Dublin Airport Authority
Submission to the
Business Regulation Forum

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DUBLIN AIRPORT AUTHORITY plc
ÚDARÁS AERFORT BHAILE ÁTHA CLIATH cpt

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Introduction

This submission is being made by DAA in response to the request by the Business Regulation Forum for views on particular areas of regulation where it is felt that improvements could be made.

The advent of economic regulation for companies in the energy, transport and communications sectors has brought significant change for those involved. Many regulatory decisions not only have a significant impact on the operators within the regulated market, but can also impinge on wider national economic, social and regional development issues.

In this context, DAA welcomes the initiative of the Business Regulation Forum and the company looks forward to engaging fully with the group as it goes through the process of arriving at its recommendations.

Regulation is an intervention within the market and as such it is critical that it operates for its purpose of improving competitiveness (the effective and competitive operation of markets and improvement of infrastructure) and to foster sustainable growth. DAA believes that regulation should be justified, it should be fully transparent, it should not be overtly cumbersome, it must be properly enforced and have no unintended consequences.

This document is organised in three sections:

(1) Issues relating to existing regulatory framework, based on DAA's experience of regulation in the aviation sector;

(2) Specific areas of aviation regulation we feel should be removed or require significant change;

(3) Areas of business regulation that are unnecessarily burdensome or complex.

1. Views on Regulatory Framework Issues

1.1 Requirement for Objectivity and Transparency

In order for regulated firms to be able to fund investment it is essential that potential lenders and investors have confidence that the regulatory regime will treat them fairly and give them adequate opportunity to recover costs and earn a reasonable rate of return. This confidence can be easily eroded if the regulatory regime is seen as taking arbitrary or unreasonable decisions.

From the perspective of the regulated entity, it is the manner in which a regulatory authority carries out its functions which gives legitimacy. Thus it is critical that regulators:

- Establish efficient processes and procedures
- Engage in industry consultation
- Be flexible and objective with a willingness to incorporate evolving regulatory best practice
- Think and act independently of the interests that they have to take into account when reaching their decisions
- Operate in an objective and transparent manner, giving reasoned and clear explanations for their approach and decision making
- Incorporate commercial management, corporate finance and business expertise, rather than simply relying on an abstract theoretical approach.

A lack of predictability, an inconsistent treatment of market participants, prejudgment of issues and questionnable objectivity all reduce confidence in a regulatory regime.

Under the legislation establishing the regulatory bodies, it should be ensured that regulatory authorities are statutorily obliged, when required, to account to a joint Committee of the Oireachtas for the performance of their functions. This is a minimum necessary requirement in view of the perceived democratic deficit arising from the Government's delegation of responsibility to independent regulatory bodies. Current legislation should be amended to compel all sectoral regulatory authorities to report to the Oireachtas regarding their functions on an annual basis and Oireachtas Committees should be adequately resourced to carry out this task.

Concern has been expressed that the independent sectoral regulators need additional powers to avoid the prospect of industry capture. However, under current legislation the sectoral regulators have extensive powers which allow them to obtain information from regulated entities. This provision may be used to safeguard against any form of regulatory capture by the regulated entity. The issues to be considered, at least in DAA's experience so far, are

(a) Whether regulators go far enough to inform themselves by acquiring and using information available to them and

(b) Whether they make clear in their conclusions how they have used that information.

(c) Whether regulators adopt a good faith approach to interactions with the regulated business or choose to adopt a policy of automatically making downward adjustments to correct for perceived bias on the part of regulated companies[1], i.e. an assumption of bias

[1] Note that in its 2006 decision the Aviation Appeal Panel noted in relation to the Commission for Aviation Regulation:

To date, much of the focus regarding regulatory capture has centred on the relationship between the regulator and the regulated entity, insufficient attention has been given to the potential for regulatory capture by industry third parties, in other words the tendency of regulators to give more than due weight to groups who are indirectly impacted by the regulatory outcome. This has serious implications for the independence and integrity of the regulatory process.

1.2 Incentivising Investment in Infrastructure

There is a need for a greater focus on creating incentives for regulated businesses. Regulators should strive to build in rewards for businesses that are or can become entrepreneurial, can deliver capacity and service and contribute to an efficient sector of the economy.

It has been acknowledged that the price cap model of economic regulation, which has been adopted by the Irish regulators, offers little by way of incentive for investment. This price cap regulatory model encourages firms to improve their operational efficiency rather than the efficiency of their capital spend. Experience has shown that this has caused particular problems in capital intensive industries with long asset lives where it is possible to raise spending on maintenance to delay the need for renewal. In the airport sector incentives for investment are further weakened by the use of the single till principle where commercial revenues are used to subsidise aeronautical revenues leaving less funding available for investment in infrastructure.

Investment plans are critical to decisions taken by the regulator on price regulation. The magnitude of capital spend has profound effects on the cashflow and capital structure position, its timing affects the operational throughput of the regulated company and the cost effectiveness of the capital programme will affect the regulated company's self-financing capability and the level of consumer charges. It is possible for a regulator to set a regulatory determination where short term price reductions are achieved at the expense of capital investment e.g. 73% of Dublin Airport's capital programme was rejected by the Commission for Aviation Regulation in 2001 which resulted in lower charges in the interim.

The role of the regulator should be to seek a balance between the objective of protecting the immediate interests of present users and ensuring the long term ability of the sector to meet the needs of future consumers. This is best achieved by applying a test of economic efficiency in order to maximise productive, allocative and dynamic efficiency.

The Commission for Aviation Regulation has recently acknowledged the need to *"maintain a regulatory framework within which the airport operator has the best possible incentives to deliver an efficient investment plan in line with the needs of airport users"*.

DAA believes that the role of sectoral regulators in providing for capital investment in regulated businesses is best discharged by:

"The Panel has aconcern that the Commission believes that DAA will always significantly over-estimate its investment costs and that the appropriate regulatory response is to adjust those estimates downwards by a significant amount, no matter how limited the available evidence on the magnitude of the perceived bias in estimation"
"there appears to be a procedure of making relatively arbitrary, downward adjustments to costs, with the implied intention of correcting for assessment bias. This necessarily implies a disincentive for good faith conduct by DAA and is out of line with best international practice"

- Accepting that infrastructure cannot be delivered unless the regulated entity's costs are remunerated.
- Recognising demand forecasting as a central component of the planning process as it has profound implications for the level and timing of investment.
- Appreciating that the regulator will never be as well resourced in addressing issues such as the design and specification of facilities as the regulated entity and its expert advisers, and as a consequence, avoiding inappropriate reductions in the regulated entity's capital programme as such actions increase regulatory risk and seriously compromise the timely delivery of airport infrastructure.
- Establishing a mechanism for the roll forward of the Regulatory Asset Base (RAB) on the basis of the actual capital expenditure – thereby ensuring that going forward the RAB accurately reflects the underlying capital costs of providing facilities, allowing prices to be equated with actual costs and promoting economic efficiency.
- Allowing for the inclusion of assets in the course of construction in the RAB to maintain price continuity, to reduce the risk of asset stranding and consequent cost of capital increases and to ensure investment is made at the appropriate time.
- Avoiding revenue clawbacks, which have been recognised elsewhere as undermining the incentive properties of the price cap regulatory model.
- Ensuring that, if assets are stranded, the rationale for stranding is soundly based and a methodology by which stranded assets might be assimilated into the RAB in the future is set out, otherwise incentives to invest are weakened and the ability to meet current and prospective user requirements is constrained.
- Recognising that the (often) short-term views of incumbents must be balanced against the long term planning required to deliver infrastructure to meet the needs of all current and prospective users in a timely manner.

2.0 Recommendations for Legislative Changes in Legislation specific to the Aviation Sector

2.1 Recommendation for Change in Section 40 of the Aviation Regulation Act 2001

The Government has appointed regulatory bodies to act independently in carrying out economic regulation of various markets. However, since regulatory decisions have a significant impact not only on the regulated entity but also on the wider economic and social environment, it is essential that legislative provisions ensure an adequate process for appeal of regulatory decisions.

An effective appeals mechanism is an essential component of a well functioning regulatory framework and it is especially important in areas where regulatory decisions may prove arbitrary, unreasonable or based on a poor standard of analysis.

Under the provisions of the Aviation Regulation Act, 2001, the process of appeal by way of appeal panel is quite a restricted procedure and falls short of an appeal on merit. The current appeal panel process available to DAA is inadequate for the following reasons:

- Under Section 40 of the Act, the appeal panel considers a Determination made by the Commission for Aviation Regulation and either confirms a Determination or where it considers there are sufficient grounds for doing so refers a Determination back to the Commission. However, the legislation does not define what would constitute sufficient grounds for referring a Determination back to the Commission.
- Appeal Panels are established on an ad hoc basis. Once an appeal is concluded the panel stands dissolved and an entirely new panel is established in relation to any new or future appeals that may be made. This can result in a lack of consistency over time.
- The process is limited as the appeal panel is not permitted to substitute its judgement for that of the Commission and the Commission can chose to accept or reject the appeal panel's recommendations. The legislation should strengthen the Panel's position by stating that the Commission should take full account of the Panel's proposals.

DAA is of the view that the provision of an adequate appeals procedure for a referral of sectoral regulatory decisions is a crucial issue that must be addressed. The current provisions for an appeal panel under Section 40 of the Act are inadequate and consideration should be given to a number of options for the introduction of procedure for a full appeal on merit including the possibility of an appeal of a regulator's decision to the Irish Competition Authority or alternatively the establishment of a specialist regulatory appeals panel which could hear appeals of decisions from across the range of regulatory authorities. Consistency of the appeals mechanism across regulated sectors will enable Ireland to develop more quickly a corpus of relevant expertise in the appeal bodies, up to and including the courts.

2.2 Recommendation for Change in Regulation 14(3) S.I. No. 505 of 1998 European Communities (Access to the Groundhandling Market at Community Airports) Regulations, 1998

The current position with respect to Regulation 14(3) of S.I. No. 505 of 1998 European Communities (Access to the Groundhandling Market at Community Airports) Regulations, 1998 is a matter of considerable concern to DAA and significantly impacts on the effective management of the airports. This section provides as follows:

> *"Where access to airport installations gives rise to the collection of a fee, the latter shall be determined by the managing body of the airport and approved by the Minister in advance in accordance with relevant, objective, transparent and non-discriminatory criteria."* (emphasis added)

Ireland is the only country in the European Union that, in transposing the Directive into national law, included a stipulation that requires airport companies to obtain prior approval from the Minister (now the Commission for Aviation Regulation) before implementing access to installations fees. This requirement would seem to be contrary to the recent Advocate General's opinion in the *Flughafen Hannover-Langenhagen GmbH v Deutsche Lufthansa AG* case where it is noted in paragraph 74 that:

> *"in stating that any fee for access to airport installations should be determined according to relevant, objective, transparent and non-discriminatory criteria, the Directive does not unduly restrict the right of managing bodies of airports to determine the prices they charge"*

Until recently there had been no clarity as to the charges that would comprise access to installations fees and a requirement for prior approval in a situation of such uncertainty is untenable. A recent legislative development at EU level[2] makes reference to many areas of airport operations[3]. DAA views many of these fees as operational charges, levied in order to facilitate the safe and efficient day-to-day management of the airports and the Commission has agreed with us thus far[4]. However, airline users continue to refer to Section 14(3) of SI505 in support of demands that the Commission adopt a more intrusive role and require prior approval of a range of miscellaneous charges at the airports. This is despite the fact that a number of the charges are applicable to a far wider group of users than simply ground handlers, so a complex situation could emerge whereby charges to one subset of users availing of airport services require approval while the remainder (not caught under the Regulations) operate under a different system.

Ultimately a situation could develop whereby the Commission would not only determine the level of DAA's airport charges income but would also directly regulate a significant proportion of the airports' commercial income streams. Such a situation would result in a degree of interference in the day-to-day management of the airport by regulatory authorities that is clearly not intended by the EU Regulations, would constitute a significant regulatory burden and could result in a diffusion of ultimate responsibility for the safe and efficient management of the airport.

Bearing in mind that Ireland is the only EU country to include this stipulation in transposing the Directive and the significant regulatory burden that it represents, DAA is of the view that the requirement for prior approval specified in section 14(3) of S.I. 505 should be removed.

[2] Flughafen Hannover-Langenhagen GmbH v Deutsche Lufthansa AG

[3] Section 16 of the Advocate General's Opinion in this case makes reference to rents collected for premises, things made available to providers of ground handling services and self-handlers and also certain cleaning and maintenance work and the issuing and checking of entry cards for the workforce of those undertakings.

[4] To date check-in desk rental charges and charges in respect of CUTE have been designated as access to installations fees

2.3 Recommendation for Change in S.I. No. 505 of 1998 European Communities (Access to the Groundhandling Market at Community Airports) Regulations, 1998 to reflect Service Quality Concerns

The economic conditions currently prevailing in the aviation marketplace mean that there is an increasing emphasis on reducing costs to airline users, sometimes irrespective of the implication this has for service levels. This has extended to the ground handling area and is having a detrimental effect on the standard of service quality being provided to the travelling public at Dublin Airport as follows:

- Passengers are experiencing long waiting times for check-in and baggage delivery resulting in congestion and delays.
- The airport image is seriously damaged through media reports of congestion, poor service quality etc.

Regulation 12(3)a of S.I. No. 505 of 1998 provides that the Minister (now the Commission for Aviation Regulation) shall grant an approval to a ground handler where the applicant:

> *is competent as respects experience, financial resources, equipment, organisation, staffing, maintenance and operating procedures to ensure the safety and security of installations, of aircraft, of equipment and of persons*

DAA believes that the level of service quality provided by ground handling operators is directly related to their level of competency. However, the Commission has adopted the view that the issue of service quality is a contractual matter between the ground handler and its client airline.

Given that ground handling operations can affect the efficiency of the entire airport operation, it would be consistent with the approach adopted in other countries if the airport authority were to be given the power to monitor quality standards delivered by ground handling operations at the airports and to take action in the event that standards were not being met. Standards could be set following a consultative process involving the Commission, the airport authority, operators and users.

Alternatively, Regulation 12 could be amended to expressly oblige the Commission to set out requirements in terms of adequate resources and service standards which must be complied with if ground handling approval under the Statutory Instrument is to be obtained and retained. Approvals should be withdrawn if the required service standards are not delivered on a consistent basis. DAA can provide the Commission with information on check-in and baggage delivery standards on a regular basis to assist this process.

2.4 Proposal for legislative change in respect of the Approach to the Regulatory Till

Dublin Airport is currently regulated in accordance with a single till approach. The underlying premise of a single till approach to regulation is that, due to the complementary relationship that exists between aeronautical and some other selected airport activities, revenue from the latter should be used to supplement aeronautical revenue thereby allowing for the subsidy of aeronautical activities by non-aeronautical activities. The single till has been widely criticised on both economic and commercial grounds and a trend away from the single till has been observed in a number of jurisdictions in recent years. For example, in Sydney, Schipol, South Africa, Germany and many of the largest US airports, the single till approach is being or has already been abandoned. Airport charges under the single till may be lower than if they were based on the stand-alone costs of aeronautical assets but it is recognised that the single till provides less incentive to invest in capacity.

As an alternative, the dual till system separates aeronautical and non-aeronautical activities of an airport enterprise as they are treated as separate and independent segments of the business. Airport charges are levied to cover the costs directly attributable to aeronautical activities plus the aeronautical share of common costs incurred by the airport facility. Application of a dual till would, in practice, result in an increase in airport charges, above single till levels. The introduction of a dual till offers substantial economic benefits over the single till approach as it provides for the possibility of enhanced economic efficiency[5].

It would make more economic sense to have all of the costs of provision of aeronautical services recovered by airport charges, hence ensuring better allocative efficiency and price signalling. Moving to the dual till would enhance dynamic efficiency and therefore would best serve the long-term development of the airports sector. It should be noted in this context, that in the cases of other regulated Irish companies such as ESB, Bord Gais and Eircom, regulated activities are not subsidised with revenue from contestable markets.

The existence of the single till creates a considerable risk to the viability of the regulated company where forecasts of its commercial revenues incorporated in the single till prove incorrect as charges are set at a level based on an assumed return from commercial income.

In light of the points made above, DAA believes that it would be appropriate that a legislative amendment be made which mandates that Dublin Airport be regulated based on a dual till principle.

2.5 Recommendation for Change in Section 27 of the Aviation Regulation Act 2001

Under Section 27 of the Aviation Regulation Act, 2001 the Commission is obliged from time to time or when requested to account for the performance of its functions to a Joint Committee of the Oireachtas. However given the need to ensure accountability and transparency in the regulatory process, it is recommended that this provision should be amended to compel the Commission to report to a Joint Committee of the Oireachtas, accounting for its functions on an annual basis.

2.6 Recommendation for Change in Section 22 (b) of the State Airports Act 2004

The State Airports Act 2004 changed Section 32 subsection (5) of the Aviation Regulation Act 2001 and stipulated “a determination shall be in force for such period of not less than 4 years”. However no maximum timescale was specified which means that a Determination could be made for an indefinite period. This has created additional uncertainty and has the potential to be detrimental to achieving economic efficiency. In this context, DAA recommends that the original text of Section 32 subsection (5) of the Aviation Regulation Act 2001 be re-instated i.e. “a determination shall be in force for a period of 5 years”.

[5] The Commission continually refers to economic efficiency as the “driving principle” of its approach.

3.0 Recommendations for Changes in the Business Regulatory Environment

3.1 Local Authority Capital Contribution Levies

It is appropriate that developers contribute to the broader infrastructure requirements of the areas in which they are operating. Local Authorities may impose levies under Section 48 of the Planning Act once they have a scheme in place in accordance with certain obligations under the Act. A scheme may make provision for payment of different contributions in respect of different classes or descriptions of development. Whereas there is reasonable clarity in respect of levies imposed under Section 48, there also appears to be a facility under this Section to impose "special levies", however the calculation of these is much more difficult to assess in advance.

In addition, under Section 49 of the Act, Local Authorities may institute a "supplementary development scheme" requiring contribution in respect of any public infrastructure service or project. Such schemes may not be put in place sufficiently far in advance to allow developers preparing capital investment programmes to incorporate adequate levels of cost certainty when preparing long term capital programmes.

Airports are complex pieces of infrastructure that must be planned well in advance. In addition, Dublin Airport's charges are directly regulated by the Commission for Aviation Regulation, therefore the ability to fund infrastructure is often determined a number of years in advance of a planning application being made. In this context, the inability to predict the level of capital contribution that might be demanded well ahead of time can make business planning very difficult.

DAA recommends that any schemes for charging development levies should be devised in a form that creates certainty in the minds of prospective developers as to the nature of the obligations they may have to meet in the event of them obtaining a planning permission and guard against the perception of arbitrariness in levying capital contributions. Objectivity, predictability and transparency should be the guiding principles.

3.2 Corporate Governance Framework for State Bodies

All semi state bodies, including commercial state bodies operate under the Department of Finance Code of Practice for the Governance of State Bodies ("the Code"). The Code seeks to establish a framework for corporate governance in Irish state bodies. State bodies in general and specifically, DAA, seek to ensure that all activities are governed by the ethical and other considerations implicit in the Code. The Code however sets out quite prescriptive procedures to be followed and differs from the UK and Irish Stock Exchanges Combined Code on Corporate Governance ("Combined Code"), which is essentially a code based on 'principles' underpinned by specific provisions. The Combined Code is also based on a 'comply or explain' principle in which companies are required to comply with the principles and provisions or explain why they do not do so.

The Department of Finance Code acknowledges the difficulties in drafting guidelines, which can provide for all situations that may arise and recognises that issues of applicability and interpretation may arise in certain situations. In certain areas, the Code is more prescriptive than company law or EU regulations (procurement) and does not recognise the competitive environment in which certain commercial state bodies conduct part or all of their business, as exampled by the operation of retail outlets and the purchase of goods for resale. It is not practical to apply the strict requirements of the Code with respect to procurement of goods for resale. Another specific example includes the

requirements in relation to access to infrastructure by third parties, where the value of such transactions exceeds €70,000 specific procedures to be followed are set out in the Code. Again, in an airport context, third parties are granted access to infrastructure and in certain cases (e.g. ground handling) the price for such access is regulated by the Commission Aviation Regulation and in other cases (e.g. property rentals) prices are set by market forces. While DAA subscribes to the principle of open and fair access to infrastructure, a general prescriptive policy, covering all situations is very difficult to enshrine in guidelines.

Commercial state bodies, are from time to time involved in joint venture arrangements or other commercial arrangements at home and abroad. In many cases, the state body does not have overall control of the joint venture entity and therefore cannot insist that such entities, many of which are located outside of Ireland, comply with all the detailed requirements of the Code of Practice. State Bodies should be required to actively influence joint venture entities such that ethical behaviour is the norm and that the spirit of the Code of Practice and all relevant legislative requirements are adhered to. It is not practical however to mandate the full application of the guidelines and detailed compliance with the Code.

Commercial state companies, governed by company law provisions, prepare annual financial statements and directors' reports in accordance with Irish accounting standards Irish GAAP) or international accounting standards (IFRS) and company law requirements. Many state companies also, on a voluntary basis comply with the Combined Code. In addition, these companies are required to comply with and report to the relevant Minister on compliance with the Department of Finance Code. The underlying principles of corporate governance are similar in the various guidelines/legislative requirements but differences in detailed application and compliance can arise. Assessing compliance with detailed guidelines in different formats is time consuming and good standards of corporate governance can be set and adhered to by establishing a common basis for compliance. For commercial bodies, this should perhaps be company law, Irish or international accounting standards as applicable and the Combined Code.

3.3 S.I. 340 Waste Management (Waste Electrical and Electronic Equipment) Regulations 2005

While DAA fully agrees with the need to address issues surrounding electrical waste, the legislation as implemented gives rise to practical problems and related potential additional costs for our retail operations, which were probably not anticipated in advance and which should be addressed. These include inter alia, the following:

Need for display of three prices per item i.e. the Total cost, the WEEE Environmental Management Charge (EMC) and the Net Cost

Price and EMC data must be displayed at point of sale and on receipts. This results in difficulties fitting all the required data on till receipts and on smaller items. A further complication caused by the price display requirements is that of merchandising products with differing EMC charges on the same shelf space or gondola display. Given that on any one gondola / shelf unit there may be several different products which fall into different WEEE categories with different related EMC charges it can be very difficult to get all the information onto labels and display material. Taken together this may result in customer confusion and ultimately loss of sales, particularly in an airport environment when customers generally have less time available to decipher complex pricing. In addition to the possibility of lost sales,

there are other costs from issues such as IT customisation costs to display EMC on receipts, sourcing and purchase of pricing guns that cater for 3 prices and costs of additional display material.

10 different categories for EMC charges

The directive provided for a range of categories of WEEE e.g. large household appliances, consumer equipment, electrical and electronic tools etc. The level of EMC charge payable is dependant on the category to which a product is assigned so accurate assignment is important. However, there are difficulties regarding the consistent interpretation of the category that individual products should be best assigned to. This is a particularly important issue in the rapidly changing product areas such as electronics. Additional administration costs are borne by the business as a result of the need to monitor the appropriate categorisation of products.

Suppliers charge the EMC charge to retailers for collection from end purchaser

An EMC charge is levied to cover the costs associated with the appropriate disposal of WEEE. While suppliers pass on the EMC charges to retailers, there is no commonality of approach – some invoice at line item level for each individual delivery while others group and submit consolidated invoices. In addition, the EMC charge includes both VAT and a small margin that raises issues around revenue recognition and accounting. Inclusion of EMC charges as part of the supplier price impacts on margin analysis in terms of comparability with prior periods and price pointing of products and will take some time to wind out. This results in additional administration costs associated with tracking and reconciling supplier charges for EMC.

Requirement to register with and deal with individual local authorities in addition to the central monitoring body

DAA operates businesses in Dublin, Cork and Shannon. The legislation requires that companies register with the applicable local authority in order to facilitate the funding of the disposal of WEEE. Initial contacts indicate an apparent lack of clarity as to how the legislation is to be policed and applied across various Local Authorities. This results in additional administration costs from having to deal with different approaches from area to area.

Business to Business WEEE

DAA is a major purchaser of electronic items that are not for resale. Some suppliers of these items sell to both retailers and end users. When DAA procures items that are not for resale we are often charged an EMC in error. This is creating additional cost and administrative problems.

There is particular confusion and ambiguity regarding bulbs/lamps/light fittings and EMC's in the legislation for business to business customers. Some suppliers are interpreting the legislation whereby they apply EMC's on lamps when the items are not for resale, though this was clearly not the intention of the Directive. This is creating additional costs to the Company.