

**Submission to the
Public Consultation on the
Review of
Airport Charges Regulation in Ireland**

16 September 2016

Commission for Aviation Regulation

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1. Executive Summary

The Commission, the body responsible for the economic regulation of airport charges at Dublin Airport, welcomes the findings of the report by Indecon International Economic Consultants which forms part of the Department of Transport Tourism and Sport's Review of the Regulatory Regime for Airport Charges in Ireland. We are at the disposal of the Department of Transport, Tourism and Sport and Indecon to provide clarifications on our response, or to provide additional evidence or analysis.

The paragraphs below provide a summary of our responses to the specific questions set out in the consultation paper. Section 2 provides some background to the current economic regulation of airport charges of Dublin Airport and subsequent sections address each of the questions posed by the Department's consultation document in more detail.

- Q1.** *Do you agree with the findings on market definition?* - While the definition of the market can be open to different views, the level of concentration is such that reaching a definitive view on the geographic market is not necessary.
- Q2.** *Should airports with significant market power be regulated?* - Airports provide an important and essential service. Where an airport holds market power, regulation is required to ensure it cannot use its dominant position to charge excessive prices, deliver lower capacity or offer a lower quality of service than airlines and passengers desire.
- Q3.** *When would you remove or impose regulation?* There is a continuum of market power, ranging from a perfectly competitive situation to a monopolistic one. If an assessment shows a significant change in the level of market power, it would be appropriate to adapt the regulatory model to fit the changing circumstances.
- Q4.** *Does Dublin Airport have significant market power and should it be regulated?* Dublin Airport holds significant market power which warrants economic regulation. Our Herfindahl-Hirschman index (HHI) estimate of 7,153 for 2015 indicates a very highly concentrated market and a presumption of significant market power. For comparison, we estimate the HHI for the UK airport market in 2015 at 1,410, and for the London market alone at 3,324.
- Q5.** *Degree of countervailing power held by airlines?* We have seen no evidence of countervailing power such that airlines can compel Dublin Airport to reduce prices, improve the quality of service, deliver particular capital projects or change other aspects of the service provided. Any countervailing power is severely limited by passenger preferences for Dublin Airport, the level of peak capacity utilisation and the costs to airlines of switching airport.
- Q6.** *Is there a need to promote competition and how?* We support the proposal to include the promotion of competition as a statutory objective. This will be a focus to review our approach to regulation to ensure it is appropriate to the level of competition for services provided by the airport.
- Q7.** *Who should carry out market power assessments?* We are best placed to carry out these assessments. We have the skills and knowledge base for such work, and as they would naturally be done between price determinations we would have the available capacity. We see efficiencies in a situation where the same body is responsible for both conducting market analysis and taking any necessary action based on the outcome of that analysis, as is common practice in many regulated industries.
- Q8.** *Are longer term proposals to enhance competition feasible? Impact on regulation?* If arrangements are put in place to enhance competition, there should be a reassessment of the

regulatory framework. We are not convinced that the need for economic regulation will be eliminated in the short or medium term. In the UK, approximately half of the London market share by passenger is enjoyed by the largest airport, Heathrow. This equates to about 30% of the overall UK share. Despite the level of competition among airports, of which there are five in the London area alone, the CAA has found that price cap regulation is still necessary at Heathrow.

- Q9. [Is single till price cap regulation the most appropriate at Dublin Airport?](#) Price cap regulation with a single till is the most appropriate regulatory model at this time. A single till approach most closely replicates how an airport setting charges in a competitive environment would operate. Discretion over the regulatory model should remain with the Commission and not be fixed in legislation as this allows for the timely adaptation of the regulatory framework as circumstances change.
- Q10. [Would more flexibilities improve regulatory regime and, if so, what?](#) There is flexibility in the current regime which historically has not been fully utilised. Using existing legislation, the Commission could substantially change the way it regulates Dublin Airport. We could, for example, establish an arrangement to facilitate more constructive engagement between Dublin Airport and airlines and put in place arrangements to ensure that passenger views are taken into consideration. We have started a process to introduce more flexibility and will be building on this over time.
- Q11. [Is a statutory basis for regulation warranted?](#) A continued statutory basis for airport charges is warranted. The current system allows the Commission regulate charges at Dublin Airport in a way which is appropriate to the current dominant position of Dublin Airport. If the market power of Dublin Airport was to reduce, a less intrusive regulatory regime may be more appropriate.
- Q12. [Do you support amending existing statutory objectives to focus more on passengers?](#) The removal of the interests of the regulated entity as a primary objective and a refocusing on the interests of existing and future passengers aligns with best regulatory practice. Enabling the financial viability of the airport should, instead, be a factor to which the Commission should have due regard.
- Q13. [Do you support promotion of competition as a statutory objective?](#) We support the proposal to include the promotion of competition as a statutory objective. This will be a focus to review our approach to regulation to ensure it is appropriate to the different levels of competitive services provided by the airport.
- Q14. [Should Ministerial Directions be limited and how enforced?](#) Ministers have the right to issue policy directions to deliver national policy. At the same time, independence is essential to ensure good regulatory outcomes. We note that the scope of Ministerial Directions varies among Irish regulators and suggest that any proposal to amend the current model should include a consideration of existing arrangements in other sectors.
- Q15. [Do you favour consultation of any Ministerial Direction of Capex?](#) Ministers would benefit from applying a clear and transparent consultation process as they would have the opportunity to consider the responses from interested parties to inform decisions.
- Q16. [Should there be more engagement before determination process? How facilitated?](#) We welcome Indecon's recommendations and suggest that they can be implemented without legislative changes. A clearly defined process would contribute to engagement that is meaningful, effective and aligned with the interests of airlines and passengers. We can play a facilitator role to encourage consultation that follows basic principles of accountability,

transparency, collaboration and trust.

We can develop guidelines giving effect to a meaningful dialogue between the airport and users. This could become part of the formal price determination process. For example, Dublin Airport could be required to demonstrate that they have gone through a prescribed process as part of their submission to the Commission, highlighting areas of agreement with airport users. To facilitate this process, the Commission can consider the appointment of an independent chair to encourage participation in the process and also to provide updates.

The Commission is of the view that the use of a licensing system would give it greater flexibility to ensure resilience and monitor compliance, combined with greater powers of enforcement. By way of example, any obligations placed on Dublin Airport in relation to consultation could be placed in its licence. It would also be the appropriate place to include obligations relating to the development of short and longer term investment plans or passenger obligations. As circumstances change, the Commission has the flexibility to amend the terms of the licence; following a clearly set out process.

- Q17. [Views on the establishment of a new consultative group on airport charges?](#)* We are of the view that this group should be an integral part of the process for Dublin Airport when they are preparing a submission to the Commission. We recommend that the group's terms of reference (and other matters including the level of detail to be provided by members of the group to each other) are determined by the Commission as part of the process referred to in Q16. The Commission plans to examine options around consultation in the coming year and will consult with all parties on how best to achieve the desired outcomes. We do not believe legislative change is needed for this.
- Q18. [Should CAR undertake research to ascertain views of users and how?](#)* Establishing a Consumer Challenge Group would sharpen focus on the views of passengers during an airport charges consultation and should become a formal part of that process. Consideration needs to be given to how this group is established, funded and its remit. By way of example, CAR could work with this group to determine the areas of interest that warrant research. Either CAR or the group could undertake research and include findings in the price determination process.
- Q19. [Should the current appeals process be abolished?](#)* We agree that the current process could be improved upon. However, before recommending it should be abolished we would encourage working with other agencies to undertake a rigorous assessment of the regimes put in place in other regulated sectors to determine the most effective model.
- Q20. [Views of the proposed appeals structure?](#)* We would welcome a review of our appeals process to be part of a wider review of appeals structures in other regulated sectors. This would inform any decision on the most appropriate structure to adopt.
- Q21. [What is the appropriate organisational structure for airport charges regulation?](#)* The current structure of the Commission enables it to fulfil its objectives cost effectively. We would welcome any expansion of our remit to include other functions either within economic regulation or administrative regulation. Additional functions would allow for additional efficiencies and also expand opportunities within the Commission, which would enable it to be better able to recruit and retain key skilled staff.
- Q22. [Options available \(incl. mergers\) to ensure the org. structure has sufficient critical mass?](#)* Price determinations are periodic, but the work involved is less cyclical than may be expected. Monitoring compliance, policy development and preparations for a determination all take considerable resources. That being said, the Commission would welcome additional functions as stated above. Countercyclical functions (e.g. market power assessments) may assist in

smoothing the work force requirements. At the same time, it is worth exploring efficiencies that can be gained from working more closely with or merged with another regulatory authority either within or external to the transport sector.

Q23. Interim actions strengthening CAR's regulatory functions? Enhanced links with other regulators? Continued and enhanced collaboration between regulators nationally and internationally can achieve substantial benefits. The Commission is actively involved in the Thessaloniki forum on airport charges which consists of all EU regulators of airport charges. Nationally, the Economic Regulators Network is a collaboration between the economic regulators in Ireland.

2. Background

Benefits of Regulation to Consumers

- 2.1 Regulation is commonly viewed as a second best solution, to be implemented where competition fails or is not feasible. The purpose of regulation is to simulate, as closely as possible, a competitive market outcome. A natural monopoly such as Dublin Airport has strong incentives to set airport charges above the competitive level which would result in a loss of consumer welfare. Imposing a price cap at what we estimate to be a competitive price is in the interests of airlines and passengers.
- 2.2 Given that an estimated 52% of passengers passing through Dublin Airport are residents of Ireland, and most of the others will spend money here, efficient airport charges have a significant positive effect on the wider Irish economy. Also, as a small open economy Ireland is highly dependent on international trade and foreign direct investment, and a decrease in air traffic activity would have significant indirect effects on a number of industries.
- 2.3 While it is difficult to ascertain the level of airport charges that would be set by Dublin Airport in the absence of regulation, Indecon note that on average, the price cap has been 36% lower than the price requested by Dublin Airport over the period 2001-2019. This equates to a saving of approximately €1.7 billion for airlines and passengers.
- 2.4 Airport charges make up a significant proportion of an airlines’ costs and thus a significant proportion of the ticket prices paid by passengers. As shown in Figure 2.1, for Ryanair €8 of the average fare of €47 goes on airport and groundhandling fees. In 2015, €10 of each one-way fare from Dublin went to Dublin Airport. We would expect that setting a cap on charges below the unconstrained level would increase airline demand, partially through an increase in the number of routes that can be operated profitably. There is strong evidence of competitive behaviour among airlines at Dublin; this implies that any cost savings or increases would be passed on to passengers.

Figure 2.1: Per Passenger Revenue and Cost for Ryanair in 2015

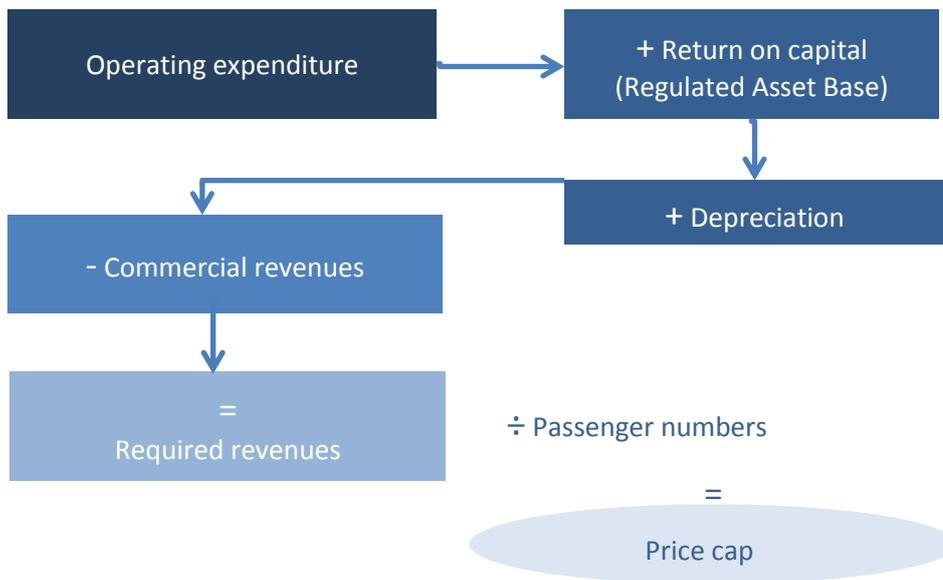


Source: Ryanair Annual Report

Approach to Regulation

- 2.5 The Commission sets a per-passenger price cap on the aeronautical charges that can be levied by Dublin Airport. The cap is based on allowances for operating expenditure, capital costs and commercial revenues. These are set at a level designed to replicate a competitive market. The required revenues are divided by the forecasted passenger numbers to arrive at the price cap. Figure 2.2 below describes this building blocks approach.

Figure 2.2: The Building Blocks Approach – Deriving a Price Cap



2.6 Under this arrangement an airport is incentivised to outperform these targets. In effect, instead of competing against other airports, Dublin Airport competes against targets set by the Commission. Dublin Airport keeps any additional profit from increased commercial revenue or reduced operating expenditure for a period of five years, at which point it is passed on to consumers. As the cap is set at a per passenger level, Dublin Airport is strongly incentivised to maximise the use of existing infrastructure and increase traffic. Efficient capital expenditure is incentivised through grouped capex allowances; any underspend on a project may be allocated to new or existing projects within that grouping.

Infrastructure

2.7 One of our three statutory objectives is to facilitate the efficient and economic development of Dublin Airport to meet the requirements of current and prospective users of Dublin Airport. Since the establishment of the Commission in 2001, Dublin Airport has been able to add significant capacity, improve the quality of service and maintain existing infrastructure.

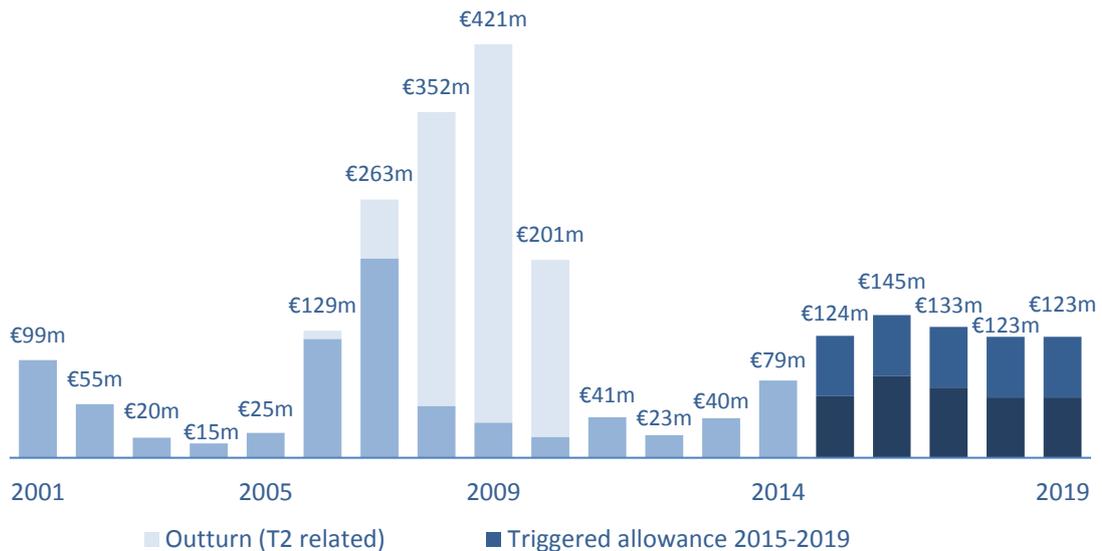
2.8 As part of the five year determination process, capital projects are carefully examined, and following a process of consultation, a decision is made as to the appropriate allowance and remuneration mechanism. Consultation for capital projects plays an important role in order to minimise the tendency of regulated monopolies to incur unnecessary costs, invest in capital projects that airlines/passengers do not need or fail to invest in projects that are required.

2.9 The Commission aims to ensure that only capital projects that are necessary and cost effective enter the Regulatory Asset Base (RAB) and get a reasonable rate of return. In the absence of regulatory controls, Dublin Airport would have a strong incentive to over-invest in order to increase the RAB and thus its profits. This would be to the detriment of airlines and

passengers¹.

- 2.10 The total amount of allowances made for capital expenditure since 2001, when price cap regulation was introduced, is in the order of €2.4 billion. For the construction of Terminal 2 alone a total allowance of €933 million was made between 2007 and 2010. The 2014 Determination allows €341 million of non-triggered capital expenditure and additional €308 million for triggered projects. About 80% of the triggered allowance will remunerate the North Parallel Runway Project.

Figure 2.3: €2.4bn of Capital Expenditure allowed from 2001 to 2019



Source: Dublin Airport outturn data (2001-2014), CAR 2014 Determination (2015-2019). Data in July 2014 prices.

Quality of Service

- 2.11 Price cap regulation should also encourage the provision of satisfactory quality of service levels for airlines and passengers. Therefore, in the 2009 Determination, the Commission introduced a link between the price cap and the quality of service delivered by Dublin Airport. The quality of service targets, 12 in total, were developed in consultation with stakeholders, and include metrics related to security queue times and baggage handling as well as passenger feedback on ease of movement through the airport, cleanliness and comfort, and helpfulness of staff.
- 2.12 A significant improvement in quality of service levels at Dublin Airport has been observed since the introduction of the quality of service targets and a monitoring system, see Figure 2.4 below. In the 2014 Determination, Dublin Airport risks losing up to 4.5% of its annual revenue should it fail to meet the targets set.

¹ In our response paper we refer to airlines and passengers as users of Dublin Airport as most of the references relate to these parties. However we fully acknowledge that, in legislation, user has a wider definition.

In the State Airports Act 2004, a user is any person –

- (a) for whom any services or facilities the subject of airport charges are provided at Dublin Airport,
- (b) using any of the services for the carriage by air of passengers or cargo provided at Dublin Airport, or
- (c) otherwise providing goods or services at Dublin Airport.

Figure 2.4: CAR Targets versus Increasing Satisfaction of Passengers at Dublin Airport



Source: ACI Passenger Survey Data reported by Dublin Airport.

Transparency

- 2.13 The Commission sets a price cap in an open, accountable and transparent way. Interested parties are afforded opportunities to make their views known through consultation processes. We publish views received from interested parties, stating whether we accept or reject the representations made and outlining our reasoning for any decision. We also meet regularly with interested parties to discuss policy issues.
- 2.14 We aim to make our decisions as transparently as possible; where submissions made are commercially sensitive, we seek other ways to make the same point to avoid including redacted information in our publications. Determinations made by the Commission can be appealed to the Minister who will setup an appeals panel to hear the grievances. Interested parties also have the option to judicially review our decisions. The Commission is also held accountable to the House of the Oireachtas.
- 2.15 The Commission has protected the interests of airlines and passengers by setting a price cap in the period 2001-2019 and setting minimum targets of quality of service since 2010. At the same time, we have had due regard to enabling the efficient and economic development of Dublin Airport by allowing over €2.4 billion of capital expenditure enter the regulated asset base. Finally, the Commission has enabled the financial viability of Dublin Airport by setting an appropriate price cap allowing Dublin Airport access the capital markets at reasonable rates, thus enabling investment for long-term growth.

Airport Charges Directive

- 2.16 In 2009 the European Union Airport Charges Directive (ACD) came into force.² The objective of the Directive is to establish a general framework setting common principles for the levying of airport charges at all EU airports with an annual passenger throughput of over 5 million passengers. A key provision of the Directive is to provide for mandatory consultation and information exchange between airports and airlines in relation to matters that may have a bearing on infrastructure development at airports, operational costs and airport charges. Where possible, the airport and airlines are encouraged to reach agreement on the level of airport charges.
- 2.17 The Directive does not replace the need for national regulation where an airport has significant market power. Rather it provides for the minimum level of consultation and transparency

² Directive 2009/12/EC of the European Parliament and of the Council of 11 March 2009 on airport charges, OJEU L70/11.

required in any system of setting or regulating airport charges.

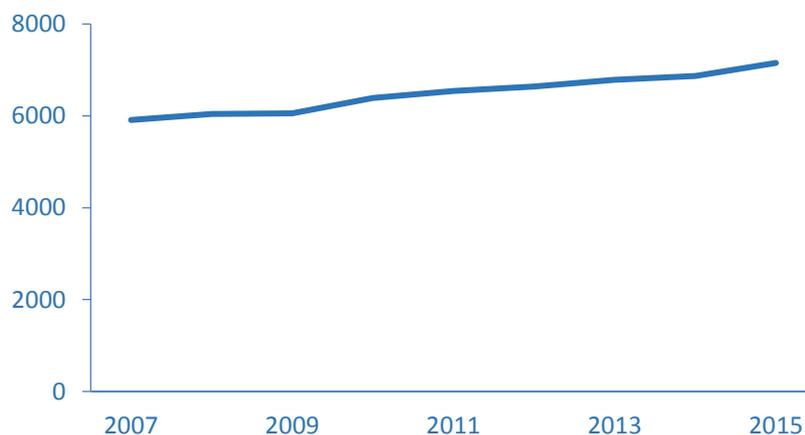
- 2.18 In total, the Directive applies to 69 of the busiest and most important airports in the EU. In Ireland and Northern Ireland, it only applies to Dublin Airport. The majority of these are subject to another form of regulation in addition to the directive. Only 19 are only subject to the Directive, 32 are subject to price cap regulation (including Dublin) and 15 are subject to another type of economic regulation (rate of return for example).³
- 2.19 We would note that the incremental burden imposed by price cap regulation at Dublin Airport is relatively low, given that much of the information required by the Commission in setting a price cap would need to be produced anyway to comply with the consultation and transparency requirements set up in the 2009 Airport Charges Directive.
- 2.20 The Commission is involved with the Thessaloniki forum of European airport regulators. The goal of this forum is to advise the European Commission on the implementation of the ACD, as well as to develop best practice guidelines on a range of areas related to the economic regulation of airports. The Commission is leading a subgroup to develop guidelines for consultation and setting the cost of capital.

³ SDG Evaluation of Directive 2009/12/EC on Airport Charges prepared for the European Commission.

3. Market Power

- 3.1 We agree with the finding that Dublin Airport holds significant market power. The dominant position of Dublin Airport is evident using any sensible measure of market power and any reasonable definition of the market. This market power, if left unchecked and unregulated, would result in a significant loss of consumer welfare. We agree with the finding that price cap regulation of Dublin Airport should continue given its level of market power. The Commission believes that periodic checks on the level of market power held by Dublin Airport is sensible and that regulation should be tailored to match the outcome of such assessments.
- 3.2 The trend is that Dublin Airport is becoming more dominant. All Irish airports were affected by the economic recession starting in 2008. Traffic at Dublin Airport fell by 22% from pre-recession peak to trough, Cork and Shannon airports fell by 37% and 64% respectively. However, Dublin Airport recovered more quickly and this has increased its market share and hence its increased dominance. 2015 traffic at Dublin was 35% ahead of the lowest recession point in 2010. Cork has yet to show any signs of recovery, while Shannon has seen some growth since 2013, but from a very low base post-recession. Figure 3.1 shows how the concentration in the Irish airport market has steadily increased since 2007.

Figure 3.1: Increasing Concentration* in Irish Airport Market

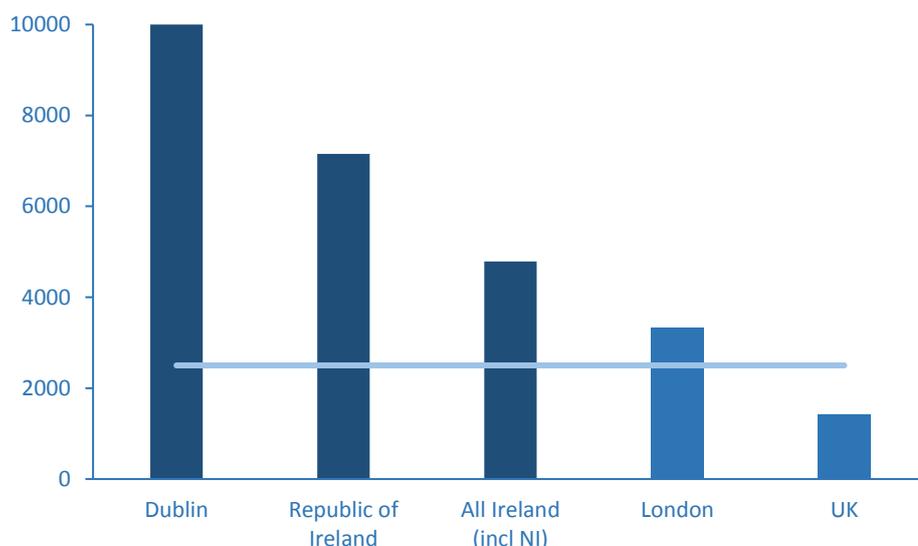


*Source: Passenger number data from CSO. *HHI ranges from 0 (perfect competition) to 10000.*

- 3.3 The concentration seen in the Irish airport market, driven by Dublin Airport, far exceeds the concentration in other airport markets where economic regulation is still deemed necessary. As seen in Figure 3.2 in 2015 the London market had a Herfindahl-Hirschman index (HHI)⁴ of 3,324 and the wider UK market 1,410, compared to 7,173 in the Irish Market.

⁴ The Herfindahl-Hirschman index (HHI) is a measure of market concentration calculated by summing the square market shares of each firm competing in a market. It ranges from close to zero (perfect competition) to 10,000 (monopoly).

Figure 3.2: Irish Airport Market is Highly Concentrated Relative to the UK



Source: 2015 Passenger number data from CSO and CAA

Do you agree with this finding on market definition? If not, what would you propose as a more appropriate definition?

- 3.4 Market definition has some inherent difficulties, but given the level of concentration in the airport market in Ireland reaching a definitive view on the geographic market is not necessary.
- 3.5 Any feasible market definition would not change the finding that Dublin Airport has significant market power and thus continued regulation is recommended. Even with wide definitions such as the island of Ireland, Dublin Airport completely dominates the market. When all airports on the island are included, Dublin Airport still has significant dominance with a market share of 67% in 2015.
- 3.6 It may be appropriate to go beyond Ireland if the market for transfer traffic is included. A passenger travelling from, say, Newcastle to New York must do so indirectly, and there should be competition for that transfer passenger. However, the competitive pressures in this segment is more likely experienced by the airlines rather than the airports. This does not take away from the fact that the transfer traffic is very important for Ireland as it makes marginal routes viable, thereby increasing connectivity.

Do you concur with the view that only airports which hold significant market power should be subject to economic regulation?

- 3.7 Airports provide an important and essential service. They contribute to connectivity and economic activity. Therefore, where an airport holds market power, regulation is required to ensure it cannot use this dominant position to charge excessive prices, deliver lower capacity or offer a lower quality of service than airlines/passengers desire. This monopoly behaviour could result in a loss of consumer surplus and a subsequent loss of economic activity. Economic regulation is necessary to emulate the effects of a competitive market, thereby preventing such an outcome. The type of regulation required depends on the market power of the airport.
- 3.8 Where an airport does not have market power, economic regulation is not required. In certain circumstances, even where competitive pressures exist, it may be prudent to have some oversight on how charges are set. For the most part, the Airport Charges Directive fulfils this function. The Airport Charges Directive requires that charges are set in a transparent non-

discriminatory way following consultation between the airport and airlines.

In what circumstances would you propose the removal of economic regulation in the airports sector, or impose it on airports which do not hold significant market power?

- 3.9 We would note that there is a continuum of market power, ranging from a perfectly competitive situation to a monopolistic one. If an assessment were to show a significant change in the level of market power, it may be appropriate to adapt the regulatory model to fit the changing market.
- 3.10 The current price cap model is designed to fit a situation where Dublin Airport holds significant market power. In the absence of significant market power, price cap or any other type of economic regulation is unnecessary and undesirable. However, even if the outcome of a market power assessment is the absence of significant market power of Dublin Airport, monitoring would be required under the Airport Charges Directive to ensure charges are non-discriminatory and set in it a transparent and consultative way.

Do you agree with the finding that Dublin Airport holds significant market power, which necessitates airport charges regulation for that Airport?

- 3.11 The Commission agrees that Dublin Airport holds significant market power which warrants economic regulation. Figure 3.1 traces the HHI index for the Republic of Ireland airport market from 2007 to 2015. The HHI index measures the level of concentration in a market based on the market shares of firms competing in that market. It shows clearly that the market has become more concentrated in that time. This trend has been driven by an increase in the market share held by Dublin Airport, from 75% in 2007 to 84% in 2015.
- 3.12 Indecon states that a market with a HHI estimate greater than 2,000-2,500 is deemed to be highly concentrated. This threshold is represented by the light blue line in Figure 3.2. Our estimate of 7,153 for 2015 indicates a very highly concentrated market and given that the market is overwhelmingly concentrated at Dublin, a presumption of significant market power. For comparison, we estimate the HHI for the UK airport market in 2015 at 1,410, and for the London market alone at 3,324.

Do you agree with Indecon's assessment of the degree of countervailing power held by airlines?

- 3.13 We have seen no evidence of countervailing power such that airlines can force Dublin Airport to reduce prices, improve the quality of service, deliver particular capital projects or change other aspects of the service provided. We would agree with Indecon that any countervailing power is severely limited by passenger preferences for Dublin Airport, the level of peak capacity utilisation and the costs to airlines of switching airport.
- 3.14 Where an airline, or airlines, holds significant countervailing power, this can act as a counterweight to an airport's own market power. By threatening the airport with a withdrawal of business, an airline may be able to force an airport to charge lower prices or change aspects of the service provided.
- 3.15 For such a threat to be effective, the airline must have a significant market share at the airport which the airport could not easily replace. It must be in the interests of the airport to comply rather than lose business from the airline. A threat must also be credible, in that the airlines must have a viable alternative location to move its business.
- 3.16 If airline users of Dublin Airport in fact had buyer power and could make a credible threat of switching airports, it would be in the best interest of any such airline and Dublin Airport to sign a bilateral contract. Bilateral contracts would allow Dublin Airport to reduce the passenger-

volume risk that would arise if airlines had buyer power and there was competition with other airports. These contracts would also allow the airlines to get an airport charge, infrastructure investment and service level that better fits their own business model.

- 3.17 The absence of any bilateral contracts between Dublin Airport and its airline users further supports the Commission's view that there is no evidence of airlines having enough buyer power to force Dublin Airport reduce its airport charges, provide cost-effective and required capital expenditure or offer an adequate quality of service.

4. Promotion of Competition

Do you agree that there is a need to promote competition in the Irish Airport Sector? What should be done to promote it?

- 4.1 We support the proposal to include the promotion of competition as a statutory objective. This will provide us with a focus to review our approach to regulation to ensure it is appropriate for the different levels of competitive services provided by Dublin Airport.
- 4.2 The Commission agrees that the promotion of competition is a common feature in regulation. In the UK, the Civil Aviation Authority (CAA) look to promote competition in the airport market as a first principle. Many other regulators in the UK and Ireland are charged with a statutory duty to promote competition, including Comreg, CER, Ofcom, Ofgem, and Ofwat. The extent to which a regulator can promote competition in a particular market will, in part, depend on the level of market concentration and the identification of parts of that market which are conducive to being unbundled (provided separately as opposed to a package).
- 4.3 In general, competitive markets deliver the best outcomes for consumers. We see areas of opportunity to encourage competition between existing airports, in particular between the regional airports. However, creating credible competitive pressures for Dublin Airport would require careful consideration.
- 4.4 Economies of scale are very significant for airports. The cost base is composed of large capital investments and relatively inelastic operating costs which results in a natural monopoly type situation. The fixed costs associated with a second airport in Dublin would be significant. Any mechanism to promote competition for Dublin Airport such as the development of a second airport and competition between terminals at Dublin Airport would represent significant changes in Government policy and should be subject to cost benefit analyses to determine if passengers will benefit from these changes. The Commission is fully supportive of competition, working to promote it in other markets such as groundhandling services at Irish airports, and would welcome working with the Department to further research the potential for promoting competition for Dublin Airport to the benefit of users.
- 4.5 Indecon notes that Cork and Shannon Airports already face effective competition and consequently should not be subject to regulation. The Commission agrees with this view, and furthermore we believe that competition should be overseen and promoted among regional airports.

Who is best placed to carry out market power analysis in the Irish Airport Sector?

- 4.6 It is our view that we would be best placed to carry out periodic market power assessments. We have the skills and knowledge base for such work, and as they would naturally be done between price determinations we would have the available capacity. We also note that the Commission would be the body charged with implementing any resulting changes in the regulatory approach. We see efficiencies in a situation where the same body is responsible for both conducting market analysis and taking any necessary action based on the outcome of that analysis, as is common practice in many regulated industries.
- 4.7 The Commission would agree with the suggestion that periodic assessments of market power should be undertaken with a view to updating the regulatory approach to the market should conditions change. We would support an approach whereby the appropriate regulatory model for each airport is decided upon based on the results of a market power assessment. This is similar to the approach taken in the UK, the Civil Aviation Act (2012) requires the CAA to regulate an airport appropriately if it meets the criteria of the Market Power Test (MPT). One

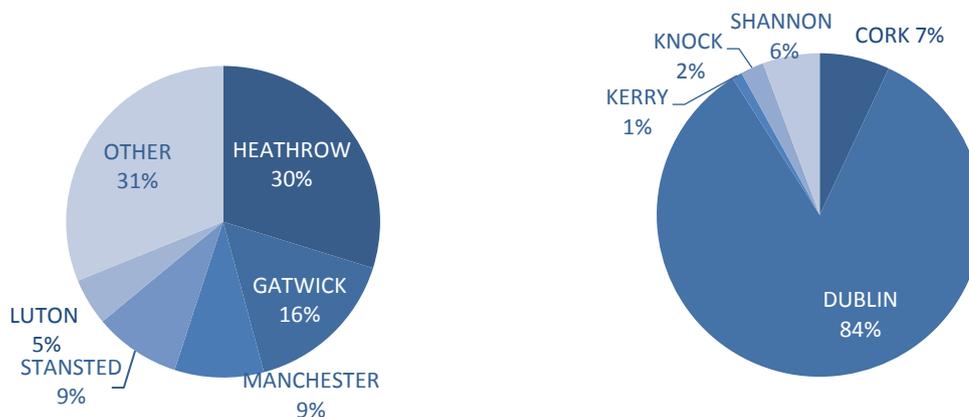
element of this test is a requirement that the airport must have substantial market power in its ‘airport area’. The outcome of market power assessments guides regulatory policy, in 2014 the CAA relaxed the regulatory approach at Gatwick Airport having found evidence of a decrease in market power.

4.9.1 An evidence-based, flexible regulatory model has also been adopted in regulated industries in Ireland. ComReg is responsible for conducting market assessments on five markets that have been identified by the EU commission as susceptible to ex ante regulation, and in additional markets subject to certain conditions being satisfied. ComReg is tasked with the geographic market definition, the assessment of the existence of significant market power, and the imposition of conditions to the dominant provider in order to promote competition. These conditions include the publication of relevant information and non-discriminatory pricing. The Commission for Energy Regulation (CER) is required to monitor gas and electricity retail markets to identify any changes, and where necessary to take appropriate action.

Are the longer term proposals to enhance competition within the airport services provision at Dublin Airport feasible and would they eliminate or reduce the need to regulate?

4.9.2 It is not apparent that longer term proposals to enhance competitive pressure on Dublin Airport would render regulation unnecessary. In the UK, approximately half of the London market share by passenger is enjoyed by the largest airport, Heathrow. This equates to about 30% of the overall UK share. Despite the level of competition among airports, of which there are five in the London area alone, the CAA has found that economic regulation in the form of price cap setting is still necessary at Heathrow. It is therefore questionable whether the promotion of competition in the Irish airport market, with a view to reducing the market power held by Dublin Airport to a point where regulation is unnecessary, is feasible. However, if arrangements are put in place to enhance competition, there should be a reassessment of necessity and form of the regulatory framework.

Figure 4.1: Dominance in UK Market Much Less than in Irish Market



Source:CAA for UK data, CSO for Irish Data

5. Regulatory Regime

Do you agree with the finding that price cap regulation, with a single till is most appropriate for the economic regulation of airport charges at Dublin Airport?

- 5.1 The Commission agrees that price cap regulation with a single till is the most appropriate regulatory model at this time. Price cap regulation optimises incentives relative to other forms of regulation. The airport is incentivised to operate at an efficient cost, increase commercial revenues, grow traffic and seek efficiencies in capital expenditure. These efficiencies are periodically passed on to airlines and passengers. For these reasons, as Indecon outlines, price cap regulation is practised extensively by regulators of airports and other entities with significant market power.
- 5.2 We agree that a single till approach is currently the most appropriate. Indecon notes that it reflects the reality of interaction between aeronautical and commercial activities. A single till approach most closely replicates how an airport setting charges in a competitive environment would operate. Profits from commercial activities are directly related to the level of aeronautical activities; an airport in a competitive environment would have regard to the impact of airport charges on commercial revenues. A single till approach should, therefore, lead to lower airport charges and a higher level of traffic at the airport.
- 5.3 We agree with Indecon that discretion over the regulatory model should remain with the Commission and should not be fixed in legislation.

If you disagree, what do you propose as the most appropriate approach?

- 5.4 The type of economic regulation implemented should be periodically reviewed and tailored to fit the level of market power held by the airport. A change in legislation would be required to achieve this as the current framework only allows for price cap regulation. However, for reasons outlined above we do not think that these legislative changes are required in the short or medium term given Dublin Airport's position in the market.
- 5.5 If the degree of market power held by the airport was to fall to a level whereby it could only charge competitive level prices then the need for price cap regulation would fall away. There is a continuum between this competitive outcome and full market power, similarly there are a number of options for economic regulation to minimise the negative effects of market power.

6. Flexibility

Do you think that increased flexibilities would improve the current regulatory regime, and if so, what specific changes should be made to the regulatory regime?

- 6.1 The Commission believes there is significant flexibility in the current regime but that historically this flexibility has not been fully utilised. The legislation gives us flexibility in how we implement price cap regulation. That implementation affords Dublin Airport flexibility in how it operates the airport and how it deals with changing circumstances.
- 6.2 We would caution that often when price cap regulation is criticised for being inflexible it is because of the inability of the regulated firm to pass on uncontrolled or unanticipated costs to its customers or if it is unhappy with restrictions on its allowed capital expenditure. Price cap regulation aims to emulate competition, the incentives within the price cap are key to this. The regulated firm is incentivised to control operating costs and to be efficient in its capital expenditure program.
- 6.3 The Commission would support increasing the flexibility within the system, for example, in Section 3 we discuss the option of conducting market power assessments and then tailoring the type of regulation depending on the result (currently we must use price cap regulation) and in Section 12 we discuss the added flexibilities a licencing system would give to the Commission.
- 6.4 Below we discuss some areas where there is flexibility and areas where inflexibility is required due to risk allocation or incentives introduced by price cap regulation in order to simulate competitive market outcomes.

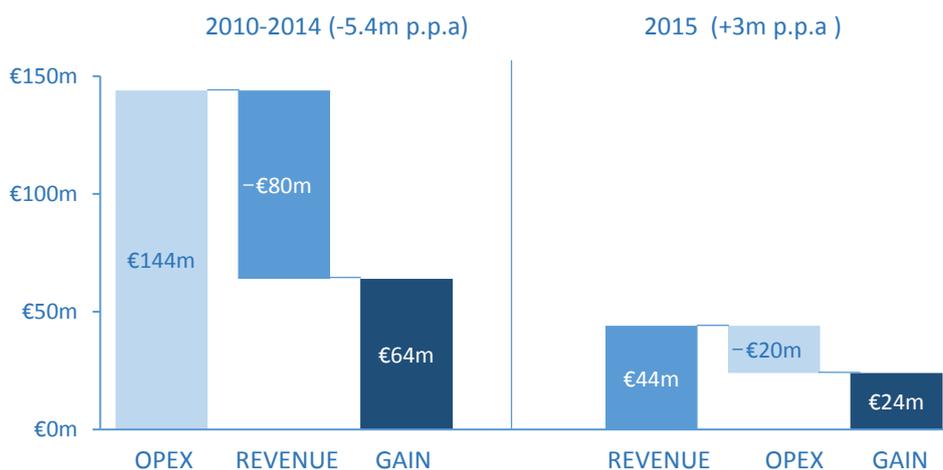
Flexibility on Type of Regulation

- 6.5 There is a significant amount of flexibility in the current regime and we are of the view that this regime can be flexed without the need for changes in primary legislation (depending upon the changes made to the current regime). Under the current legislation the Commission could substantially change the way it regulates Dublin Airport. We could, for example:
- move to a dual till system
 - stop using a Regulated Asset Base based approach,
 - combine capital costs and operating costs to a single allowance (totex) and allow Dublin Airport find the most efficient allocation between the two,
 - include sub caps to have specific caps on different services or time of day,
 - change the allocation of risks between the airport and the passengers,
 - establish an arrangement to facilitate more constructive engagement between Dublin Airport and airlines in terms of agreed investment plans, and/or
 - establish a group to represent the views of the travelling public (on a non-statutory basis)
- 6.6 The flexibility in the current legislation allows us to devise a system of price cap regulation which places the minimum restrictions on Dublin Airport, while also meeting our statutory objectives of protecting the interests of current and prospective users, facilitate the efficient and economic development of the airport and also enabling Dublin Airport to operate in a financially viable manner.

Risk Incentives and Flexibility

- 6.7 Aspects of the regulatory regime may appear inflexible because of the way risk and incentives interact in order to attain as closely as possible the outcome of a competitive market. In the price cap, different risks are allocated to different parties. The level of flexibility in an area needs to be mindful of who is bearing the risk. For example, the volume risk is allocated to the airport; if passenger numbers differ from the Commission’s forecast the airport takes the consequence of higher or lower aeronautical revenues, this can be somewhat softened with the volume effect on cost. This incentivises Dublin Airport to grow traffic where the opportunity exists, it also incentivises it to maximise the use of existing infrastructure to have the capacity to grow. In times of falling traffic it incentivises the airport to control costs in line with the falling demand.
- 6.8 The effect of the incentive to control costs when traffic is falling was seen in the previous determination period from 2010 to 2014, when passenger numbers were 5.4m lower than forecast. During this period, aeronautical revenues foregone by Dublin Airport amounted to €57m, while the foregone commercial revenues were estimated to be €23m. However, foregone revenues were more than offset by total opex savings of €144m over this period. As a result, a gain in total earnings after operating costs (EBITDA) of €64m was possible even though traffic volumes were lower than forecast.
- 6.9 This allocation of risk to Dublin Airport can seem inflexible; when traffic is growing users see the airport profiting in the short term, at times the gain to Dublin Airport can seem excessive. For instance, when passenger numbers were 13% higher than the forecast in 2015, Dublin Airport earned an extra 22% in commercial revenue and 8% in aeronautical revenue. At the same time, opex only grew by 10%. The gain compared to the forecast was €24m. When traffic is declining the effect on the airport may seem unfair, but in reality the upside and downside should balance out over time, and the strength of the incentives derived from this encourage growth and efficiencies.

Figure 6.1: Airport Takes the Volume Risk, and Responds Accordingly



Source: Dublin Airport Regulatory Accounts, CAR Calculations. Data in July 2014 prices.

- 6.10 The rolling schemes currently in place provide additional incentives and flexibility by financially rewarding Dublin Airport for 5 years for any sustained outperformance achieved compared to the targets set by the Commission in relation to savings in operational expenditure or growth in commercial revenue.

- 6.11 Incentives, allocation of risk and the associated inflexibilities are not set in legislation. The Commission can adjust the allocation of risk to strengthen incentives or better allocate it to the party best able to influence it.

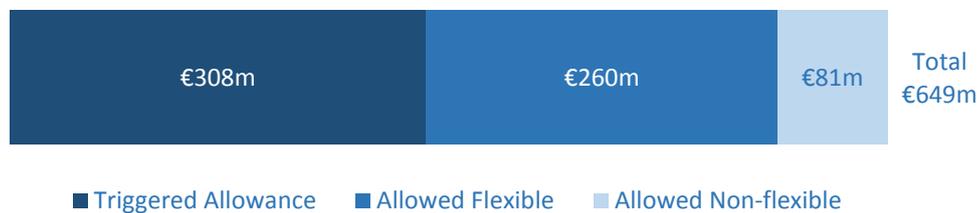
Flexibility on Capital Expenditure

- 6.12 A similar trade-off can be seen on capital expenditure. Most of the risk for capital expenditure falls on the airlines and passengers of the airport. The Commission facilitates the efficient and economic development of Dublin Airport by giving the airport commitments that certain capital expenditure will be remunerated.
- 6.13 This certainty allows Dublin Airport to invest in infrastructure in a low risk way. In most circumstances Dublin Airport is guaranteed that it will recover its costs and earn a return. This level of certainty does not exist for competitive firms; therefore, regulatory control is required to ensure airlines and passengers do not pay for infrastructure which is over specified, excessive in cost or unnecessary (in a competitive environment a company who overspends on infrastructure cannot recover the costs from its customers).
- 6.14 The Commission needs to be very mindful of this burden of risk when setting capital allowances. For this reason, a rigorous process should be followed before a capital allowance is approved. The Commission also endeavours to set a fair remuneration of capital cost based on appropriate levels of market risk and returns for shareholders, and assuming a notional (financially sound) capital structure of Dublin Airport. We aim to strike a balance whereby the airport is not placing excessive capital costs on passengers but also that airlines are not blocking capacity for anti-competitive reasons.
- 6.15 It is worth considering that where a capital project is necessary to deliver required capacity it is in the interest of airlines to support the project as without it they may be unable to grow their business at the airport. The Commission is always mindful of potential regulatory gaming from all sides on capital projects.
- 6.16 Within a determination period, circumstances can differ to those forecast when making the determination. These changing circumstances can result in different costs, revenues and capital expenditure needs than forecast. Passenger numbers, a key component of the price cap and a driver of the capital investment, is subject to volatility. For example, in September 2014 Dublin Airport were forecasting 20.7m and 21.2m for 2014 and 2015, the outturn was 21.7m and 25m respectively.
- 6.17 In general, changing circumstances related to capital investment can be dealt with by using various mechanisms that are included in the determination such as increasing capital allowance through triggered projects and allowing for flexibility of capital investment within groups of projects.
- 6.18 Trigger mechanisms are used to adjust the price cap on the occurrence of an event where the Commission deems additional allowances are necessary. The 2014 Determination includes four trigger allowances⁵ adding €308m that allow the airport to increase the maximum level of airport charges per passenger, should a change in circumstances require that Dublin Airport undertake additional capital expenditure. The triggers are set in addition to a non-triggered capital allowance of €341m, which is 62% higher than Dublin Airport spent in the period 2010-2014 excluding the allowance for the construction of Terminal 2.

⁵ The four triggers remunerate the North Runway Project, Additional Line-up Points Project, Hold Baggage Screening Standard 3 Project, and the Pier 2 Segregation Project.

- 6.19 Capital allowances in a determination also allow for a degree of flexibility. As circumstances change, Dublin Airport can reallocate the allowance to projects of different scale or projects not in the investment plan. The level of flexibility varies by capex group. In some cases, the allowance is tied to specific projects referred to as deliverables; should these projects not be delivered, the allowance for the relevant group is revised down by the appropriate amount. To protect the interests of current and prospective users, this flexibility can be exercised on condition that the total spending in a group remains below the allowance for that group.
- 6.20 The 2014 Determination divides capex groups into six categories with different degrees of flexibility. Specifically, 56% of the allowance for Airfield Maintenance is flexible, as is 61% of the allowance for Revenue Projects and 97% of the allowance for Business Development. Allowances for IT, Landside Terminals Maintenance, and Other Projects are not subject to any deliverables and are therefore 100% flexible. The capital allowance tied to specific projects is equivalent to €81m, whereas €260m can be reallocated by Dublin Airport.

Chart 6.2: Total Capex Allowance 2015-2019

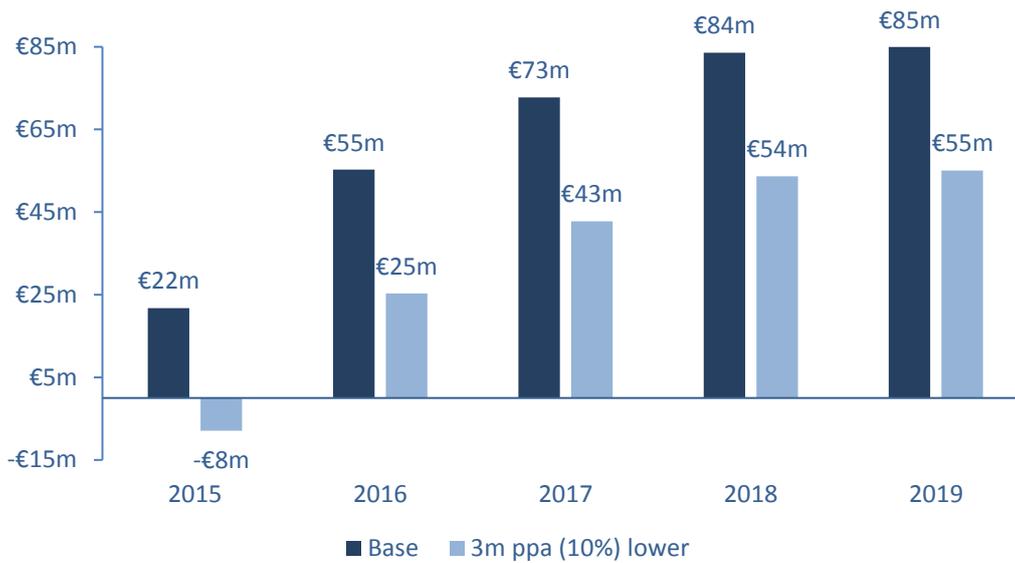


Source: CAR 2014 Determination.

Financial Flexibility in the Price Cap

- 6.21 When setting the price cap the Commission is required to ensure that Dublin Airport is financially viable. It does this not just in the base case but also performs stress tests to ensure that Dublin Airport would be financially viable if outturns are not as forecast. The standard price cap assumes a significant contribution to the shareholder; some €300m for the current determination period. Shareholders bear much of the risk within a company, as such if circumstances conspire against the company the contribution to shareholders provides a buffer.
- 6.22 The 2014 Determination allows enough flexibility for Dublin Airport to manage considerable downside passenger traffic risk. Under a scenario where passenger numbers were 10% lower than the forecast in the first year of the determination, operational expenditure would fall slightly on average by 1.5% (€2.9m). Commercial revenues would also drop by 6.3% (€9.7m), aeronautical revenues by 10% (€22.1m) and funds from operations (FFO) by 21% (€29.4m).
- 6.23 Under this scenario, there would be a negative free cash flow of €7.8 million in the first year due to a lump sum pension payment of €54.7 million, but it would be positive for the rest of the determination period. The Commission notes that the outcome of the forecast only assumes a drop in passenger numbers and does not consider any action by Dublin Airport in response to it. As demonstrated by the outturns of Dublin Airport during the 2010-2014 determination period, even if passenger numbers drop, the outturn free cash flow can be positive. This is due to Dublin Airport being expected to adjust to a drop of demand by increasing its efficiency and cutting back on operational and capital expenditure.

Figure 6.3: Positive Average Free Cash Flow even with 10% Lower Passengers than Forecast



Source: CAR Calculations

6.24 The financial viability of Dublin Airport is healthy even if traffic numbers are well below the forecast and without considering the possible cost saving efficiencies and lower capital expenditure the Airport may achieve. The Debt: EBITDA ratio gets closer to the target associated to the current BBB credit rating of Dublin Airport, whereas the FFO: cash interest and EBITDA: interest ratios are above the minimum threshold for such credit rating.

Adjusting Flexibility and Risk Allocation

6.25 Incentives, allocation of risk and the associated inflexibilities are not set in legislation. The Commission can adjust the allocation of risk to strengthen incentives or better allocate it to the party best able to influence it.

6.26 In addition, the Commission is currently consulting with Dublin Airport and airport users on a process for consideration of supplementary capex allowances during a determination period. While there is flexibility within a determination to adapt to changing needs, in exceptional circumstances these flexibilities may not be sufficient. The Commission is discussing the use of an option currently existing in the legislation that consists of a statutory review of a determination that would potentially allow incorporating a supplementary capital investment plan.

7. Statutory Objectives

- 7.1 The primary objective of an economic regulator should be the protection of the interests of the end users. The 2013 Government Policy Statement on Economic Regulation recommends that objectives should have a hierarchy and states that “Government views the promotion of the consumer interest and national competitiveness as key national objectives which should be prioritised”.
- 7.2 We would welcome a move to having a single objective, to protect the interests of current and future passengers. In order to achieve this objective, we would need to have regard to aspects of our current objectives, for example, the financial viability of Dublin Airport and to facilitate the development of the airport.

Is the continued statutory basis for airport regulation warranted?

- 7.3 As outlined in Section 3 of this paper, a continued statutory basis for airport charges is warranted. The current system allows the Commission to regulate charges at Dublin Airport in a way which is appropriate to the current dominant position of Dublin Airport. It allows us to set a price cap, but allows sufficient flexibility on how we do it (further explored in Section 6).
- 7.4 If the market power of Dublin Airport was to reduce, a less intrusive regulatory regime may be more appropriate. We discuss this in Section 3. To achieve this flexibility, changes to the legislative framework would be required in order to allow us move away from price cap regulation.

Would you support amending the existing statutory objectives to focus more on the interests of existing and future airport users, as outlined above?

- 7.5 We agree with Indecon that the removal of the interests of the regulated entity as a primary statutory objective would be aligned with best regulatory practice. Enabling the financial viability of the airport could instead be a factor to which the Commission should have due regard, given its relevance to the interests of current and future users. This is the approach adopted by other sectoral regulators.

Do you support the proposed new statutory objective of the promotion of competition?

- 7.6 The Commission supports the promotion of competition as a statutory objective but suggest that the promotion of passenger interests is our principal function. This would allow us assess any measures to increase competition and to demonstrate whether or not they allow us protect the interests of existing and future passengers. For example, allowing capital projects at Dublin Airport which deliver additional capacity would increase Dublin Airport’s dominance in the market and at the same time may well be fully consistent with the Commission protecting the interests of passengers. As in other markets, actions can be taken that increase average charges to promote competition that perversely are not in the interests of passengers as they are required to pay higher prices. As we have said before, we fully support the promotion of competition and suggest there is an extensive exploration of how the customer impact is assessed.

8. Ministerial Directions

Should Ministerial Directions be limited and how enforced?

- 8.1 Ministerial Directions are currently limited, in Section 10 of the Aviation Act, 2001, to general policy directions, and the more specific element of Government policy has been articulated and enacted in other sections such as sections 32 and 33 of the Act. Aspects of general policy may not be suitable to be enacted as legislation. For example, the Commission has received general policy directions in the past that it is Government policy that Dublin Airport not receive any funding from the Exchequer and that a second terminal be built at Dublin Airport. That type of policy statement may not be found in legislation but represents an important consideration to be taken into account when determining airport charges. The Commission understands that the Minister should be in a position to deliver such national aviation policy, while we also believe that our independence is essential to ensure good regulatory outcomes.
- 8.2 Section 10 provides a formal, transparent mechanism to provide such policy direction to a regulator whilst respecting the balance that must be struck between independence and general policy directions. This is a fairly common provision and permits a residual Ministerial power to be exercised in the interests of issuing appropriate policy directives to a regulator. The regulator in return must be accountable for administering the Act and report on how it has fulfilled the specific Government policy as enacted in legislation and further general policy directions given to it in so doing.
- 8.3 Now that the Government has published a National Aviation Policy, having regard to explicit policy in regulatory decisions is easier. The Commission would encourage that the National Aviation Policy is reviewed periodically and would also welcome if the timing of reviews gave consideration to the timing of the regulatory cycle.
- 8.4 Ministerial directions that require regulators to take account of general policy objectives may conflict with the objectives of the regulator. In order to avoid such a situation, the Commission believes it is necessary to set clear criteria on how the priority of various statutory and national policy objectives should be ranked by regulators.

Do you favour consultation of any Ministerial Direction of Capex?

- 8.5 Ministers would benefit from applying a clear and transparent consultation process giving them the opportunity to consider the responses from interested parties to inform decisions.

9. Consultation

- 9.1 The Commission supports the use of consultation to arrive at outcomes which meet the needs of users. Consultation between the airport and airlines is important and should feed into regulatory decisions. Consultation by the Commission with a wider group of interested parties is equally important.
- 9.2 A number of aspects of consultation are currently working well, or better than they may have in the past. Since 2012, the Airport Charges Directive also provides for an annual consultation on charges. In total, there are a number of opportunities and forums for passengers and airlines to have their opinions heard.
- 9.3 However, the danger is that those opinions are merely heard and not actioned upon. The challenge is to have a consultation process which is deliberative rather than just information sharing. In this regard, the Commission intends to do further work on the process around consultation between the airport and airlines and with passenger representatives. We will also be consulting on how the outcomes of consultation lead into regulatory decisions.
- 9.4 We welcome the recommendations of the Indecon report relating to consultation however, we do not believe legislative change is required to deliver better outcomes from consultations.

Do you agree that more engagement should be encouraged between the airport and airport users prior to the determination process? How could the regulator facilitate this?

- 9.5 Consultation on capital investment between Dublin Airport and the airlines and passengers is essential, given the lack of perfect competition that would ensure that required capital infrastructure is supplied at minimum cost and that users do not have to pay for infrastructure that is not needed or cost-inefficient.
- 9.6 Structured consultation is however subject to information asymmetry. During past determinations, airlines have claimed not to have had knowledge of investment plans nor to be provided with sufficient project information to engage in constructive consultation. Information asymmetry places the airlines at a disadvantage and leads to sub-optimal outcomes for the negotiating parties. In this context, a better defined process would contribute towards formal engagement that is meaningful, effective and aligned with the interests of airlines and passengers.
- 9.7 Although statutory consultation should not be led by the regulator, the Commission should play, where appropriate, a facilitator role to encourage consultation that follows basic principles of accountability, transparency, collaboration and trust.
- 9.8 Specifically, the Commission should develop (through consultation) a set of guidelines giving effect to the minimum consultation requirements including:
- timelessness/transparency,
 - auditability of the provision of information,
 - detailed business plans,
 - maintenance plans,
 - need for the project,
 - cost-benefits appraisals,
 - timescale for implementation,

- project's impact on estimated opex and commercial revenues and
- Impact on airport charges.

9.9 For this purpose, additional practical means of protecting commercially or operationally sensitive information could be explored. As part of this process the Commission should consider how the views of passengers are taken into consideration. Constructive Engagement should become part of the formal price determination process. For example, Dublin Airport could be required to demonstrate that they have gone through the process as part of their submission to the Commission. To facilitate this process, the Commission would consider the appointment of an independent chair to encourage participation in the process and also to provide update reports to the Commission.

9.10 We are of the view that legislative change is not required to implement this type of arrangement and, as noted previously, we are in the initial stages of consulting on how to enhance the existing regulatory model and this subject will be included in that consultation process.

Heathrow – Constructive Engagement

9.11 Constructive Engagement (CE) is mandated by the CAA since 2005 and promotes early, structured discussion and negotiation between Heathrow Airport and the airlines on central issues of the price review process. CE enables Heathrow Airport to formally engage with airlines and informs the development of its business plan before submission to the CAA. Based on CE, regulatory decisions by the CAA are significantly better informed about users' future requirements for service, capacity, resilience and cost efficiency.

9.12 The CAA believes CE in previous periodic reviews reached progress especially concerning the capital plan, the scope for capital efficiency and the suite of service measures. In the view of the CAA, CE is the primary means for ensuring effective scrutiny of capital investment at Heathrow Airport by the airlines, which collectively have the incentives and the expertise to hold the Airport to account.

9.13 In addition, IATA state that "both IATA and ACI point to the recent CE around London Heathrow's new capex plan, including transparency on the impact on charges over the coming five-year period, as exemplary. Negotiations led to an aligned three-billion pound investment strategy that is endorsed and supported by the Heathrow airline community, including 97 airlines."⁶

Consultation under the Airport Charges Directive

9.14 As the chair of the consultation working group of the Thessaloniki forum on Airport Charges, the Commission is currently working on the setting of harmonised guidelines on consultation and transparency across European countries. The guidelines, which are particularly required when airports hold significant market power, will form a set of acceptable practices to make consultations more constructive and collaborative and the exchange of information more timely and detailed.

⁶ Airport charges: regulation with teeth. IATA. 19 February 2015. <http://airlines.iata.org/analysis/airport-charges-regulation-with-teeth>

What are your views on the establishment of a new consultative group on airport charges at Dublin Airport?

- 9.15 A consultative group could achieve a more deliberative regulatory outcome. The Commission would place considerable weight on any agreements reached by the group in setting the various building blocks of the regulatory formula.
- 9.16 The group would be particularly useful for reaching agreement on the required infrastructure and the required quality of service.
- 9.17 The group would need comprehensive information in order to make proper assessments, for example, for a capital project the group would need a comprehensive business plan justifying the project and detailed cost information.
- 9.18 Such a group could operate with the current legislation. We believe this group should be an integral part of the process for Dublin Airport when they are preparing a submission to CAR. As such we are of the view that the terms of reference of the group should be determined by the Commission as part of the process referred to in Section 9.8 above. The Commission plans to examine options around consultation in the coming year and will consult with all parties on how best to achieve the desired outcomes. We do not believe legislative change is needed for this.

Should CAR undertake research to ascertain the views of airport users? How might this research be undertaken?

- 9.19 The determination of airport charges requires the Commission to have a broad understanding of the views of all interested parties. The views of the Airport and airlines are made known to the Commission during consultations. However, the Commission is aware of the need to implement additional mechanisms to become better informed of the views and needs of passengers and better reflect them in the airport charges determination.
- 9.20 Passengers' needs that would inform the regulatory process could be identified by conducting qualitative and quantitative research, including focus group discussions and interviews, as well as willingness-to-pay and benchmarking analyses. Consultation with the Airport and airline users about the objective, methodology and data requirements of such research projects would be held in advance.
- 9.21 The Commission is of the view that setting up a Consumer Challenge Group would help to better represent the passengers during an airport charges consultation. Such a group would benefit from the outcomes of passenger-related research, would represent passengers during consultations, and would advise the Commission on the quality of passenger engagement with the Airport and the degree of consideration and implementation of passengers' needs in its overall business plan.
- 9.22 This would be consistent with Indecon's recommendation to amend the Commission's duties to place more focus on the passenger.
- 9.23 The merits of setting up a Consumer Challenge Group would be consulted on with interested parties. Consultation must ensure that the terms of reference of these groups guarantee their transparency, credibility and independence.
- 9.24 The protection of consumers' interests has recently become an important duty of a number of

regulators. In the UK, the CAA's strategy is currently focused on empowering air travellers through information sharing, and ensuring that they are receiving choice, value and fair treatment. The CAA uses the input from its own research on air travellers' needs, but also research by consultants and an independent Consumer Panel set up in 2012 to inform its regulatory review process.

- 9.25 In addition, the CAA is currently consulting on the terms of reference of a Consumer Challenge Forum that would act in the interests of consumers by independently challenging, assessing, and making recommendations to Heathrow Airport and the CAA during the consultations for the next regulatory review of airport charges and services.
- 9.26 A very similar approach of engagement with consumers is used also by regulators in other sectors. For instance, Ofwat in the UK requires direct engagement between consumers and their water companies regarding services and tariffs. A sector-wide Customer Advisory Panel informs the regulator, among others, about the cost of capital, and a Customer Challenge Group discusses and challenges the degree of responsiveness to consumers' views of water companies and their inclusion in final business plans.

10. Appeals

- 10.1 An essential element of regulation is a system of challenge, appeal and redress. Appeals allow affected parties to assert their rights when they believe a decision is wrong or has been reached in an incorrect manner.
- 10.2 The Commission would welcome an examination of the current appeal process. However, we would have some concerns with the proposed solution which we outline below.
- 10.3 Rather than trying to devise a bespoke system of appeal for airport charges we would welcome a common approach to appeals across all economic regulators in Ireland. With this in mind we would note that the 2013 Government Policy Statement on Sectoral Economic Regulation stated, “feedback from the Forfás review and the wider consultations suggests that the Commercial /High Court process works very well and that appellants against a number of regulator decisions in reality undergo a single stage appeals process by taking appeals directly to the High Court or Commercial Court. A number of sectoral Departments already use this procedure as the formal appeals mechanism. Others are encouraged to use this approach where appropriate and provided it does not contravene existing EU law.”
- 10.4 The benefit of this type of appeal are: (i) certainty from a binding decision of the High Court, (ii) brevity of process in that an earlier appeal to some form of Appeal Panel is foregone and (iii) clarity in that both regulated firms and regulator present their views in open Court for consideration and adjudication.
- 10.5 The appeal process should facilitate good regulatory outcomes, supporting a stable and predictable regime. It is important that the appeal process is not merely another round of input into the regulatory decision.

Background on Current Appeals Options

- 10.6 Once a decision has been made on airport charges it can may be revisited in three ways:
- a review on the basis of a substantial ground pursuant to section 32(14)
 - an appeal by way of judicial review pursuant to section 38
 - an appeal to an appeal panel established by the Minister pursuant to section 40
- 10.7 Thus interested parties such as Dublin Airport, airlines using Dublin Airport or other users have three different avenues by which they may challenge or appeal the determination on airport charges. Determinations made by the Commission have been revisited using each mechanism at different times since 2001.
- 10.8 Abolishing the appeals panel mechanism would leave the option of appealing to the high court. Each of the four determinations on airport charges has seen an application for review by the High Court on these grounds. It is also an effective mechanism for holding the Commission accountable for its decision as it requires the Commission to defend its decisions by explaining why the procedure it followed was correct, why the application of the law used was correct and why, having regard to the facts of the matter the decision is reasonable.

Do you agree with the proposal to abolish the current appeal process?

- 10.9 We agree that the current appeal process could be improved. However, before recommending it should be abolished we would encourage, working with other agencies, to undertake a rigorous assessment of the regimes put in place in other regulated sectors to determine the

most effective model.

What are your views on the proposed new appeals structure?

- 10.10 As noted above, we would welcome a review of CAR's appeals process to be part of a wider review of appeals structures in other regulated sectors. This would inform any decision on the most appropriate structure to adopt. We are not convinced the proposed process is different enough to the current process to achieve substantially different results. A much more detail plan would be required to allow us to comment fully. Our comments here are some initial thoughts.
- 10.11 We have some concerns with the suggestion that rather than Ministerial appointment of members of the appeal panel, members should be appointed by the parties under dispute. The likely outcome is that Dublin Airport and the two main airlines would appoint the appeals panel. The consequences of decisions of an appeal process may reach wider than these three parties. An appeal process should protect the interests of all users of the airport.
- 10.12 Indecon also identified major defects in the inability of an appeal panel to alter any regulatory determinations and recommends a strengthened appeals panel that is able to confirm, set aside or refer decisions back to the regulator. The Commission agrees that allowing an appeal panel to affirm, refer back or set aside whole or part of a determination would strengthen the appeals process. However, we also believe that an appeal panel should not become a de facto regulator, making the regulatory decisions taken by the Commission ineffective.
- 10.13 The Commission considers that appeals are not the only form of accountability. Interested parties are able to engage in consultation and share information with the regulator prior to its determinations. Consultation constitutes an additional mechanism that promotes transparency and accountability of the Commission and offers the opportunity to interested parties to raise concerns and help prevent regulatory error or unfair decisions.

Common Approach across all Irish Regulators

- 10.14 There is a wide variety of appeal processes for regulatory decisions in Ireland. Differences in the appeals process includes various venues, generally appeal panels or Circuit/High Courts, and a range of remedies available, such as affirming, changing, setting aside or replacing a regulatory decision.
- 10.15 Appeals of determinations made by the CCPC, ComReg and CER are heard by the High Court who can confirm, vary or annul their determinations. The experience of ComReg indicates that since appeals are heard by the High Court, their resolution takes less than 6 months, which is a considerable improvement compared to the delays experienced when the Electronic Communications Appeal Panel was in place.
- 10.16 In contrast, appeals of decisions made by the Commission are heard by appeal panels whose members are appointed by a Minister. An appeal panel can refer back determinations to this Commission but it cannot vary or overturn them.
- 10.17 In conclusion, there is no unique appeals process for regulators across Ireland resulting in a less transparent regulatory environment. The Commission considers that there should be a standard process for appealing a regulatory decision in Ireland in order to ensure its effectiveness, predictability and consistency. With this in mind, we would welcome the approach outlined in the 2013 Government Policy Statement on Sectoral Economic Regulation and quoted above, to use the court system as the appeals mechanism.

11. Organisation Structure

Given the analysis undertaken by Indecon, what do you consider to be the most appropriate organisational structure for airport charges regulation in Ireland?

- 11.1 The current structure of the Commission enables it to fulfil its objectives successfully and cost effectively.
- 11.2 The Commission would welcome any further expansion of its remit to include other functions either within economic regulation or administrative regulation. Additional functions would allow for additional efficiencies and also expand opportunities within the Commission, which would enable it to be better able to recruit and retain key skilled staff.
- 11.3 Consideration must also be given to the organisational structure required under the Airport Charges Directive. The Independent Supervisory Authority must meet the following criteria:
- It must be an independent authority established or nominated to ensure the correct application of the measures taken to comply with this Directive.
 - Member States must guarantee the independence of the independent supervisory authority by ensuring that it is legally distinct from and functionally independent of any airport managing body and air carrier.
 - Member States that retain ownership of airports, airport managing bodies or air carriers or control of airport managing bodies or air carriers shall ensure that the functions relating to such ownership or control are not vested in the independent supervisory authority.
 - Member States shall ensure that the independent supervisory authority exercises its powers impartially and transparently.
 - Member States may establish a funding mechanism for the independent supervisory authority, which may include levying a charge on airport users and airport managing bodies

The Commission possesses all of these mandatory characteristics by virtue of the manner of its establishment under the Aviation Regulation Act, 2001. Therefore, it is designated as the national independent supervisory authority in Ireland for the purposes of the regulation of airport charges.

Given the intermittent nature of airport charges regulation, what options are available to ensure that the organisational structure has sufficient critical mass, including mergers with other regulatory entities within and outside the aviation sector?

- 11.4 Making a determination of airport charges is periodic, but the work involved is less cyclical than may be expected looking in from the outside. Monitoring compliance, policy development and preparations for a determination all take considerable resources. In addition, work force planning allows the Commission to respond to the cycle in terms of staffing levels.
- 11.5 That being said, the Commission would welcome additional functions as stated above. Countercyclical functions may assist in smoothing the work force requirements, the obvious example here would be if the Commission was the body responsible for conducting market power assessments of the airport market.
- 11.6 The Commission would also welcome the possibility of merging with another suitable

organisation. A merger would create a larger organisation with more opportunities for existing staff and possibly make it easier to recruit key staff. A larger organisation would also benefit from a larger core knowledge base with less risk of loss of institutional memory when key staff leave. Efficiencies may also be possible with shared services.

What interim actions could be taken in the shorter term to strengthen the regulatory functions of CAR? How might links between CAR and other economic regulators be enhanced?

- 11.7 Many benefits can be achieved through better collaboration between regulators nationally and internationally.
- 11.8 The Thessaloniki forum of European airport regulators was recently established and the Commission believes it can gain greatly from this interaction with other regulators of airport charges throughout Europe. The goal of this forum is to advise the European Commission on the implementation of the ACD, as well as to develop best practice guidelines on a range of areas related to the economic regulation of airports. As mentioned previously, the Commission is leading a subgroup to develop guidelines for consultation and setting the cost of capital. Since the start of 2016, this forum has also engaged for the first time in extensive sharing of information, for example, information on the calculation of the cost of capital. The gains from such collaboration are substantial.
- 11.9 The Economic Regulatory Network is a grouping of the key Irish economic regulators which was setup in response to the Government's initiatives on Better Regulation. This network shares best practice which supports a more consistent regulatory approach. Collaboration, secondments and knowledge transfer between regulators has been successful to date, and the future potential will continue to be explored.

12. Additional Suggestions

Use of Licensing System

- 12.1 The Commission believes that the use of a licensing system would give it greater flexibility to ensure resilience and monitor compliance, combined with greater powers of enforcement.
- 12.2 In the UK, the Civil Aviation Act 2012 introduced a more flexible licensing regime for airports which are deemed to have market power. This system has the interests of users at its core, enabling the CAA to include conditions which would not typically feature in standard price cap regulation. The primary duty of CAA under the 2012 Act is to further the interests of users. To this end, section 18 of the Act empowers the CAA to include in a license any condition which it believes to be in their interest.
- 12.3 CAA granted licences to the operators of Heathrow and Gatwick airports which came into force on 1 April 2014. Heathrow is required to put in place a detailed operational resilience plan to protect, as far as possible, the interests of users of the airport in the case of unforeseen disruption to normal operations. These contingency plans must be published. Where such an event occurs, the licensee must provide accurate and timely information for the benefit of interested parties.
- 12.4 Heathrow is reasonably required to ensure financial resilience to maintain operations, as well as to submit a continuity of service plan to the CAA, to be implemented in a situation where the Licensee is no longer able or willing to manage the airport.
- 12.5 There are also conditions related to consultation. Heathrow is required to consult on a wide range of issues including airport charges, capital investment, service quality, traffic forecasts and operational resilience.
- 12.6 CAA may alter a license in accordance with Section 22 of the Act where it believes that there has been a material change in circumstances since the granting of the license, and as a result of this change, a modification of the license would be in the interests of users. This must be consulted on with interested parties. A notice must be published specifying the change and inviting submissions, following which a decision is made by the CAA having regard to any submissions received. Additionally, certain aspects of the license relating to quality of service metrics are subject to 'self-modification'; they may be altered directly by the Airport and the Airlines reaching a consensus. At Heathrow, self-modification of the quality of service metrics has already taken place three times since the license was issued in 2014.
- 12.7 Schiphol Airport in the Netherlands, like Dublin Airport and Heathrow Airport, has been deemed to hold monopolistic market power. It is also regulated by means of an operating license. As well as setting out the framework for deriving a price cap, the license includes a requirement that the Airport produce a development plan at least once every three years. This must show how the Airport intends to meet predicted demand over the next five years. It must also show progress against the previous development plan. Failure to abide by any term in the license can result in the imposition of a fine. The license may also be revoked from the airport operator if the Dutch Ministry for Transport believes that the continuity of service at the airport is at risk due to mismanagement. The Minister is given broad power to issue instructions to the airport operator to prevent or rectify mismanagement in advance of taking such a step.
- 12.8 In the UK, a failure to uphold any licence condition leaves the licensee open to sanction. CAA issues a contravention notice if it suspects contravention of a licence condition. This can be followed up with an enforcement/urgent enforcement order and/or the imposition of a

penalty. The Civil Aviation Act 2012 allows the CAA to impose penalties for breach of licence condition or breach of enforcement order, up to 10% of qualifying turnover or 0.1% daily penalty. The CAA have stated that the amount should be proportionate to the offence and the damage caused, as well as the degree of culpability.