

**DECISION OF THE
AVIATION APPEALS PANEL 2010**

Established by Order of the Minister for Transport

4 March 2010

**APPEAL OF RYANAIR
AGAINST DETERMINATION OF
THE COMMISSION FOR AVIATION REGULATION CP4/2009**

**MICHAEL DURACK SC
PROFESSOR GEORGE YARROW
JOHN BUTLER CPA**

1. THE DETERMINATION

- 1.1 The Commission for Aviation Regulation (*“the Commission”*) published its final determination on airport charges at Dublin airport for the period 2010 – 2014 on 4 December 2009. The determination has effect from 1 January 2010.
- 1.2 The table below shows the maximum revenue per passenger Dublin Airport Authority (*“DAA”*) can collect at Dublin airport per the Commission’s final determination CP4/2009:

	2010	2011	2012	2013	2014
Maximum revenue per passenger if T2 not operationally ready	€8.93	€8.11	€7.90	€7.70	€7.50
Maximum revenue per passenger if T2 operationally ready 1st November 2010	€9.32	€10.44	€10.23	€10.03	€9.83

- 1.3 The maximum revenue per passenger in 2009, under the previous determination, was €7.39 per passenger.
- 1.4 The above figures or “price cap” represents the maximum amount that the DAA can charge on a per passenger basis for each year between 2010 and 2014. The Commission has pointed out that it is open to the DAA to charge passengers less than this price cap and/or to charge passengers on a *“differential basis for the*

facilities that they might or might not want to use, subject to the constraints of competition law and ICAO rules”¹.

2. THE OBLIGATIONS OF THE COMMISSION

2.1 Section 33 of the Aviation Regulation Act 2001 (as substituted by section 22 of the State Airports Act, 2004) provides:

“(1) In making a determination the objectives of the Commission are as follows—

- (a) to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport,*
- (b) to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport, and*
- (c) to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.*

(2) In making a determination the Commission shall have due regard to—

- (a) the restructuring including the modified functions of Dublin Airport Authority,*
- (b) the level of investment in airport facilities at Dublin Airport, in line with safety requirements and commercial operations in order to meet the needs of current and prospective users of Dublin Airport,*
- (c) the level of operational income of Dublin Airport Authority from Dublin Airport, and the level of income of Dublin Airport Authority from any arrangements entered into by it for the purposes of the restructuring under the State Airports Act 2004,*
- (d) costs or liabilities for which Dublin Airport Authority is responsible,*
- (e) the level and quality of services offered at Dublin Airport by Dublin Airport Authority and the reasonable interests of the current and prospective users of these services,*
- (f) policy statements, published by or on behalf of the Government or a Minister of the Government and notified to the Commission by the Minister, in relation to the economic and social development of the State,*
- (g) the cost competitiveness of airport services at Dublin Airport,*

¹ *Per* ‘press statement’ published by the Commission 4 December 2009, accompanying determination CP4/2009.

(h) imposing the minimum restrictions on Dublin Airport Authority consistent with the functions of the Commission, and

(i) such national and international obligations as are relevant to the functions of the Commission and Dublin Airport Authority.”

2.2 Section 10(1) of the Aviation Regulation Act, 2001 empowers the Minister for Transport to “*give such general policy directions to ... the Commission as he or she considers appropriate to be followed by the Commission in the exercise of its functions*”. Subsection (2) goes on to provide that “*the Commission shall comply with any direction given under subsection (1)*”.

3. MINISTERIAL DIRECTION

3.1 By letter dated 27 October 2009, the Minister for Transport issued a Direction (“*the Ministerial Direction*”) to the Commission under Section 10 of the 2001 Act. The Commission was directed to:

“ensure that the Dublin Airport Authority’s financial viability is protected in order to implement government policy on:

(a) The role of Dublin Airport as an international gateway for Ireland and its key strategic role in relation to air access, inward investment and general economic development;

(b) 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 this context;

(c) the development of Terminal 2 as quickly as possible as set out in the Government decision of May 2005;

(d) the operation of Dublin Airport Authority on a commercial basis without recourse to Exchequer funding or an equity injection by the State and in that context the need to secure lender confidence and raise debt financing on a cost efficient basis”.

4. APPEALS:

4.1 Section 40 of the Aviation Regulation Act, 2001 provides:

“(2) The Minister shall, upon a request in writing from a person to whom this Section applies who is aggrieved by a Determination under Section 32(2) or 35(2), establish a panel (“Appeal Panel”) to consider an appeal by that person against the Determination.

(5) An Appeal Panel shall consider the Determination and, not later than three months from the date of its establishment, may confirm the Determination or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, refer the decision in relation to the Determination back to the Commission for review.

(6) An Appeal Panel shall notify the person who made the request under sub-section (2) of its decision under sub-section (5).”

4.2 The Establishment of the Appeal Panel:

The Minister for Transport received requests from 3 parties aggrieved by the determination of 4 December 2010 and by Order of 4 March 2010 the Minister for Transport established an Appeal Panel to consider the Appeals of: Aer Lingus; Ryanair and DAA against the Determination published as Commission Paper (CP4/2009).

- 4.3 The Appeal Panel members are: Michael Durack S.C. (Chairman); Professor George Yarrow and John Butler CPA.

5. PROCEDURES FOLLOWED BY THE PANEL

- 5.1 Section 40(4) of the 2001 Act provides that an Appeal Panel shall determine its own procedure. The Panel took the view that, on the proper interpretation of the section, each of the Appeals should be considered individually. The Appeal Panel adopted the following procedure:-

- (i) Each Appellant was invited to make written submissions;
- (ii) The Commission was invited to respond to each submission in writing;
- (iii) Each Appellant was invited to reply in writing to the Commission's response;
- (iv) An oral hearing of each Appeal was held where the Appellant presented its appeal in the presence of the Commission. The Panel decided to conduct these oral hearings otherwise than in public. A stenographer kept a record of each oral hearing and the Appellant and the Commission was provided with a copy of the transcript.

6. POWERS OF THE APPEAL PANEL – SCOPE OF REVIEW

- 6.1 The provisions of Section 40(5) require the Panel to consider the Determination and having so considered it, to either:

“Confirm it or, if it considers that in relation to the provisions of Section 33 or 36 there are sufficient grounds for doing so, to refer the decision in relation to the Determination back to the Commission for review”.

- 6.2 The Panel may not substitute its own view for the view of the Commission. It does not have the power to reject the Determination or amend the Determination in any respect. It may only refer the decision in relation to the Determination back to the Commission for review where it considers that there are sufficient grounds for doing so by reference to the provisions of Section 33 (in this instance).
- 6.3 Notwithstanding the limitations on the scope of the review by the Appeal Panel, Aer Lingus submits that it is still open to the Panel, as an expert body, to take a strong view on how it believes the Commission should deal with matters (if any) that it may decide to refer back for review and further that it is not a prerequisite to any referral to show that there has been a breach of procedure or that the Commission had acted unreasonably, as the power granted the Appeal Panel under section 40 is not so limited².
- 6.4 Ryanair went further and submitted that an appeal under section 40 was a “full appeal” and as such on any review the Commission could not, on review, ignore information thrown up through the appeal process and confine itself only to facts that were available to it at the time of the Final Determination³. By way of example, it submitted that to do otherwise would have the absurd result of the Commission ignoring the €9.4 million dividend paid to the State by DAA.
- 6.5 Having considered all of the above submissions the Appeal Panel determined that:
- (a) If the Panel was not satisfied that the Commission had properly considered the matters referred to at Section 33 and the Ministers Direction it would refer the Determination back to the Commission for further consideration.
 - (b) If the Panel was satisfied that the Commission has considered the matters referred to at Section 33 and the Minister's Direction but was satisfied that there were sufficient grounds to do so, it would refer the Determination back to the Commission for further consideration.

² Pages 6 and 7 of transcript of Aer Lingus oral hearing, 28 April 2010.

³ Pages 33 to 36 transcript of Ryanair oral hearing, 29 April 2010.

(c) In all other events, it would uphold the Determination.

6.6 The Panel also determined that it would have regard only to material which was before the Commission when it made the Determination and not to subsequently procured materials or subsequent events except in circumstances where the later materials or events clearly and directly imply that previous judgments and conclusions, capable of having significant effects, could no longer be reasonably sustained.

7. THE COMMISSION'S APPROACH TO THE APPEAL

7.1 The Commission was concerned with the process proposed by the Panel. It took the view that it could not be a respondent in the ordinary sense. It could not argue for its Determination or make submissions that its decisions were correct as the Panel may decide to refer issues back to it for review and it would then become responsible for making the final decision. It maintained that it was necessary for it to take an independent stand. It decided that it would therefore confine its response to drawing the attention of the Panel to materials, statements, analysis and decisions which informed its Determination.

7.2 The Panel took the view that there was merit in this submission, particularly as the Panel could only decide that there were "sufficient grounds" for a review but the ultimate decision lay with the Commission.

7.3 At the oral hearing Ryanair was critical of the approach adopted by the Commission to the appeal process. It pointed to the fact that the 2008 Appeal Panel asked the Commission to act as Respondent in the appeals but that the Commission did not really engage in the process, preferring to rely on its written submissions. It alleged that despite the 2008 Panel making clear recommendations and referrals to the Commission, for example to carry out a

detailed and transparent analysis of the capacity of T1, that the response of the Commission in CP2/2009 was as follows (quoting from CP2/2009):

“2.11 *It appears to the Commission that where it did not explicitly rebut an appellant’s criticism of the Determination in the Oral Hearing the Panel tended to accept the view of the appellant and referred those matters back to the Commission for review. This is despite the fact that, the Commission in advance had drawn the Panel’s attention to the parts of the Commission’s Determination (including the annexes) where the Commission’s reasoning was set out in relation to those criticisms*”.

7.4 Ryanair expressed frustration at such an approach and went so far as to say this was “game” playing by the Commission “*to avoid ever answering the questions that they say they have answered by way of reference to their submissions*”⁴. Mr. Hayden SC for Ryanair submitted that a section 40 appeal is:

*“a full appeal and the CAR should participate appropriately. They can’t, if they are unhappy with a panel determination, say because, ‘Because we didn’t engage it seems the Panel accepted all the appellant’s grounds’, on the basis that they, themselves, voluntarily didn’t engage. This whole exercise is treated by the CAR as an adversarial issue. Rather than engaging with users and trying to reach a consensus, it seems to be that if you make an appeal, we have given our grounds and that’s it and then complain if those grounds aren’t upheld by the Panel, as if the Panel didn’t understand what was going on, because it becomes a self fulfilling prophecy.”*⁵

7.5 While the Panel accepts that the Commission may not wish to argue in favour of its Determination, merely stating where its reasoning for a decision is to be found does not protect the decision from review under Section 40. Where the Panel considers the reasoning adopted by the Commission is inappropriate, it is entitled to say so and refer it back for review. The Panel recognises the logic of the Commission’s position that, as it may be asked to review material and aspects of its Determination, its needs to keep an open mind and should therefore avoid getting drawn into having to defend all aspects of its Determination.

⁴ Line 17 onwards page 16 transcript of Ryanair oral hearing, 29 April 2010, Martin Hayden SC for Ryanair.

Nevertheless, the Panel is of the view that it is over-formulistic for the Commission to refuse to engage at any level. It is entirely to be expected that there may be points raised where the Commission itself can quickly and easily come to the view that it should look at the matter again, for example, where there has been a simple misunderstanding or error. It would greatly facilitate the Appeal process if such misunderstandings, once identified and in respect of which there is no fundamental disagreement, could be confirmed by the Commission as matters which should be reviewed. This would allow the Panel to concentrate on areas of fundamental dispute between the Appellant and the Commission.

7.6 Since the Commission was set up in 2001, there appears to have been ongoing interaction between it and the various interested parties which is reflected in a vast amount of correspondence, issue papers, consultants' reports, expert evidence, draft and final determinations and Appeal Panel Decisions. The parties clearly have an intimate knowledge of its contents which is not, and could not, be shared by the Panel. Without the assistance of the Appellants and the Commission in identifying the relevant documents and issues, the Panel could not complete its task in the limited time provided by statute. The Panel is grateful for the assistance offered by all the parties.

7.7 At the Panel's request, the Commission provided written details of this consultation process in a letter dated 23 March 2010. This included a helpful table summarising this process, a copy of which is annexed hereto at **Appendix A**.

⁵ Line 4 onwards, page 47 transcript of Ryanair oral hearing, 29 April 2010.

8. RYANAIR GROUNDS OF APPEAL AND COMMISSION RESPONSE

8.1 Ryanair submitted written grounds of Appeal to the Appeal Panel on 24 March 2010. The Commission responded in writing on 7 April 2010. Ryanair in turn, provided a written response to the Commission's reply on 14 April 2010. An oral presentation was made to the Panel by Ryanair together with its Counsel, Martin Hayden SC and Frank Beatty B.L., instructed by Jennifer Lynch Solicitor in the presence of the Commission, on 29 April 2010.

8.2 Ryanair's appeal to the Panel focussed on 9 specific areas or grounds under the following headings:

- (i). Issues regarding the remuneration of T2;
- (ii). Differential pricing;
- (iii). Indexed depreciation: policy *volte face*;
- (iv). Inappropriate Methodology / Debt Inflation Shield;
- (v). X- factor 2007 – 2009;
- (vi). T1X Incremental Revenues and Remuneration;
- (vii). Excessive Cost of Capital Allowed;
- (viii). Regulated Entity Accounts and Accounting Practices;
- (ix). Failure to adequately consider Cost of Competitiveness of Services at Dublin Airport.

8.3 Issues regarding the remuneration of T2:

8.3.1 Ryanair submitted that the Commission "*showed reckless disregard towards the interests of users by not adhering strictly to the recommendation of the 2008 Appeal Panel (relating to the proper assessment of T1 Capacity), prior to finalising its assessment of the proportion by which T2 was oversized*"⁶ and requested that the Panel "*refer the Determination back to the Commission for reconsideration in relation to this issue*".

⁶ Paragraph 2.2 Ryanair's written response to the Commission's written submissions to the Panel.

- 8.3.2 The Commission pointed to the attempts it made to hold the meeting on the capacity of T1 recommended by the 2008 Appeal Panel and to the exchange of written submissions that did occur on the issue. They also submitted that Ryanair had not in fact grounded any appeal under this heading⁷.
- 8.3.3 At the oral hearing Ryanair pointed to the cap on passenger numbers on the eastern campus in Fingal County Council's Local Area Plan (Ryanair referred to a figure of 30 million⁸ DAA said the figure is 32 million⁹) and what it submitted was the Commission's failure to act as an appropriate check on the sizing of T2¹⁰.
- 8.3.4 The 2008 Panel's recommendation was considered by the Commission in CP2/2009. This appeal is concerned with determination CP4/2009. It is not an appropriate matter for this Panel to engage in an assessment of whether the Commission did or did not properly address the recommendations of the 2008 Appeal Panel in CP2/2009 with a view to referring matters back. The Commission was free to affirm or vary its 2007 Interim Determination having considered the recommendations of the 2008 Aviation Appeal Panel.
- 8.3.5 This Panel is concerned solely with the present Determination CP4/2009 and the issues raised by certain parties aggrieved by that Determination and in the instant case the issues raised by Ryanair. In so far as some of the issues raised in former appeals are considered and inform the reasoning and are part of the Determination CP4/2009, and are raised as a ground of appeal, these will be considered.
- 8.3.6 In May 2005, the government announced the Aviation Action Plan which involved, *inter alia*, the building of Pier D and the commissioning of T2. The Commission was obliged to make a determination of the maximum levels of charges to be levied at Dublin Airport before 30 September 2005. In the time available, DAA was unable to prepare a fully worked up capital investment

⁷ Paragraphs 11 and 12, page 3 of the Commission's written response to Ryanair's Appeal.

⁸ Pages 9 and 10, transcript of Ryanair oral hearing, 29 April 2010.

⁹ Page 11 written transcript of DAA oral hearing, 30 April 2010, Mr. Moran for DAA.

program but provided a preliminary document. The Minister appointed an independent expert group to verify the specification and costs to be incurred on the project. A full CIP was completed in October 2006 as approved by that group which involved a significantly higher sum.

8.3.7 It is accepted that the traffic projections did not anticipate the current economic slowdown and that there is significant excess capacity for present needs. However, it must also be accepted that T2 is a large and significant item of infrastructure which has a long projected life and its development was driven by Government policy to provide for the long-term needs of the State. Whether the Commission could or should have acted to restrict its size is a matter of history. The Commission has dealt with this increased cost and made determinations delaying the entry of capex into the RAB via a Box 2 Trigger which is postponing the recovery of the investment.

8.3.8 The dispute relevant to this appeal is the impact that this oversizing should have on the treatment of T2 CAPEX and OPEX for the *current regulatory period 2010 – 2014*.

8.3.9 **In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review.**

8.3.10 **Regulatory Consistency:** - Ryanair raised issues of alleged regulatory inconsistency on the part of the Commission. It submitted that the Commission’s rejection of user representations regarding the allowance of €635m into the RAB (when T2 becomes operationally ready) on the stated belief that the DAA made its investment in T2 based on the Commission’s 2007 Interim Determination was inconsistent with the evidence adduced by Ryanair. That showed DAA’s commitment to undertake the investment in relation to T2 to its current size and specification was made long before the 2007 Interim Determination issued¹¹.

¹⁰ Pages 29 and 30; and 107 and 108, transcript of Ryanair oral hearing, 29 April 2010.

¹¹ Paragraphs 2.6 and 2.7 Ryanair’s written response to the Commission’s submissions to the Panel.

Ryanair further submitted that if DAA undertook this investment on the basis of “indications” given by the Commission (prior to any determination) and such indications constitute matters regarding which regulatory certainty should be granted then the same regulatory certainty should be equally afforded to users in relation to the issue of differential pricing and the “User Pays” principle¹².

8.3.11 The Panel is of the view that whether or not the DAA was committed to the investment in T2 prior to the 2007 Interim Review or whether it undertook it on the basis of indications given by the Commission, neither is relevant to the appeal against this 2009 Determination. Ryanair is in effect asking this Panel to make a determination on when DAA became ‘committed’ to T2. The Panel is of the view that attempting to draw a line in time after which DAA became ‘committed’ to T2 would be an arbitrary exercise. It is probable that there were commitments of resources by DAA to T2 before the Interim Determination but also further much larger commitments, with State support, thereafter.

8.3.12 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer this aspect of the Commission’s decision back for review.

8.3.13 In its written reply to Ryanair’s appeal the Commission stated that this ground of appeal appeared to relate to the Commission’s failure to mandate differential pricing¹³. Many of the issues raised here do appear to the Panel to be linked to an argument on differential pricing and are considered in more detail later under that ground.

8.3.14 ***Financial Viability:*** - Ryanair submitted that “*if it is the case that the Commission has agreed to remunerate the DAA for its investment in T2 in order to avoid financial viability issues, then this should be accomplished by accelerating depreciation on assets that have properly been admitted into the RAB rather than*

¹² Paragraph 2.10 Ryanair’s written response to the Commission’s submissions to the Panel.

¹³ Paragraph 13, page 3, the Commission’s written response to Ryanair’s appeal.

by admitting inappropriate assets into the RAB or by inappropriately transferring all volume risk to the users in advance of the finalisation of construction”¹⁴.

8.3.15 By way of reply the Commission pointed to its consideration of DAA’s financial viability in both the draft and final determinations. It also pointed to the accelerated depreciation of “Area 14” at paragraph 9.47 of the Final Determination¹⁵.

8.3.16 Ryanair, in reply, stated that the acceleration of depreciation on area 14 is not relevant to its submission which relates to the impact of financial viability issues on the Commission’s assessment of T2¹⁶.

8.3.17 A number of factors appear to have been taken into account by the Commission in its assessment of the level of remuneration of T2, and there appears to be no reason to think that it erred in not providing for greater accelerated depreciation. This is an adjustment more usually associated with a reduction in the expected economic life of an asset, for example because of more rapid obsolescence.

8.3.18 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review.

8.3.19 *Transfer of Risk from DAA to Users: –*

8.3.20 Ryanair submitted that there has been an unwarranted full transfer of the downside financial risks resulting from the radical drop in passenger forecasts during the construction of T2 from DAA to users. It submitted that it is difficult to reconcile the elimination of the downside financial risks for DAA’s €35m investment in T2 with the Commission’s comments on the management of Operating Costs at CP4/2009 where it states that:

¹⁴ Paragraph 1.3(g) Ryanair Appeal.

¹⁵ Paragraph 16, page 4 the Commission’s written response to Ryanair’s Appeal.

¹⁶ Paragraph 2.13, page 5, Ryanair’s written response to the Commission’s submissions.

“Economic Regulation seeks to impose the same sorts of disciplines on a firm to manage its costs that a firm subject to competition might face”¹⁷.

8.3.21 Ryanair also rejected the reasoning behind the Commission’s refusal to consider fixing prices for the 2010-2014 regulatory period based on 2007 traffic forecasts *“since the DAA did not make an investment on that basis in 2007;”* as Ryanair again submitted that the DAA did not rely on the 2007 Interim Determination when making its T2 investment decision¹⁸.

8.3.22 The Commission by way of reply pointed to its consideration of the treatment of the remuneration of T2 in its Final Determination; the 2007 Interim Review and to its consultation paper CP1/2007 where is sought responses from parties on how the risks associated with a large investment project should be allocated between users and the airport¹⁹.

8.3.23 It is a limitation of existing approaches to airport regulation, in other jurisdictions as well as in Ireland, that unexpected reductions in demand tend to lead to increases in airport charges. Ryanair is correct to point out that this is not a relationship (between demand and prices) that might be expected to occur in circumstances where airports compete for business, and that this is a weakness of the regulatory system. The Commission has, in fact, made a number of adjustments to the regulatory arrangements in an attempt to mitigate the upward pressure on charges in the next period. The Panel have also recommended, in response to the Aer Lingus Appeal, that the treatment of the time profile of retail revenues be reconsidered by the Commission. However, the Panel is of the view that the broader issues of time profiling and risk sharing are better approached cautiously, because changes that lead to deferred cost recovery can easily be misinterpreted by capital markets. It is the Panel’s view that they would be better

¹⁷ Paragraph 6.37 CP4/2009, quoted at paragraph 1.4(d) Ryanair Appeal.

¹⁸ Paragraph 1.4(b), Ryanair Appeal and paragraph 2.15 Ryanair written response to the Commission’s submission.

¹⁹ Paragraph 18, the Commission’s written response to Ryanair’s Appeal.

addressed over a longer time period, in the course of the next review, rather than by a more hasty reconsideration now.

8.3.24 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review.

8.3.25 *“User Pays” Principle* - Ryanair submitted that *“notwithstanding the two box approach that has been adopted in relation to the remuneration of T2, the failure of the Commission to adhere to its guiding principle of “user pays” together with its failure to introduce differential pricing will result in Ryanair passengers being required to pay for facilities that they do not and will never use”*²⁰.

8.3.26 The Commission in its reply inferred from this that Ryanair was seeking to have the Determination amended to mandate some form of differential pricing²¹ and Ryanair confirmed this in its written reply to the Commission’s submissions²². As a result this ground of appeal is considered with the issue of differential pricing at 8.4 below.

8.4 Differential Pricing:

8.4.1 Ryanair submitted that providing a dedicated low cost terminal was critical to addressing the needs of present and future airport users and that this has not been addressed by the DAA or the Commission. It pointed out that Ryanair offered to build such a terminal at no risk to DAA²³. It submitted that there is not uniformity of willingness to pay for services across all airlines.

8.4.2 The Commission dealt with Ryanair’s submissions on differential pricing at paragraph 10.10 of the Final Determination:

²⁰ Paragraph 1.5(c), Ryanair Appeal.

²¹ Paragraph 20, the Commission’s written response to Ryanair’s Appeal.

²² Paragraph 2.19, Ryanair’s written response to the Commission’s submissions to Panel.

“The Commission supports the principle of differential pricing, allowing users to pay more or less depending on exactly what services they want and the value of those services to them. However, this Determination does not mandate a particular structure of charges at the airport. The analysis required would face similar challenges to those outlined above when discussing the case for a sub-cap on charges paid by passenger airlines to ensure they do not subsidise cargo or general aviation users. Such an analysis would also have to consider the costs net of commercial revenues that passengers of different airlines might generate at the airport. It is even possible that airlines that want their passengers to process through a basic facility should pay higher airport charges since the costs of such a facility net of commercial revenues exceed the costs net of commercial revenues of providing a more developed facility. Aside from the analytical challenges, the Commission is also concerned that to impose sub-caps requiring some form of price differentiation risks denying the 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 will want to use a particular pier (for example). In this case, the appropriate response would be for the DAA to increase the charge for using that pier relative to the charge for using other piers until such time as the structure of charges meant demand for any given pier does 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. Instead it would presumably have to require some airlines to pay higher charges to use a pier they do not wish to use”.

8.4.3 Interestingly, both Ryanair and the Commission quoted from page 20 and 24 of CP6/2007, decision on the 2007 interim review in support of their positions on this issue²⁴:

²³ Page 96, line 6, transcript of Ryanair oral hearing, 29 April 2010.

²⁴ Ryanair at paragraphs 2.12 and 2.14 of its written submission of Appeal and the Commission at paragraph 25 of its written response to Ryanair’s Appeal.

“ The Commission did not propose to impose differential pricing, although it was satisfied that such a proposal would not conflict with rules concerning abuse of a dominant position (e.g. Article 82 EC). The Commission supported the principle of users being charged different prices for different levels of service. It indicated that the costs of future capital expenditure plans to improve the quality of service in T1 (or T2) would only be included in the RAB if users of the terminal indicated a willingness to pay for the improvements. Where users indicated a preference for lower charges rather than higher service quality, the DAA should seek to meet these requirements”²⁵.

And:

“The Commission reiterates that it is keen for the DAA to tailor services for users at Dublin Airport so that if different users would prefer different mixes of quality and price, these options should be provided where possible. The building of a second terminal will afford the DAA more opportunity to do this. Airlines should be offered non-discriminatory access to both low-cost and high-cost facilities, when both are available. Plans to spend money upgrading a terminal will need to have the support of users. If T1 users indicate a preference for a lower quality of service and lower airport charges, the Commission will expect the DAA’s plans to reflect these preferences”²⁶.

8.4.4 The Commission submitted that CP6/2007 did not mandate the use of differential pricing²⁷. Ryanair on the other hand sought to “contrast the Commission’s willingness to abandon the principles, intentions, expectations and requirements regarding differential pricing as expressed by the Commission in 2007 and set out above, with its current pronouncements regarding a “regulatory contract” based on which both the regulated entity (CP4/2009 [A3.6]) and its investors and lenders (CP4/2009 [9.50]) are invited to “take comfort that the Commission will continue to allow remuneration of investments which it has previously allowed into the RAB”²⁸.

²⁵ CP6/2007 page 20, paragraph 5.

²⁶ CP6/2007, page 24 paragraph 2.

²⁷ Paragraph 25, the Commission’s written response to Ryanair’s Appeal.

²⁸ Paragraph 2.16, Ryanair Appeal.

- 8.4.5 Ryanair submitted that the “*dilution of intent that is evident in the Commission’s 2009 policy, relative to its 2007 policy (that was formulated in the context of the Commission’s decision regarding the remuneration of the DAA for its investment in T2), denies users regulatory consistency and certainty regarding policies that were, and that remain, of fundamental importance in protecting the reasonable interests of users of Dublin Airport in relation to Dublin Airport*”²⁹.
- 8.4.6 The Panel is of the view that there is considerable merit in Ryanair’s submission for differential pricing. Ryanair is a low cost airline. It operates an internet on-line check in system where the passengers print their boarding passes before leaving for the airport. This means that they need neither boarding desks nor check-in kiosks. The end result is that T1 is capable of dealing with significantly more passengers than it was a few years ago. This potentially contrasts with the services likely to be required by longer haul passengers at whom T2 is largely aimed. Ryanair submitted 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 meaningless³⁰.
- 8.4.7 It is precisely because of Dublin Airport’s monopoly position that it should strive to cater for different ‘airline business models’. DAA’s failure thus far to do so has the possible effect that some business models are favoured over others. This in turn implies a potential restriction or distortion of competition in airline markets which the Panel feels should be addressed by the Commission.
- 8.4.8 As already noted at paragraph [1.4] above, the press statement accompanying CP4/2009 states that it is open to DAA to charge passengers on a “*differential basis for the facilities that they might or might not want to use, subject to the constraints of competition law and ICAO rules*”. 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

²⁹ Paragraph 3.2, Ryanair’s written response to the Commission’s submissions.

³⁰ Page 78, line 3 onwards, transcript of Ryanair oral hearing, 29 April 2010, Ms. Congon for Ryanair.

encourage DAA to employ differential pricing. Indeed, the Commission appears somewhat minded to the later approach in relation to the length of the North Runway. 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.

8.4.9 The Panel's views on the desirability of greater accounting transparency, particularly in relation to commercial revenues, are also relevant to this ground of appeal. The analytical challenges posed for the Commission by differential pricing would be greatly ameliorated by more detailed regulatory accounts being prepared by DAA, in accordance with good accountancy practice. The Panel is of the view that the ability of a regulated monopoly to provide differential services, if that is what customers want, is a very important one - arguably no less important than the pricing for services that are provided. It therefore merits considerable regulatory attention.

8.4.10 In the circumstances the Panel considers that sufficient grounds HAVE been established to refer the Commission's decision back for review. Specifically, the Panel refers the matter back to the Commission for it to consider how best differential pricing might be initiated.

8.5 Indexed depreciation: policy *volte face*:

8.5.1 Ryanair's submission relates to the Commission's decision to change its methodology (prior to 2004) of calculating "return of investment" by reference to the un-indexed RAB to one of calculating it by reference to the indexed RAB. There appears to be an acceptance on all sides that the change in methodology was appropriate. Ryanair's complaint relates to the fact that it was done "*without adequate or any notification, explanation or consultation with users at that time or since*"³¹.

³¹ Paragraph 4.6 of Ryanair Appeal.

8.5.2 The change of methodology referred to above occurred in 2004 and while there was correspondence in 2009 between Ryanair and the Commission in relation to this historic alleged *volte face* the Panel has no role in referring such historic matters back “*for consultation*” at this stage.

8.5.3 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review.

8.5.4 Ryanair’s concerns regarding the impact of this change on the methodology used by the Regulator is discussed in greater detail at 8.6 below.

8.6 Inappropriate NPV Methodology / “Debt Inflation Shield”

8.6.1 Ryanair submitted that the methodology currently being adopted by the Commission to calculate “return on” and “return of” investment is leading to excess profits being earned by the regulated entity³². It submitted worked examples to the Commission and to the Appeal Panel at the oral hearing which it said demonstrated that calculating “return on investment” by applying a real WACC to an indexed RAB whilst at the same time calculating “return of” investment by reference to depreciation of the Indexed RAB leads, in inflationary periods, to returns to equity that are higher than the return that is deemed appropriate by the regulator.

8.6.2 Ryanair contended that the excess return arises *inter alia* because the methodology adopted by the regulator ensures:

a. “Returns to equity;

- i. *Sufficient “return on” investment to pay equity holders the required nominal rate of return on equity.*
- ii. *Sufficient “return of” investment to repay the equity holders the indexed value of their investment.*

b. Returns to debt holders;

- i. *Sufficient “returns on” loans to pay the debt holders the required nominal rate of interest on their debt.*
- ii. *Sufficient “return of” debt to repay the debt holders the indexed value of their loan – notwithstanding that having paid nominal interest on the loan, the principle that requires to be repaid is the original amount borrowed rather than the indexed value of the amount borrowed, leaving a surplus “return of” debt that is not required to repay debt holders.*
- c. *The surplus earmarked for but not required to repay debt holders reverts to equity investors over and above that which is stated to be required by the regulator.”³³*

8.6.3 Essentially, Ryanair submitted that while conceptually an indexed RAB multiplied by a real interest rate is a real return, computationally (on its worked scenarios) the return that is allowed by the Commission is a nominal return and proffered the “debt inflation shield” as an explanation for this phenomenon:

“If it doesn’t happen as a result of this phenomenon then there is a requirement to explain the excess returns that are within the spreadsheets. The issue that we have is, if you think that the debt inflation shield does not apply in this situation then please explain why and if you explain why then please also take a look at what is evidence of excess returns and explain to us how those excess returns arise.”³⁴

8.6.4 Ryanair also pointed out that it had to use assumptions because they didn’t have the real figure, which touches on the issues raised in relation to regulated entity accounts and accounting practices, discussed in more detail at 8.10 below.

8.6.5 The Commission deals with Ryanair’s submission at paragraphs 8.12 and 8.112 of the Final Determination with an additional annex, Annex 4, devoted to it. At A4.2 the Commission states as follows:

“The Commission has decided not to adjust its approach in response to Ryanair’s concerns about a debt-inflation shield. It refutes any suggestion that the Commission has ignored a well-known problem in regulation: an

³² Paragraph 4.1 of Ryanair Appeal.

³³ Paragraph 4.5 Ryanair Appeal.

³⁴ Page 122, line 1 onwards, transcript of Ryanair oral hearing, 29 April 2010, Martin Hayden SC for Ryanair.

internet search using Google for the term “debt inflation shield” on 27 November 2009 yielded no links, other than to the Commission’s website where Ryanair’s response to the draft determination was hosted. Moreover, the Commission has spoken with a number of regulatory economists, none of whom were familiar with the issue Ryanair raises. More importantly, for a number of reasons the Commission does not accept Ryanair’s argument that an adjustment to its depreciation policy is required:

- *It appears to be based on a misunderstanding of the Commission’s approach to regulation;*
- *It assumes that there is an arbitrage opportunity available because lenders systematically set nominal rates without regard to future inflation;*
- *The available evidence does not suggest that the DAA is necessarily earning excess profits; and*
- *It is possible to construct alternative examples to those provided by Ryanair that suggest, if Ryanair’s logic was accepted, the Commission should revise the price cap upwards.”*

8.6.6 The Commission then goes on to expand on each of the bulleted points in more detail.

8.6.7 At the oral hearing much was made of the Commission’s reference to a Google search not yielding any hits. However, Ryanair acknowledged some confusion may have been caused due to the use of the term “debt inflation shield”, a term coined by it to refer to a complex and rather obscure aspect of economic theory. Furthermore, the Commission made reference to conducting such a Google search to refute Ryanair’s submission that the Commission was ignoring a “well known” problem in regulation. It is clear from the Final Determination that the Commission did not dismiss Ryanair’s submission solely on this basis.

8.6.8 In support of the submission that “*a cursory review of the available economic literature would have directed the Commission to articles by some of the foremost economist in the world relating to the existence of the debt inflation shield*” the

Panel was referred to an article by Modigliani, F and Cohn, R.A. entitled “*Inflation, rational Valuation and the Market*” published in the 1979 Financial Analysts Journal, (35, 24-44) and an article entitled “*An empirical study of inflation distortions to EVA*” by Warr, R.S., published in the 2005 Journal of Economics and Business, (57, 119-137).

8.6.9 Neither of these articles were brought to the attention of the Commission prior to its Final Determination. However, Ryanair submitted that this was “*a matter of some insignificance*”³⁵ and that its representations “*do not depend for their authenticity on the existence of articles or on the terminology used. Rather, they rely for their authenticity on the logic of the arguments used and on the worked examples submitted.*”³⁶

8.6.10 Under “*approach to regulations*” Ryanair submitted that the Commission’s own calculations at Figure A4.1 CP4/2009 support its submission. It said that the discount factor used by the Commission to induce a zero NPV approximate to the Nominal Discount Rate “*establish[ed] the point that Ryanair has been making which is that using the Commissions methodologies to calculate “returns on” investment and “return of” investment, yields a return that is equivalent to the Nominal Cost of Capital not the Real Cost of Capital*”³⁷.

8.6.11 Ryanair submitted that the Commission’s interpretation of table A4.2 CP4/209 is also flawed. In the Final Determination, the Commission relied on this table as demonstrating that excessive returns were not being earned by the DAA. However, Ryanair submitted that the table calculates and references the ratio of operating profits to fixed assets rather than calculating and referencing the return to equity holders, which was where Ryanair had pointed to the excess returns in its worked examples³⁸.

³⁵ Paragraph 5.7, Ryanair’s response to the Commission’s written submissions.

³⁶ Paragraph 5.9, Ryanair’s response to the Commission’s written submissions.

³⁷ Paragraph 4.12, Ryanair Appeal.

³⁸ Paragraph 4.26, Ryanair Appeal.

8.6.12 The Commission by way of reply set out *inter alia* details of meetings, telephone calls and correspondence between it and Ryanair on this issue of the “debt inflation shield” from May 2009 onwards. In addition to all of this engagement, the Commission also interacted with a variety of regulatory economists, including other European regulators none of which “*yielded any results concerning the concept of a debt-inflation shield*”³⁹.

8.6.13 Ryanair submitted that the Commission didn’t understand the point it was trying to make and therefore clearly couldn’t have adequately considered it prior to the Final Determination⁴⁰. It appears to the panel that there was considerable consultation and engagement by the Commission with Ryanair and others, on this issue. The Panel is of the view that it was open to the Commission on foot of the submissions made to it by all parties to reject Ryanair’s preferred approach to the cost of capital estimation. This is so even if one takes all of Ryanair’s calculations to be correct. The Panel is of the view that the Commission has followed an orthodox approach to the cost of capital estimation. It is an approach which is well recognised and utilised in regulation. By contrast, Ryanair’s suggested approach is not. While the Commission has made a determination at the high end of the reasonable range using this orthodox approach, it is within the reasonable range.

8.6.14 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review.

8.7 X-factor 007 - 2009:

8.7.1 Ryanair alleged that, contrary to what the Commission says, it never in fact intended in the 2005 Determination to have an X Factor that allowed for Airport Charges at Dublin Airport to increase in real terms. Instead it submitted that the

³⁹ Paragraph 38, the Commission’s written response to Ryanair’s Appeal.

⁴⁰ Page 115, line 3 onwards, transcript of Ryanair oral hearing, 29 April 2010.

evidence points to an “*error made by the Commission which went unnoticed by users in the consultation process prior to the 2005 Determination*”⁴¹.

8.7.2 It submitted that the Commission’s assertion that no error occurred is inconsistent with its admission in CP3/2009 that a negative X gives rise to pricing falling in real terms and with the Commissioner’s confirmation (at meetings with Ryanair during the consultation process) that the formula into which the X was applied was intended to be changed between the 2001 and 2005 determinations⁴². Ryanair submitted that Mr. Guiomard’s comment that “*the X causes prices to fall*”⁴³ shows that it was not being used as an efficiency factor, but as a smoothing factor⁴⁴.

8.7.3 Ryanair also submitted that there was no “*appropriate notification or consultation regarding either the swing in the X Factor from positive to negative or to the formula changes or explanatory notes referred to by the Commissioner*”⁴⁵.

8.7.4 The Panel is of the view that there is no merit to this submission as a basis for referral back for review. The Panel is of the view that the regulatory position should have been clear to any reasonably informed analyst at the time and it would be disproportionate to ask the Commission to reconsider every aspect of a determination where the explanation could have been a little clearer.

8.7.5 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review.

⁴¹ Paragraph 6.3, Ryanair’s written response to the Commission’s written submissions.

⁴² Paragraphs 5.11 and 5.12, Ryanair Appeal.

⁴³ Transcript of meeting between Ryanair and the Commission, Ryanair File D, Tab 1.

⁴⁴ Page 146, line 18, transcript of Ryanair oral hearing, 29 April 2010, Martin Hayden SC for Ryanair.

⁴⁵ Paragraph 6.13 of Ryanair’s written response to the Commission’s submissions.

8.8 T1X Incremental Revenues and Remuneration:

8.8.1 In the Final Determination the Commission has included T1X capex in the RAB but at the same time, for the purposes of deriving a price cap, has calculated the return on and return of capital allowed to exactly equal the forecast incremental commercial revenues associated with the project. As the Commission had no published incremental revenue forecasts for T1X, it assumed that the project will generate €5m extra per year⁴⁶. The Commission stated that this approach “is consistent with what was proposed in the 2007 interim review” in that it “has made an allowance for the recovery of costs associated with this investment that exactly offset the assumed commercial revenues. It is charges neutral such that a higher or lower forecast for these incremental revenues would not affect the allowed airport charges”⁴⁷.

8.8.2 Ryanair submitted that the approach is not consistent with the approach proposed in the 2007 interim review. It submitted⁴⁸ that the policy the Commission stated it would adopt in its 2007 interim review was set out at page 30 of CP6/2007 as follows:

“A further €55 million relates to T1X. While the Commission will add this to the RAB if the DAA proceeds with the project, the Commission still intends only to offset the costs of T1X with demonstrated increases in commercial revenues accruing from the project. The project should be charges neutral. The increases in commercial revenue will have to be relative to current trends” (emphasis added by Ryanair).

8.8.3 Ryanair submitted that in circumstances where no evidence had been produced either by DAA or the Commission that demonstrated any increase in commercial revenues accruing from the T1X project that it was not correct for the Commission to assert that it is “charges neutral”. It submitted that such an “assertion can only be valid if it can be established that the revenues that the Commission has estimated should be attributed to T1X are in fact incremental

⁴⁶ Paragraph 8.28, CP4/2009.

⁴⁷ Paragraph 7.27, CP4/2009.

⁴⁸ Paragraph 6.3, Ryanair Appeal.

revenues to the airport”⁴⁹ and not at the expense of commercial revenues in other retail areas in T1.

8.8.4 Ryanair submitted that *“as a consequence, the capital costs should be removed from the price cap calculation but the estimated commercial revenues of T1X should be added to the estimated Commercial revenues for the remainder of T1 and included in the single till.”*⁵⁰

8.8.5 By way of reply the Commission reasserted that it has followed an approach consistent with how it indicated it would treat the investment when it made an allowance for the projects in the 2007 interim review and referred the Panel in particular to the following references:

- *“Maximum Levels of Airport Charges at Dublin Airport Final Decision on Interim Review of 2005 Determination, CP6/2007, July, pages 1, 3, 9 Table 2 page 25, 26, [at Ryanair File B, Tab 1]*
- *Draft Decision Interim Review of 2005 Determination on Maximum Levels of Airport Charges at Dublin Airport, CP5/2007, May, pages 13, 64-67, 88, Table 1 page 94, 111-113 [at Ryanair File B, Tab 2]”*⁵¹

8.8.6 The Commission also referred the Panel to certain sections of its Final Determination; Draft Determination; issues paper and written response by DAA and DACC on T1X⁵².

8.8.7 The Commission submitted that *“Ryanair’s appeal appears to be based on the belief that T1X concession retail revenues are not incremental revenues”* and

⁴⁹ Paragraph 6.10, Ryanair Appeal.

⁵⁰ Paragraph 6.12, Ryanair Appeal.

⁵¹ Paragraph 47, the Commission’s written response to Ryanair’s Appeal.

⁵² Paragraph 50, the Commission’s written response to Ryanair’s Appeal.

invited the Panel to refer to the spreadsheet model that accompanied the Final Determination in seeking to establish whether this concern was correct or not⁵³.

8.8.8 At the oral hearing, Ryanair submitted a spreadsheet to the Panel, based on the Commission's own "ready reckoner" and submitted that when you take out the €5million on each side of the equation, it is not revenue neutral as suggested by the Commission – one is left with an unexplained deficit of over €4million (the revenue requirement drops from 692.9 to 688)⁵⁴. This discrepancy, Ryanair submitted, is not explained.

8.8.9 It appears to the Panel that Ryanair's appeal is not based, as suggested by the Commission, on "*the belief that TIX concession retails revenues are not incremental revenues*" but rather on the basis that no evidence has been adduced to suggest that there are any incremental revenues associated with TIX at all. If there is no evidence that there are any incremental revenues associated with the capital spend on TIX then it is inappropriate for the Commission to "assume" such incremental revenues to allow the capital expenditure into the RAB when it previously indicated it would only "*offset the costs of TIX with demonstrated increases in commercial revenues accruing from the project*"⁵⁵. As to the evidence required to assess the level of any incremental revenues, the position is complicated by the need to establish a counterfactual position, i.e., what would retail revenues have been in the absence of the investment? This is a matter that does not appear to have been satisfactorily addressed in the Determination.

8.8.10 It is the Panel's view that many of the issues raised here could be more readily identified and dealt with if a more efficient and transparent accounting system, particularly in relation to the accounting of retailing revenues, was adopted by the regulated entity. This is discussed further at 8.10 below.

⁵³ Paragraph 51, the Commission's response to Ryanair's Appeal.

⁵⁴ Pages 159 and 160, transcript of Ryanair oral hearing, 29th April 2010.

⁵⁵ Page 30, CP6/2007.

- 8.8.11 It is the view of the Panel that there does appear to be an inconsistency in the Commission's approach to T1X capital expenditure in its Final Determination and the approach it indicated it would take in the 2007 interim review. It is accepted by all parties that regulatory consistency is extremely important and while this cannot always be achieved and maintained in all areas, if there is to be a change in approach the reasoning behind such a change should be fully set out and considered.
- 8.8.12 It is not sufficient for the Commission to simply "assume" an increase in revenue and assert that it is therefore charges neutral (which Ryanair submits it is not). The Commission should have taken appropriate steps to satisfy itself that its assumption in this regard was correct. The Panel is of the view that a greater effort should have been made by the Commission to secure more detailed information from DAA regarding total T1 revenue to allow it ascertain the level of increase in T1 retail revenue and in particular what portion of revenue (if any) can be attributed to the T1X improvements. Such an exercise would have highlighted the issue raised by Ryanair in this ground of appeal and clarified whether adjustments needed to be made to reflect any underperformance of retail revenues arising from the T1X works. The Commission's task in this regard would be made considerably easier if the Panel's recommendations, below, regarding a more efficient and transparent accounting system were adopted.
- 8.8.13 In the circumstances the Panel considers that sufficient grounds HAVE been established to refer this aspect of the Commission's decision back for review. Specifically, the Commission should carry out an analysis of the extent of incremental retail revenue attributable to T1X (if any) before allowing the capital expenditure associated with this project into the RAB.**

8.9 Excessive Costs of Capital Allowed:

- 8.9.1 Ryanair submitted that the Cost of Capital that has been determined by the Commission is inappropriately high as it makes no appropriate reduction in the cost of capital to account for reductions in the risk allocated to that entity⁵⁶.
- 8.9.2 Ryanair submitted that the *“Commission’s policy of limiting the exposure of the DAA to the risk of actual traffic volumes not reaching forecast levels within regulatory periods by resetting the bar at each new determination and thereby transferring all long term risk for to users, does not appear to Ryanair to have been taken into account by the Commission when assessing the level of risk to which the regulated entity is exposed for the purposes of calculating an appropriate cost of capital”*⁵⁷.
- 8.9.3 The Panel was also referred to Burkard Pedell’s book, *“Regulatory Risk and the Cost of Capital”*⁵⁸ at the oral hearing, on this issue.
- 8.9.4 At the oral hearing, the Panel queried whether Ryanair had any evidence or data, on relevant comparators, that they wished to present to show how much they would expect the debt premium to be (assuming it will never be zero)⁵⁹. The Panel received some data by letter dated 7 May 2010. This does support the argument that the assumed debt premium is on the high side however, given the differences in timing and conditions among the loans quoted, the Panel is of the view that it is not decisive and ultimately it did not affect the Panel’s decision on this issue.
- 8.9.5 The Commission pointed to the orthodox approach used, estimating weighted average costs of capital (WACC), making use of the capital-asset pricing, as it has done in previous determinations. It also referred the Panel to the Issues Paper inviting comments on the approach the Commission might use to estimate the cost

⁵⁶ Paragraph 7.1 and onwards, Ryanair Appeal.

⁵⁷ Paragraph 7.7, Ryanair Appeal.

⁵⁸ Published by Springer, 2006; page 163, line 26 onwards, transcript of Ryanair oral hearing, 29 April 2010.

of capital⁶⁰. Following the Draft Determination, which set out proposed ranges for the various components making up the WACC calculation, as well as the point value it proposed to use, Ryanair responded and argued for an equity-risk premium of zero. Paragraphs 8.144 and 8.145 of the Final Determination sets out the Commission's response to this. The Commission also referred to the meeting between the Commission and Ryanair, prior to the Final Determination, on 23 September 2009 where there was some discussion on DAA's cost of capital⁶¹ and to what it described as "*a long history of discussions on the cost of capital, demand risk and financial viability*"⁶².

8.9.6 For its part, Ryanair replied that while the above mentioned documentation sets out the Commission's thinking on the Cost of Capital, it does not specifically point out where the issues highlighted by Ryanair under this ground of appeal are addressed⁶³. The Commission has assumed a real cost of debt of 4.1% in the Final Determination⁶⁴ and it acknowledges that this is now towards the higher end of the scale⁶⁵. The Panel is of the view that the Commission is entitled to make such a judgment, at the higher end of the scale, provided it is within that reasonable scale.

8.9.7 Ryanair submitted that this is not within a reasonable scale. However, in order for the Panel to assess whether the Commission is in fact significantly outside a reasonable scale, a comparator or data to that effect is required. Ryanair submitted that the Commission itself has not made clear what it used as a comparator.

8.9.8 This leads on to another point argued by Ryanair, regarding transparency. It submitted that while the Commission indicated it was "*sympathetic to the*

⁵⁹ Per Prof. Yarrow, page 165, line 15 onwards, transcript of Ryanair oral hearing, 29 April 2010.

⁶⁰ Paragraph 54, the Commission's response to Ryanair's Appeal.

⁶¹ Page 15, the Commission's response to Ryanair's Appeal.

⁶² As set out in the table on page 16, the Commission's response to Ryanair's Appeal.

⁶³ Paragraph 8.1, Ryanair's response to the Commission's submissions.

⁶⁴ Paragraph 8.152, CP4/2009.

⁶⁵ Paragraph 8.148, CP4/2009.

*argument that the costs of debt should be lower if the Commission's statutory objective relating to financeability is interpreted as offering the DAA the option of high airport charges to meet debt obligations regardless of the circumstances that lead to such a situation"*⁶⁶ it did not in fact make any adjustment, nor did it identify any adjustment it did make.

8.9.9 The difficult task for the Panel is that there are a series of individual calculations involved in the cost of capital. It requires the exercise of judgment on a whole set of detailed issues. It is not, in the Panel's view, appropriate to cherry pick one aspect, even if it is significant component, and seek to vary it without looking at the whole. This is especially so when the Panel is being asked to assess one component in the abstract. In absence of information that suggests that the Commission's determination on this issue clearly falls outside the reasonable scale for this kind of debt the Panel is not inclined to refer matters back to the Commission for review.

8.9.10 Even if such information were available, the issue would then have to be considered in the context of the overall cost of capital estimation, as a less generous view taken by the Commission on one component may be counterbalanced by a more generous view on another component.

8.9.11 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.

8.10 Regulated Entity Accounts and Accounting Practices:

8.10.1 Prior to the Final Determination Ryanair submitted to the Commission that:

- a) *"The manner in which the Commission is dismissive of all queries relating to the historical audited accounts of the regulated entity and the lack of understanding displayed by the Commission regarding the importance of*

⁶⁶ Paragraph 8.144, CP4/2009, quoted at paragraph 7.7 of Ryanair Appeal.

those accounts is a matter that is of concern to Ryanair.

- b) It defies logic that ex-post analysis of audited regulatory accounts is not carried out by the commission and made available to users that would or could substantiate whether or not super-normal profits are being earned by the regulated entity.*
- c) It is equally illogical that the commission could elect to fix a price cap without a detailed knowledge of the most pertinent information about the cost base of the company that can only be gained from a detailed understanding of and familiarity with both the process of cost allocation from the DAA into the regulated entity, and from an understanding of the cost base of the company gained from a knowledge of its historical performance.*
- d) No determination can or should be finalised until such time as this substantial information deficit is rectified. It should be confirmed that the requisite skills exist within the office of the regulator and that those skills are being applied analytically, on an ongoing basis as an integral part of the process of determining price caps for Dublin Airport”.*

8.10.2 The Commission responded to this at paragraph 1.10 of CP4/2009 as follows:

“Information relied on by the Commission to help make this Determination includes information already in the public domain, as well as information provided by the DAA or other interested parties. In some cases, parties provided the Commission with information that it had not sought; in other instances, the Commission made a request for such information. When possible, the Commission has placed such information in the public domain. More generally, the Commission has sought to satisfy itself that information provided to it is consistent with other available information. For example, the Commission has checked that more disaggregated data provided by the DAA are consistent with the regulatory accounts that the DAA prepares. The regulatory accounts themselves are not in the Commission’s view, especially helpful for the purposes of making a determination governing the period 2010-2014. The Commission has sought more detailed information from the DAA than is available from the regulatory accounts. Moreover, the regulatory accounts are backward looking, whereas the Determination sets a price cap for future periods and so the Commission needs to form a view on how costs and revenues at the airport are likely to evolve. For these reasons, the Commission has not sought to undertake the kind of analysis of the DAA’s regulatory accounts that

Ryanair argued was necessary in its response to the draft determination. Extracts from the DAA's 2007 and 2008 regulatory accounts have been published."

8.10.3 Ryanair submitted that this approached by the Commission is fundamentally flawed:

*"the Commission's policy of not grounding its determinations regarding Airport Charges on accurate and appropriate accounting information, whether to reconcile previous expected outcomes with actual performance on an ex-post basis, or to analyse historical performance with a view to making ex-ante forecasts, or to ensure that the available Accounts are "fit for purpose" through input and control of the basis on which those accounts are prepared, fundamentally undermines the regulatory process itself and calls into question the rationality of the determinations made, and absolutely denies both users and the Regulator information that is required to appropriately consult in relation to Determinations"*⁶⁷.

8.10.4 Ryanair also referred to a letter, dated the 11 June 2009⁶⁸ and obtained under the Freedom of Information Act, which it stated confirmed that the Commission did not have sufficient accounting information at its disposal to enable calculations of costs and revenues to be properly analysed into those relating to Commercial Activities and those relating to Aeronautical Activities. The letter *inter alia* states:

"The Commission does not make an apportionment of costs between regulated charges and commercial property charges due to its use of a single till to calculate charges. Consequently the Commission does not have any documents, notes, minutes explaining the apportionment of costs between regulated charges, and commercial property related charges. As a result, it has no documents furnished by the DAA within the past five years, or minutes between DAA and the Commission at which such apportionment of costs was discussed".

⁶⁷ Paragraph 8.7, Ryanair Appeal.

⁶⁸ Ryanair File B Tab 5, page 5.

8.10.5 By way of reply, the Commission stated “*it is not clear exactly what ex post analysis it believes the Commission should take*”⁶⁹. It pointed to its 2008 Issues Paper which it submitted contained various charts and tables setting out the 2005 regulatory targets and outturn data for various series⁷⁰. It submitted that for the Draft Determination the forecast passenger numbers and levels of operating costs and commercial revenues were all made with reference to past performance and that in relation to operating costs DAA’s performance was reviewed by consultants in 2008 and the report published with the Draft Determination⁷¹. It refers to sections of the Final Determination and in particular to paragraph 1.10 (already quoted at 8.10.2 above)⁷².

8.10.6 The Commission also confirmed that the 2009 Determination was the first Determination that the Commission made where parties have had extracts of the regulatory accounts of the DAA (for the years 2007 and 2008). It stated that “*it used the information in these regulatory accounts, along with previously published information on the Regulatory Asset Base (RAB), to estimate the Return on RAB shown in Table A4.2 of the Final Determination*”⁷³. The Commission also referred the Panel to annual compliance reports, published since 2002 (save for years in which in a new Determination is made), on the DAA, the purpose of which is to ensure that DAA has complied with the prevailing price cap⁷⁴.

8.10.7 The Commission also submitted that it invited Ryanair to set out what additional information it thought the Commission should seek and how it might use such information and that Ryanair’s response, while critical of the accounting information available, was “*unclear*” as to “*precisely what extra information was necessary or how such information might be used, other than as a check that DAA had not been making excessive returns*”⁷⁵.

⁶⁹ Paragraph 60, the Commission’s response to Ryanair’s Appeal.

⁷⁰ Paragraph 61, the Commission’s response to Ryanair’s Appeal.

⁷¹ Paragraph 63, the Commission’s response to Ryanair’s Appeal.

⁷² Paragraph 65, the Commission’s response to Ryanair’s Appeal.

⁷³ Paragraph 66, the Commission’s response to Ryanair’s Appeal.

⁷⁴ Paragraph 67, the Commission’s response to Ryanair’s Appeal.

⁷⁵ Paragraph 69, the Commission’s response to Ryanair’s Appeal.

8.10.8 At the oral hearing Ryanair confirmed that it has not been provided with the audited accounts they had sought from the Commission, which the Commission had indicated would be provided⁷⁶. Ryanair queried whether there are any audited accounts and/or whether the accounts are fit for purpose.

8.10.9 In relation to the information available to the Commission Ryanair submitted that the Commission “*has failed to ground its determination on solid, reliable and properly verified accounting information*”⁷⁷. In relation to the ex-post analysis it submitted that this should be “*an ex-post analysis of the results of previous determinations by reference to Audited Accounts of the regulated entity’s affairs for the periods governed by the previous determinations*”⁷⁸.

8.10.10 Ryanair submitted that it is precisely because the Commission makes determinations that are forward looking and necessarily involve forecasts, that an appropriate variance analysis of forecasts to outcomes is carried out, as outcomes tend to differ from forecasts. Such a variance analysis it submitted, is necessary to ensure that future forecasts and determinations can be properly grounded⁷⁹. That variance analysis in turn depends on the validity and accuracy of the accounting information used in preparing the analysis⁸⁰.

8.10.11 It is the view of the Panel that it is normal and good business practice that variance analysis is carried out to compare what actually occurred versus what was forecasted / budgeted to occur. This is regarded by businesses as a vital tool in the business planning process. The fact that this has not been the practice within this regulatory system heretofore is not an argument against adopting such an approach in the future. There is no reason why a management information system cannot be implemented to carry out a detailed variance analysis comparing

⁷⁶ Page 192, line 5, transcript of Ryanair oral hearing, 29 April 2010; and paragraph 9.10 Ryanair’s written response to the Commission’s submissions.

⁷⁷ Paragraph 9.1, Ryanair’s written response to the Commission’s submissions.

⁷⁸ Paragraph 9.2, Ryanair’s written response to the Commission’s submissions.

⁷⁹ Paragraph 9.3 and 9.4, Ryanair’s written response to the Commission’s submissions.

⁸⁰ Paragraph 9.6, Ryanair’s response to the Commission’s submissions.

forecasts to actual outcomes. It seems axiomatic to the Panel that a backward view is important in assessing a business' future needs and for improving its efficiency and accountability. Furthermore, the absence of detailed accounting information creates suspicion and confusion amongst users and may lead to protracted procedures in finalising determinations.

8.10.12 The single till is an inheritance from an earlier period when commercial revenues were a smaller part of airport income; airports were closer to public utilities and accounting methods (lacking the benefits of modern IT) were less able to make sensible cost allocations among different activities. These things have changed yet regulatory systems tend to exhibit considerable inertia in responding to the changes. A cursory analysis of regulated entity accounts without a more detailed consideration of the cost allocation process in light of these significant changes is therefore difficult to justify. It is not for the Panel to comment on alternatives to the single till, but within the current regulatory arrangements there is considerable scope for improving both the analysis of the commercial revenue issues and the accounting. It appears to the Panel that by merely using the information contained in the regulated entity accounts prepared by DAA to estimate the return on the RAB the Commission is not doing enough to satisfy itself that there is no cross subsidisation between the regulated and commercial activities of DAA. The Panel are conscious that there are limits on the resources that are available to the Commission in carrying out its regulatory duties. However, DAA prepare separate regulated entity accounts⁸¹. With DAA's sophisticated IT systems DAA should be able to produce divisional financial accounting information in any way that may be required (retail / regulated / other) including a separate analysis for T1 and T2.

8.10.13 Nevertheless, on balance and save where expressly identified above (e.g. in relation to T1X) the Panel's view is that it would be a disproportionate burden to require the Commission to carry out such a variance analysis at this stage and review its entire Determination in light of this analysis for this regulatory period.

⁸¹ Page 21, line 11, transcript of oral hearing 30th April 2010, Mr. Gray for DAA.

8.10.14 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission’s decision back for review. However, the Panel recommends that regulated entity accounts, with detailed divisional analysis should be prepared by DAA and variance analysis be carried out by the Commission for future Determinations.

8.11 Failure to adequately consider Costs of Competitiveness of Services at Dublin Airport:

8.11.1 Following the Draft Determination Ryanair offered to provide confidential data on the charges it pays at a variety of other airports. It also suggested that the commission might seek similar information from other airlines at Dublin Airport. The Commission did not take up Ryanair’s offer.

8.11.2 Ryanair submitted that the Commission failed to take account of the effect of competition at Dublin airport and made no attempt to survey, review or study the trends of pricing at international airports or the effect of competition on airports which it alleged has resulted in substantial price reductions for airport users and sought a referral of this aspect of the Determination.

8.11.3 Paragraphs 11.24 – 11.27 of the Final Determination refer to the cost of competitiveness of airport services at Dublin Airport. Paragraph 11.27 provides as follows:

“Following the draft determination, Ryanair offered to provide confidential data on the charges it pays at a variety of other airports. It also suggested that the Commission might seek similar information from other airlines at Dublin airport. The Commission did not pursue this offer since it concluded that the other sources of evidence on charges that it had looked at were more relevant, and also sufficient, for the purposes of making a determination. The Commission’s task is to make a determination governing all airport charges that the DAA may collect at Dublin airport. Data sources relating to what other airports are collecting, rather than

what certain individual airlines pay at different airports (which may reflect particular deals they have struck), provide a better insight into the overall competitiveness of Dublin airport. Moreover, the Commission considered that it already had sufficient evidence to conclude that Dublin airport was neither the cheapest nor most expensive airport around, and that to satisfy its statutory objectives relating to efficient operations at Dublin airport and to allow the DAA to operate the airport in a sustainable and financially viable manner, the Commission would have to set the charges in recognition of the DAA's position regardless of what data from individual airlines showed about how the charges they pay at Dublin airport compare to what they pay at other airports."

8.11.4 In its reply to Ryanair's Appeal the Commission also referred to Panel to the section on "Target level of service quality" in its Issues Paper (October 2008) which contains a discussion on how airport charges at Dublin compare to those at other airports in the Airports Council International (ACI) survey⁸².

8.11.5 The Commission also referred the Panel to a slide presented by DAA at a capex consultation meeting between the DAA and airport users on 8 April 2009 together with the transcript of the meeting⁸³.

8.11.6 Ryanair replied by saying the documentation and consultations referred to by the Commission were not sufficiently up to date to be relied on at the time of the Final Determination⁸⁴. At the oral hearing it also submitted that the airports used by DAA for comparative analysis are inappropriate, submitting that Manchester is a more appropriate comparator.

8.11.7 The Panel is satisfied that the analysis carried out by the Commission was sufficient for it to consider the issue of the cost of competitiveness of services at Dublin Airport in accordance with its statutory objectives.

⁸² Paragraph 72, the Commission's response to Ryanair's Appeal.

⁸³ Paragraphs 73 and 74, the Commission's response to Ryanair Appeal.

⁸⁴ Page 24, paragraph 10.1 and onwards, Ryanair's written response to the Commission's submissions.

8.11.8 In the circumstances the Panel considers that sufficient grounds have NOT been established to refer the Commission's decision back for review.

9. CONCLUSIONS:

9.1 The Panel's concludes that sufficient grounds have been established by Ryanair to refer the following matters back to the Commission for review:

(a) Differential pricing: the Panel refers this matter back to the Commission for it to consider how best differential pricing might be initiated.

(b) T1X Incremental Revenues and Remuneration: the Commission should carry out an analysis of the extent of incremental retail revenue attributable to T1X (if any) before allowing the capital expenditure associated with this project into the RAB.

9.2 Furthermore, while sufficient grounds have not been established for a review for this regulatory period, the Panel recommends 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.

Dated 1 June 2010

Michael Durack SC

Professor George Yarrow

John Butler CPA