AIRLINES FOR EUROPE

POSITION PAPER
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A4E'S POSITION ON THE DETERMINATION OF THE COST OF CAPITAL AT REGULATED AIRPORTS

SUMMARY

This paper sets out A4E's position on the determination of the cost of capital at regulated airports. A4E seeks to lower the cost of the EU's airports by ensuring that monopoly airports are effectively regulated, that passengers receive the full benefit of the non-aeronautical revenues which they generate at airports, and that charges are cost-related, efficient and non-discriminatory. A4E calls for reform of the legislation governing airport regulation in Europe and for a more effective regulation of monopoly airports.

A4E believes that in its current state, the EU Airports Charges Directive 2009/12/EC (ACD) is inadequate and ineffective as it only deals with the procedural aspect of consultation and does not protect airport users and consumers from abuses of market power by airports. The ACD fails to provide the right framework for incentivising airports to be efficient and for preventing excessive charging and excess profitability. In fact the Directive fails to require that airport charges should be cost related and based on efficient cost, and it fails to specify the appropriate level of transparency that would encourage cost- based charging and cost efficiency.

A4E believes that the ACD's provisions on how the level of airport charges is set should be reviewed, or the ACD should be reformed, in order to guarantee that the determination of the cost of capital at airports be regulator led, based on a robust methodology and supported by expert technical input.

Airlines for Europe (A4E) is Europe's new and largest airline association, based in Brussels. Launched in January 2016, the association consists of Aegean, Air France KLM, easyJet, Finnair, International Airlines Group (IAG), Jet2.com, Lufthansa Group, Norwegian, Ryanair, TAP Portugal and Volotea, and plans to grow further. With more than 500 million passengers on board each year, A4E members account for more than 60 per cent of the continent's passenger journeys, operating more than 2,500 airplanes and generating EUR 97 billion in annual turnover.

INTRODUCTION

The EU Airports Charges Directive 2009/12/EC (ACD) is inadequate and is ineffective in protecting airport users and consumers. It does not provide for instance any indication on how the cost of capital should be determined at regulated airports.

A4E believes that strong, robust, independent and effective economic regulation is needed to replicate competitive market outcomes where airports enjoy significant market power, in order to protect airlines and their passengers from airports abusing their market power. It is therefore imperative that airport charges be based on efficient costs and investments that deliver the services that passengers and airlines require, and are willing to pay for.

THE PROCESS FOR SETTING THE COST OF CAPITAL

A4E recognises that airport shareholders are entitled to a fair return on their investment. Yet the scale of the return airports should earn, and over what period return should be acquired, is problematic. A4E is concerned about the process for how the cost of capital is set at some airports, particularly in terms of the methodology used, the level of transparency around the data used and the lack of expert technical input. Airports, for instance, consistently overestimate the risk to their business. Inconsistencies in the approach chosen to determine the cost of capital have resulted in wide variations in the level of the Weighted Average Cost of Capital (WACC) across airports in Europe, with WACCs often set unreasonably and unjustifiably high.

The cost of capital being a critical component of airport charges it is vital that it be determined in a sound way that reflects market realities. Where airports enjoy significant market power, the cost of capital should reflect this situation. A4E believes that the cost of capital should be based on robust methodology and subject to expert oversight, that it should be determined by an independent authority, not by the airport itself, and that it should not be set by concession agreements or by national law.

A4E encourages the European Commission to ensure that the cost of capital of regulated airports is set transparently and appropriately – that is, according to true levels of risk. A4E looks to the Thessaloniki Forum of Airport Charges Regulators to set out guidance on both the methodology and the process for how the cost of capital should be set. In particular:

- airports should only recover efficient costs through charges;
- the cost of capital should reflect the inherent risk in the nature of the entity – i.e. a regulated infrastructure entity with significant market power where risk is diversified through fierce airline competition and an extended route network;
- the cost of capital should be determined by an independent regulator staffed with trained experts, or with the help of external, independent consultants if necessary;
- the factors contributing to the cost of capital should be set out in a transparent manner;
- all relevant stakeholders should be consulted on the data and determinants of the cost of capital, and the final cost of capital should reflect these consultations.

THE TOOLS TO DETERMINE THE COST OF CAPITAL

A4E believes that the Capital Asset Pricing Model (CAPM) is an adequate tool to set the cost of capital at regulated airports. The CAPM is by far the most recognised and used model to determine the cost of capital. The individual parameters of the CAPM – risk free rate, asset beta, equity risk premium, gearing, cost of debt, tax rate and asset value (RAB) – which contribute to determine the cost of capital should be consistent and set at a reasonable and justifiable level.