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“Airport Charges in Times of Crisis”

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1. Introduction

ACI EUROPE welcomes the Thessaloniki Forum's work on the economic, commercial and regulatory consequences of the Covid crisis. As the Terms of Reference (ToRs) state, this is ***'an exceptional and unforeseeable circumstance that has caused a disruptive and disproportionately large drop in air traffic and the relating costs and revenues of airports'***. Moreover, it is now clear that recovery from the depths of the crisis will not be speedy, at least so far as aviation is concerned. Indeed, the potential for variants to spread across borders, as has already been evident this year, is likely to mean that public health concerns and restrictions continue to constrain aviation activity into the future. It will be years before we see 2019 levels of airport passengers.¹

While the emphasis in the ToRs appears to be on the short term challenge that the sector and regulators face, it is important to recognise that decisions made now in response to those challenges may themselves (as this paper explains) have significant longer term consequences. There is therefore the potential for significant 'scarring' to the long-term detriment of the sector and the contribution it makes to connectivity, the facilitating of broader economic activity and the creation of more productive economies. Nowhere is this more true than for airports which, given the capital intensive nature and relatively fixed cost base, rely on decision making for the long term. Investment decisions today determine the quantum and quality of the airport services that will be provided in the future. There is therefore an important role for regulators to allow airports, in consultation with the airport users, to decide which investments are needed to secure future capacity and service.

While the initial focus of the ToRs appears to be on the evolution of airport charges during the pandemic, ACI EUROPE doubts whether this will tell us very much. This is because the scale and nature of the pandemic effect on activity has been so great as effectively to decouple pricing from its normal economic moorings. Some airports have offered discounts, but maintaining prices was also a market-determined decision where airports have been faced with continuing operational costs and levels of activity resulting from public health and border restrictions. Indeed, in an environment going forward where such restrictions are likely to remain for some time prime determinants of aviation activity, the usual role of pricing in encouraging recovery may be attenuated. This makes it more important that such pricing decisions are left to the commercial judgment of individual airports, assessing the particular circumstances they face.

We respectfully propose that the Working Group should equally focus on how the adverse effects of the pandemic might best be mitigated to the longer-term benefit of airports' customers - airlines and passengers. Solutions will vary depending on individual airports and their regulatory arrangements.

¹ Different units of measure (aircraft movements, revenue passenger-kilometers, passengers, work-load units) result in different estimated quarters during which the quarterly traffic will recover to 2019 levels.

2. Covid impacts on airports

2.1. Traffic, revenues, and costs down

The aviation sector has experienced nothing like the Covid crisis. While 9/11, SARS and the 2008/9 financial crash all resulted in significant traffic downturns these have been dwarfed by the current crisis. The most severe of these reverses was the 2008/9 episode where European airport traffic fell by at most -13.6% in February 2009 and -5.4% for the entire year 2009 compared to 2008. By contrast, traffic in the post-outbreak Q2-4 of 2020 was -83.8% for EU27 below the same period in 2019. Traffic in 2021 first quarter for the EU27 countries remained 83.2% below the levels of Q1 2019. While this contraction has impacted all parts of the aviation supply chain, the physical configuration of airports and their operating model have posed special challenges.

Nearly every airport in Europe closed some or all of its facilities since April 2020 to reduce cost.² Airports have sought to temporarily close facilities, reduce head count either permanently or (using Government furlough programmes) temporarily, and defer or cancel capital expenditure. The aim has been the conservation of cash in aid of financial survival. Nonetheless, airports have a relatively high share of fixed costs, and even airports' variable costs can only be reduced much more slowly than the speed with which revenue declined.

The particular characteristics of airports have constrained the economies that could be made. **The relative indivisibility of physical facilities limited the degree of temporary-closure that was feasible**; airports with multiple facilities could close excess terminals and runways but still needed to maintain an operating minimum even where it was in excess of that required for the traffic available. Airport air traffic control and other essential safety services are similarly indivisible. **Some airports may also have had to remain open for essential services where a more purely commercial approach might have suggested closure.** Others have had to keep facilities open for vital cargo needs – especially personal protective equipment for medical facilities and in recent months vaccine supplies and vaccines.

2.2. Actions taken by airports are efficient responses to extraordinary times

Airports faced very 'high powered' incentives to reduce costs because of the sheer scale of traffic reduction and the strength of the link between passenger throughput and revenues (including commercial revenues).³ The financial consequences meant that airports had to take every operational decision that they could to reduce cash outflows. Differing responses by airports will likely have been conditioned by varying operating and physical characteristics, while any differences between what could be achieved in different parts of the aviation supply chain are more likely to derive from varying cost structures than any lack of cost cutting will.

The resulting working assumption for regulators should therefore be that the actions taken by airports were 'efficient' and that retrospective second-guessing of airport management decisions is both unnecessary and unlikely to be productive when

² While terminal & land-side facility closures have been nearly impossible to track comprehensively, Eurocontrol's Network Operations Manager's COVID Notice to Airpeople (NOTAM) offer indications of the widespread closure of infrastructure. The documents are available here:

<https://www.public.nm.eurocontrol.int/PUBPORTAL/gateway/spec/>

³ Ensuring liquidity for airports during the COVID-19 crisis, ACI EUROPE Working Paper, June 2020, para 2.1.

<https://www.aci-europe.org/component/attachments/attachments.html?id=1023>

collective efforts could more profitably be focussed on solutions to the problems that have resulted.

3. The prolongation of this crisis is important today

It is important to recognise that the Covid crisis is not over. There no longer can before aviation a sharp V-shaped recovery. Indeed, the crisis has so far constantly surprised on the downside. As of the beginning of April 2021 the core EU/EEA/CH/UK market was still down by over 80 per cent. Looking to the future, ACI EUROPE's current April 2021 base forecast broadly maps the pessimistic scenario in its forecast of only 6 months ago. Full traffic recovery to 2019 levels is not now anticipated until 2025. The current pessimistic scenario would see that put off further.⁴

In the meantime, the traffic shortfall relative to capacity is likely to sharpen pressures on airport pricing. **Airlines are putting airports into competition, one against another, for the business there is in a situation of initial excess capacity.**⁵ ACI EUROPE has already identified a gap between traffic and revenue recovery that is likely to be exacerbated by these competitive pressures.⁶

The financial consequences result in airports **reducing or deferring capital investment.** The effects of revenue shortfalls are cumulative; cash conservation will, in the absence of countervailing regulatory or government measures, remain a key driver and, notwithstanding that the efforts that airports make, debt levels are likely to mount further. The capital-intensive nature of airports means that **reducing capital spend is the most effective and immediate way of conserving cash. But that has long term consequences.**

4. The consequences of Covid for airport investment

The level of service that airports can provide – both capacity and comfort – is determined by **investment undertaken some years ago and decided on years before** that. The resulting long lead times reflect the capital-intensive nature of the industry and the physical nature of the infrastructure it requires, often complicated by the need to build within existing operating environments. The service that airports provide 5-10 years from now will therefore depend on decisions taken in the near future. The effects of the Covid crisis therefore pose significant risks.

1. First, **airport balance sheets are strained. Debt may be difficult to raise and/or significantly more expensive** as credit rating agencies reassess the credit worthiness of individual airports and the prospects for the sector. This is exacerbated by the move towards “green finance” which may limit the capital markets for sectors seen as carbon intensive – notably at the end of 2020 the European Investment Bank stated it would no longer provide financing to airport expansion projects.

⁴ COVID-19 & AIRPORTS Traffic Forecast & Financial Impact, Revised 2021 & Medium-Term Forecast, April 2021, ACI EUROPE. <https://www.aci-europe.org/component/attachments/attachments.html?id=1394&task=download>

⁵ “Budget airlines put squeeze on airports in coronavirus cost drive,” Reuters (May 28, 2020); <https://www.reuters.com/article/us-health-coronavirus-airlines-airports-idUSKBN2341JL>

⁶ COVID-19 & AIRPORTS Traffic Forecast & Financial Impact, Revised 2021 & Medium-Term Forecast, April 2021, ACI EUROPE, p.7

Airport debt overall has increased significantly because cost reduction necessarily could not keep pace with traffic and revenue decreases; circumstances will have varied from airport to airport. Some airports have seen their credit ratings downgraded where there was already limited headroom.⁷ Creditors have nevertheless been supportive both in relation to debt issuance and covenant waivers.⁸ Shareholders have had to contribute through foregone dividends and equity injections, but also the foreclosing of future dividend paying capacity to avoid defaulting on bond covenants. Overall, the financial position of airports is significantly more strained and vulnerable than before Covid.

2. **Second, the Covid experience makes airports a fundamentally more risky proposition for equity investors.** There is already evidence of this in the marked and sustained increase in airport equity betas since the crisis. This clearly indicates that **a Covid-like event was not previously priced in.** The crystallisation of a (previously theoretical) global pandemic risk, the potential for it to be devastating and prolonged and the greater sensitivity to the possibility of future global pandemics are all bound to affect equity investors' perceptions and appetites.

While volume risk was already inherent in the airport business in a way it is not in other regulated industries (such as water, electricity or telecommunications), the impact of Covid is of an unprecedented scale. **This fundamentally changes how regulators need to assess the risks of airport infrastructure.**

Left unaddressed, the unavoidable consequences of Covid will be less and more costly airport investment into the future with adverse consequences for airport customers and the wider economy. In this way the Covid crisis has the potential to scar the airport and aviation sectors for a long time. **The question for regulators is what they can do to mitigate the consequences of Covid in ways that leave airports in a better position to address future challenges to the benefit of airlines, passengers and the wider economy.**

5. Competition and pricing

As ACI EUROPE has previously noted, all airports have to compete at the margin and for important segments of their business.⁹ Those **competitive pressures are likely to strengthen in the aftermath of Covid, driven by a combination of initial excess capacity** relative to demand and the likely acceleration in the process of **airline consolidation** whereby a limited number of airlines effectively shape the aviation market. They are increasingly able to place airports in competition with one another. That happens in normal times and is only likely to intensify post-Covid. Airports predominantly serving the **more footloose point to point carriers** are likely to be most exposed but there are also likely to be **pressures on hub airports, particularly where carriers serve multiple hubs and can effectively play one off**

⁷ Negative Rating Actions Taken On European Airports Due To COVID-19 Restrictions, S & P Global Ratings, March 2020.

⁸ European Airports and Airlines: Recovery Prospects, Moody's Investor Service, November 2020.
<https://events.moody's.io/events/mie12085-airport-traffic-recovery-and-future-prospects-2>

⁹ 'The continuing development of airport competition in Europe', Oxera (September 2017)
<https://www.oxera.com/insights/reports/the-continuing-development-of-airport-competition-in-europe/>

against another. The post-Covid experience is likely to add to the evidence that airports are increasingly in competition and to reinforce the arguments for proportionate regulation. As European Commission Executive Vice-President Vestager has frequently stated, regulation should not intervene into a market where competition is not threatened.¹⁰

Any discounts offered post-Covid should, subject to non-discrimination, be a matter for the commercial judgment of individual airports in negotiation with airlines and in line with their (differing) commercial strategies. **The resulting trend of airport pricing is unlikely either to be apparent now, or when it is, to be reflected in published charges as opposed to aeronautical revenue outturns.**

The fact that some airports will be prepared to discount their pricing in the short term to deal with competitive pressures should not be taken to suggest that a general reduction in airport pricing is an appropriate response to the Covid crisis. We set out below some of the **considerations that appear to point in the opposite direction.**

- 1) First, the share of airport costs in airline's total costs is sufficiently low as to mean that **airports could realistically make only a negligible contribution to any attempt to stimulate end-consumer demand.** If reductions in airport charges are not driving changes in air fares paid by consumers, then airlines are asking for these reductions only as a way to have regulators enforce the transfer of financing pain between different parties in the aviation eco-system.

Moreover, **depending on the precise nature of continuing social distancing, airport capacity may well be reached well before the traffic levels achieved in 2019. This will be particularly true of the most prized peak slots. With any such shortage of capacity – whether at airports or amongst airlines – airlines will be able to increase yields, as has already been publicly recognised.**¹¹ If anything the disconnect between airport pricing and fares paid by passengers could become more marked during Covid recovery than already identified in the 2018 ICF report commissioned by ACI EUROPE.¹²

- 2) Second, **the main contribution that airports can make to post-Covid recovery is to ensure that their airport facilities are fully ready for any resurgence of passengers.** That is likely, if anything, to generate upward pressures on charges as it generates increases in operating costs given the post Covid public health requirements.
- 3) Third, it is important to differentiate the recovery from Covid from other traffic perturbations. **Continuing traffic shortfalls are likely to be caused by prevailing public health constraints rather than demand shortage per se.** Compared with the 2008/9 financial crash (and typical economic recessions) consumers generally are

¹⁰ Commissioner Vestager, 2017, "Competition enforcement is a bit of a paradox. Our job is to help the markets work better, and more freely. But to do that, we have to intervene in the market. That makes our work very delicate. We shouldn't step in when competition isn't really threatened."

¹¹ Michael O'Leary on BBC, quoted in Daily Mail, 19 May 2021. <https://www.dailymail.co.uk/news/article-9587615/Michael-OLeary-warns-holiday-prices-increase-10-CENT-summer.html>.

¹² 'Identifying the drivers of air fares', ICF (2018). <https://www.icf.com/insights/transportation/identifying-the-drivers-of-air-fares>

emerging from the Covid with their household balance sheets strengthened, driven by government financial support for jobs and forced household saving due to lockdowns. Price is therefore less likely to be the key confidence factor in getting aviation moving again than consumer perceptions of the public health risks at the airport (and through the broader journey) and of the certainty with which journeys can be made.

In light of these considerations ACI EUROPE questions whether there would be great value from the Thessaloniki Forum interrogating trends in airport charges during the crisis and currently. It is more important to focus on some of the key regulatory issues that will drive future pricing, associated airport investment and performance and resulting consumer and economic benefit.

6. Formulating a regulatory response to Covid

6.1. Recognising the logic of cost based regulation

Where airports are subject to light handed regulation or are effectively outside of price regulation, airport operators will be free to set a price path that, subject to competitive pressures, enables them to secure the revenues needed over time to cover costs and secure the necessary financing. They may face some turbulence but they have degrees of freedom not accorded to airports subject to more intrusive price regulation.

Airports subject to intensive price-regulation operate in a framework where costs and a return on (the WACC) and of (depreciation) the regulated asset base (the RAB) set the maximum allowable revenue. This type of regulation has the effect that in good times, increasing traffic tends to have a depressing effect on prices even as some of the airport's costs rise to deal with demand. But such systems have a logic which tends to increase charges in bad times, and the more so where the bad times are on the scale of Covid.

The key elements that need to be considered to understand the outcomes of price regulation based on a RAB and WACC are:

- The largely **fixed cost nature of airports** which means that, notwithstanding best efforts to make economies, significant reductions in traffic will tend to lead to increases in prices. This is the simple arithmetic of building block cost numerators and traffic denominators.¹³
- The **limited opportunities that airports have, given the existence of the airport slot allocation system, to lay off volume risk** in a way that is available to operators in other capacity markets. To be clear, airlines are willing to go to great lengths to protect slots and prevent other airlines from gaining access to those slots and providing traffic volume. As one airline CEO stated in January, *"If we have to fly empty, we'll probably offer nine euro tickets ourselves to keep those flights in the system"*.¹⁴
- The relatively **low risk customarily embodied in the WACC allowed by regulators**. Airports have generally been regarded as regulated assets carrying less risk than the stock market norm. Moreover, regulatory assessments in recent years have also been

¹³ For an arithmetical example, see 'Re-thinking Economic Regulation as a result of the COVID-19 traffic shock', ACI EUROPE WORKING PAPER (June 2020); <https://www.aci-europe.org/component/attachments/attachments.html?id=1023>

¹⁴ Lufthansa Would Operate €9 Flights To Keep Its Airport Slots, Simple Flying (January 21, 2021). <https://simpleflying.com/lufthansa-9-euro-fares/>

against a relatively benign environment, both in relation to underlying economic circumstances and lack of one-off events which may have accentuated perceptions of low airport risk. While some airports have had traffic risk sharing arrangements most have not. **But the key point is that the market's and regulators' assessment of traffic risk will not have encompassed the scale and longevity of the Covid downturn. That is demonstrated by the marked movement in airport betas.**¹⁵ Had Covid turbulence been within anticipated risk parameters such movement would have been more constrained.

- Regulatory frameworks and decision-making within them can have a significant effect on **investors' perceptions of risk** and therefore the WACC. This means that investors will be focussed not only on the design of future regulation and its impact on risk but on how regulators treat the accumulated losses due to the pandemic.
- The extent to which **adherence to fixed 5 year regulatory periods acts to increase airport risk through potential non-recovery of costs.** The operation of five yearly resets in conditions of enhanced traffic uncertainty of the sort likely to prevail over the coming years will risk airports losing revenues from allowances that are strictly bounded by regulatory periods, effectively diminishing the value that investors can attach to the regulatory asset base.
- Any restraints on pricing freedom could mean that airports are unable to direct support to those routes and services which most need it.

Left unaddressed by regulators these issues will have adverse consequences for airport customers in the near and longer terms This is because airports will be regarded as riskier entities, with implications for the cost of equity and debt finance. Strained balance sheets as a result of 2020 and 2021 losses will reduce credit quality and increase debt costs. This will put upward pressure on charges while airports' ability to finance investment and the cost of doing so will be adversely affected, **precisely the opposite of what is required to enhance traffic recovery and ensure that airports are on the front foot in investing to meet zero carbon targets.**

It is important to recognise here the **additional pressures entailed by governments' greenhouse gas reduction commitments.** Without access to public subsidies for green/decarbonisation investment, airports need to be in a position to self-finance what will be more expensive investment. Capital expenditure that achieves higher standards of energy efficiency and that enables airports to achieve decarbonisation and net zero goals comes with a cost premium. This premium has been estimated at 8% for greenfield capex, and 14-19% for brownfield capex.¹⁶

6.2. Cost based regulation should be more flexibly applied

There are a number of possible adjustments to the way that cost based regulation operates to increase flexibility and reduce unknown risk, and thereby improve the prospects for airport affordability by mitigating increases in the airport cost of capital. These propositions have

¹⁵ Post-COVID airport regulation: a clear path, Oxera Agenda series, March 2021, p.2

¹⁶ Study forthcoming by ACI WORLD on Airport Capital Expenditure Gap.

already been presented in ACI's June 2020 Working Paper on economic regulation¹⁷ and in independent work by the Oxera and Frontier Economics consultancies.¹⁸

In considering them regulators need to bear in mind that **what is done in the short term will, for good or ill, also impact the long term through the medium of investor risk perceptions and the cost of capital.**

To be clear: this means **that actions which appear to convey short term benefit to airport users may in fact work against those users' long-term interests if those actions increase the cost of capital and difficulties of financing airport investment.**

Conversely, acceptance of airport costs may through reducing risk perceptions work to the benefit of users.¹⁹ This is a point which applies at any point in time but is magnified now because of the scale of the Covid shock, the huge impact this has had on airport finances and the fundamental change in airport risk that has materialised.

There is **a benefit to regulators acting quickly to allay investor concerns before the regulatory process itself becomes yet another risk factor** and the new airport risk level becomes solidified and is as a result more difficult to change.

Debt as well as equity investors are interested in the functioning of the regulatory system—credit rating agencies in assessing airports are likely to look for evidence of regulatory support.²⁰

Regulation will for the foreseeable future be operating in conditions of greater traffic uncertainty, making more difficult the forecasting that forms the basis for building block calculations and, more fundamentally, affecting the question of the degree of risk to which airports are subject. Less easily forecastable traffic increases the chances that regulatory outturns will depart from those anticipated. Whereas in principle these outturns might be anticipated to be symmetrical, in practice the regulatory and customer pressures for optimistic forecasting (given the favourable pricing impact of higher forecasts) will tend to lead to an asymmetrical outcome which is likely to be of concern to investors. Aside from forecasting issues, the experience of Covid has sensitised investors to a public health risk that may have always been there but had never fully crystallised before. Absent mitigating regulatory measures the cost of capital will increase.

Fortunately, **there are a number of regulatory adjustments that can be made which will serve to mitigate pricing pressures, including through acting directly to reduce airport risk. These are discussed in the next section. They need not alter the fundamentals of the building block approach but, rather entail operating it in a more flexible way.** There are, of course, arguments for looking again at whether such regulatory arrangements are necessary everywhere they are currently deployed. This question is dealt with further in Section 7.

¹⁷ 'Re-thinking Economic Regulation as a result of the COVID-19 traffic shock', op cit

¹⁸ Destination unknown: airport regulation in the wake of COVID, Oxera Agenda series, April 2020; Post-COVID airport regulation: a clear path, Oxera Agenda series, March 2021.

'A regulatory flight path to recovery' Frontier Economics,; <http://www.frontier-economics.com/uk/en/news-and-articles/articles/article-i7414-a-regulatory-flight-path-to-airport-recovery/>.

¹⁹ This dynamic has been recognised by the UK CAA in Economic regulation of Heathrow Airport Limited: response to its request for a covid-19 related RAB adjustment, CAP 2140, CAA, April 2021, p.7

²⁰ CAP 2014, UK CAA, para 3.43

6.2.1. Sharing traffic risk

Many airports did not have traffic risk sharing arrangements going into Covid, and even for the airports which did have such mechanisms, the Covid shock overwhelmed any anticipated adjustments and therefore could not mitigate impacts of the situation. So, the first measure to anticipate involves some form of traffic risk sharing whereby some proportion of airport traffic risk would be borne by customers, where this does not already exist in the regulatory framework.

This could take the form of a simple pandemic exclusion clause whereby perturbations resulting from **a pandemic, or comparable public health crisis, would lead to a reopening of the regulatory settlement** or a calculation for sharing resulting revenue divergence with customers. However, it is easy to foresee that there might be arguments at the time around the definition of a pandemic, particularly if the impact in Europe had been severe but, overall, the WHO definition had been missed.

The better alternative might therefore be a more general, numerically based mechanism operating to the upside and downside, much like that applying to European air navigation service providers (ANSPs). The numbers could be calibrated either to recognise the assumed flexibility that airports have to vary their costs in line with traffic or to replicate the degree of traffic risk that airports have in practice assumed over the recent past. The latter would leave the balance of traffic risk between airports and their customers effectively unchanged in 'normal' times but provide airports with security over the tail risk involved in major perturbations like pandemics.

In all this it is important that **such a mechanism should be seen as less about transferring risk from airports to customers** (indeed, it could be designed - as suggested above - to mirror the risk balance of 'normal' times) but rather about creating arrangements which enable the parties jointly to mitigate the increase in the costs that airports (and thereby customers) will have to pay for their financing following the revelation to investors by Covid of the reality and potential scale of pandemic-related traffic risk. The mechanics of a traffic risk sharing mechanism will need to involve **revenue flexibility within and between regulatory periods** if the impact on airport charges is to be managed consistent with recovery from traffic disruptions. These issues are covered below.

6.2.2. More flexible regulatory periods

This option primarily impacts airports with multi-year regulatory periods. It may be able to operate in tandem with a traffic risk sharing scheme or as an alternative to it. Five-year regulatory periods tend to have rigid parameters, in principle to provide incentives. During a severe disruption, this means that revenues not recovered (because of a traffic shortfall) in period are lost even where, as with regulatory depreciation, they go to the heart of the investable proposition that is represented by the RAB. Under revised arrangements defined costs that could not be recovered in period would be rolled forward into future periods.

6.2.3. Timing of regulatory cost recovery

Both of the above propositions involve recovery of lost revenues either within period or in future periods. **There will be issues around the timing of such recoveries.** These are greater the more significant the recoveries are. European ANSPs pre-Covid have operated under a n+2 regime whereby traffic risk sharing adjustments, up or down, were made two years after the relevant year. That has operated well. However, the scale of the adjustment

required by Covid has led to discussion of recoveries being phased over 5 or 7 years to avoid a disproportionate spike in prices. **In light of the Covid experience it would be possible to think in terms of automatic formulae which tied length of recovery to the relative scale of the adjustments**, so that modest adjustments were recovered or rebated quickly so as to avoid the unnecessary build-up of a tail of regulatory receivables, reserving the airports' financing capacity for those events, comparable to Covid, where it is really required and of course for ongoing investment.

To the extent that lower traffic levels and recovery of Covid shortfalls entail short term charge increases that are judged to have the potential to impede traffic recovery there may be scope to alter depreciation profiles so that recovery of depreciation is deferred to be recovered across a larger number of passengers.

6.2.4. Dealing with the past

While it might be tempting for regulators and customers to argue that such losses be met by shareholders, two countervailing considerations need to borne in mind.

Firstly, regulatory systems are generally expected to adjust to exceptional events, even if these have not been spelled out explicitly. Covid would meet any conceivable definition of 'exceptional'.

Secondly, even if regulators would prefer to avoid this above responsibility, there is still good reason for action. Investors' perceptions of sector risk are formed not just by the theoretical design of regulatory frameworks but by their experience of how regulation has operated in practice, particularly when confronted by an exceptional crisis and truly transformative losses and financing strains.

What therefore might seem like an easy win for customers will not be so if the longer-term consequences for investor risk appetite are factored in.

This argues for regulators on a case-by-case basis reviewing airports' 2020 and 2021 positions to **determine what proportion of revenue losses should be recovered in future charges**. In doing so it would be reasonable to take account of any government support that had been received. **The scale of the sums involved means that there will need to be examination of appropriate profiling of recoveries so that the necessary charges increases do not act to deter recovery but, rather, are phased so that they are recovered from the larger amount of traffic that will eventually pass through post-Covid**. The important thing for airports seeking to finance the resulting debts in the markets is that there is clarity over both the likelihood and timing of the recoveries.

The approach to such regulatory modifications aimed at deferring revenue recoveries needs to take account of how far, as suggested earlier in this paper, the recovery from the Covid episode is likely to involve as much traffic price sensitivity as more usual recessions and/or airport or airline capacity constraints with potential implications for airline yields.

6.2.5. Pricing flexibility

There is a reasonable regulatory interest in non-discriminatory pricing by airports that have market power. Beyond that, however, **regulators should be in favour of flexible pricing which, as a recent report by Frontier Economics demonstrates, can work to enhance economic welfare**.²¹ While, as explained above, the nature of the post-Covid economy, the

²¹ 'Price differentiation in the context of airports', Frontier Economics (December 2020).

limited impact of airport charges and the public health origin of the restrictions on air travel does not suggest that a general restraint on airport charges is necessary to stimulate aviation recovery, individual airports have recognised that targeted schemes to support particular routes or to assist with restart costs can be a way of ensuring as balanced a recovery as public health regulations allow and of sharing risk with airline customers. It will be important that regulatory systems do not get in the way of these commercial judgments in what is (and will increasingly be post-Covid) a competitive market for airline customers.

6.3. Effect on scope of application of the EU's Airport Charges Directive (ACD)

The EU Airport Charges Directive applies to any airport *'whose annual traffic is over five million passenger movements and to the airport with the highest passenger movement in each Member State'*.²² The severe reduction in passenger volumes has meant that 46 of the 72 airports that exceeded 5 million passengers in 2019 fell below 5 million passengers in 2020. Many will again be below the threshold of in 2021, and there is a possibility that some airports previously subject to ACD requirements may not return to that position for a time.

To the extent that the Covid crisis abates rapidly and the aviation market returns to 'normal' so any issue around the ACD threshold will dissipate.

Were the recovery to take longer and/or to be unevenly spread in a way that adversely impacts smaller airports then a number of airports may find themselves outside the scope of the ACD for longer. This would be a natural corollary of a smaller or differently structured airport market.

ACI EUROPE believes that we need to keep this issue in perspective. It is certainly not among the most pressing or important Covid consequences that face European policymakers and regulators. Moreover, **airports will keep close to their customers and maintain arrangements for consultation, particularly in trying times**. To do otherwise could be self defeating. Airports are also unlikely to see benefit from wholesale change of consultation arrangements where departure from the scope of ACD is likely to be very short term. There will be a degree of self-regulation in these circumstances.

Of course, Covid could lead to some airports falling outside the ACD's ambit for longer. This should be accepted, of course, as **a natural consequence of a scheme with an arbitrary passenger threshold** and should be seen in the context of the increase in the number of airports covered by ACD since its inception. Leaving out of consideration the UK's airports, the number covered by ACD has risen from around 55 in 2009 to 77 in 2019.

7. Looking beyond Covid

The discussion in this paper has inevitably concentrated on the need for regulators to recognise the severity of the Covid impacts on airports and to address some of the rigidities in the operation of regulatory models that will otherwise impede recovery and pose long term threats to airport investment at a time when the pressure is on the sector to change and invest to move towards net zero carbon goals. This reflects the current dominance of economic regulation, usually of a relatively rigid cost-based variety, in the sector.

²² Directive 2009/12/EC of the European Parliament and of the Council of 11 March 2009 on airport charges

However, it also serves to underline the costs of that regulation. **The fact that we are, one year into an almost existential crisis, still discussing possible adjustments to regulation to meet the clear needs of the sector demonstrates how ill-suited models of regulation designed for stable utilities are to the fast moving, commercial and uncertain world of airports.**

The regulatory changes that we have suggested in this paper – pricing flexibility, more balanced risk sharing with customers, flexibility for cost recovery between regulatory periods, greater recognition of the long term planning and investment horizons of airports – would as well as assisting with recovery from Covid help move regulation in a direction that would **mirror better the realities of the commercial world.**

These regulatory proposals **also raise starkly again the question of why so much of the European airport sector is so heavily regulated when there is so much evidence of airport competition and the availability of alternative, lighter regulatory models** which would allow greater room for commercial interaction between airports and airline customers, including through the conclusion of contracts.

It is ACI EUROPE's view that the sector and its customers would benefit from a reduction in the scope of (mainly national level) economic regulation commensurate with the degree of airport competition that is increasingly apparent. For some airports regulation could be lifted entirely, for others modified and lightened. This is an ongoing debate. The more immediate task, recognising the reality of existing regulatory frameworks, is that these are modified to ensure that the sector emerges from Covid in a sufficiently financially resilient place to be able to engage with customers' future requirements and, crucially, the Net Zero carbon emissions policy priority. If current regulatory frameworks prove insufficiently flexible to enable a resilient recovery then that will itself add to the arguments for a more fundamental look at how far they are really adding value for end consumers as opposed to shadow boxing with assumed (and in reality much degraded) market power.

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