Consultation Brazil

Interested parties have been invited by ANAC to submit contributions regarding economic aspects relevant to the next round of airport concessions in Brazil. As response to this inquiry, the following table has been compiled to illustrate different factors of influence to be considered when revising the economic regulation of airport concession. It shall be emphasized, that this table does not constitute a comprehensive recommendation regarding how to regulate the specific airports to be privatized. Nevertheless, the arguments raised in the table are based on best practices and global experience of regulatory regimes and address the issues pointed out in the request for contributions by ANAC.

In addition to the points raised related to the economic regulation, we took the liberty to provide you with an additional contribution that might find consideration in your process of structuring the new round of airport privatizations.

#	Topics related to economic regulation	Explanation
1.	**General / cost relatedness**	Generally, it needs to be emphasized that the regulation of tariffs should be analyzed and eventually determined in consideration of the overall concession's regulation and requirements. For an efficient tariff regulation, it is beneficial and recommendable to establish a transparent, non-discriminatory and cost related structure of tariffs. In the past privatization rounds, the concession agreements defined high fixed investment requirements, regardless of demand, which have not been reflected in the tariffs (price cap regulation). While a non-cost related regulatory system minimizes regulatory costs (effort for collecting and measuring efficient costs) at the level of the regulator and the regulated entity, it leads to false incentives. In order to incentivize concessionaires to invest in infrastructure and to provide the required infrastructure at the respective airports, it is advantageous to link tariffs to costs (related to aviation infrastructure). Especially at smaller airports where aeronautical revenues represent the majority of income, a cost-relatedness is crucial to incentivize concessionaires to invest in infrastructure. At the same time, it is important that expansion investments are driven by demand and not fixed investment obligations. Airlines and airport users are often under extreme cost pressures and thus are only willing to pay for infrastructure that is used by them. The level of future investments can be managed by setting certain service levels at the various airports based on peak-hour traffic. In such a regulatory regime (cost-related), a consultation mechanism involving the airport and airport users is recommendable and generally represents the fairest approach, despite the higher regulatory costs. The regulatory regime should provide the flexibility of airports presenting a common proposal of changing tariffs after conducting negotiations with airport users (considering the expansion program at each airport). In this context, it is essential that there exist escalation mechanisms under which the regulatory authority ultimately determines the changes of tariffs based on transparent calculation mechanisms. Such escalation mechanism is important in order to avoid blocking investments in infrastructure due to non-agreement between airport and airport users.

		The underlying assumption here is that investments in expansion of infrastructure (unavoidable efficient cost and cost increases) shall be recovered by higher tariffs. The engagement between airport and airport users as part of a consultation process needs to be clearly defined. Airport users that shall participate in a consultation process should be limited to airlines which are the most relevant users. The involvement of a greater number of participants increases complexity without overly increasing the benefits for the involved parties (airport users, airports, regulatory authority) and thus is not advisable. Furthermore, for a better predictability for airports and airport users and in order to limit regulatory costs for all involved parties, tariffs should be defined in a consultation process for a determined period of 5 years. Alternatively, especially for the smaller airports additional costs for future investment programs could be compensated through a re-equilibrium (higher tariffs, longer concession duration, and/or lower concession fee). This approach allows a compensation of required investments for new capacity not only through higher tariffs (which potentially could lead to a non-competitive level) but also through longer concession terms and lower concession fees. The necessity of future investments can be determined in a consultation process involving the regulatory body, airport users and the concessionaire.
2.	**Price cap vs. revenue caps**	Among the various regulatory regimes, price caps or revenue caps can be applied in combination with a cost related approach. In the past privatization rounds, ANAC opted for a price cap regulation under which maximum prices are applied on every single charge by allowing a maximum percentage growth over each charge, but a shift of the price structure itself is not permitted. This means that the airport could not react to a changing traffic pattern over time. Should for example an airport start to attract transfer passengers as opposed to Origin & Destination only, the airport operator may want to introduce or modify a transfer charge to reflect the use of the terminal facilities by the transfer share of passengers, which would reduce the charge for the departing passengers who otherwise pay exclusively for the infrastructure used by transfer and departing passengers. The structure of the charges should reflect at all times the specific profile and the traffic strategy of the airport. To meet this requirement and in order to provide a higher flexibility than in price cap regimes, the revenue cap approach is far more adequate. Under this approach, a regulator looks at the total average cost per traffic unit (passenger or cargo) and restricts the growth of that number. In this regard, revenue caps based on fixed revenues per passenger may be suitable for airports if cargo operations do not have a major share. Otherwise, a revenues cap based on workload units (Pax and Cargo) may be more appropriate. In general, a revenue cap approach provides greater freedom to structure tariffs and to implement incentives. How the operator structures the underlying cost base should be decided by the operator along the policy principles – e.g. lower domestic fares to incentivize feeder traffic, reduce landing fees and increase passenger fees to take over some of the traffic risk from the airlines, increase aircraft parking

		fees in capacity constraint airports to incentivize airlines to park somewhere else and speed up turnaround times, among many others. Additionally, a revenue cap approach in combination with a cost-relation approach further provides a higher flexibility in setting tariffs and facilitates the creation of various models for the different sized airports within a cluster, responding to potential changes of the airline business model and the aviation sector (e.g. regional hub airports, intercontinental hub airports, low cost airports, O&D airports, and mixed models). As demonstrated, flexibility in policy issues can and should be effectively addressed under regulatory regimes, and the revenue cap approach is by far the more recommendable approach, price capping has become obsolete in a fast changing environment.
3.	**Decentralization vs. centralization**	In light of the previous arguments, strongly emphasizing the necessity of linking tariffs with costs, it seems beneficial to decentralize the regulatory entity and locate such entity into the region (of the regulated airports) where the regulatory authority is in a position to assess the specific infrastructure and its costs. However, concurrently, it is important to ensure a transparent and standardized approach of economic regulation with clear allocations of roles and definition of procedures. Although specific models for the individual airports might differ in this new privatization round, a transparent and standardized approach can be easier achieved at a centralized entity. A centralized regulatory body also enables an optimized know-how sharing within the regulatory authority compared to local regulatory entities and provides a stronger standardization and thus more certainty for investors. All regulatory regimes contain a certain degree of subjectivity (e.g. evaluation of x-factor) which could be minimized through a central, common and transparent approach. A centralized approach, however, does not mean that responsibilities of team members within a central regulatory authority can be allocated to specific clusters/regions in order to ensure asset specific know-how. Based on the arguments above, it is highly recommendable to remain with a central regulatory authority and only allocate individual responsibilities to a team with local and specific asset know-how. This further prevents overlapping responsibilities between central and local authorities.
#	**General topics**	**Explanation**
	Airport operator requirement	The management of various airports (profitable and loss-making airports) within an airport cluster requires a certain experience to manage the airports – individually and in a group – efficiently. In the previous privatization rounds, ANAC decided to establish certain requirements for airport operators as part of a bidding consortium in order to ensure a minimum of experience to provide best-in-class services for the respective airports. While in the past, those requirements were rightfully limited to experiences at airports of a defined size (based on passenger volume), it is highly recommendable to consider additional requirements for the new round of privatization. As the new round of airport privatizations comprises primarily airport clusters, the requirement should not be purely limited to the experience

		at airports with a similar passenger size. As mentioned before, the efficient management of airport clusters requires a slightly different experience. For this reason, potential investors should be required to demonstrate experience of managing an airport group with a minimum of 3 airports within a cluster.