



**AIRPORTS COUNCIL
INTERNATIONAL**

BEHIND THE REGULATORY TILL DEBATE

Ensuring that airports have the right tools to deliver
capacity and service in the air transport ecosystem



THE REGULATORY TILL IN BRIEF

- The regulatory till is a term used to describe which businesses of an airport fall under the scope of economic regulation. Airports supply a variety of services to airlines and aircraft, to passengers, to third-party suppliers accessing the airport, and to local communities around the airport.
- The 'single till' system requires an airport to place all of its revenues, from charges to airlines and commercial revenues at the airport, against one single cost base.
- The 'dual till' system requires an airport to separate its aeronautical and non-aeronautical businesses into two separate cost-centres. The hybrid till uses some commercial revenues to offset aeronautical costs.
- The definition of single, dual and hybrid tills is not straightforward, as most airport tills are in reality somewhere between the two.
- The type of till applied is not an indicator of market power – rather it is the reflection of a business' commercial approach and method for accounting for commercial and retail revenues.
- Both single and dual tills are used widely in practice – In Europe 52% of airports applied a single till, 37% applied a dual till, and 10% applied a hybrid till in 2016. Single till airports handled 26% of European traffic, with hybrid till and dual till receiving 29% and 39% respectively.
- The dual till offers many advantages, including clarity about revenue streams; proper allocation of risks of airports' commercial ventures to the airport, as well as the rewards; and full economic pricing of aeronautical services at their actual cost, to send the right signals about investment.
- Ultimately, the choice of regulatory till is best left to the airport within its regulatory regime.

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UNDERSTANDING THE REGULATORY TILL



This briefing further provides details about the regulatory till. Most discussions on the regulatory till inherently pre-assume that a single, hybrid or dual till regime needs to be implemented – which implies a form and degrees of regulation that may not actually be appropriate or necessary in practice. Imposing a specific type of regulatory till at a European level will never serve the actual regulatory requirements at all individual airports. European regulation should allow an airport to apply the regulatory till structure that suits the need of the airport, its users and community.

→ SINGLE TILL

In a single till, revenues and costs for an airport's aeronautical and non-aeronautical businesses are taken into account when setting the level or ceiling for airport charges. This means that commercial activities of an airport, for instance from off-site parking to high street retail, still fall under regulatory controls.

In application, the single till effectively requires an airport to use its commercial profits to reduce the amount of aeronautical costs that can be charged to users by first deducting profits from an airport's non-aeronautical business. Airport charges are not based on the cost of the aeronautical services, but on that cost minus any commercial revenues.

In some jurisdictions, the removal of certain parts of an airport's business from the regulated perimeter under the single till is allowed.

→ DUAL TILL

The dual till sets the aeronautical charges based on the cost of providing aeronautical services. Non-aeronautical costs and revenues are accounted for separately.

To apply a dual till, an airport operator divides the airport into aeronautical and non-aeronautical business units, and often has its accounts verified and audited by independent auditing firms.¹ More specifically, under a dual till:

- Only the parts of the airport dedicated to aeronautical services or necessary for aeronautical activities, for example surface access, have costs that are to be recovered through aeronautical charges.
- The parts of the airport that provide retail, real estate, food and beverage, shopping and even kiosks within the terminal have costs that are to be paid for out of revenues earned from those activities.

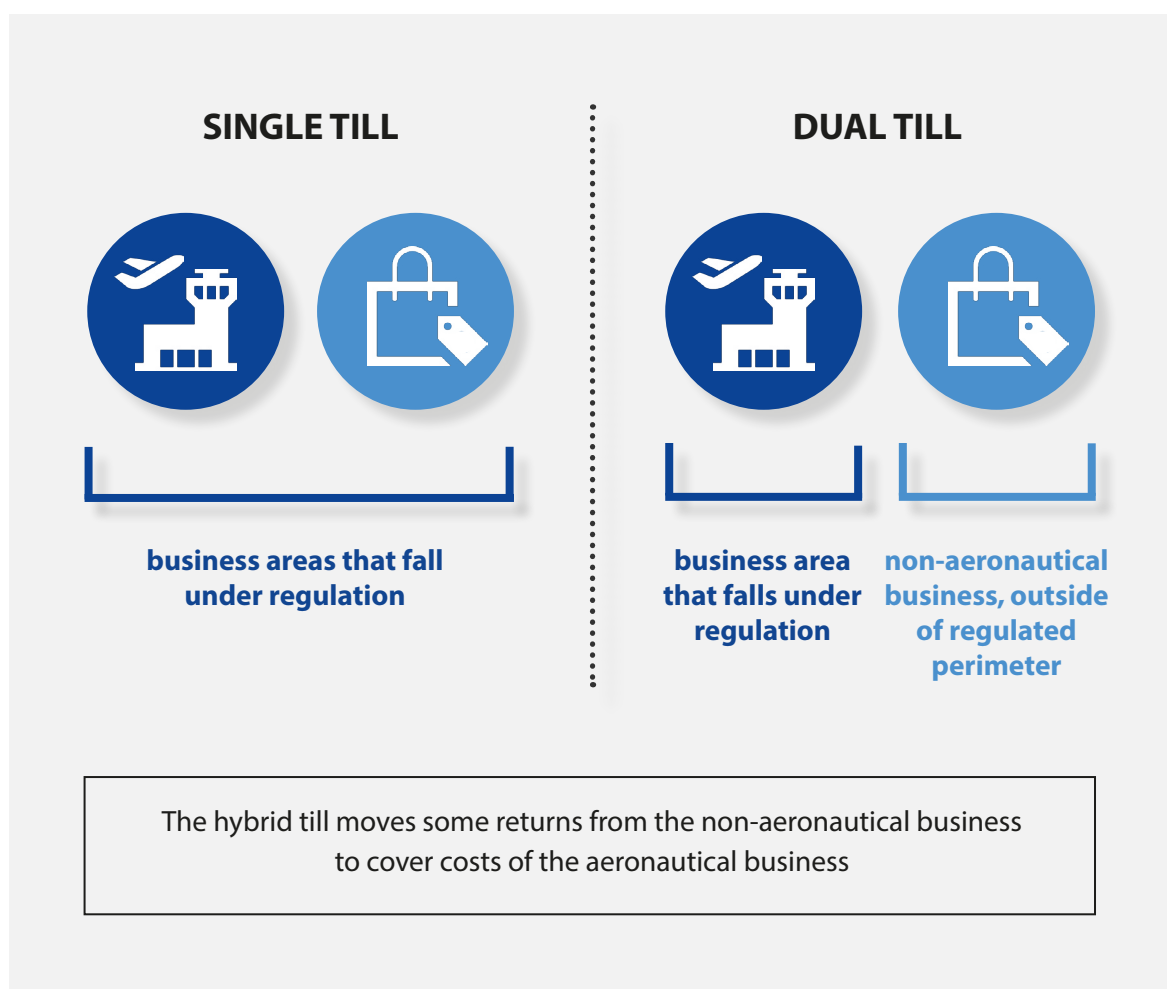
1. In its research papers from 2002 on the establishment of the dual till for London airports, contractors for the UK CAA found that it would be possible to accurately monitor the appropriate allocation of airport facilities and costs to the correct till. *"Airport Cost Allocation Report"*, Europe Economics for the UK CAA (30 April 2001)

The dual till evolved as airports became more intensively engaged in commercial and retail activities, airport operators, owners and regulators realised that better financial accounting was needed.² Furthermore, to ensure that regulation only extends to where it is needed, the dual till restricts the range of regulation to the “monopolistic bottleneck”³

→ HYBRID TILL

The hybrid till moves some returns from the non-aeronautical business to cover costs of the aeronautical business.

FIGURE 1: REGULATORY TILL CONCEPTS

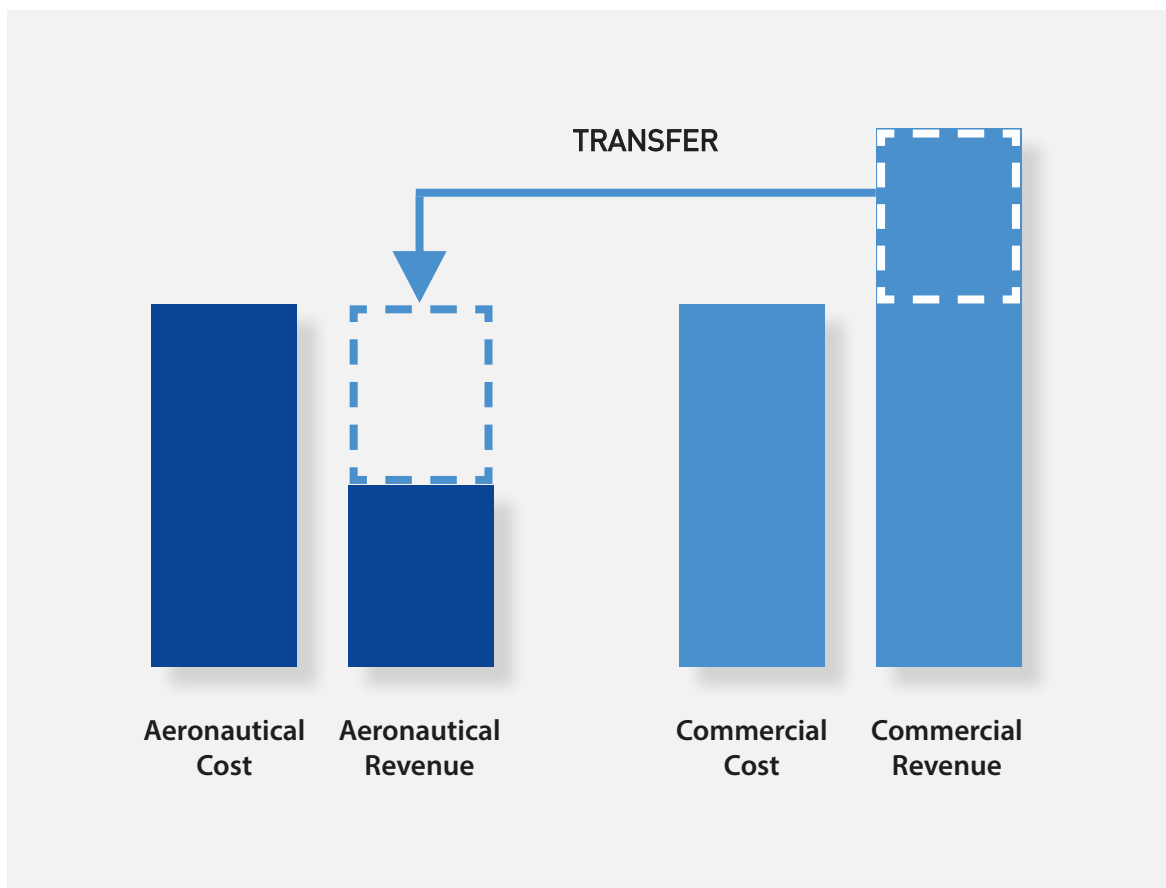


2. The first European airport to apply a dual till was Hamburg Airport in 2000. Niemeier, “Regulation of airports: The case of Hamburg airport- A view from the perspective of regional policy”, January 2002.

3. Ibid.

In practice, the difference between the two systems is that a single till airport must use revenue from commercial activities to cover the shortfall in the aeronautical business (in the chart, the box outlined in white shows how commercial revenues are shifted to cover losses in the aeronautical business). The result is a transfer of economic wealth to the airlines in the form of costs below the real price of the aeronautical services that they obtain.

FIGURE 2: AIRPORT CHARGES ARE NOT COST-RELATED UNDER A SINGLE TILL BECAUSE REVENUES FROM COMMERCIAL ACTIVITIES SUBSIDISE AERONAUTICAL COSTS



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THE AIRLINES' SELF-
INTERESTED DEMAND
FOR SINGLE TILL



The arguments for and against the single and dual till have been resurrected in many different jurisdictions on many different occasions. Most recently, airlines have focused on intervening in the ability of an airport to choose how it conducts its accounting by proposing that regulators should force airports to apply a single till.⁴ Airlines' arguments in favour of applying the single till can be sorted into two categories. Neither of these arguments stand up to evidence or reason.

Airlines claim that airports applying a dual till have more expensive charges

The structure of costs, and the use of non-aeronautical revenue to provide incentives or rebates, may result in real charges (aeronautical revenue per passenger) that are the same under a single till or dual/hybrid till. Financial data for airports in scope of the EU's Airport Charges Directive shows that aeronautical revenues (actual payments by airline) for dual and hybrid till airports was 1.7% lower than at single till airports in 2015, and -0.9% in 2016. This data should be assessed only as a general indicator of the closeness of charges at airports regardless of till. Numerous other theoretical and empirical studies have upheld this fact.⁵ The level of airport charges depends on many variables, one of which is the regulatory till, and there is no reason to assume that an airport with a dual till will be more expensive for an airline to operate at than that same airport applying a counterfactual single till.

Airlines claim that the commercial revenues are created by "their passengers" and therefore a single till is the only "fair" model

The airlines' claim of an "indivisible link" between the passengers that airlines transport between airports and the non-aeronautical revenues that passengers generate is a distributional argument with little merit. While the airline may feel that the passenger belongs to them, this does not entitle the airline to gain from the investment that airports have taken in competitive commercial and retail ventures. If the airlines' proposition applies, then it is also true that the destination brings the passenger to use air travel in the first place. No airline pays a destination for the ability to deliver passengers there, so no airport should be forced to subsidise an airline for the passengers. The question of fair return depends on who takes the risk. With the investment risk taken by the airport, it is also the airports and its investors who should see the rewards. Airlines themselves are free to invest in or operate their own commercial activities inside airports, as some do.

4. Airlines for Europe (A4E) issued a position paper in March 2017 stating that "single till is the only way to effectively regulate airport charges." https://a4e.eu/wp-content/uploads/2017/04/A4E-Position_Single-Till_March-2017.pdf

5. "Interestingly, it seems that the regulation mechanism does not influence substantially on the level of prices charged by airports. Neither the type of regulation mechanism (rate of return or price-cap regulation) nor the scope of regulation (single-till or dual-till) is a very relevant factor." Germà Bel, Xavier Fageda, Factors Explaining Charges in European Airports: Competition, Market Size, Private Ownership and Regulation, Documento de Trabajo 2009-31, Economía de las Infraestructuras, FEDEA – Abertis (November 2009)] Steer Davies Gleave in 2017 for the European Commission examining the evolution of charges at airports in scope for the EU's Airport Charges Directive found that, "Airports with hybrid tills, those that are free to set prices or have no till have witnessed either only a slight increase or a decrease in airport charges." ["Support study to the Ex-post evaluation of Directive 2009/12/EC on Airport Charges" Steer Davies Gleave (December 2017), 4.165.]

3

KEY CONSIDERATIONS FOR CALIBRATING THE REGULATORY TILL



The regulatory till should not exist to subsidise airlines, but should ensure that airlines pay fair costs, that airports earn sufficient revenues to finance long-term costs, and that consumers benefit from quality airports and affordable connectivity.

➔ AN AIRPORT SHOULD BE ALLOWED TO APPLY THE TILL BEST SUITED FOR THE AIRPORT, AIRLINES AND PASSENGERS

The application of a specific till structure should allow an airport, within its regulatory environment, to better serve all airlines and passengers. The application of a specific till should:

- **Base airport charges on costs**

A dual till structure allows an airport to run the aeronautical side as its own business, and provides transparent information about the full cost of providing the aeronautical services.

This is compatible with the 'user pays' principle, widely promoted as the most effective economic mechanism to ensure the users of infrastructure receive the right price signals determining their consumption levels.

It should be noted that, to compete against other airports to attract airlines and traffic, an airport may choose to lower its costs in a commercial agreement with airlines. To do this, an airport will use revenues from commercial and retail services to lower the fees it charges airlines to use the airport.

Under a single till the revenues earned from the non-aeronautical business are subtracted from the cost of the airport, before setting aeronautical charges based on the remainder. This is an enforced cross-subsidisation of profits from the commercial business to reduce cost-recovery needed in the aeronautical business. Consequently, users under a single till system will never pay the full costs of the facilities and services they use.

- **Induce cost efficiencies**

Both single and dual till structures can provide incentives to airport operators to increase efficiency and perform on their targets. The dual till provides a clear signal of the real price of the aeronautical services.

The dual till model places a strong incentive on the airport operator to run the most efficient aeronautical business, keeping costs low for airlines, to enhance its competitive position. Competitive constraints limit the ability of an airport to put in place airport charges at levels about what is supported in the market. By definition an airport, working in a competitive environment, strives towards an increase of volume. If an airport would not strive towards cost efficiency, then it would undermine its competitive position. A higher volume will lead to a more efficient usage of capacity, lowering the cost per passenger. In a dual till system, this leads to lower charges.

The single till structure provides incentives for efficiency and development by incorporating forecast commercial revenue and allowing the airport to maintain the upside should it outperform the forecasts. By re-setting these forecast over a fixed time-period, this provides both incentives for the airport to out-perform the forecast and to invest in the facilities. However, a single till passes profit from non-aeronautical activities to airlines through lower charges than the real cost, effectively subsidising airlines.

- **Drive commercial innovation**

The dual till provides the rewards of investment into commercial developments to the airport operator, as the airport operator takes on board all of the risk associated with its commercial ventures. Therefore, an airport operator with a dual till may have more reasons to make innovative investments.

While many single till airports have driven quality and commercial innovation, it is not possible to consider the counter-factual of the increased risks that the airport may have taken under a dual till regime.

• **Manage risks efficiently**

Airports can take on the risk to develop commercial and retail facilities – but it is neither reasonable to expect that airlines should take the risk for financing this cost, nor that airlines should stand to benefit from rewards in this area.

In dual till regimes, airport operators are the only party to bear the risk of commercial ventures. Efficiency requires allocating risks in consideration of the differing opportunities of the participants to mitigate impacts of worse-than-anticipated business conditions. Airport operators can leverage off their knowledge of airport businesses' clients to weather the consequences of declining commercial profitability.

Under single till regimes, part of risks correlated to commercial businesses is transferred to airlines through higher volatility of airport's regulated charges. Given the rising competitive conditions of these businesses and the lag time necessary to replace an underperforming commercial operator, worse-than-forecast financial results of an airport's commercial businesses is an outcome that deserves scrutiny. If an airport's commercial businesses deliver worse-than-forecast financial results, that could lead to higher-than-anticipated aviation charges due to lower subsidies to be transferred from one till to the other. This contradicts a key principle of economic regulation that calls for an efficient allocation of risks between market participants.

• **Ensure long term development of sufficient capacity and quality**

Airports have faced chronic under-investment or late investment, not infrequently as a result of airlines' tactical use of charges consultations and infrastructure consultations to oppose necessary investment for capacity increases or service quality enhancements. Under-investment is visible in the growing capacity constraints, identified in EUROCONTROL's *Challenges of Growth* series.

The single till prices the use of aeronautical infrastructure below the full cost of providing that service, and as a result may lead to under-investment.⁶ Airports that operate with a single till do clearly have pressures to invest into developing capacity to meet the traffic demand and capital expenditure data demonstrates that single till airports continue to invest adequately to meet traffic demand.

6. This issue was also stressed by the UK CAA in the 2000 Consultation Paper, *The 'Single Till' and the 'Dual Till' Approach to the Price Regulation of Airports.*^{3.38} Of course, many investments will support both aeronautical and commercial activities (for example new terminals). More generally, investments which result in greater passenger numbers will generate additional commercial revenues. Long run returns on these investments will be increased under a dual till, since the commercial part of the return will no longer be clawed back. Thus incentives to invest in increasing capacity are likely to be greater under a dual till than under a single till."

The dual till provides clear pricing signals about true aeronautical costs and allows an airport to earn sufficient revenues on the aeronautical business to attract private financing for capital expenditure on new infrastructure. Regarding service quality, the dual till provides airports with a revenue source to fund investment that individual airlines or groups of airlines have rejected in consultation meetings. If the airport must progress with the investment, to serve passenger needs, despite airline opposition, the dual till provides the airport with the financial resources to do so.

➔ THE TYPE OF TILL APPLIED IS IRRELEVANT TO MARKET POSITION

It is widely recognised that the type of till has nothing to do with market power.⁷ There is no reason why the highly competitive commercial business of airports should fall under the same regulation as the aeronautical business. The dual till came to be used at airports because it is a normal commercial approach.

Airlines have turned to a simple, but misleading, argument to argue in favour of enforcing the single till at airports. Airlines allege that economic theory shows that an airport, in a competitive marketplace, would necessarily have to lower its aeronautical charges as much as it could, using all of its revenue from the commercial business, to attract more airlines, or it would lose these airlines to an airport that did so.

This theoretical argument does not hold true in the real world. The airlines' argument is based in theory using representative airports (where all airports are assumed to be identical). A more realistic framework recognises that airports have different 'firm characteristics' defining the commercial revenues that they generate. This framework would show that airports must compete against similar airports and can differentiate their services based on quality and other factors which explain variations.

Airports operate in two primary markets. The first market is the aeronautical market. This includes all the parts of the airport that serve to allow airlines to use the infrastructure to land and move aircraft to embark and disembark passengers. Evidence indicates that competition constrains the ability of airports to take advantage of any degree of market power.⁸

7. Niemeier wrote that "The single till passes potential monopoly rents from non aviation activities to the users through lower charges, but thereby it does not prevent the creation of market power. As most probably monopoly rents are lower than locational rents, the single till shifts rents without increasing efficiency." Niemeier – Regulation of Large Airports: Status Quo and Options for Reform Discussion Paper 2009-10 - © OECD/ITF, 2009, p. 18.

8. Oxera, "The continuing development of airport competition," September 2017.

The second market that an airport serves is the commercial & retail services in and around the airport. Airports in Europe today are innovative businesses. Parking garages at the airport must offer value and convenience in comparison with local transit, taxis, and off-site parking. Real estate offerings must compete with sites away from the airport. Shops have to offer more convenience and better value than the high street. And in retail and food and beverage, airlines themselves compete; loudly marketing their offerings on the airplane. The commercial business is a fully competitive market. So why should it fall under a regulatory regime which is meant to monitor for potential abuse of market power?

4

THE REGULATORY TILL & THE POLICY CONTEXT



➔ 2011 EUROPEAN COMMISSION WHITE PAPER ON TRANSPORT⁹

The White Paper contains the Commission's vision for the future of the EU transport system and defines a policy agenda for the next decade. While the specific issue of airport regulatory tills would not fit within a wider strategy document, the White Paper does embrace broader principles which provide guidance on such more granular policy issues.

In particular the White Paper endorses the increased use of the 'user-pays' principle – i.e. the standard economic principle that efficiency is maximised when users of infrastructure (in this case) pay for the full costs incurred in providing these facilities and services. To do otherwise creates distorted incentives and ensures a mismatch between supply and demand resulting in an inefficient market outcome. For example, in the aviation sector, if a congested airport operating under a single till consequently does not charge the full price for use of a scarce runway, more airlines and passengers will be incentivised to use that airport, even though there is already insufficient capacity. Meanwhile service quality may be lower than passengers actually demand (even aside from the problems associated with congestion), and the airport operator faces more challenges in making the investment necessary to relieve the congestion. This will become increasingly an issue as the European airport capacity crunch continues to squeeze.

As summarised in the White Paper *'Transport users pay for the full costs of transport in exchange for less congestion, more information, better service and more safety.'*¹⁰

Users under a single till system will never pay the full costs of the facilities and services they use. This may not be compatible with the principles underlying EC's overall transport strategy.

➔ 2009 EU AIRPORT CHARGES DIRECTIVE

The Directive is neutral on the nature of the regulatory till. However, recital 9 references the principle of cost-relatedness. An adherence to this principle may not be consistent with single till pricing where the single till model charges do not fully reflect actual costs.

9. *'Roadmap to a Single European Transport Area – Towards a competitive and resource efficient transport system'*

10. *Ibid*, Para. 19

➔ THE INTERNATIONAL CIVIL AVIATION ORGANIZATION (ICAO)

ICAO is neutral on the nature of the regulatory till, stating that *'consistent with the form of economic oversight adopted, these costs **may** be offset by non-aeronautical revenues'*.¹¹ ICAO provides additional interpretation of this principle.¹² Amongst the guidance, ICAO states the following:

- *'All aeronautical and non-aeronautical revenues from the operation of an airport accrue, in the first instance, to the airport.'*
- *'There are likely to be a range of different appropriate treatments of non-aeronautical revenues by airports.'*
- *'When determining how non-aeronautical revenues may be used, high priority should be given to the investment needs of airports.'*

As with the EU White Paper, ICAO considers that *'as a principle it is desirable ... that the users shall ultimately bear the **full and fair share** of the costs of providing the airport'*.¹³ Again, a proper application of this principle may not be compatible with a single till approach.

➔ EUROPEAN COMMISSION, GUIDELINES ON STATE AID TO AIRPORT AND AIRLINES, 2014 /C 99/03

Paragraph 64 the Aviation State Aid Guidelines explains the permissible arrangements for an airport to offer an airline to start operations at the airport. This paragraph gives permission to cross-subsidise the aeronautical costs with non-aeronautical revenues in a specific commercial agreement with an individual airline. Because paragraph 64 applies to a specific arrangement between an airport and one airline, it is about how to assess at the margin that an airport accounts for all of its revenue streams to be able to offer incentives or rebates. Paragraph 64 does not say that cross-subsidisation from non-aeronautical revenues is the norm, nor that an airport must cross-subsidise across all of the airport's activities as under the single till.

Furthermore, paragraph 97 of the Guidelines states "Investment costs relating to non-aeronautical activities (in particular parking, hotels, restaurants, and offices) are ineligible", creating a clear differentiation between aeronautical and non-aeronautical accounts.

11. 'Doc 9562 - Airport Economics Manual- 3rd edition', ICAO, 2013, Para. 4.119 (ACI EUROPE emphasis)

12. Ibid, Table 4.6

13. 'Doc 9082 - ICAO's Policies on Charges for Airports and Air Navigation Services', 9th edition 2012, ICAO – Section II, Para. 1 (ACI EUROPE emphasis)

5

PROVIDING AIRPORTS
WITH THE MANAGEMENT
TOOLS TO DELIVER THE
OPTIMAL OUTCOMES FOR
PASSENGERS



CONCLUSION

AIRPORTS' FINANCIAL MANAGEMENT IS BEST DETERMINED BY THE OPERATOR

It is of utmost importance to have a framework in place which provides the best conditions for correct airport capacity development in a period when the challenge for European aviation is infrastructure.

Airport competition is an established feature of the European air transport sector today, with airports competing for new and existing airline services, competing for connecting traffic, and competing for passengers in the local area. The aviation marketplace amplifies airport competition and determines airports' price and quality levels. In this competitive marketplace, airports are sophisticated businesses that are focused on increasing their traffic volumes, providing higher quality service to airlines, and meeting passengers' needs.

The price structure should allow airports to sustain themselves in the long term by generating sufficient profit to allow for sufficient investment in future capacity.

In this competitive context, the decision of the regulatory till should be left to the airport, within the regulatory context established in the country where it operates.



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