18 August 2020

Commissioner Mannion
Commission for Aviation Regulation (CAR)
3rd Floor, Alexandra House
Earlsfort Terrace
Dublin 2, D02 W773
Ireland

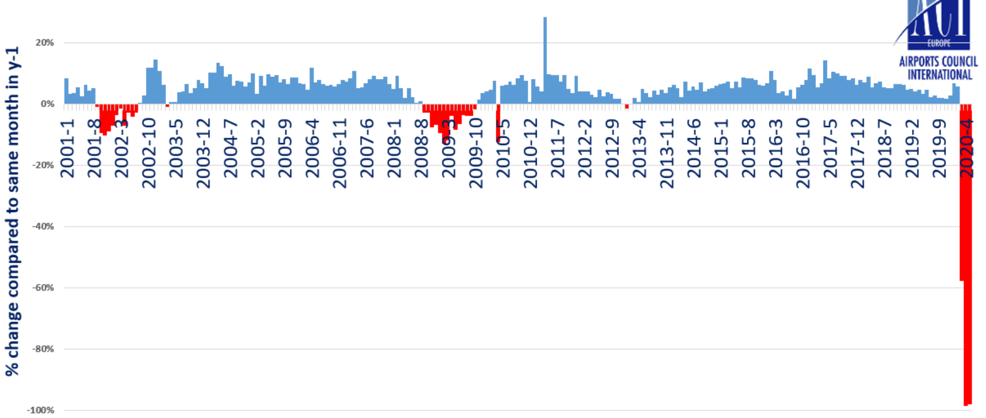
Re: Consultation paper on the COVID-19 price regulation response for airport charges at Dublin Airport (CP3/2020)

Dear Commissioner Mannion,

ACI EUROPE welcomes the paper published on 30 June to consult on the COVID-19 price regulation response for airport charges at Dublin Airport. This initiative from the Commission for Aviation Regulation (CAR) is an important regulatory action to ensure the credibility of economic regulation, the long-term financial equilibrium of Dublin Airport, and its ability to serve airlines, passengers and society.

Public health responses necessary to stop the spread of the COVID-19 pandemic have had a **drastic impact on Europe's airports.** Passenger traffic decreased by -64.2% during the first half of the year and came to a **near standstill in the second quarter, with a drop of -96.4% compared to the same period in 2019.** The **impact on Dublin Airport particularly was even greater,** given its exposure to the United Kingdom and the later but stronger quarantine requirements enacted.

Figure 1: Monthly European airport passenger traffic year-on-year, 2001-2020



In this letter, ACI EUROPE firstly argues that this shock should lead **to implementation of an alternative regulatory mechanism** in place of regulator-determined prices; and secondly, recognising the deeply embedded place of building-block based regulation for Dublin Airport, argues **that the 2019 Determination must be re-opened**.

Economic regulation is surely not meant to impose on airports conditions that are rigid, inflexible, and largely divergent from the assumptions of the regulatory agreement. Such an outcome would challenge the credibility of economic regulation.

1) **ACI EUROPE urges regulators to acknowledge the gravity of the situation, and to recognise that intrusive price-setting economic regulation is no longer relevant.**

Airport competition & airline buyer-power can no longer be discarded [Question 4]

ACI EUROPE suggests to the CAR that it consider this crisis as a moment not for a ***'re-do'*** of the 5 year price determination, but a time to ***'re-set'*** the entire method of price regulation of Dublin Airport**.** Alternative methods for economic regulation that have proven to work well in other jurisdictions, protecting consumers, promoting competition, and resulting in prices, capacity & quality that are determined by market forces.

ACI EUROPE has long argued that for many airports in Europe, a price cap established from regulator-determined building blocks is unnecessary. Such a regime is established with the best intentions to protect consumers from over-paying and prevent distortion in downstream competition, but the inevitable imperfections may instead serve to simply protect airlines' sunk costs. Furthermore, regulatory rigidities may prevent an airport from offering varied pricing schemes which stimulate competition in the airline market, where the air fares paid by consumers are ultimately determined.

Increasing evidence demonstrates that there is effective competition in the marketplace for providing airport services. This especially holds true for airports serving airlines that operate from multiples bases and/or multiple hubs. These airlines can switch their aircraft between bases and routes. An airport facing a small number of large buyers may also face a disproportionate response to any change in airport charges. The underlying demand from consumers for transport services, by impacting airline's pricing power, will have a direct impact on the return that the airline obtains on a route and the prospects for the airline to maintain the route. This marginal flight is where competition happens, and where the market determines prices.

Alternative regulatory models that would allow already the *"optimum response of an operator"* exist. The CAR is more than adequately informed on the types of regulatory models, which were recently reviewed in the paper ***Remedies Available to ISAs to Address Potential Misuse of Significant Market Power by Airports*** published by the Thessaloniki Forum of Airport Charges Regulators in December 2019. Implementing an alternative regulatory method would improve on:

- **Timeliness**: The Irish regime will require a minimum of 4 months (if this consultation concludes with Option 1) and up to 18 months (a full review concluding at end of 2021). Other airports, where prices are still monitored by an economic regulation authority, have already come to agreements with airlines about the adjustments to prices necessary [see for example Flughafen Zürich AG successfully concludes Negotiations on Flight Operations Charges (15 July 2020)]
- **Costs:** The extensive processes for the determinations of the price cap at Dublin Airport have ensured high transparency & lengthy consultation in which all parties can feel that they were heard, but at a great cost. And it has not avoided appeals, by both airlines and the airport.
- **Airport-Airline engagement:** Airlines and airports have often appealed decisions to a further level. ACI EUROPE has frequently pointed out that in a regulator-centric regime, both parties work on influencing the outcome of the

regulator’s determination. When the parties are incentivized to come to an agreement between themselves, without resorting to the regulator, the parties will constructively engage. The UK Civil Aviation Agency’s experience with constructive engagement is instructive on this.

- **Capital expenditure planning:** Dublin Airport’s Capital Investment Plan is intensely debated between the airport and users. This is logical because capital expenditure is what drives changes in airport charges, and airlines would like to minimise their airport costs, while also having capacity available at the time when they want to use it, while preventing airline competitors from entering the market. This timing mis-alignment is and will be a point of disagreement with some airlines operating at an airport. Ensuring that airports have more complete ownership of capital expenditure & master planning will remove this as a source of friction.

- **Consumer outcomes:** Clear evidence, from other airports with capacity constraints, reveals that airlines charge air fare premiums when they can benefit from scarcity.[1] One key issue that is treated exogenously to the price determination is the availability of landing and take-off slots at Dublin Airport. However, the scarcity of slots and the use of an administrative allocation process, as enforced by the EU regulation on the allocation airport slots, rather than allowing economic & pricing mechanisms to allocate slots to the most efficient user as a way of increasing consumer welfare, could be improved through a more flexible regulatory system.

2) **When circumstances change significantly, regulators must engage with airports to allow for modifications and flexibility in existing multi-year settlements for the regulation to remain credible.**

Re-opening regulatory settlements for airport charges is a necessity [Questions 1 & 3]

We are aware that the building blocks approach is fundamental to the Irish Government’s preferences for economic regulation of Dublin Airport, and the approach used by the CAR since 2001. CAR may find it undesirable to change this approach. In that case, ACI EUROPE believes that a wide-ranging review of the regulatory settlement is required.

Paragraphs 1.3 – 1.4 state that the assumptions used in the 2019 Price Determination are out of line with actual developments, and are unlikely to converge during the coming 5 years.

With each year, the divergence between the assumed inputs for the price determination and the actual real figures will increase, with the result that the price will be based on input assumptions which are divorced from reality.

In the immediate term, CAR should seek to **decisively offer clarity about the price cap,** for the airport and its users, while also enabling the airport to develop a long-term

[1] Richard Batley, Phill Wheat & Peter Mackie, "Independent Peer Review of Recent Research on the Existence of Scarcity Rents at Heathrow," University of Leeds (22nd August 2019), Study Funded by the Civil Aviation Authority (CAA).
SEO Amsterdam Economics & Cranfield Centre for Air Transport Management (2017) The impact of airport capacity constraints on air fares. Report for ACI EUROPE.

financial plan. This step, **which should be completed in weeks**, can then be followed by a more extensive review of all inputs [Question 3(a)] to the 2019 Determination. This is an initial urgently needed action. Given that airport charges at Dublin Airport were already reduced by 18% against the flat-pricing proposal, a further reduction when the airport is already suffering losses amounting to hundreds of millions of Euros is unthinkable.

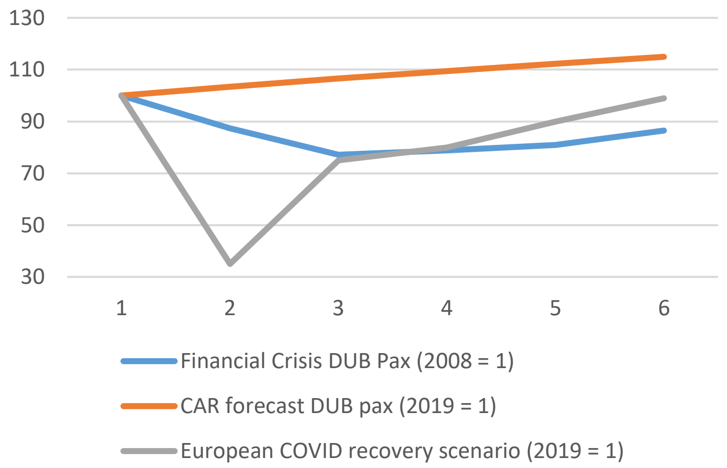
The **issue of an over-collection on a per-passenger level shows the illogic of a mechanically applied price regulation during a shock**. The structure of charges may lead to a revenue/passenger ratio that exceeds the targeted price cap – but Dublin Airport will still be losing millions of euros. To require the airport to pay back at the end of the year the amount allegedly over-collected from the simplistic revenue/passenger ratio would demonstrate an unfortunate tendency in the regulation.

In the following year, it is important to **review all the inputs to the 2019 Determination**. Such an extensive review is unavoidable when the fundamental input – traffic, the denominator for the price cap determination – diverges so far from predictions. Traffic forecasts for Dublin Airport, and at any other airport right now, are practically not feasible to produce with any confidence.

To provide an idea of how far from actual figures this forecast will be, Figure 2 shows the passenger traffic performance at Dublin Airport during the Financial Crisis and economic recovery (blue line), compared to the forecast by CAR for the next 5 year period, as well as an indicative scenario from ACI EUROPE for European airport passenger traffic recovery up to 2024.

Table 2: CAR Passenger Forecast for the 2020-2024 Regulatory Settlement

	2020	2021	2022	2023	2024
Passenger Forecast in use	34,018,557	35,104,318	36,130,831	37,127,690	38,137,380



In the last week of July, both IATA and ACI EUROPE published forecasts for the long-term recovery which see a recovery of full-year 2019 traffic only taking place in 2024. Both these forecasts, similar to the CAR's consultation paper, note the wide range of uncertainty for the development of air traffic. Specific to Dublin Airport, there is a history of recovery from shocks (2009 financial crisis) that took longer than the European average.

At the same time, simply adjusting traffic volume inputs is obviously insufficient. Other building blocks must also be re-set to ensure provision of the right airport infrastructure for passengers and users. **Airport operating** expenditures do not vary in fixed proportion to traffic.

Capital expenditure should adjust to real demand need in the long-term. In principle, a longer regulatory period would be more consistent with airport planning horizons and would enable costs to be averaged in a way that enabled a smoother transition from the congestion to the investment phase of the airport's life. However, the lengthening of regulatory periods brings with it the disadvantages of greater uncertainty. Airports invest in infrastructure for the long-term (30 years for terminals and 60 years for a runway). Regulators will need to support the continuation of airport development for when the demand inevitably returns. Short-sighted cancellation of capital expenditure will exacerbate the capacity constraints which were the biggest worry of 2019.[2]

Commercial revenue generation is especially uncertain as future traveller purchasing behaviour is unknown. The imposition of a single till to subsidise airlines costs with non-aeronautical revenues should especially be critically reviewed at this time, to recognise that an airport has a reasonable expectation to earn a fair reward on commercial investment, and that at the same time the risk of commercial investments should not be placed on airlines.

It must be recognised that estimating costs and forecasting traffic to the level of granularity required by precise RAB modelling becomes more difficult the further into the future it is done, the more so when the sector is as dynamic, commercially oriented and fast moving as European aviation.

Regulating for an uncertain future may require letting the market work

The reflection that CAR is giving today to economic regulation of Dublin Airport will allow the development of robust frameworks during the evolution of the market.

There are more than 450 commercial airports in Europe vying for traffic during the recovery from COVID-19, and only a handful of airlines that are actively shaping the air transport market. The recovery of aviation depends not on guaranteeing affordability for airlines, but the ability of the entire sector to achieve a long-run financial equilibrium.

ACI EUROPE is grateful to the CAR for its consideration of this initial response and is pleased to continue to participate in the discussion.

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[2] Eurocontrol, Challenges of Growth, https://www.eurocontrol.int/publication/challenges-growth-2018