

# **Aer Lingus Response to the CAR on ATS Charges (CP5/2001)**

Aer Lingus welcomes the opportunity to contribute to the Commission for Aviation Regulation's review of ATS charges. High quality ATS and other navigation services are crucial to safety and to the continuing development of Ireland's aviation sector. Safety and high quality service come first but we also note that navigation charges, while a small proportion of total aviation costs, can significantly affect the competitive position of the aviation sector in Ireland against foreign competitors.

Overall, we believe that the IAA is doing a good job in providing navigation services, both in terms of the quality of its service and its efforts to reduce costs to its customers. The Commission's task in this review should, in our opinion, be to establish a regulatory regime to ensure that this good performance continues, rather than to propose radical reforms. Unit ATS charges have fallen substantially in recent years, as the IAA has accommodated rapid traffic growth without a proportional increase in costs. This increased efficiency has not come at the expense of reduced service – indeed the IAA has improved its capability to the extent that better ATS services have increased the effective capacity of Ireland's airports. Without such improvements, controls might have had to be introduced on aircraft movements in Dublin, to the detriment of the aviation sector and the Irish economy more generally.

Because we see little need for wholesale reform (and because the charges under consideration are relatively small) we have not compiled detailed answers to each of the questions raised by the Commission in its CP-5 consultation paper. Instead, this note sets out our views on what we see as the key issues raised in that paper.

## **Framework for regulation**

We support incentive regulation through price caps. We believe that the IAA should receive a proportion of the benefits from cost reductions, to promote continuing efforts to reduce costs. However, as noted above, we believe that the IAA is currently performing efficiently and we would not want to see an unduly "tough" price control that could prevent investments to enhance service quality. Charges should not rise but we would be surprised if there were scope for a substantial reduction.

## **Structure of charges**

The Commission has asked whether it would be appropriate to introduce a more complex charging structure, based on estimates on marginal costs. We do not see any need for such a change and we strongly doubt the practicality of any such scheme.

Firstly, it is notoriously difficult to estimate marginal costs of navigation services, whether long run investment costs or short run social costs, because it is not possible to allocate costs reliably to specific activities. Too many navigation costs are shared between different activities and attempting to assign costs to aircraft movements is unlikely to result in a meaningful set of price signals to customers. Furthermore, there is considerable redundancy of equipment to provide back up for safety reasons. A particular problem with ATS is distinguishing between social costs caused by navigation bottlenecks<sup>1</sup> and those for which the airport operator is responsible.

Secondly, it is worth noting that complex pricing structures can only be justified if they result in changes in behaviour (such as re-scheduling away from peaks). ATS charges are far too small to result in any such changes. Even if (for example) charges at peak times were to double, costs would only rise by about 50p/passenger. No airline will change its schedule in response to such a change and we find it hard to believe that any passengers would select alternative flights if the increase were passed on in fares.

Similar arguments apply to other possible changes to the charging structure – such as two-part tariffs, changes to the weighting given to MTOW in the charging formula or separate charges for different services. We doubt that any analysis could reliably result in a more efficient charging structure and we are confident that any such changes would not result in changes to behaviour (and would therefore have no beneficial effects). We therefore see no reason to alter the existing charging structure.

## **Scope of charges**

At present, ATS charges in Ireland are consistent with those in other European states in that they cover costs associated with aerodrome and approach control of flights entering or leaving a 20km radius from the airport. In effect, this formula sets the relationship between charges for national traffic and charges for carriers over-flying Ireland.

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<sup>1</sup> These only arise in very exceptional circumstances in Ireland and we see no reason for altering the charging structure to reflect these rare events.

The relationship between the two is particularly important for the Irish aviation sector because of Ireland's geographical position. The appropriate decision process for changing this balance is therefore at the European level. We understand that the European Commission is considering whether changes are necessary and we would not support any unilateral changes to the balance of charges while those discussions are under way.

### **Price control mechanism**

Cost-reflective pricing should indicate a cap on total revenue, with the cap set by reference to forecast traffic.

### **Exemptions**

At present, military and emergency services and small aircraft are exempt from ATS charges. We see no reason for maintaining the exemptions on any of these categories. Clearly, ATS costs are incurred by military and emergency services. The costs of these essential activities should be paid by general taxation. Exemption of very small aircraft is even less justified – again, they impose costs (cash costs and, in principle, congestion) that are paid by other users.

### **Investment, incentives and consultation**

Our experience is that the Authority does a good job in ensuring that its investments to improve quality and accommodate increasing traffic are timely and efficiently costed. At present, therefore, we do not believe that the Commission needs to establish any incentive regime to ensure that this will continue, nor to establish a complex monitoring system. Obviously, if problems arise in the future this may be required but the regime that (implicitly) applies to the Authority at present seems to be working.

We would urge the Authority to maintain its approach of consulting the aviation industry on large new investments and perhaps the overall investment programme. Such consultation needs to be effective and timely to allow changes to be made if customers disagree with plans.

### **Cost base and cost of capital**

Costs recovered in ATS charges should be only those investment and operational costs solely incurred in the provision of ATS services. Assets should not be included in the regulatory asset base until they are actually completed, to guard against perverse incentives not to carry out planned investments. Assets should be valued at historic cost, updated for inflation and reasonable depreciation.

The expected rate of return (under the price cap approach) should be set equal to the cost of capital. Traditional CAPM models of the cost of capital are unlikely to be of direct relevance in this case because of the lack of comparators with traded shares to reflect any industry-specific risk. ATS services are generally provided by State bodies.

We find it unlikely that the IAA faces any real commercial risk in the same way as would either a private sector company or a state-owned company operating in competitive markets. Any investor will be aware of the IAA's statutory obligations with regard to providing air services and would doubtless conclude that the investment is no more at risk than investment in a Government department to provide its services. The IAA provides services to which the Government is committed. Consequently, there is no obvious reason why the cost of capital should be set above the Government's own cost of capital.

### **Quality**

Again, we see no reason to establish a complex monitoring regime or a set of specific incentives to promote service quality. Statutory obligations define most of the relevant quality measures. At present, we are satisfied that the Authority is meeting these obligations effectively and improving quality where necessary. In particular, we strongly support the proposed reduction in separation between aircraft landing at Dublin to three miles. This will prevent constraints emerging at that airport. If for some reason the IAA does not implement this essential improvement, airlines will have to bear significantly increased costs. A compensation scheme would be appropriate under such circumstances.

### **Efficiency and benchmarking**

We suspect that benchmarking ATS charges would be very difficult because of the different circumstances and coverage of charges in different countries. In any case, we would be surprised if any such process (at least within Europe) did not show the IAA to be significantly more efficient than its rivals. We note for example that Eurocontrol reports that Ireland has the equal-lowest (with Cyprus) en route unit rates in Europe, at less than 25% of UK rates. ATS charges are almost certainly proportionately low. The IAA needs to continue to perform at the competitive frontier but we believe that simple checks on the comparative level of ATS charges are sufficient at present.

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**I enclose the response of Aer Lingus to the Consultation Paper on Economic Regulation of Aviation Terminal Services Charges (CP5/2001).**

**Please do not hesitate to contact me further in relation to the submission enclosed.**

**John O'Donovan**

**Company Secretary**