

**MAXIMUM LEVELS OF AVIATION TERMINAL SERVICE CHARGES that
may be imposed by the Irish Aviation Authority
ISSUE PAPER CP3/2010
COMMENTS OF AER LINGUS**

1. Introduction

A safe, reliable and efficient terminal navigation service is paramount to Aer Lingus' operations. Aer Lingus welcomes the opportunity to comment on the Commission for Aviation Regulation's planned determination process for the period from 2012.

Aer Lingus' prime concern with respect to the economic regulation process is that there are the necessary controls and incentives to drive the terminal navigation service provider to conduct its business in the most efficient and cost effective way possible and in a manner which meets the operational requirements of airlines.

As with other carriers, Aer Lingus has in recent times undergone major structural changes and has focused on strategic initiatives to radically reduce its costs and improve the quality of its service. It is therefore necessary for airlines to have productive working partnerships with the various service providers and it is incumbent upon those service providers upon whom airlines depend to have a similarly progressive approach to costs and quality.

While the Issues Paper invites comments on a number of specific points, Aer Lingus is primarily concerned with the overall strategic effectiveness of the regulatory process. During these challenging economic times and in particular the latter parts of the present regulatory period, Aer Lingus, like other airlines, has had to deal with very significant increases in the cost of terminal navigation in Ireland. These high charges, with significantly greater rates of increase than other regions, are well documented elsewhere. It is generally accepted that these charges have been detrimental to the combined business interests of the service provider and the affected airlines by depressing consumer demand. Indeed, the recent reduction of the airport departure tax by the Government recognises the link between lower costs and traffic volumes.

The concern with the recent price increases is that they have been able to happen under and in line with the regulatory process methodology. As a result, the regulatory process has not provided effective protection to the vulnerable airline community in these difficult times. Therefore Aer Lingus urges the regulator to consider new and strategically inventive ways to control the cost of terminal navigation services in Ireland.

Aer Lingus supports and looks forward to participating at all stages of the regulatory process and will work with the Commission as it puts forward new and progressive initiatives. As stated previously, the changes to the regulatory process need to be more than mere adjustment of the parameters into the existing regulatory formula. Instead, fundamental change to the regulatory process is required to ensure that costs are controlled and that the service provider operates to the highest levels of service at a competitive price.

In addition to addressing the specific issues raised, Aer Lingus takes this opportunity to set out the principles and objectives that should be pursued and achieved during the regulatory process.

2. Approach to regulation.

A key objective of the regulatory process is that it creates a scenario that drives the service provider to operate in the most efficient way possible in the absence of competition. The regulatory process should be progressive and dynamic and encourage the service provider to align itself with best international practice to ensure that it performs well in an increasingly competitive environment. The service provider ought to be incentivised to improve cost efficiency and should be subject to the same principle of risk and reward that would exist in an open market.

Economic regulation should enable the regulator to motivate the service provider through incentives and targets in order to ensure that the service provider operates to the best levels of service and cost efficiency. Aer Lingus is in favour of the Terminal Service Unit approach to terminal navigation charging set out in EC Regulation 1794/2006. Aer Lingus would suggest that the new standard should be used in all instances so as to increase understanding and clarity on the charging rate.

With respect to risk sharing, it is unacceptable that airlines face systematically higher unit rates at a time of reduced traffic. Commercial sensitivities make it incumbent upon airlines to find ways and means to conduct their business so that they can respond quickly to changes in market demand. This is despite the significant cost of fixed assets and also the difficulties of accessing variable numbers of staff which are driven by changes to flight schedules. Therefore, the service provider should have to face the same economic realities as the airlines in this regard. To insulate the service provider from these economic realities is in stark contrast to how a competitive market would operate and creates an artificial environment for the service provider.

While the challenges of providing a TNS service that is fully cost elastic may be difficult, the 50% insulation provided under the current volume risk sharing formula is too limited and has led directly to the unprecedented recent increases in charges. Where traffic volumes fall, airlines are not only subject to the loss of revenue but are also subject to significant increases in costs under the current formula. It is therefore only reasonable that the service provider should face an equal amount of the risk of falling traffic volumes.

Aer Lingus agrees that the regulatory period should be reduced to 4 years to facilitate more regular price reviews and to facilitate harmonisation with any changes arising from the SES II Directives.

3. Quality of service:

Aer Lingus works on a continuous and committed basis with the service provider and other relevant parties to ensure that the best possible levels of service are delivered. This process is ongoing and exists outside of the economic regulatory context. However, with respect to the regulatory process, Aer Lingus supports a regime that ensures that the service provider faces the financial consequences for non-

performance. As an airline, Aer Lingus is subject to the direct and indirect consequences of flight delays and cancellations which inevitably result in very significant costs and lost revenue for the airline. For instance, the cancellation of flights due to the disruption caused by radar failure in July 2008 resulted in additional costs and lost revenue for Aer Lingus in excess of €1 million.

There are numerous studies and analyses which demonstrate the actual costs involved and Aer Lingus would welcome involvement in further analysis during the regulatory consultation process. However, at this juncture, Aer Lingus would suggest that two appropriate reference points are the Eurocontrol Westminster Report¹ and also the provisions of EU Regulation 261/2004. By definition, airlines face the direct consequences of non-performance and therefore each element of the service delivery chain should be aligned to those adverse consequences. In this regard, the Commission should have particular regard to the recent customer consultation process with the UK service provider which resulted in three core delay terms being adopted which are deemed to more accurately reflect the actual financial impact on airlines of delays.

Efficient and on-time flight performance encourages passengers to travel and therefore there is an implicit motivation for all stakeholders to drive up the volume of traffic and to stimulate the greatest level of economic activity.

4. Traffic forecasts

As stated above, Aer Lingus expects that a mechanism be put in place to ensure that the service provider can react quickly to changes in traffic volumes. While Aer Lingus does not object to the use of the objective Eurocontrol traffic estimates, it would encourage the regulatory process to ensure that the service provider can respond to the relatively short-term season-to-season adjustments to airlines flight schedules. Airlines have a direct connection to the travelling public and therefore adjust their schedules to the levels of demand in the market place. While benefiting from the economies of scale, the costs and charges for TNC should be proportional rather than inversely proportional to the market demand.

5. Operating expenditure

As stated at the outset, Aer Lingus has undergone radical cost base transformation over the last 18 months and continues to do so. Many prevalent and major airline groups have had to deal with long established work agreements that have driven the cost of business to unsustainably high levels.

Aer Lingus encourages the Commission to use its unique position to rigorously scrutinise the service provider's cost base and to adopt the most progressive approaches to operating cost control. Aer Lingus would encourage the Commission to look at both the internal cost performance of the service provider and also the wider competitive opportunities that now exist in the terminal service market place. While the regulatory process cannot be the cost accountant for the service provider, it should

¹ Costs of Air Transport Delay in Europe, Institut du Transport Aérien, November 2000
www.eurocontrol.int/prc/gallery/content/public/Docs/stu2.pdf

create an overarching environment that drives the service provider to achieve best cost performance on an ongoing basis so that all stakeholders achieve the best return on their investments.

While Aer Lingus is not privy to the detailed accounts of the service provider, it certainly feels, through analysis of the information contained in the Issues Paper, that there is a marked opportunity to reduce costs. Aer Lingus has recent experience of working with staff representatives and third party suppliers to ensure that it achieved a lean cost base. While Aer Lingus appreciates and has supported the service provider in its efforts to reduce the service provider's staff cost base, Aer Lingus urges the regulator to raise the bar in challenging the service provider's business plans. Without a doubt there are elements of the expenditure that have increased disproportionately and significantly in recent years – these must be tackled from a cost perspective, e.g. staff cost, administration and meteorological services.

With respect to benchmarking and assessment of efficiency, the ultimate manifestation of success is increased volumes of air travel at sustainable fares. Consequently, the level of stimulated demand by the airlines will be an indication of an overall package of efficiency and productivity by the service provider. As recognised by the recent Air Travel Tax Charge reduction, lower costs should assist in driving demand. Therefore the level of traffic is actually the fundamental measure of aligned objective success. Finally, Aer Lingus agrees as is suggested in the Issues Paper that incentives should be rolling and not loaded to any part of the regulatory cycle.

6. Capital costs

Aer Lingus values capital spend as a mechanism for an organisation to make the investments necessary to meet changing business demand, adhere to mandatory changes and implement new systems that will improve overall efficiency. Therefore, Aer Lingus is supportive of capital expenditure that can deliver overall cost benefits.

In the context of the starting point for the RAB, Aer Lingus would support the CAR's suggestion of reducing the opening RAB by the amount of under-spend, plus an adjustment for interest earned on under-spend.

However, Aer Lingus feels that all expenditure, for example a new tower at Dublin Airport, must be justified by business and passenger demand. In addition, with reference to the asset life table, the figures shown should be reconsidered using best accounting standards.

7. Other issues

With respect to the timing of realising over and under-recoveries, Aer Lingus believes that with the implementation of a more dynamic regulatory framework, the instances of over and under-recovery will be dramatically reduced. Notwithstanding this, any deferment of an under-recovery is quite simply a postponement of a certain liability and therefore under normal circumstances, under-recoveries where appropriate should be dealt with in a manner which creates the lowest possible cost to the airlines taking into consideration the cost of financing the under-recovery by the service provider.

However, this approach should not be confused with the situation pertaining to 2010 where the service provider chose not to price up to the maximum price cap and, in doing so, created an automatic under-recovery which it now seeks to address. Such a decision to price below the cap for purely commercial reasons taken in view of prevailing economic circumstances should not be eligible for recovery in subsequent years.