



ACI EUROPE Position on Airport Charges

ACI EUROPE believes that the current Airport Charges Directive works well, but that further improvements can be made to the current regulatory framework for airport charges in Europe.

5 key principles will ensure that any economic regulation of airports is focused on meeting the needs of passengers. They will also help ensure that airport regulation is in line with the priorities of both the European Commission's Aviation Strategy and will deliver conditions which facilitate and incentivises sufficient investment into airport infrastructure.

These improvements should be delivered via an evolution in the implementation of the existing EU rules at a national level, with cooperation between national regulators and supported by European Commission guidance.

INTRODUCTION

Aviation is a strategically important sector. It underpins the investment, international trade, tourism and productivity increases that drive economic growth and job creation in Europe. Every 10% increase in air connectivity brings a 0.5% increase in GDP per capita.¹

Adequate airport infrastructure is a core enabler of air connectivity, and in Europe this needs to be paid for via airport charges. It is therefore essential that Europe's overall policy framework on airport charges properly reflects market realities, focuses regulatory intervention where it is genuinely needed, and delivers on the longer-term needs of the ultimate end-users – EU citizens travelling by air.

The EU Airport Charges Directive was adopted in 2009, with an implementation deadline of 2011 for Member States. Within its scope are all airports with more than 5 million passengers per annum (mppa) and the largest airport in each Member State. This encompassed circa 85 airports in 2015. Airports are required to consult with airlines before proposing new charges. To ensure an informed consultation, airports must also make available specific financial and operational information. Each Member State has an independent regulator. If airlines are not satisfied with the proposed charges, they can appeal to this regulator, who will make a final decision. In many Member States these core requirements are part of more elaborate regulatory frameworks which place additional requirements upon the airport.

More recently, a forum allowing all national independent regulators to share experience & best practice and chaired by the European Commission ('the Thessaloniki Forum') has been created to further strengthen the application of the Directive. The Forum has already released 'Guidelines' as to how regulators should implement the consultation &

^{1&#}x27;Economic Impact of European Airports', InterVISTAS, Jan 2015 (link)

transparency requirements of the Directive, and on the calculation of the Weighted Average Cost of Capital. The Directive has also been complemented by industry guidelines outlining in detail how its requirements should be fulfilled in practice.²

Practical evidence demonstrates that the Directive is working well, in spite of its relatively recent implementation. However, a recent assessment of the aggregate performance of the 21 largest airports in the EU & EFTA countries indicates that overall airports are delivering strongly within the current framework. At half these airports, charges actually decreased or remained stable in real terms. Where airport charges increased, these were needed to ensure investment into airport infrastructure. Airports' ability to secure this investment allowed the delivery of necessary airport capacity and significant increases in passenger satisfaction. To fund these improvements, charges at the assessed airports increased by an average of just €2.85 per passenger, over the decade.³

ACI EUROPE has outlined 5 key principles that are essential if Europe is to have an optimal approach towards airport charges. These principles should be deployed via an evolution in the implementation of the current Directive at a local level — with no need for a revision of the Directive itself. The increasingly diverse nature of Europe's airport industry means that any new centralised set of EU-wide legislation is not going to match the specific regulatory requirements at individual airports.

EXECUTIVE SUMMARY

- 1. Key Principles for the Economic Regulation of Airports in Europe
 - Airport competition has now become an established reality, resulting in significant competitive pressure for the airport industry overall – any regulatory framework on airport charges should reflect this via Airport Market Power Tests as well as proportionate & objective regulation;
 - Airport investment drives connectivity, passenger service quality and ultimately wider economic growth & job creation – any regulatory framework must therefore facilitate and incentivise airport investors to continue to provide funding;
 - c. A proportionate regulatory framework should facilitate and incentivise a commercial dynamic between airports and airlines wherever possible;
 - d. Member States and national regulators must remain empowered to flexibly regulate an increasingly diverse & dynamic European airport industry;
 - e. Airport regulators must remain fully independent, focused on the longer-term interests of passengers and the promotion of wider economic development.
- 2. The Optimal Legal Mechanism to Deliver these Principles
 - a. The focus should be on national-level implementation of the current rules no revision of the Airport Charges Directive is necessary;
 - b. If there is to be a revision of the Directive, any new framework should empower national regulators to intervene according to the requirements of specific market realities.

² E.g. 'ACI EUROPE Recommended Practices on Articles 6, 7 & 8 of the Airport Charges Directive', ACI EUROPE, May 2016 (link)

³ These airports are precisely the once which airlines have focused on as having substantial market power. Analysis taken from 'Leveraging Airport Investment to Drive the EU's Aviation Strategy', ACI EUROPE, June 2016 (link)

KEY PRINCIPLES FOR THE ECONOMIC REGULATION OF AIRPORTS IN EUROPE

Airport competition has now become an established reality, resulting in significant competitive pressure for the airport industry overall – any regulatory framework on airport charges should reflect this via Airport Market Power Tests as well as proportionate & objective regulation.

Airports in Europe are in the majority of cases strongly competitive businesses. Airport competition also forms the basis of the EC State Aid 2014 Guidelines⁴ - these rules were designed specifically to avoid the distortion of competition between Europe's airports. A full reflection of airport competition is now needed in airport charges regulation, to restore regulatory and policy alignment. While the EU's Aviation Strategy has recognised airport competition,⁵ this has yet to be integrated into regulatory control of airport charges.

Airport competition is multi-faceted – ultimately comprised of different range of competitive pressures. Pan-European airlines & airline groups with multiple bases can pick and choose the airports at which they deploy their aircraft, giving them very strong bargaining power when negotiating on charges. Non-European airlines looking to deploying their long haul capacity also enjoy the same kind of bargaining power, as they put European airports in competition not just with each other but also with airports in other parts of the world. Finally, given their large sunk investments into fixed infrastructure, airports can also be very vulnerable if a based airline threatens to move even just a proportion of existing or future traffic to another airport. They must therefore make competitive offers to airlines, if they are to safeguard their businesses.

Passengers also have choice. Most airports have overlapping catchment areas with another airport – and often with multiple other airports - providing passengers with a clear choice of airports. Transfer passengers have a wide choice of airports through which they can transfer.

One clear limitation of the Directive is its scope which bears no relation with the actual competitive position of an airport and is now at odds with the policy established for State aid. Ultimately, this will have to change.

Airports are responding to airline and passenger freedom to choose by offering attractive prices and services. At the vast majority of airports in Europe, these competitive pressures are more than sufficient to discipline airport behaviour. Therefore, no economic regulation of these airports is necessary.

Where there is uncertainty as to whether regulation is necessary, national authorities should perform Airport Market Power Tests. These assess the competitive pressures that an individual airport faces on a pan-European level, based on the choice that the airport's passengers and airlines have and the subsequent implications for an airport's overall ability to increase charges. They are used in the UK to determine which airports should be regulated, and if so, to what degree. Any subsequent regulatory intervention should be proportionate to the degree of airport market power identified in the test.

Airport investment drives connectivity, passenger service quality and ultimately wider economic growth & job creation – any regulatory framework must therefore facilitate and incentivise airport investors to continue to provide funding.

⁴ 'Communication from the Commission - Guidelines on State aid to airports and airlines (2014/C 99/03)'

⁵ 'When airports are subject to effective competition, the market should determine the level of airport charges and there is no need for regulation' Sec. 2.2, 'An Aviation Strategy for Europe', European Commission, Dec 2015

⁶ Eurostat counted 45 commercial airports in the UK in 2015. Of these the CAA now only regulates 2 – London Heathrow & Gatwick.

Proportionate regulation of airport charges is so important because these charges are required to maintain and expand airport capacity, and to ensure sufficient levels of passenger service quality – in line with the user pays principle. This is essential for the facilitation of greater air connectivity – a core goal of the EC's Aviation Strategy, and a key enabler of economic growth and job creation⁷.

Europe's airports have been delivering on this responsibility. Over the past decade, the largest 21 airports in the EU and EFTA countries invested over €53 billion back into infrastructure. This delivered capacity for an additional 175 million passengers to go through these airports each year – the equivalent of adding an extra London Heathrow, Paris Charles de Gaulle and Paris Orly to the European airport network.⁸ Overall passenger satisfaction increased by +12.4%, with passengers reporting similar increases in satisfaction across circa 30 different metrics.⁹

Significantly more airport investment is needed in the years ahead. EUROCONTROL estimates that by 2035 some 2 million flights will not be able to take off due to a lack of sufficient airport infrastructure, meaning that 237 million passengers will be unable to fly. There will be more than 20 airports operating at or near full capacity for 6+ hours per day, compared to just 3 in 2012.¹⁰

But such investment must be paid for. Three out of every four passengers in Europe now depart via an airport with private shareholders. And EC State Aid rules in practice remove the possibility of public support for large airports 12. Unlike in other parts of the world, this means that airports need investors or creditors to ensure that their infrastructure is maintained and expanded. These investors and creditors will provide the funds – but only if they can be repaid with a reasonable return.

Passengers and airlines therefore have to pay a sufficient level of charges to cover the cost of the airport facilities and services from which they benefit. Any regulatory intervention must take this into consideration, to ensure that such investment continues.

A proportionate regulatory framework should facilitate and incentivise a commercial dynamic between airports and airlines wherever possible

A more commercial dynamic between airports and airlines has been shown to lead to smoother profiles of airport charges, with more limited increases and decreases in charges. This means that large investment projects can be delivered to the travelling public in a less risky and therefore more cost-effective manner.¹³ In contrast more intrusive regulatory intervention has led to dramatic 'spikes' in charges at airports in Europe over the past decade.¹⁴ As well as increasing risk and costs, this further undermined airport-airline relations.

⁷ 'Economic Impact of European Airports', InterVISTAS, Jan 2015 (link)

⁸ The capacity added very closely matched demand – at the end of the period these airports collectively handled an additional 168 million passengers per annum.

⁹ 'Leveraging Airport Investment to Drive the EU's Aviation Strategy', ACI EUROPE, June 2016 (<u>link</u>)

¹⁰ 'An Aviation Strategy for Europe', European Commission, Dec 2015

¹¹ 'The Ownership of Europe's Airports 2016' ACI EUROPE, March 2016 (link)

¹² Para 105. 'Communication from the Commission - Guidelines on State aid to airports and airlines (2014/C 99/03)'

¹³ For example financing costs are lowered if there is less risk and it may also be possible to limit the level of borrowing required to finance the project. See 'Economic regulation of new runway capacity – CAP 1279', UK Civil Aviation Authority, March 2015 (link)

¹⁴ Over the last decade, the largest increases in airport charges have been at those airports which were most tightly regulated. See **Section 3** of ACI EUROPE Analysis Paper 'Leveraging Airport Investment to Drive the EU's Aviation Strategy' (link)

Given this, for those airports with a significant degree of market power, 'fall-back' or 'trigger' regulation may be most appropriate. In such frameworks the regulator has the power to introduce a more elaborate regulatory regime or to intervene directly, with the airport's behaviour ultimately being disciplined by this threat of intervention. Importantly, the consequence of any such regulatory action must remain unknown in advance – this is essential to incentivise both airport and airlines to focus on commercial negotiation rather than political lobbying.

Such an approach can also facilitate airport-airline commercial contracts – bilateral agreements that typically ensure lower airport charges in return for airline commitments to deliver specific volumes of passenger traffic. Additional conditions concerning issues such as service quality may also be included in such contracts.

For more information on trigger regulation and airport-airline commercial contracts see the Analysis Paper 'Competition in the European Aviation Sector' – available on the ACI EUROPE website.

Intrusive forms of regulation incentivise both airports and airlines to take more extreme and opposing positions and can create unnecessary 'spikes' in airport charges. This transforms healthy commercial tension into unhelpful political conflict. Wherever possible, forms of regulation must be employed which encourage both parties to engage constructively in a commercial environment.

Member States and national regulators must remain empowered to flexibly regulate an increasingly diverse & dynamic European airport industry

To be proportionate and fit for purpose, strong regulation should reflect actual market realities. The current EU framework on airport charges allows regulation to be tailored to national circumstances - and even to the competitive position of individual airports. Member States and independent regulators have indeed taken different approaches, reflecting local circumstances and needs.

In this respect, it must be acknowledged that airport networks and city systems are perfectly valid and well accepted business models in Europe and therefore their particular features must be taken into account. Several Member States use this approach to ensure optimum air connectivity for their regions and the availability of sufficient airport capacity. Such airport groups offer a sustainable and financially viable means of ensuring that EU citizens and businesses are not unnecessarily denied air connectivity. A specifically-tailored regulatory framework is required in such circumstances.

As European airports face increasing competitive pressures, and with different Member States having different connectivity requirements, the landscape will become even more diverse. Where it has been clearly demonstrated that regulation is needed, or where Member States chose to operate airport groups, it will be essential that Member States and regulators retain the power to determine locally the optimal regulatory approach. Specific approaches (e.g. prescriptive & detailed rules on specific forms of regulation, single vrs. dual till etc.) should not be imposed upon national or local authorities by pan-EU rules. Similarly, any EU involvement in airport charges should remain via a European Directive rather than a European Regulation.

Airport regulators must remain fully independent, focused on the longer-term interests of passengers and the promotion of wider economic development.

Irrespective of any future changes to the regulatory framework, there will continue to be competing calls as to how regulation should be implemented. To ensure both optimal outcomes for end users (passengers &

businesses) and a common basic approach across Europe, regulators must remain fully independent. Independence can only be assured if regulators are driven by the principle that their role is to protect the longer-term needs of the traveling public – and not the specific concerns of individual industry interests.

This means that airport charging should be sufficient to ensure that passengers are still able to benefit from airport infrastructure which has been appropriately maintained and expanded via adequate levels of investment.

Sufficient airport capacity is also essential to facilitate proper airline competition and to ensure low air fares. At capacity constrained airports, passenger demand that exceeds supply can result in higher air fares. Indeed passengers in Europe are currently paying a premiums on air fares totalling €2.1 billion each year, due to a lack of sufficient airport capacity¹⁵. In such environments regulators should verify that it is the passenger that ultimately benefits from regulatory intervention. Regulation should ultimately facilitate the provision of adequate facilities for the passenger and deliver adequate capacity to allow competition in the airline market thereby driving down air fares − rather than unsustainably low airport charges and artificially high air fares for the airline.

Any intervention in the aviation market should be ultimately to promote the longer-term interests of the travelling public – not specific players within the sector. Independent regulators should therefore focus on the longer-term needs of passengers.

THE OPTIMAL LEGAL MECHANISM TO DELIVER THESE PRINCIPLES

The European Commission is conducting an in-depth evaluation of the current Airport Charges Directive. As part of this evaluation the question will be considered as to whether the Directive should be revised.

After careful consideration of all options, ACI EUROPE has concluded that the current rules offer the best opportunity to improve the system of regulation of airports in Europe, in both the short and the longer-term. There is no compelling case for a revision of the Directive:

- The indications are that overall the Directive has performed well, with the top 21 airports in particular delivering strong value to their customers over the past decade. The European Commission's 2014 Communication on the implementation of the EU Airport Charges Directive noted that "at this early stage the Commission finds that a number of the main objectives of the Directive have already been achieved." ¹⁶
- The Directive was only due to be implemented in 2011 and is still relatively young. Some Member
 States (e.g. Italy, Spain) introduced entirely new national frameworks when implementing the
 Directive these would most likely have to be re-opened in the event of a revision. Regulatory
 consistency & as much certainty as possible are essential for investment-intensive industries such as
 airports.

Most fundamentally however, the current Directive is a flexible tool, empowering national regulators to respond to specific local circumstances. The UK CAA is a good example of this –it focuses on those individual

¹⁵ 'The Impact of Airport Capacity Constraints on Air Fares', January 2017, SEO Economic Research & Cranfield University

¹⁶ 'Report from the Commission to the European Parliament and the Council on the application of the Airport Charges Directive', European Commission, May 2014

airports which it considers to have substantial market power, and has built a bespoke regulatory approach for each airport.

As the European airport industry continues to become increasingly competitive and diverse, any single set of detailed regulatory prescriptive rules will be less and less fit for purpose. And in parallel, the flexibility afforded by the current Directive will become even more valuable. The challenge now is to empower national regulators to make best use of this flexibility, to tailor their approach to the specific requirements of individual markets and jurisdictions.

There are organisational arrangements in place to facilitate this. Already, the Thessaloniki Forum of European airport regulators has released 'Guidelines' on the Directive's requirements on consultation & transparency, as well as on the Weighted Average Cost of Capital.¹⁷

European Commission Guidelines would offer a complimentary means of supporting regulators in their work.

The current Directive also allows regulators to deliver on the demands of the airline industry – but also to exercise their own judgement and to determine whether these demands are appropriate at an individual airport level.

¹⁷ 'Recommendations on Consultation and Transparency' & 'Recommendations for the Setting and the Estimation of the WACC of Airport Managing Bodies', Thessaloniki Forum of Airport Charges Regulators, December 2016

Ultimately, longer-term work on the implementation of the current rules, which reflects economic principles and the objectives of the Aviation Strategy, will offer the opportunity to deliver outcomes that satisfies all parties – so long as the flexibility to reflect specific market circumstances is safeguarded.

The Perennial Question of the Regulatory Till

The issue of the regulatory till is again being raised by stakeholders ahead of the Commission's evaluation of the Airport Charges Directive.

ACI EUROPE's core position is that such discussions are not helpful in a European context. All discussions on the regulatory till inherently pre-assume that a single, hybrid or dual till regime needs to be implemented – which implies a form & degrees of regulation that may not actually be appropriate or necessary in practice. And imposing a specific type of regulatory till at a European level is never going to meet the actual regulatory requirements at all individual airports.

Finally, the regulatory till debate is also inherently a zero-sum game, with both parties fighting over the margins from commercial activities at airports – concentrating on this issue will create further division and mistrust within the sector.

If however the regulatory till does become part of the discussion, ACI EUROPE strongly advocates for the preservation of a dual till approach, as the most economically rationale approach. Under dual till systems, each party retains the risks and rewards for the activities they undertake. Airports, who operate directly or oversee activities such as retail and food or beverage should retain the margins when they make the right commercial decisions. Equally they should suffer when business plans to not materialise as planned. This ensures that airports continue to face the right incentives to run efficient & commercially viable business activities.

The single-till argument that 'it is the airline which brings the passengers to the airport, and therefore the airline should get the margins from retail' should be strongly resisted. Were this logic consistently applied to the whole aviation sector, airlines would have to pay revenues to the local governments of the destinations they fly to, on the grounds that 'it is the destination that brings the passenger to the airline, and therefore the destination should get the associated margins'.

This is clearly not economically rationale. Whichever party undertakes the business activity should bear both the associated risk and receive any subsequent return.

CONCLUSION

ACI EUROPE believes that the above principles applied to the current regulatory framework can deliver improved outcomes which best serves the needs of the travelling public and the wider economy, and which are in line with both the Aviation Strategy and the Jobs, Growth & Investment Agenda. While tension over airport charges is most likely an inherent feature of the aviation sector, a more proportionate, market-driven, passenger-focused & commercially-based approach is likely to channel these tensions into healthy negotiations rather than political conflict. Essential to this will be local regulatory freedom to respond to specific market realities.
