendering of Pier D and the final contract award, increased passenger throughput in Pier A, combined with a step up in immigration inspection procedures, compounded by the fact that Pier A does not provide for segregation of CTA and European passengers led to the urgent requirement to increase immigration processing capacity for Pier A.

Improving Building Aesthetics & Life Cycle Improvements - €2.2m

A number of changes to the finishes of the building were incorporated into the final design, including additional metal panel finishes to internal walls, supplying tiling to the washrooms, additional stainless steel cladding to columns (harder wearing) and upgrading of sanitary ware fittings. Some upgrades were made to the building services in order to reduce the future maintenance costs, including additional insulation to the roof, upgrade of the gas installation to reduce summer heating bills, and variations to the travelators to incorporate self-lubricating chains.

Retention of TBG facility - €0.5m

The original scheme planned for the removal of the TBG in time for the completion of the apron works on the south side of the new Pier. However, due to airline requirements for further contact stands (over and above the 14 permanent contact stands being provided by Pier D), construction schedules were modified to facilitate the retention of the TBG. This modification resulted in a net increase of a further 5 contact stands. Extra costs were

incurred by the contractor due to the requirement to work around the TBG in order to complete the revised apron works.

Airport Operations driven changes - €3.8m

As passenger numbers continued to grow rapidly during the construction period, pressure from the airlines, and consequently from airport operations for availability of apron area around the Pier D site increased. In order to facilitate this demand, the number of remote stands that could be taken out of service at any one time was restricted to two (stands) from the three or four originally assumed at tender stage. This meant that the apron works were slower and consequently more expensive to complete.

Changes to tenant requirements - €0.3m

Some of the detailed requirements of the tenants that occupied Pier D retail units were subject to change prior to fit-out.

Value added scope increases - €2.5m

There were several additions or changes to the scope of the project which resulted in enhanced or additional assets, with an associated increase in costs. Examples are as follows

- Provision of flat panel interactive display system (FIDS) for passenger flight information, instead of CRT technology. This upgrade was necessary in order for the new Pier D system to be compatible with the overall airport system.
- Provision of upgraded non-slip floor finishes in certain areas of the building
- Modifications and design changes to gate desks
- Provision of new temporary corridors to TBG in order to keep this facility in service as required by the airlines.

There was also a large scope increase in road realignment, car parking, pavements, lighting and landscaping in area underneath elevated walkway and in front of OCTB to comply with the requirements of the Heritage and planning authorities.

Design Development - €5.6m

As part of its various submissions to CAR during the Interim Review process, DAA explained the need to include an adequate contingency sum to cover design development. This was deemed necessary for a project that at the time was the largest undertaken by the company (in value terms), involved both airside and landside construction sites and the provision of major underground services. The use of a design development budget is normal in most construction projects, particularly those with a fast-track programme whereby final design of many items is still being carried out while the early phases of actual construction have commenced. Due to the scale and complexity of the Pier D project, there were in fact hundreds of design development items, mostly small in value. Examples of some of the larger items include

- Alterations to specification for handrails, balustrade glazing thickness and overall heights for structural reasons.
- Changes to waterproof paint and reinforcement to walkway concrete.
- Changes to deflection heads on internal partitions to allow for structural deflections.
- Future proofing layout of services in apron to facilitate addition of fuel hydrant.
- Amendments to the precast staircases.
- Alterations to roof steelwork to facilitate changes to mechanical services.
- Changes to floor screeding material to allow faster curing (setting) times and thereby facilitate faster project progress.

As can be seen from the above the drivers of Pier D cost overruns have been caused by either (i) circumstances beyond the control of DAA, (ii) the provision of additional required facilities and services to users or (iii) amendments to suit user requirements. In such circumstances these additional capital costs should be included in the Opening RAB and DAA should not be penalized for such incurring this cost. This is explained further below.

Circumstances outside of DAA's control

- Additional costs incurred in the delivery of Pier D were due to factors such as planning restrictions, for example the requirement for road realignment and landscaping associated with the OCTB's listed status.

- Technological progress meant that additional sums had to be invested in FIDS to ensure that Pier D was compatible with the overall airport systems.
- Necessity for investment in the provision of updated requirements of Pier D retail tenants to maintain commercial revenue streams.
- Obligation to address emerging capacity constraints in areas such as immigration.

In particular, design development was a key driver of Pier D costs which was outside of DAA's control. Alterations and amendments to design were essential to deliver a fully-functioning finished facility, given the tight time constraints which were externally imposed upon DAA.

The provision of additional required facilities & services to users

Additional costs were also incurred in ensuring that the facility provided the optimal level of services and costs to users. Aesthetic and life cycle improvements were required to ensure that users would enjoy additional usage of facilities before the costs associated with repair and replacement arise. Extra insulation and gas installation upgrades were required to reduce energy costs. DAA's innovation allowed the provision of an additional 2 contact stands at minimal cost.

Amendments to suit user requirements

Despite the scale and challenging timeframes, DAA made all efforts to facilitate users during the construction phase. This included the retention of the Temporary Boarding Gate facility and the provision of new temporary corridors to the facility, which were costed under 'value added scope increases'. Work was also tailored to suit airline operational requirements on the apron, incurring associated costs.

Appendix II: Summary of Retail Operating Costs as per Booz Report 27th Nov 2009

Cost Category	Booz Reference to Retail	Floor space as cost driver?
Cleaning Payroll	Retail Common Areas requires 3 FTEs for daytime cleaning	DAA retail space referenced
Retail Payroll	70 FTEs required	Booz lists a number of drivers, one of which is floor space
Repairs & Maintenance Non-Payroll	"DAA operated retail also requires repairs & maintenance"	No comment from Booz
Rent & Rates	DAA's own retail space facilities are rateable	Yes
Technology Operating Costs	"Some costs for retail technology are also assumed to be included"	No comment from Booz
Fees & Professional Services	"Some fees are related to retail, believed to comprise financial transaction services"	Financial transaction services costs not driven by space
Other Overheads	Booz refer to pie chart in which retails costs represent 2% of 'Other Overheads'	"Retail other overheads are transferred from T1" indicates that costs are not space-driven

Appendix III– Airport Charges at Dublin Airport

Dublin Charge Type	Dublin Charge Basis	Dublin Valid from 1st May 2010 (€)	
		Summ Season	Wint Season
Runway Movement Charge (Per tonne MTOW or part thereof)	Period		
	Per Tonne	8.10	5.30
Aircraft Parking (Per 15 minutes/ part thereof)	Wide/Contact	34.90	
	Narrow/Contact	27.90	
	Wide/Remote	9.60	
	Narrow/Remote	7.70	
	Light Aircraft Parking areas	2.65	
	Long Term Remote	N/A	
Airbridge Use	Per 15 minutes/part thereof	7.35	
Passenger Charge (Per departing passenger)	Departure on a Contact Stand	10.00	
	Departure on a Remote Stand	6.30	
	Transfer Passengers	1.90	

Appendix III– Examples of Differential Terminal Charges

Examples of low cost terminals demonstrate that there is a clear difference in the level of service provided. The following information has been compiled from a range of publically accessible sources.

A small number of airports have introduced differential pricing at a terminal level. In the main these relate to the provision of a lower or more basic service level terminal at a lower cost.

The attached comment from an article in ACI Airport Business (December 2009) indicates the issues involved for one such airport – Marseille:

There is a strong differentiation between the level of charges applied at MP1 and MP2, with the passenger charge in the low-cost facility 70% lower; the landing and parking fees, meanwhile, are the same. Operational costs are lower at MP2, as it is a true low-cost offer, with no push back of the aircraft and no air bridges.

“For the French Civil Aviation Authority (DGAC), the low-cost terminal was a completely new project – they were surprised that we were offering a lower service with a lower rate,” said Regis. “The only airline that reacted was Air France, claiming that we were not applying the correct charge and that the full-service carriers were subsidising this. To solve that, the French DGAC had to spend three months at the airport from June 2008, during which time they checked our cost accounting and they testified that the way we were charging was correct. We have a very clear idea of what the correct cost is for each terminal.” However, legal challenges are not over –Air France still has a pending claim that the airport received a subsidy from the City Council, as well as a claim that it has an illegal marketing contract with Ryanair. “The process is more time-consuming than anything,” said Regis, who is very confident about the outcome.”

Concerns regarding the implementation of differential charging have also exercised IATA:

“IATA argues that the charges discriminate against network carriers, while there is also concern about possible cross-subsidisation from the main terminal. IATA's dismay reflects its wider concern about the charging mechanisms associated with the development of such facilities. "In theory it is okay to have different charges, but in

practice our worry is that the financial cost allocation at some airports can result in market pricing," explains Jeff Poole, IATA's director of industry charges and taxation"¹⁷

The clear difference in the level of service provided is demonstrated in the examples set out below.

Copenhagen SWIFT – “CPH SWIFT provides a whole new product to passengers preferring simple no-frills travel and a lower price instead of one with many options and a high level of service,” says Brian Petersen.

- Purpose built for Type C (type aircraft maximises the cost efficiency and the throughput at SWIFT)
- 30 minute turnarounds for all aircraft
- No security check on arrival passengers thus limiting usage to EU flights only (CPH “considered the possibility of introducing arrivals security but rejected it in view of the additional complexity and cost which it would cause”)
- Common check-in facilities with a common use bag drop solution (at least 90% of passengers must check in online, via mobile phones or at self-service kiosks meaning that self-check-in/bag drop desks are standard)
- Point-to-Point, no transfer possibilities

Bordeaux Billi “An air terminal offering up to date simplified services, this is Billi - Bordeaux illico!” (Bordeaux Straight away!) Low cost means that, “everything is done differently except for security and safety measures, which are exactly the same as with traditional airlines.”

- Purpose built, simplified design to meet the needs of the low cost airline sector
- Access to airlines via pedestrian walkway with all boarding/disembarking on foot
- 25 minute turnarounds for all aircraft

¹⁷ <http://www.flightglobal.com/articles/2007/11/16/219613/budget-buildings-the-rise-of-low-cost-terminals.html>

Marseille-Provence MP2

- Former cargo terminal
- 25 minute turnaround time
- Everything superfluous has been redesigned to keep only the essentials: Security, usability and security
- No luggage carts can be used within the terminal
- No airbridges used

Finland (Turku and Tampere) Terminal 2

- Former cargo terminal – only essential renovation carried out
- Only one airplane can be serviced at a time – Service times are limited to agreed times
- Terminal and groundhandling services provided at a basic level

Singapore Budget Terminal & Kuala Lumpur Low Cost Carrier Terminal:

“Budget – Enjoy the difference!”

“The 35,290 square meters of terminal is designed and built to suit the Low Cost Carrier (LCC) business model that requires basic terminal facilities and amenities.”

- Purpose designed low cost terminal buildings
- Basic terminal facilities and amenities
- Single storey buildings eliminating the need for escalators, travellers and airbridges

Lyon-Saint Exupéry - proposed low cost terminal “will offer reasonable, cost-related discounts for the simplified terminal.”

Appendix IV – Ryanair Response to Consultation Re Service Quality

	Issue	T1	T2	Difference
Ryanair Response to CP6/2008	Availability of critical equipment such as baggage systems	Baggage systems will be subject to the Commission's service quality standards. Maintenance and response times will reflect this	Baggage systems will be subject to the Commission's service quality standards. Maintenance and response times will reflect this	None
	Security screening	Security screening queue times will be subject to the Commission's service quality standards. Queuing times will reflect this	Security screening queue times will be subject to the Commission's service quality standards. Queuing times will reflect this	None
Ryanair Response to CP3/2009	Outbound Baggage availability	Baggage systems will be subject to the Commission's service quality standards. Maintenance and response times will reflect this	Baggage systems will be subject to the Commission's service quality standards. Maintenance and response times will reflect this	None
	Preference for Stansted scheme. This includes:			

	Availability of various passenger and airline facing equipment	Maintenance regime in T2 will provide same equipment availability as T1	Maintenance regime in T2 will provide same equipment availability as T1	None. Asset availability will be the same in both facilities
	Availability of pier service for airlines	N/A	N/A	None. The structure of Dublin Airport will mean that piers will not need to be designated to different terminals. Passengers will be able to enter T2 & use Pier E, and enter T2 and use Pier B, for example. Similarly, passengers processed in T1 will be able to access Pier E as well as Piers A, B and D.
	Security screening queues	Security screening queue times will be subject to the Commission's service quality standards. Queuing times will reflect this	Security screening queue times will be subject to the Commission's service quality standards. Queuing times will reflect this	None

Appendix V: Establishing a Differential Charge for Terminal Services

The following is a preliminary examination of the series of high level questions which would have to be addressed prior to the establishment of any potential differential charge. There are multiple permutations of answers to these questions and therefore significant analysis would be needed in order to provide an appropriate basis for a potential charge.

Primary element would be to establish if there is a service level differential between the two terminals which could justify a differential charge

If a service level is identified then need to look at possible basis for this charging differential

- Market/Demand
- Cost
- Other

If a cost differential is selected then a number of key areas of decision -making including

- Definition of the charge
- Capital cost element
- Allocation of operating costs
- Allocation of commercial revenues/single till contribution

1. Definition of Charge

In order to potentially establish a differential charge the following issues will need to be addressed

- What type of charge is it?
- What is the basis for this charge?
- What does it the charge cover?
- How is the charge defined?

What type of charge is it?

- Average cost
- Long run incremental
- Short run marginal cost

What is the basis for terminal charge?

- Terminal activity
- Terminal size square footage
- Asset based assessment

What would T1/ T2 charge cover?

- Terminal only
- Terminal & Apron
- Terminal & Departure/Arrivals interfaces
- Terminal & runway

When the above issues have been addressed then there will be a requirement to examine and allocate the different cost elements to the two terminals

- Capital Costs
- Operating Costs
- Contribution from Commercial Revenues

2. Capital Costs

Required to find the appropriate basis for assessing capital costs, this will involve looking at capital costs in terms of historic costs and ongoing capital investment.

Historic Capital Costs

What basis should be used for assessing historic costs?

- Regulated Asset Base as per CAR 2009 Determination
- DAA Fixed Asset Register
- Regulated Asset Base reconciled with DAA fixed Asset Register
- Other Basis

Ongoing Capital Costs

What basis should be used to assess ongoing investment?

- Recoverable Capital Expenditure as allowed by CAR in 2009 Determination
- DAA 2010-2014 CIP
- DAA out-turn capital expenditure
- CAR CIP Reconciliation
- Other Basis

Cost of Capital

A key decision will then have to be taken as to the appropriate cost of capital to be used in allowing a rate of return on capital investment.

Possible measures could included

- Regulated WACC as per CAR's 2009 Determination
- DAA's assessment of nominal discount rate
- DAA's own assessment of WACC

Consideration would be required as to whether a common WACC be applied to both terminals or whether a separate WACC be calculated for each terminal

If there is a requirement to assess an individual WACC for the separate terminals assume that CAPM model would be used

Which elements of WACC should be calculated on a terminal basis?

- Cost of Debt
- Equity Premium

- Beta

Allocation of Capital Costs

What broad categories of assets need to be considered and individually assessed?

- Assets directly connected to T1 or T2
- Assets indirectly attributable to T1 or T2
- Assets common to T1 or T2

What assets are directly connected to T1 or T2? Possible list could include

- Check-in desks
- airbridges,
- airside buses
- departure lounges
- immigration and custom services
- public address systems
- closed circuit surveillance systems
- security systems
- baggage handling and reclaim areas
- public amenities
- moving walkways
- other public areas in terminal
- lifts
- escalators

- flight information systems

What would fall in to the indirect cost category?

- corporate support assets
- roads and other infrastructure
- other

What assets would be defined as common to T1 and T2?

- Connectivity assets
- Runway
- Airfield assets.

How do you allocate directly attributable assets?

- Asset by asset allocation
- Market value approach
- Opportunity cost

What methodology do you use to allocate indirect costs?

- On a per passenger basis
- On a revenue/turnover basis

- On a usage basis (How would this usage be measured?)

How do you allocate common costs?

- On an incremental cost basis (How should this be assessed?)
- On a per passenger basis
- On a revenue/turnover basis

Depreciation Charge

A methodology will need to be adopted in relation to the calculation of depreciation costs.

Need to decide as on the asset valuation that is to be used in calculating this charge.

- Actual accounting depreciation and project future costs as set out in DAA's CIP 2010-2014
- Regulatory depreciation as per CAR and project future costs as per 2009 Determination
- Actual accounting depreciation and projected future costs as per 2009 Determination
- Regulatory depreciation as per CAR and capital expenditure allowances as per 2009 Determination

Where CAR's estimates of depreciation then what methodology should be applied in relation to T1 and T2

- Straight line depreciation
- Unitisation Approach
- Annualised Approach

3. Allocation of Operating Costs

What broad categories of direct operating cost need to be considered?

- Payroll & related costs
- Repairs & maintenance
- Rent & Rates
- Insurance
- Energy
- Marketing

What broad categories of indirect operating cost need to be taken into account?

- Costs of corporate services
- Maintenance & other costs relating to campus infrastructure (roads, water, energy, security and other support services)
- Regulatory levies
- What elements of joint cost need to be identified?

- Shared personnel
- Connectivity costs between terminals
- Repair and maintenance of shared infrastructure
- Other

How do you allocate indirect and joint costs?

- On a per passenger basis
- On a revenue/turnover basis
- On a usage basis
- Other

4. Allocation of Commercial /Single Till Revenues

Requirement to identify and examine the different categories of commercial revenues

- Direct Retail
- Concession Retail
- Car Parking

- Property
- Advertising
- Other Commercial Operations

Need to identify and apportion the direct net revenues connected to either T1 or T2

- Direct Retail in Terminal
- Concession Retail in Terminal
- Food and Beverages in Terminal
- Advertising/Property rental in Terminal
- Carparking
- Groundhandling and other miscellaneous income e.g. CBP, Check-in desk, PRM

Need to identify and apportion the indirect net revenues associated with T1 or T2

- Property rental on campus
- Advertising on campus
- Carparking excluding carparks directly linked to either terminal
- Contribution from taxi licensing and other transportation licensing fees

How should these indirect net revenues be allocated?

- On a per passenger basis
- On a revenue/ turnover basis
- Other