Final Consultation Document: Quinquennium 2 (QQ2)

Sangster and Norman Manley International Airports

10 December 2018

Contents

Figures and tables

Glossary

‘AAJ’: Airports Authority of Jamaica

‘ACE’: Additional Capital Expenditure

‘AIF’: Airport improvement fee

‘CAPEX’: Capital expenditure

‘CPI’: Consumer price index. A measure of general price inflation

‘JCAA’: Jamaica Civil Aviation Authority

‘NMIA’: Norman Manley International Airport

‘OPEX’: Operating expenditure

‘**PSC’:** Port Security Corps

‘QQ2’: Quinquennium 2, the next five-year review of airport charges at Norman Manley International Airport and Sangster International Airport

‘RAB’: Regulated asset base

‘SIA’: Sangster International Airport

‘WACC’: Weighted average cost of capital

1 Introduction

This document sets out a summary of the responses we have received to our consultation on the 2020 rate review (QQ2) for Sangster and Norman Manley International Airports[1] and our updated positions. This document is intended to assist airports in forming their business plans.

When we published our initial consultation document in October, we invited comments on our proposed approach and included specific questions for stakeholders. We have received responses to our consultation document from MBJ, NMIA and IATA.[2] IAG re-submitted its response[3] to Oxera's key issues report, which was published in 2017.[4] We note that some of IAG's comments are no longer applicable as they are based on work from an earlier stage of the review, but we have addressed the responses where they remain relevant.

In addition to these formal responses, we have held a number of discussions with stakeholders about our proposals for QQ2, including the Board of Airline Representatives of Jamaica (BARJ), the Jamaica Tourist Board, the Ministry of Tourism, representatives from government departments on the Air Policy Committee, and the Fair Trading Commission. Their comments and feedback are incorporated in this document as relevant.

The structure of this document is as follows:

- Section 2 clearly defines the revenue yield cap that is being proposed for QQ2, as this is a key element of the proposed regulatory regime and there were a number of comments from stakeholders on this aspect.
- Sections 3 to 9 then address each area of our consultation document in turn. Each section includes a brief summary of the issues raised and the JCAA's position in the initial consultation document. We then summarise stakeholder feedback along with our responses to the points raised and an update of our position where relevant.
- Section 10 addresses issues raised by stakeholders that are additional to our consultation document and questions.
- Section 11 concludes with a summary of our updated positions after taking all stakeholder feedback into account.

Within the overall rate review process, the next step is for airports to submit their business plans on 25 January 2019. In the meantime, they should be engaging proactively and extensively with airlines and other stakeholders to inform the development of those business plans. Following our review of these business plans, we will set out our proposals for charges for QQ2 in April 2019.

[1] JCAA (2018), 'Consultation Document: Quinquennium 2 (QQ2)', 23 October.
[2] MBJ/Intervistas (2018), 'Key issues for the regulatory review,' prepared by InterVISTAS Consulting Inc. for MBJ Airports Limited, 10 November; NMIA (2018), 'Response from NMIA to Jamaica Civil Aviation Authority (JCAA)', 12 November; IATA (2018), 'IATA Response to Consultation Document', 3 December.
[3] IAG (2018), 'Key issues for the 2020 Rate Review at Norman Manley International Airport ("NMIA") & Sangster International Airport ("SIA")'.'
[4] See Oxera (2017), 'Key issues for the 2020 rate review,' prepared for the Jamaica Civil Aviation Authority, 11 September.

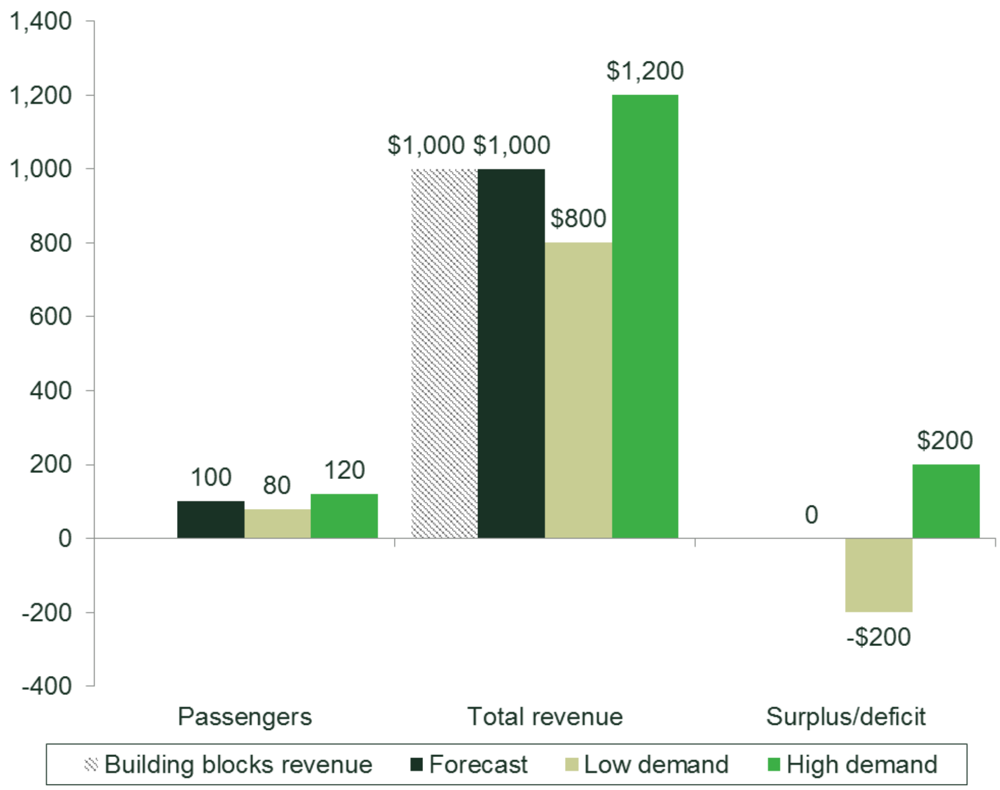
2 Defining the revenue yield cap

As set out in our consultation document, we consider that the most appropriate form of regulation to apply for the 2020 rate review is incentive regulation. We note from the consultation responses that there appeared to be a lack of clarity about the precise form of incentive regulatory regime that we were proposing. As such, we consider that is useful to provide specific guidance on this issue ahead of discussing the more detailed issues in the consultation document.

One important regulatory decision is whether there is a cap set on revenue or prices. A price cap places the risk of actual passenger volumes deviating from forecasts on the airport. Under a price cap, the airport stands to gain if passenger numbers are greater than those forecast, but it might not be able to earn its target rate of return if passenger numbers are lower than forecast. A commonly used version of a price cap at international airports determines the cap based on the forecast revenue per passenger, or forecast revenue yield, and as such is referred to as a **revenue yield cap**. We use the terms revenue yield cap and price cap synonymously in our consultation document.

To illustrate how this might work, suppose an airport is forecast 100 passengers over the rate review period, and based on building blocks revenue of $1,000, a revenue yield cap of $10 per passenger is put in place. Figure 2.1 below demonstrates that, in a ‘low demand’ scenario in which actual passenger numbers are only 80, the airport would not be able to collect the $1000 of allowed revenue (as it would only collect $10 x 80 passengers). On the other hand, if passengers were greater than expected then the airport may be able to earn more than the allowed revenue set by the regulator.

Figure 2.1 Hypothetical example of revenues under a revenue yield cap



We note that in its consultation response, MBJ differentiates between airports that operate under a price cap (e.g. Heathrow and Dublin) and those that operate under a revenue yield cap (only Changi Airport is mentioned). We do not recognise this distinction; at Changi, Dublin and Heathrow, a revenue per passenger (or revenue yield) is determined based on allowed revenues and forecast passengers. Under all of these regulatory regimes, if an airport outperforms on passenger numbers it benefits by collecting the additional revenue yield from these passengers. As such, the regime we are suggesting is in line with these airports as well as a number of others that MBJ has identified as ‘price cap’ in its response.

An alternative approach would be to cap total revenues and allow prices to fluctuate in response to changing levels of demand. In this case, if demand is lower than expected then the price per passenger would need to rise in order to ensure that the airport earns the same level of allowed revenue. On the other hand, if passenger numbers are greater than expected then the price per passenger would fall. In all scenarios, the airport earns the same amount of overall revenue. As noted by NMIA in its consultation response, this effectively transfers volume risk from the airport to the airlines and passengers. While this approach eliminates the potential for regulatory error or exogenous shocks to have an impact on the financeability of the airport, it also reduces the airport’s incentives to grow traffic.

Figure 2.2 demonstrates the potential for fluctuation in prices paid by airlines / customers when a revenue cap is applied. In this case if demand is lower than expected, then the price per passenger would need to rise in order to ensure that the airport earns the same level of allowed revenue. On the other hand, if passenger numbers are greater than expected, then the price per passenger would fall.

Figure 2.2 Hypothetical example of a total revenue cap

We agree with stakeholders that an approach that incentivises airports to achieve passenger growth is important. At MBJ, passenger numbers have been increasing significantly recently, but for many years, passenger numbers were well below forecast levels. At NMIA, passenger numbers have not returned to the levels achieved in 2006/07. As such, we consider that a revenue yield cap should be put in place for the next review.

3 Stakeholder engagement

3.1 JCAA's initial position and consultation questions

Stakeholder engagement is an important feature of this regulatory review. As part of their business plans and airport charges proposals, the airports should highlight the points of consensus and disagreement with airlines and other stakeholders.

There are some areas where it may be more reasonable than others for the parties to engage and reach agreement. For instance, while we welcome stakeholder engagement on areas such as the appropriate WACC or RAB valuation, we will continue to have the ultimate role in determining the appropriate levels in these areas. However, it would be reasonable to expect engagement and agreement with stakeholders on, for example, the level of service quality desired, traffic forecasts and capital investment programmes.

To the extent that there is evidence of good customer engagement, and in areas where there is broad agreement between the airport and stakeholders, we will apply less regulatory scrutiny (with the exception of highly technical areas, as outlined above). Therefore, the more effective the consultation, the more efficient the rate review will be since we will only have to undertake detailed analysis for areas of difference between the parties.

On issues where the parties are unable to agree, the airports should highlight how they have taken stakeholders' feedback into account and the reasons for the parties' different positions.

We invited responses from stakeholders to the following questions.

1. Do you consider that the proposed process for stakeholder engagement is appropriate?
2. Do you agree with the key principles set out to guide stakeholder engagement? Are there other principles that should be considered?

3.2 MBJ Airports Limited

In MBJ's consultation response, it states that the proposed process for stakeholder engagement on higher level aspects (rather than inputs and outputs) is appropriate. MBJ notes that it currently engages with stakeholders, including airlines and others, on various topics and will continue to do so during the 2020 rate review process.

In addition to the key principles set out to guide stakeholder engagement, MBJ suggests that it will look to the guiding principles set out in ACI World's recommended best practices on transparency and consultation with airlines in setting airport charges.[5] We note that these guidelines are meant to be aspirational rather than prescriptive, and that they are not intended to replace the International Civil Aviation Organization's (ICAO) policies[6] or national requirements. We therefore welcome MBJ looking to these guidelines in addition to following the industry-wide guidelines set out by ICAO.

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[5] ACI World (2017), 'Recommended Practices on Transparency and Consultations with Airlines on Setting Charges.'

[6] ICAO (2012), 'ICAO's Policies on Charges for Airports and Air Navigation Services', Doc 9082, Ninth Edition' https://www.icao.int/publications/Documents/9082_cons_en.pdf

3.3 NMIA

NMIA recognises that stakeholder engagement is particularly relevant to the airport as it works with a number of large airlines who will dedicate the necessary resources to make the process effective. NMIA agrees that the process should be led by the airport and notes that it has already begun to engage with airlines with respect to the 2020 rate review process.

NMIA agrees with the key principles set out to guide stakeholder engagement and suggests that it could be useful to engage with passengers directly (via surveys or workshops) to get their views on the airport experience. We welcome this approach as well as NMIA's other suggestions regarding asking airlines about their experiences at different airports. NMIA also notes that it would like the JCAA to encourage airlines to share information and ambitions for the future development of the airport. This is in line with the key principles that we set out in our consultation document, which require 'all parties to provide relevant information in a timely manner.'[7]

We do not agree that disclosure of operating costs or non-aeronautical revenue data to stakeholders is likely to raise issues of confidentiality. Indeed, particularly given the importance of labour costs in the overall cost base, it will be important to disclose information about labour costs (although we appreciate this would not be disaggregated to the level of individual staff members). This information is regularly disclosed to stakeholders by international airports. If NMIA still has concerns regarding confidentiality, we are happy to discuss this further.

NMIA has raised concerns that the current timetable does not leave it with sufficient time to engage with stakeholders and incorporate the outputs into its business plan. As set out in our consultation document, the timetable is driven by the need to reach a decision six months before airlines and passengers pay the new charges. It is also important that there is sufficient time for the JCAA to review the business plans submitted by the airports in order to make informed proposals for QQ2. If NMIA has any further questions or issues with the current timetable with respect to specific aspects, we would be happy to discuss this further.

3.4 IAG

IAG broadly agrees that the proposed extent of engagement between MBJ/NMIA and stakeholders is appropriate. However, IAG has highlighted the need for airports to provide adequate information in a timely manner in order for stakeholders to have sufficient time to respond. We note that this is in line with the key principles that we have set out to guide stakeholder engagement to help the process function more smoothly.

3.5 IATA

In its response, IATA states that it is acceptable for the airport to lead the consultation process with airlines. However, IATA considers that it is important for the JCAA to attend all consultations. We do not feel that it is necessary for the JCAA to be directly involved in stakeholder engagement, but we request that any documents provided as part of this process are submitted to us.

IATA also mentioned that it is important to agree on traffic with users as the airport would benefit from under-forecasting traffic. We note that we have

[7] JCAA (2018), 'Consultation Document: Quinquennium 2 (QQ2) NMIA', p. 9

included advice on traffic forecasting in our business planning guidance, and have also previously suggested that it is important that stakeholders provide the airports with information on their traffic plans to ensure accurate forecasts.

IATA suggests that the key principles to guide stakeholder engagement should follow ICAO guidelines. We agree that it is appropriate to follow these industry-wide guidelines in addition to the key principles we have set out in our consultation document.

3.6 JCAA updated position

For the 2020 rate review process, the JCAA expects to see a step-change in stakeholder engagement from MBJ and NMIA compared to previous reviews, including providing stakeholders adequate time to respond to and comment on plans, and choose between options. We would also expect stakeholders to be more forthcoming in providing information and views to the airports.

We note that MBJ has already begun the consultation process with airlines and other stakeholders regarding the check-in experience and customs and immigration, and that NMIA is seeking to engage with all stakeholders, including passengers. It is important that the responses provided by stakeholders in these consultations are incorporated into the airports' business plans.

With regard to the principles, we propose using the industry-wide ICAO guidelines (Doc 9082) in addition to the key principles we have previously set out to guide stakeholder engagement.

While the JCAA does not need to be directly involved in stakeholder engagement, we request that any documents provided to stakeholders (including information on which stakeholders the airports are engaging with) are provided to us.

4 Form of regulation

4.1 JCAA's initial position and consultation questions

While the airlines at SIA and NMIA are likely to have some degree of countervailing buyer power, the functioning of light-touch and contractual regulatory approaches rely on active engagement and challenge from stakeholders. When we have spoken to stakeholders in the past, they have advised us that they consider that the JCAA is the best party to ultimately decide on the key factors for this rate review.

We believe that rate of return regulation is inappropriate based on the incentives that it provides, and its inconsistency with our duty to promote efficient airports. Rate of return regulation provides weak incentives for cost reduction, as any reduction in costs leads to a corresponding reduction in revenues.

Therefore, the most appropriate form of regulation to apply for the 2020 rate review for SIA and NMIA, in keeping with our duty to 'promote the efficient, economic and profitable operation of airports', is incentive regulation. As explained in section 2, we consider that a revenue yield cap should be put in place for the next review.

We consider that the determination of the required revenues, and hence charges, in this regime should be based on a RAB–WACC building blocks approach. Within this process, we will estimate the target rate of return and forecast efficient cost levels, so that a reasonable cap can be set.

The airports will already have established asset lives and depreciation profiles for the CAPEX invested at the airport. Our starting point for the next review would be to better understand the airports' choice of asset lives and depreciation profiles before proposing any changes. One established methodology for determining the rate of return is an estimate of the company's weighted average cost of capital (WACC).

While we will ultimately decide on most of the parameters noted above for this rate review. Over time, as stakeholders build up experience of the regulatory regime and the cost bases of the airports are better understood, the onus of deciding the parameters could shift from the JCAA to stakeholders. This means that there would still need to be discussions about, for example, the appropriate level of costs, but this could be determined based on agreements between airports, airlines, passenger representatives and other stakeholders, more in line with a contractual regulatory approach.

We invited responses from stakeholders to the following questions.

1. Do you consider that incentive regulation based on a RAB–WACC building blocks approach is the most appropriate regulatory approach for the 2020 rate review? If not, what form of regulation do you consider would be more appropriate given the JCAA's duties, and why?[8]

2. What methodology do you think is most appropriate for setting asset lives and deprecation profiles?

[8] We are also addressing the following question in this section: 'Do you agree that a revenue yield cap is most appropriate for the 2020 rate review? If not, please explain why.' This question had previously been included in Section 6 but the responses to the two questions touch on similar issues and so we include those together here.

3. Do you agree with the JCAA's proposed approach for determining the WACC?

4.2 MBJ Airports Limited

MBJ does not agree that a revenue yield cap is the most appropriate regulatory regime for the 2020 rate review. We note that instead MBJ would like to see a more light-touch regulatory approach with incentives for capital investment, traffic growth and service levels. MBJ notes that given the airport's small size, a light-touch regulatory approach would provide 'the highest level of incentive for the development of the airport.'[9] MBJ also suggests that due to its complexity and time-consuming nature, a RAB-WACC building blocks approach can add to the regulatory burden.

A revenue yield cap would provide strong incentives in the areas MBJ mentions, and we consider that MBJ's comments may not apply to the revenue yield cap regime (as opposed to a revenue cap) as described in section 2. Indeed one of the issues mentioned by MBJ in the context of the previous review is that aeronautical revenue was not in line with costs. We consider that the RAB-WACC building blocks model will resolve this concern.

In the longer term our intention is that the parameters of the regulatory regime can be determined more based on negotiation between stakeholders and the airports rather than being determined by the JCAA. This is in line with the light-handed regulatory regime suggested by MBJ.

This does not mean that we envisage a change to the overall regulatory framework every five years. In contrast, the regulatory regime that we are establishing now is intended to remain in place for future rate reviews. Indeed, we agree with MBJ regarding the importance of consistency in the regulatory model. However, we intend that the balance between the JCAA deciding on the parameters of the rate review and the parameters being determined based on negotiation between the airport and stakeholders would evolve over time.[10]

MBJ suggests that if the JCAA proceeds with the RAB-WACC building blocks approach, then it is imperative that MBJ is given flexibility to set the structure of its charges. We agree that this is appropriate, as long as the airport consults with users on any changes in the structure of its charges and complies with ICAO guidelines (see section 6).

With respect to the depreciation profile, MBJ proposes that the profile of depreciation of airport assets should not be in a straight line, but rather 'in an accelerated (or geometric) fashion.'[11] MBJ further states that the appropriate methodology for setting the asset's useful life 'should be the lesser of the asset's useful life or the remaining life of the concession contract.'[12]

While MBJ has not provided justification for its proposed approach, we understand that its objective is to ensure that depreciation profiles for regulated assets aligns with the term of its concession agreement. However, we do not consider that this would be appropriate. Given the limited time left in the concession agreement, charges would be very high in the next few rate review periods if assets were depreciated only to the end of the concession contract.

[9] MBJ/Intervistas (2018), 'Key Issues for the Regulatory Review', p. 20
[10] We note that one version of this could be a contractual approach. While MBJ suggests this is typically used in situations where this a majority public ownership of the airport, we note that this is often not the case—for example, at Gatwick and Copenhagen Airports. Indeed, MBJ refers to Gatwick's regime in footnote 4 of its report.
[11] MBJ/Intervistas (2018), 'Key Issues for the Regulatory Review', p. 20
[12] MBJ/Intervistas (2018), 'Key Issues for the Regulatory Review', p. 20

We also note that accelerated depreciation is typically an approach used by regulators to address potential cash flow issues for companies, rather than as a standard depreciation profile. Instead, we would suggest that MBJ would need to maintain two accounts—statutory and regulatory accounts—and assets may be depreciated differently between these two sets of accounts. This will allow MBJ to apply a concession based depreciation profile to assets recorded in the statutory accounts, whilst applying a different depreciation profile to assets in the regulatory accounts.

Finally, MBJ agrees with the JCAA's approach for determining the WACC.

4.3 NMIA

NMIA agrees that a revenue yield cap is the most appropriate regulatory regime for the 2020 rate review. NMIA has stated that it is happy to carry the volume risk as long as this risk is 'properly included in the cost of capital calculation as appropriate.'[13] NMIA suggests using work load units instead of passenger volumes in the price cap calculation. While we understand that this is due to GAP's ambition to grow cargo volumes at NMIA, we consider that the current price cap, which would apply to bellyhold cargo and cargo-only flights as well, can already provide this incentive.[14]

NMIA acknowledges the benefits of the RAB-WACC building blocks approach as it gives confidence to investors and provides good incentives to achieve OPEX efficiency. However, NMIA favours a more light-touch approach and proposes evolving the RAB-WACC methodology in accordance with the Mexican system of airport regulation. We understand that the system proposed by the JCAA is similar to the Mexican regime in many respects. There are some aspects of the Mexican regime that differ, but which we do not consider are appropriate for NMIA and SIA—for example, forecasting traffic and costs over a 15-year period can be very difficult. If there are particular aspects of the Mexican regime that NMIA think would be relevant to the 2020 rate review, then we would welcome further evidence and justification as to why these aspects are appropriate.

NMIA notes that if the JCAA decides to follow the RAB-WACC building blocks approach, then it would be most appropriate to use the asset lives and depreciation profiles in its statutory accounts. NMIA does not want to introduce additional complexity of reconciling between the regulatory and statutory accounts. We note that the determination of whether there need to be two sets of accounts depends to some extent on the approach to RAB valuation ultimately used. This is further discussed in Oxera's RAB valuation paper.

We agree with NMIA that the WACC must be set such that the airport is still incentivised to invest and to reflect the ambitious capital expenditure programme to which the airport has committed. NMIA has suggested that the WACC will need to reflect country specific risk. We agree that this could be something relevant to consider in the context of estimating the WACC for the 2020 review and would welcome further submissions on this in NMIA's business plan.

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[13] NMIA (2018), 'Response from NMIA to Jamaica Civil Aviation Authority', (JCAA) p.9

[14] Landing and take-off fees on commercial airlines based on MTOW or MAW includes the weight of notional cargo. On cargo-only flights, there will not be a passenger charge, but there will be a landing / take-off fee and parking charges. The reason for not setting separate cargo charges or including them in the cap is that passenger charges notionally cover airport passenger terminal services. NMIA also currently has a low level of cargo services and provides few services for cargo. NMIA could discount cargo services below the cap in order to incentivise these services.

4.4 IAG

IAG considers that a RAB-WACC building blocks approach is the most appropriate regulatory approach for the 2020 rate review. IAG notes that while CPI-X regulation places a greater burden on both the regulator and the regulated firm, it is 'a price worth paying'[15] because of the improved benefits it delivers.

With regards to the depreciation profile, IAG favours a mechanism on a 'per passenger' basis over straight-line depreciation. As future passengers might be assumed to be higher in number, they will be better able to share the impact of the costs. We do not agree with the unitised depreciation approach suggested by IAG. This depreciation profile can lead to price volatility. We do not consider that it leads to significant benefits, and our position is that any benefits would be outweighed by the additional complexity of such an approach.

We agree with IAG that setting the regulatory WACC must be undertaken diligently in order to achieve the full benefits of regulation.

4.5 IATA

In its response, IATA agrees that a revenue yield cap can be acceptable if 'it reflects cost-relatedness.'[16] However, IATA notes that, whilst the proposed incentive regulation is acceptable, it should be tied to a single-till mechanism. We do not consider this to be the case and address the till regime in the following section.

We agree with IATA that assets should be depreciated in a straight line and that asset lives should follow international accounting standards.

IATA agrees with our proposed approach for determining the WACC, but has asked for clarification regarding the cost of equity calculation. We note that in our business planning guidance to airports we have stated that this parameter will be based on the capital asset pricing model.[17]

4.6 JCAA updated position

We continue to consider that a revenue yield cap together with the RAB-WACC building blocks approach is the most appropriate form of regulation to apply for the 2020 rate review, as well as for future rate reviews. We have noted the comments regarding light-touch regulation. While we do not consider that light-touch regulation is appropriate for QQ2, this is an approach we would seek to move to over the course of future regulatory periods within the same overarching regulatory framework.

We do not consider that unitised or accelerated depreciation profiles (as suggested by IAG and MBJ respectively) are appropriate for the 2020 review. Our position, consistent with IATA, is that straight line depreciation is most appropriate for the 2020 rate review.

[15] IAG (2018), 'Key issues for the 2020 Rate Review at Norman Manley International Airport ("NMIA") & Sangster International Airport ("SIA")', p.3
[16] IATA (2018), 'IATA Response to Consultation Document', p. 2
[17] JCAA (2018), 'Business Planning Guidance for NMIA and SIA for QQ2', p.18

5 Till regime

5.1 JCAA's initial position and consultation questions

While there are merits of both single- and dual-till regimes, we consider that a hybrid-till approach is the most appropriate regime for the next review. We determined this for a number of reasons. First, while aeronautical and non-aeronautical services are not perfectly complementary, there are likely to be some demand dependencies between the two. A hybrid-till regime may therefore be optimal in terms of economic efficiency, as it allows an airport to use some of its profits from non-aeronautical activities to contribute to the costs of aeronautical services without the complete cross-subsidy required under a single-till regime, or no cross-subsidy in a dual-till regime.

We consider that there are three main options within a hybrid-till approach, as follows.

1. **Activity-based hybrid till**. Under this approach, some non-aeronautical activities would be included in the regulated till, while some activities would be excluded. The split could be based on activities that are perceived to be more related to aeronautical activities. For example, car parking might be included in the hybrid till, while retail revenue could be excluded. In this type of hybrid till, assets would need to be allocated to the regulated or the non-regulated till.

2. **Fixed revenue-sharing**. Instead of designating specific activities as within or outside the till, a fixed proportion of non-aeronautical revenue would be used to reduce the charges (i.e. included within the till).

3. **Dynamic revenue-sharing**. Rather than deducting a fixed proportion of non-aeronautical revenue, a certain amount could be deducted depending on the performance of other aspects of the regime. For example, as we set out at the time of the last review, the proportion deducted could vary depending on the airport's performance on traffic as compared with forecasts.

While there are no right answers to the proportion of profit-sharing that is appropriate under a hybrid till, it should strike a balance between leading to airport charges that are in line with those that would arise in a competitive environment, and retaining some of the positive incentive properties to invest.

We invited responses from stakeholders to the following questions.

1. Do you agree that a hybrid-till regime is most appropriate?

2. Which type of hybrid-till regime do you think is most appropriate?

5.2 MBJ Airports Limited

In its consultation response, MBJ states that it preferred a dual till, but that it considered that applying a hybrid till regime at the 2020 rate review was reasonable as long as this till regime has a 'reasonable sharing approach.' We would be interested in any proposed methodology for determining a reasonable sharing approach in MBJ's business plan.

We do not agree with some of the arguments put forward against a single till, for example the statement that under a single till regime an airport 'is not allowed to earn a return greater than what is deemed as "reasonable" by the regulator.'[18] Under a revenue yield cap of the type the JCAA intends to implement at QQ2, outperformance relative to forecasts on non-aeronautical revenue, traffic or OPEX would increase the airport's return (potentially above the WACC), independent of the till regime selected.

We note MBJ's statement that, of the three hybrid options provided, a dynamic revenue sharing option would be preferable. In addition we note MBJ's suggestion that the sharing rate would apply to the forecast levels of non-aeronautical revenue, while there would be no sharing rate applied to non-aeronautical revenues above forecast.[19] MBJ also suggests that the amount of non-aeronautical revenue shared in the next review period could depend on performance relative to traffic forecasts.

5.3 NMIA

In its consultation response, NMIA note that its preference is for a dual till regime, but that it supports the use of a hybrid till. NMIA's comment on being permitted to price below the cap set by the regulator is addressed in section 6.

With regard to a dynamic revenue-sharing methodology we will consider submissions on how this might work as part of NMIA's business plan.

5.4 IAG

IAG notes that 'only a single-till mechanism is appropriate, as this reflects the situation in competitive market, whilst other mechanisms are wrong and encourage regulatory gaming.'[20] IAG further states that:

- no competitive firm would operate under a dual or hybrid-till regime;
- there are misallocation concerns under a dual or hybrid-till regime approach;
- airports are already adequately incentivised to invest in commercial activities.

We do not agree that any till mechanisms other than single till are 'philosophically wrong and impossible to regulate.'[21] Indeed, this is not consistent with regulatory precedent where many airports have, and have for many years, operated under hybrid or dual till regimes. This includes: Aéroports de Paris, Mexican airports, New Zealand airports and Brussels Airport.

We also note that in IAG's response to Heathrow's (H7) price review, it recommended that 'truly commercial parts of the airport could be taken out of today's regulated frameworks, and investors in those facilities (including HAL's shareholders) could potentially earn higher returns than currently allowed - provided customers are not compromised in the form of higher charges.'[22] We note that the context of this review was on increasing capacity at Heathrow, and that IAG's comment refers to alternative delivery mechanisms for airport expansion. We would not suggest that the above applies directly to the review at SIA or NMIA. It nonetheless demonstrates that it can be appropriate for the

[18] MBJ/Intervistas (2018), 'Key Issues for the Regulatory Review', p. 11
[19] We note that MBJ refer to this as a mixed hybrid and dual till regime, but even in a hybrid till regime airports are typically permitted to retain the outperformance on non-aeronautical revenue relative to forecast. Therefore we consider that MBJ's proposal is in line with a hybrid till regime.
[20] IAG (2018), 'Key issues for the 2020 Rate Review at Norman Manley International Airport ("NMIA") & Sangster International Airport ("SIA")', p.2
[21] Ibid., p. 11
[22] IAG (2017), 'Consultation on Core Elements of the Regulatory Framework to Support Cpacity Expansion at Heathrow', p. 3

regulator to take a less intrusive approach to regulation for sufficiently competitive elements.

Ultimately, the aim of economic regulation is to determine the price of a good that cannot be delivered through competition. Where a subset of goods offered by a firm operate in a competitive environment it can therefore be appropriate to exclude them from the regulatory scope. It is not relevant that firms who operate entirely within a competitive environment do not operate a single till mechanism, as the till itself is a regulatory construct which is only relevant to firms who are subject to price regulation.

5.5 IATA

IATA states a preference for a single till, with the rationale that other types of till regimes do not incentivise airports to focus on growing core aeronautical activities. As non-aeronautical revenue is strongly related to growth in core aeronautical activities, we do not consider this to be the case.

Were a hybrid till regime considered, IATA indicates a preference for a ‘fixed revenue sharing mechanism.’ We would interpret this as a fixed percentage of non-aeronautical revenue contributing towards the revenue yield cap. IATA suggests that the sharing rate should be set such that the benefits of growth are shared with users, rather than simply covering costs.

5.6 JCAA updated position

Overall, given MBJ’s preference for a dual till, and IAG’s preference for a single till, it is unlikely to be possible to identify an approach to the till regime that is consistent with the position of all stakeholders. A hybrid till regime, which enables some portion of non-aeronautical revenues to subsidise charges, is a sensible approach and represents a compromise between these two positions. In their submissions, stakeholders stated that an activity based hybrid till is likely to lead to unnecessary regulatory burden and regulatory gaming. We agree and therefore propose to restrict our focus at QQ2 to one of the other two hybrid till approaches: a hybrid till with a fixed sharing mechanism (as supported by IAG and IATA) or a hybrid till with a dynamic sharing mechanism (as supported by MBJ).

6 Setting the rates

6.1 JCAA's initial position and consultation questions

Within the overall cap, we consider that airports should be provided with flexibility to set the structure of charges and undertake periodic or annual rebalancing of airport charges. However, it will be important to ensure that the airports consult with users on any changes in the structure of charges.

Airports should also be permitted to offer airlines discounts below the maximum price cap—for example, incentive schemes to encourage airlines to enter the Jamaican market. However, charges and discounts must be set in accordance with ICAO's Doc 9082, which promotes four charging principles—consultation, non-discrimination, cost-relatedness and transparency.

We invited responses from stakeholders to the following questions.

1. Do you agree that a revenue yield cap is most appropriate for the 2020 rate review? If not, please explain why.[23]

2. Do you agree that airports should be provided with the flexibility to set the appropriate structure of charges, subject to consultation with airlines and overall guidance from the JCAA?

6.2 MBJ Airports Limited

MBJ has stated that it strongly agrees that the airport operator should be allowed to set the structure of its charges, taking into consideration the views of the airlines and the guidance from the JCAA. We note that, in addition to this, MBJ would like to have flexibility to structure charges specifically for incentive schemes for new airlines and/or routes.

6.3 NMIA

NMIA has stated that it agrees that the airport should be given flexibility to set the appropriate structure of charges, including adjusting the aeronautical charges between years. In particular, it has requested guidance from the JCAA regarding the treatment of discounts with respect to aeronautical tariffs. NMIA's preference is for allowed revenue to be calculated after any discounts. Our current position is that commercial decisions that NMIA makes should not factor into the allowed revenue, and as such allowed revenue should be calculated before discounts.

6.4 IAG

IAG notes that the airport should be allowed to set the appropriate structure of airport charges (within reason). However, IAG believes it is unreasonable for the airport to differentiate between different types of traffic as this would be discriminatory and would not deliver any clear benefits. We disagree with IAG as, in line with ICAO guidelines, airports are allowed to differentiate between different types of traffic as long as this is done in a non-discriminatory way.

6.5 IATA

In its response, IATA state that flexibility to structure charges is acceptable as long as it is done in agreement with users. IATA suggests that both users and the airport should be able to propose a change in fees and that this could be

[23] As previously noted, we have addressed this question and the response from stakeholders in section 4 regarding the form of regulation.

achieved via an annual consultation. We agree that it is important for the airport to consult with users on any changes in the structure of the charges.

IATA believes that airports should not be able to differentiate charges for different types of traffic. We disagree with IATA as, in line with ICAO guidelines and as noted above, airports are allowed to differentiate between different types of traffic as long as this is done in a non-discriminatory way.

6.6 JCAA updated position

Consistent with stakeholder feedback, we consider that the airports should be provided with flexibility to set the structure of their charges. It is considered normal commercial practice for airports to offer discounts to airlines below the price cap and we do not plan to impose any restrictions on this at QQ2, provided that ICAO guidelines are adhered to. We will set a maximum price cap at QQ2 and airports can discount or price below this for existing or new airlines.

7 Capital expenditure

7.1 JCAA's initial position and consultation questions

Our first reference for setting the RAB will be the airports' existing RAB values. These will be retained insofar as the principles and approaches used to set the values correspond to regulatory best practice. Further guidance on this has been set out in Oxera's report on RAB valuation.

We consider that it is important for the airports to establish robust CAPEX forecasts in line with the methodologies set out in our business planning guidance. However, we appreciate that CAPEX plans may change over the course of the period, for example to reflect a change in customer requirements. Therefore, we consider that it would be appropriate to include a mechanism for making adjustments within the period as well as at the end of the period (in advance of the next rate review) to take account of differences between actual and forecast CAPEX.

We invited responses from stakeholders to the following questions.

1. Do you agree with the JCAA's proposed approach for setting the RAB?
2. Do you consider that there should be a mechanism for adjusting CAPEX within period? If so, which mechanism do you consider is most appropriate?
3. How do you consider the AIF should be treated as part of the review?

7.2 MBJ Airports Limited

In its response to the consultation document, MBJ states that it would want an inflation-adjusted RAB based on a historical indexation of assets. We would request that MBJ identify the index it feels is most appropriate, with supporting evidence as to why this is the most appropriate approach given it is a change from the current approach at the airport (which is based on historic costs).

MBJ submitted a response on formalising the additional capital expenditure mechanism (ACE) from the last review and considers that such a mechanism is needed for the next review. The process recommended by MBJ takes the following form:

- the level of CAPEX is agreed at the price control for the regulatory period based on existing information;
- proposed changes are then submitted to the JCAA during the price review, in the event of unanticipated capital expenditure, acceleration of agreed schemes or postponement of agreed schemes;
- the JCAA chooses to approve a within period change to the cap, defer the change to the next regulatory term or reject the change, with the recognition of MBJ's interim financing costs.

While we agree with the mechanism set out above in principle, we would recommend that if MBJ can demonstrate that any proposed change has been agreed with stakeholders, then the JCAA would apply limited regulatory scrutiny. In this regard we consider the ACE mechanism as described at the time of the last review would be appropriate. The mechanism was explained as part of MBJ's submission to the last review:

> Although we have set out our base capital expenditure programme, we believe that it is important to give the airport the ability to undertake, and be

> remunerated for, additional projects, where this will be in the interests of airport users – and Jamaican civil aviation as a whole. We are therefore proposing that the airport should be allowed, following consultation with the stakeholders, to bring forward proposals for Additional Capital Expenditure (ACE) in the course of the regulatory period. These proposals will be approved (or otherwise) by the regulator who will also set the addition to the price required to remunerate the airport up to the time of the next review.[24]

We agree with MBJ that overspending due to inefficiencies or underspending due to greater efficiencies in the delivery of the CAPEX programme would not be considered as part of any additional CAPEX mechanism. As such, the ACE would generally be limited to changes caused by factors external to the airport.

MBJ's position is that there should be an allowed rate of return and depreciation for AIF funded assets, although it does not address whether this should be incorporated within the RAB or sit outside the RAB framework. MBJ states that OPEX resulting from AIF funded assets should be recoverable.

7.3 NMIA

In its response to the consultation document, NMIA has noted that it prefers either a historical cost accounting (HCA) or derived approach to valuing the RAB. In Oxera's RAB valuation paper, Oxera explains that a derived RAB approach may be difficult to implement given the way in which the JCAA set the price cap in the last review. However, Oxera notes that HCA is a recommended approach for QQ2.

With respect to a mechanism for dealing with unanticipated capital expenditure, NMIA states that a price control re-opener would be inappropriate. NMIA does not express a clear preference between the three other approaches outlined: an agreed change control process, a pre-agreed adjustment mechanism or CAPEX triggers.

With regard to the airport improvement fee (AIF), NMIA notes the need to separate the AIF between risk and non-risk expenditure. We note that as the AIF is currently being used predominately to pay down debt at NMIA, this is unlikely to be a material issue at QQ2. However, as the AIF may be used to fund new assets in the future, we agree that there is merit in formalising an approach at QQ2 for future reviews.

7.4 IAG

In its response to the key issues document, IAG identifies an indexed historical cost approach as the 'only viable option' for valuing the RAB. We note that this is one of Oxera's recommended approaches for QQ2 and is the current approach used by the airports.

To deal with CAPEX changes within period, IAG proposes an additive CAPEX trigger mechanism, with users (airlines) able to approve, veto or defer the proposed CAPEX.

With regard to the AIF, it is not entirely clear what is meant when IAG states that 'the JCAA should ensure that the AIF is deducted from any regulated CAPEX allowances.'[25] If the above is contingent on the AIF already being passed through to tariffs (e.g. already been included in CAPEX forecasts), then this is consistent with the response of other stakeholders that the AIF should

[24] MBJ (2014), 'MBJ Airports Limited's Airport Charges Proposal', 1 May.
[25] IAG (2018), 'Key issues for the 2020 Rate Review at Norman Manley International Airport ("NMIA") & Sangster International Airport ("SIA")', p. 7.

not be double counted. IAG does not provide a position on whether it might be appropriate to include the AIF in the RAB if it was used to fund assets.

7.5 IATA

IATA indicates that the RAB should follow international standards, in line with Oxera's key issues report.[26] On the ACE mechanism, IATA agrees that flexibility is important. We would agree that consultation with stakeholders is a key element of how such a mechanism should work. IATA also comments on potential uses of the AIF and the impact of tax burden on airports. These policies fall outside of the remit of the JCAA and we therefore do not address them here.

7.6 JCAA updated position

All stakeholders have suggested that they would accept an approach to RAB valuation based on historic costs, generally where these have been indexed to CPI either explicitly or through use of a nominal WACC. We propose to consider this as our starting approach at QQ2.

Stakeholders have submitted various proposals for a CAPEX adjustment mechanism. We will consider these carefully. A key theme is the need for airports to engage with stakeholders on proposed adjustments within the period. We support this as a way to generate the most optimal outcomes while minimising regulatory burden. We note, however, that it may not always be possible for airports and other stakeholders to come to an agreement without support from the JCAA.

Stakeholders seem aligned on the approach to the AIF where this is not used to fund specific CAPEX projects. Where the AIF is used to fund specific CAPEX projects, the most supported proposal is that such expenditure could be included within the RAB. We will consider this in more detail alongside the business plan submissions. We consider that OPEX associated with AIF-funded assets should be recoverable.

[26] Oxera (2017), 'Key issues for the 2020 rate review,' prepared for the Jamaica Civil Aviation Authority, 11 September.

8 Operating expenditure

8.1 JCAA's initial position and consultation questions

Airports should provide submissions for cost items they consider to be controllable and those that they consider to be uncontrollable. To the extent that this differs from our classification, it would be helpful if the airports could provide justification for their positions.

We propose to continue to apply a pass-through mechanism for additional security costs above the forecast amount. For other uncontrollable cost items, we will not allow for a pass-through if forecasts differ from actual costs; however, there will be no efficiency target applied to these costs.

With regards to security costs, MBJ and NMIA are obliged to contract security through the Port Security Corps (PSC), and as such have no direct control over the level of these costs. However, it is essential that these services are delivered efficiently given that they are ultimately passed through to passenger charges.

We propose using US CPI as a measure of general inflation. Evidence of input price pressure incremental to this should be submitted for consideration as part of the rate review process.

We invited responses from stakeholders to the following questions.

1. Do you agree with our proposed classification of controllable and uncontrollable costs?
2. Do you consider that the pass-through arrangement should continue for additional security costs above the forecast level? Are there any other costs that you consider should be subject to a pass-through mechanism?
3. Do you agree with our approach to input price pressure?

8.2 MBJ Airports Limited

MBJ agrees with the majority of the cost classifications (into controllable / uncontrollable) in our consultation document. There are two categories that it classifies differently:

- Environmental work, which is generally dictated by government regulations, and is therefore in MBJ's view an uncontrollable cost.
- Insurance, as MBJ is obliged to hold insurance and is captive to the market rates, it is therefore in MBJ's view an uncontrollable cost.

We agree that environmental work dictated by government regulation should be treated as uncontrollable. However, we would expect MBJ to submit robust evidence linking the regulations to the scope of environmental work proposed.

With regard to insurance, our initial position would be to apply an efficiency challenge to insurance costs. While MBJ identifies that there exists a market rate for insurance products, it is not clear that this eliminates any prospect for efficiency improvements. For example, MBJ may not currently be negotiating the best deal at the lowest market rate possible. Furthermore, there could be additional steps that MBJ could take to lower insurance costs, such as investing in resilience schemes.

Even if there were no opportunities to make efficiencies in insurance expenditure directly, if the cost to insure MBJ is partly a function of the expense that MBJ incurs, we would expect required insurance expenditure to reduce in line with efficiencies over time. We therefore do not consider that these costs are uncontrollable.

MBJ indicates that it is satisfied with our proposed approach to security costs and input price pressure. We note that a separate section in MBJ's report outlines two approaches to dealing with security costs, both of which are consistent with our proposed methodology. On the interaction between security costs and the Airport Concession Fee (ACF), the ACF is not within the JCAA's control. MBJ should raise any proposed changes to the ACF directly with the Airport Authority of Jamaica (AAJ).

8.3 NMIA

NMIA agrees with the majority of the cost classifications (into controllable / uncontrollable) in our consultation document. Only utility costs are identified as being classified differently. NMIA concedes that there are actions that airports can take, such as energy and water efficiency schemes to reduce utility costs, and only the level of utility pricing is uncontrollable.

Given NMIA's response, rather than designating utility costs as uncontrollable, we consider it would be more appropriate for NMIA to put together evidence for a separate additional input price pressure factor for utility costs. This should incentivise NMIA to use these resources as efficiently as possible, whilst controlling for cost increases that fall outside of its control. This is consistent with NMIA's own proposal to 'submit evidence as to areas of OPEX in which input price growth is likely to differ from the chosen measure of CPI.'[27] We would note, however, that as CPI is a weighted average of input price pressure across the economy, we would expect NMIA to demonstrate that it has considered input price pressure 'in the round.' By this we mean that an approach that only uses input prices which have grown by more than CPI and ignoring those which have grown by less would lead to an inaccurate measure of the 'true' input price pressures facing NMIA.

We do not agree that the efficiency improvements should already be capped at a specific level (NMIA has suggested 1%), as we have not had access to airport's OPEX forecasts and have not been able to benchmark these against relevant comparators. As such, it is not appropriate to determine the X factor at this stage. The X factor will be determined as part of our initial proposals in April.

Finally, we acknowledge NMIA's comments that Jamaican price inflation is a more relevant measure of generic input price pressure, and will consider this.

8.4 IAG

With regard to IAG's request to clarify what was meant by a 'pre-efficiency' baseline, this is intended to be the level of OPEX before the application of an efficiency challenge. Depending on our analysis of the business plan submissions, we may impose a 'catch-up' efficiency target to this pre-efficient baseline in addition to the 'frontier shift' requirement. On receiving the business plans we will be better placed to outline our proposed approach in more detail.

[27] NMIA (2018), 'Response from NMIA to Jamaican Civil Aviation Authority (JCAA)', p. 13.

In its response to Oxera's key issues document, IAG states that it would be helpful for there to be a tight definition of which costs can be considered uncontrollable. In our consultation document we clearly set out definitions of controllable and uncontrollable costs.

In its submission on input price pressure, IAG states that should an airport's input price growth be found to be higher than that in the economy then it is indicative of management failure. This is a misunderstanding of what is meant by input price pressure. An example of input price pressure would be if the price of energy or water grew by more than CPI. This is independent of management control, and therefore we do not see how this can be attributed to management failure. We will verify that input price pressure submissions are considered 'in the round', whereby airports do not only submit input price claims which are above CPI, but also consider how these might be offset by costs they face which increase by less than CPI.

IAG agrees with our proposal to deal with security costs.

8.5 IATA

IATA identifies that there are steps that airports may be able to take to control levels of bad debt. We acknowledge this, and will consider the evidence the airports submit for this item in determining whether it is necessary and material to determine an efficiency target for bad debt. On the relationship between the treatment of bad debt and the WACC, we would highlight that bad debt would be considered an OPEX line in this instance. Whilst OPEX pass-through mechanisms applied to large proportions of the cost base might be expected to affect the rate of return, as bad debt is typically not a material issue for airports, the JCAA does not consider it proportionate to take this into account.

IATA comments that it is important for the JCAA to monitor the levels of uncontrollable cost items, to ensure they are kept at reasonable levels. We will monitor the forecast and actual expenditure on these items, but are not currently considering an alternative pass through mechanism.

8.6 JCAA updated position

We will undertake to explore the differences in classification of costs. Both uncontrollable cost[28] and input price pressure submissions will be expected to be well-evidenced. Good evidence would include:

- A demonstration as to why this cost is outside of management control.
- Measures that management have taken to minimise the impact of this cost.
- In the context of input price pressure, a holistic view of all input price pressures facing the airport, with appropriate offsets included for elements of the cost base which are expected to grow by less than CPI.

We will consider NMIA's suggestion that Jamaican CPI would be a more appropriate measure of general inflation in the economy. Given that the revenue yield cap will be set in US Dollars, it will be important that in considering the approach to input price pressure, the impact of the exchange rate between the US and Jamaica is taken into account. We will not consider an approach whereby any group of stakeholders systematically gains from the approach taken to input price pressure. We would consider that the CPI

[28] Including for those costs that we indicated we would consider as uncontrollable in our consultation document, e.g. security.

measure used, and more generally the approach to input price pressure, should be consistent across SIA and NMIA.

9 Service quality regulation

9.1 JCAA's initial position and consultation questions

Given the number of issues that need to be considered as part of this rate review, the generally satisfactory level of service quality performance at MBJ/NMIA and the fact that there is already some degree of monitoring, we do not consider that introducing formal service quality regulation (i.e. financial incentives to meet or beat service quality targets) is a priority for the 2020 rate review.

However, we note that at the time of the last review, there were a number of areas where SIA's and NMIA's performance was below the minimum acceptable levels and therefore there was room for improvement.

As a result, we consider that it may be appropriate to introduce a reputational incentive, whereby, for example, the airports would be required to publish their service quality performance each month in the airports and on their websites. This would lead to some level of monitoring and oversight, but without a high degree of intervention. However, we note there may be some indicators, for example with respect to asset availability, where it would be appropriate for us to take more of an enforcement role if they fall below minimum standards.

We invited responses from stakeholders to the following questions.

1. Do you consider that the use of a reputational incentive approach to regulating service quality is appropriate? Please explain why or why not.
2. If you do not consider that a reputational incentive is appropriate, what would you propose as an alternative?
3. Which service quality measures do you think should be reported under the reputational incentive proposed?

9.2 MBJ Airports Limited

In its consultation response, MBJ notes that the concession agreement requires it to comply with performance standards and maintain a minimum level of service. MBJ has suggested that the JCAA could adopt the service quality reporting and monitoring requirements already set out by the AAJ. We consider that it would be important for MBJ to engage with stakeholders to determine whether these measures remain relevant and appropriate. Subject to these indicators being the relevant ones, (and MBJ demonstrating evidence of cross-stakeholder buy-in to this package), we consider that MBJ's approach is sensible as it does not add to the regulatory burden. We welcome the fact that MBJ is open to including further service quality measures in its surveys, should this be requested by stakeholders.

In addition, MBJ highlights that service quality measures should be focused on areas where the airport has control over the function. For example, the speed of customs approvals is not within the airport's control. While we agree that some of these functions are not within the airport's control, these are still part of the overall airport experience. As such, we consider that there could be benefits in improving performance across the airport if the results in these areas were also published (while noting the airport does not have responsibility over these functions).

9.3 NMIA

In its consultation response, NMIA agrees that there is no need to introduce formal service quality regulation for the 2020 rate review. NMIA emphasizes that the airport already has specific obligations with respect to service quality as part of the concession agreement. NMIA regards a reputational incentive as a sensible approach as it increases transparency. We note that NMIA requires further discussion on the format and timings of the presentation of the service levels, including the option of publishing ASQ scores. Subject to NMIA engaging with stakeholders as part of the process to ensure that the ASQ measures are the factors that customers care about, we are content for NMIA to publish ASQ scores.

NMIA does not consider that an enforcement role is necessary for the start of the 2020 review as the new ownership of NMIA together with the commitments as part of the concession agreement should be sufficient. If the airport fails to meet a particular service quality standard, NMIA proposes that the JCAA could 'write a public letter to the airport requiring the airport operator to remedy the perceived quality failure by a particular deadline.'[29] We agree that this would be appropriate for enforcing service quality levels in the first instance. However if issues persist, other actions may be necessary.

NMIA notes that it is prepared to publish all metrics associated with passengers, including baggage and asset availability. NMIA will focus on improving the airport's service quality where it has control, but has suggested introducing transparency over the other elements of service at the airport.[30]

9.4 IAG

In its response, IAG agrees that some form of service quality regulation would be appropriate. However, IAG does not see the use of a reputational incentive as an appropriate approach to regulating service quality. It suggests that the reason for this is that, in the absence of a material consequence, airports publishing their service standards does not provide adequate incentives. Instead, IAG proposes that service quality regulation should take the form of rebates payable by airports to airlines, in cases of service failure. We do not believe that this would be necessary for the 2020 rate review, as service quality levels are generally good at SIA/NMIA. However, we acknowledge that if there is a decline in service quality performance, then such additional measures may be necessary.

9.5 IATA

In its response, IATA notes that the service quality parameters should not be limited to passenger perception of service, but should include actual operational KPIs. We consider that this concern will be addressed by the airports either publishing the indicators currently reported to the AAJ, or using ASQ measures.

9.6 JCAA updated position

We consider that a reputational incentive is most appropriate for the 2020 review compared to formal service quality regulation. Our present position is to use the indicators currently reported by airports to the AAJ, or ASQ measures

[29] NMIA (2018), 'Response from NMIA to Jamaican Civil Aviation Authority (JCAA)', p. 14
[30] NMIA (2018), 'Response from NMIA to Jamaican Civil Aviation Authority (JCAA)', p. 15 "this could for example include the time for the first to last bag since that is normally a reflection of the airline's efficient use of its ground handling staff."

as a starting point, with indicators added or removed based on feedback from stakeholders. We consider that the indicators should cover all aspects of performance of the airport, but that publication clearly states the areas for which the airports do not have direct responsibility. We would request that MBJ and NMIA include a list of the proposed indicators in their business plans based on stakeholder engagement (for which there should be clear evidence).

We would expect MBJ/NMIA to publish the results from any service quality surveys at least twice a year. However, we would welcome input from stakeholders on the frequency of these publications. For example, if the survey is conducted on a more regular basis (e.g. quarterly) then we would expect the results to be published on a quarterly basis.

If the levels of service quality at the airports do not meet targets, in the first instance we will write a public letter to the airport requiring the airport to rectify the service quality failure by a particular date. If there is a further decline in service quality performance or if targets continue to be missed, then additional enforcement measures may be necessary.

10 Other issues

A number of stakeholders raised issues outside the scope of our consultation questions. In this section, we summarise and respond to these issues, and conclude with any impact these have on the methodology at QQ2.

10.1 MBJ Airports Limited

MBJ raised two issues beyond the scope of our consultation questions.

The first issue raised by MBJ is the ACF and how regulatory decisions may impact the fee paid. MBJ made two recommendations:

- reconsidering the threshold revenue figure, above which the ACF is collected; and/or
- removing security fee revenue from the calculation for the ACF.

While MBJ suggests that the JCAA recommends these approaches to AAJ, MBJ also notes that these issues are not within our remit. As such, MBJ should speak to the AAJ about these proposals directly.

The second issue relates to the inclusion of a ‘traffic stimulation factor’ in the JCAA’s pricing model in order to account for MBJ’s suggestion that the amount of traffic growth is in part a function of the till regime.

As previously noted, the regulatory model was set-up based on the JCAA’s proposed positions. As such, the model was established on the basis of a hybrid till regime. We also do not consider that a dual rather than a hybrid till regime is likely to drive increased traffic volumes.

10.2 NMIA

NMIA did not raise any additional issues in its response.

10.3 IAG

IAG raised two issues outside the scope of our consultation questions: the treatment of tax in calculating the WACC, and the JCAA’s overall approach to gearing. We addressed the treatment of tax in our business planning guidance, where we have requested that airports submit the corporate tax rate to be incorporated within our methodology for calculating the WACC.

With regard to the JCAA’s overall approach to financial gearing, we intend to apply notional, rather than actual, gearing levels in our calculation of the WACC.

10.4 IATA

IATA did not raise any additional issues in its response.

10.5 JCAA updated position

We have not updated any of our initial positions in response to any of the other issues raised by stakeholders.

11 Conclusion

11.1 Introduction

In this section we summarise our updated positions following responses from, and engagement with, stakeholders.

11.2 Stakeholder engagement

For the 2020 rate review we expect to see more stakeholder engagement from MBJ/NMIA compared to previous reviews, including providing stakeholders with adequate time to respond to consultations. We would also expect stakeholders to be more forthcoming in providing information and views to the airports. This should include submitting information on traffic forecasts, operational plans as well as any needs and requirements with respect to terminal and runway capacity. Whilst the JCAA does not need to be directly involved in stakeholder engagement, we request that any documents regarding stakeholder engagement are provided to us.

11.3 Form of regulation

We are proposing a revenue yield cap together with the RAB-WACC building blocks approach for the 2020 rate review. However, as regulatory experience is built up and stakeholders familiarise themselves with this regime, we would expect to see a move towards more light-touch regulation over the course of future regulatory periods within the same overall framework. We propose to use a straight-line depreciation profile for the 2020 rate review.

11.4 Till regime

A hybrid till regime which enables some portion of non-aeronautical revenues to subsidise charges represents a compromise between the divergent positions of stakeholders and is consistent with economic principles. We propose to restrict our focus at QQ2 to either a hybrid till with a fixed sharing mechanism, or a hybrid till with a dynamic sharing mechanism.

11.5 Setting the rates

We propose that the airports are given flexibility to set the structure of charges within the overall cap. It is considered normal commercial practice for airports to offer discounts to airlines below the maximum price cap and we do not plan to impose any restrictions on the ability of airlines to offer discounts. However, the allowed revenue will be determined before any discounts are applied by the airlines.

11.6 Capital expenditure

All stakeholders have suggested that they would accept a RAB valuation approach based on historic costs, generally where these have been indexed to CPI either explicitly or through use of a nominal WACC. We propose to consider this as our starting approach at QQ2.

Stakeholders have submitted various proposals for a CAPEX adjustment mechanism. We will consider these carefully, and have suggested some amendments to the proposed approaches. However, we agree that a CAPEX adjustment mechanism should be applied for QQ2.

Where the AIF is used to fund specific CAPEX projects, the most supported proposal is that such expenditure could be included within the RAB. We will consider this in more detail alongside the airports' business plan submissions.

11.7 Operating expenditure

We consider that environmental works, where they have been dictated by government, are an uncontrollable cost. However, we continue to consider that utility costs and insurance costs are controllable. Both uncontrollable cost and input price pressure submissions will be expected to be well evidenced.

We will consider NMIA's suggestion that Jamaican CPI would be a more appropriate measure of general inflation in the economy.

11.8 Service quality regulation

Our updated position is to use the indicators currently reported by airports to the AAJ or ASQ results as a starting point, with indicators added or removed based on feedback from stakeholders. We request that MBJ and NMIA publish a list of these indicators in their business plans.

As part of the reputational incentive, we will require the airport to publish the results of their service quality surveys at least twice a year. However, we will consider input from stakeholders on the frequency of these publications.

If the levels of service quality at the airports do not meet targets, in the first instance we will write a public letter to the airport requiring the airport to rectify the service quality failure by a particular date. If there is a further decline in service quality performance or if targets continue to be missed, then additional enforcement measures may be necessary.

11.9 Other issues

We have not updated any of our initial positions in response to any of the other issues raised by stakeholders.

JAMAICA CIVIL AVIATION AUTHORITY