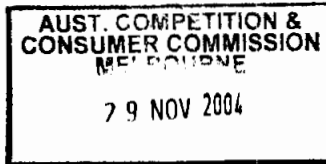




BARA

BOARD OF AIRLINE
REPRESENTATIVES
OF AUSTRALIA INC



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MARS/PRISM:

Ms Margaret Arblaster
General Manager, Transport and Prices Oversight Division
Australian Competition and Consumer Commission
GPO Box 520 J
Melbourne VIC 3001

Dear Ms  Arblaster

RE: AIRSERVICES AUSTRALIA - PRELIMINARY VIEW ON FIVE YEAR PRICING PROPOSAL

The Board of Airline Representatives of Australia (BARA) has reviewed the Australian Competition and Consumers Commission's (ACCC) Preliminary View of Airservices Australia's Five Year Pricing Proposal (the Preliminary View). BARA's comments are set out below. BARA's comments are structured in accordance with the Preliminary View format.

Consultation processes

It is BARA's view that Airservices Australia (AsA) took all reasonable steps to engage all its customers in the consultation process established for the purpose of developing its five year pricing proposal. This effort must be maintained by AsA. Therefore, BARA endorses the ACCC's view that the ISC and working group should continue to play an integral role in monitoring AsA's performance against its assumptions and estimates underlying long-term pricing arrangements.

Risk sharing arrangement

On the matter of the AsA proposals regarding activity triggers for a consultative review on the best means of dealing with an adverse event, BARA had expected such triggers to be activated at the global level. BARA viewed such an approach as delivering a reasonable balance of risk sharing between AsA and its customers.

However, BARA endorses the ACCC suggestion that risk-sharing arrangements between AsA and airlines at individual locations should be considered. Airlines delivering strong growth in activity at a particular location could be rewarded with rebates on AsA charges. The further ACCC suggestion that AsA enter into agreements with particular airport operators may be problematic. Airlines, not airport operators, are AsA customers. It is also likely that airport operators would have other, stronger incentives to increase traffic to their airports than those provided by an agreement with AsA.

Operating costs

BARA endorses the ACCC's conclusions that:

- (a) the proposed increases in AsA superannuation expenses in 2004-05 are reasonable;
- (b) the proposed increases in AsA staff numbers and costs are not unreasonable; and
- (c) the proposed increases in AsA operating expenses are reasonable.

On this matter BARA notes that the Industry Steering Committee (ISC) overseeing the development of the AsA pricing proposal undertook a detailed analysis of future full time equivalent employees (FTE) by AsA service at each location. Planned efficiency improvements were built into future FTE numbers for the purposes of operating cost forecasts.

Whilst BARA is confident that the ISC process has incorporated efficiency incentives into the AsA operating costs for pricing purposes, BARA believes there would be merit in the ISC investigating options for a CPI-X price cap to apply for future AsA pricing proposals.

Asset base

BARA endorses the ACCC's view that the agreed value of AsA's asset base should be used as the reference point for future price notifications.

Capital expenditure

BARA endorses the ACCC's suggestions for AsA to:

- (a) clearly document to stakeholders the basis of its consideration of alternative technical solutions in its business case models; and
- (b) provide greater transparency to its approach to addressing safety issues in its business case studies and in its communications with stakeholders.

Rate of return

BARA notes the extensive ACCC discussion in the Preliminary View of the AsA rate of return embodied in the price proposal. That discussion included consideration of the level of the asset beta to be adopted in determining the AsA weighted average cost of capital (WACC) and the appropriateness of phasing in the WACC.

BARA notes that the outcome of the consultations between AsA and its customers via the ISC was an agreed rate of return to AsA. The end result, in terms of allowable revenue to AsA, of the ISC commercial negotiations and the ACCC's economic analysis, are much the same. Given that BARA, as a participant of the ISC, agreed to the rate of return to AsA adopted in the pricing proposal, BARA does not see the need to differentiate between the two approaches for the purposes of the current pricing proposal. However, BARA accepts that the ACCC's view that the appropriate value of AsA's WACC is 8.95 per cent could be addressed in the next round of AsA/airlines pricing discussions.

Activity forecasts

BARA endorses the ACCC's view that AsA's general approach in deriving growth rates for traffic to the major, regional and GA airports is appropriate. However, BARA questions whether the ACCC suggestion that AsA enter into individual risk sharing arrangements with particular airports would be a workable proposition. The airport operators are not AsA customers.

Structure of pricing

Consideration of the AsA pricing structure presents complex issues. This is reflected in the ACCC's discussion of the matter in the Preliminary View.

(i) Allocation of distributed costs

BARA does not agree with the proposal to allocate distributed costs on a capacity to pay basis. Further, BARA does not agree with the ACCC's proposals for applying a capacity to pay approach to AsA's distributed costs. The ISC worked to identify the actual costs of providing terminal navigation and ARFF services at individual locations in accordance with sound accounting principles. The prices proposed for regional and GA airports, however, resulted from separate discussions between AsA and the Commonwealth Government. Any move to allocating distributed costs on a capacity to pay basis simply disguises the relationship between costs of services at individual locations and the charges imposed on the users of those services.

BARA questions the ACCC's view that AsA's 'distributed' costs which have been allocated to service lines are in the nature of common costs to those services and there is no clear (causal) basis for apportioning these costs between locations. In fact, the ISC worked to ensure that such causal links were in place. Activity based costing (ABC) principles were applied wherever possible.

(ii) "Basin" concept in setting prices for TN services

BARA does not support the AsA proposed "basin" approach to terminal navigation charges. The AsA process is flawed, seemingly based upon determining "acceptable" prices at the minor airports and then allocating the difference between costs and revenues to the major airport in setting its prices. Consequently, BARA endorses the ACCC's view that AsA should provide details of the order of magnitude of the various interactions by basin and the order of magnitude of the price adjustments implied.

(iii) Timing of price increases

BARA is willing to accept the proposed timing of the AsA price increases.

(iv) Pricing across services and user groups

BARA supports location specific pricing by AsA service and location. Location specific pricing promotes efficiency and equity. A move away from location specific pricing will promote inefficiency and inequity. BARA notes an apparent inconsistency of ACCC statements on this matter in the Preliminary View. On page 96 the ACCC concludes that the presence of cross subsidy does not necessarily imply economic inefficiency. Yet on page 68 the ACCC states that prices that are not cost reflective will generally have an adverse impact on the efficiency of the resource allocation decision between AsA and its users.

BARA believes there should be a detailed review of AsA's charging structure. However, the necessary information for such a review is presently unavailable. Therefore, it is not possible to comment on the particular matter of the structure of ARFF charges, identified by the ACCC as a major concern for a number of stakeholders. In this regard, however, BARA notes that AsA recently issued a press release to advise its intention to review the structure of ARFF charges.

BARA agrees with the AsA's assessment that it would take 3 to 6 months to complete the review. BARA is willing to work with AsA through the ISC to complete the review in a timely manner.

Impact on users

BARA generally endorses the ACCC's conclusions in relation to the impact of AsA charges on users.

Conclusion

BARA notes that the ACCC has decided not to object to the terminal navigation and enroute charges, but has objected to AsA's proposed ARFF charges. Any change to ARFF charges, as noted above, must be done following a detailed analysis by the ISC of all the information necessary. That analysis will take some months to complete and should be the subject of a further notification to the ACCC.

Please note that BARA does not agree with the ACCC's methodology or its application of the 'capacity to pay' approach in considering AsA charges. This approach seems to be motivated by concerns about possible increases in charges at regional and GA airports rather than problems associated with the ABC methodology for allocating location specific costs.

Please contact the undersigned if you have any questions in relation to the above comments.

Yours sincerely



Warren Bennett
Executive Director