

28 July 2011

Mr Anthony Wing
General Manager – Transport and General Prices Oversight Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

Dear Mr Wing,

Preliminary View on Airservices Australia's Draft Price Notification

I refer to the Australian Competition and Consumer Commission's (ACCC) *Preliminary View* on the prices to be charged by Airservices Australia (AsA) for en-route and terminal navigation (TN) services and aviation rescue and fire fighting (ARFF) services to 30 June 2016. The Board of Airlines Representatives Australia (BARA) considers that this *Preliminary View* represents a further move away from a framework that encourages the efficient pricing of and long-term investment in en-route, TN and ARFF services by AsA. BARA's concerns with the ACCC's approach to assessing AsA's proposed prices are outlined below.

BARA's understanding of the *Preliminary View*

In reading the ACCC's *Preliminary View*, BARA considers that the key issues can be summarised as:

1. AsA's proposed weighted average cost of capital (WACC) is too high. The ACCC considers that an updated nominal risk free rate and debt margin (based on an AAA credit rating) would lower AsA's WACC, reducing total allowable revenues by around \$100 million over five years.
2. The ACCC has effectively moved to a 'revenue cap' arrangement, with AsA determining the 'willingness to pay' by different user segments.
3. AsA needs to improve the quality of its consultation with users. The ACCC has expressed concern over the efficiency of the proposed capital program, given the lack of effective consultation with airlines.

The first point reflects a difference of opinion between the ACCC and AsA over the setting of the WACC, something rarely agreed between a service provider and regulator in any pricing assessment. The second point, however, represents a significant shift in the ACCC's assessment process under the prices notification provisions of the *Competition and Consumer Act 2010* (CCA). The third point reflects the inability of the ACCC to actually require AsA to implement any of the recommendations contained in the ACCC's Final Decision.

Legislative obligations

BARA is unconvinced that the ACCC has adequately discharged its legislative obligations in effectively moving to an aggregate 'revenue cap' arrangement in assessing AsA's proposed prices. In particular, subsection 95G(7) of the CCA requires the ACCC to 'discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that market power in setting prices.'

Given a lack of commercial and/or competitive disciplines, AsA has the incentive to use its market power at major international airports to pursue broader political and interest group objectives. BARA is concerned that AsA's understanding of 'willing to pay' may be determined largely by the lobbying efforts of those who would benefit the most from AsA using its market power to enhance their financial interests at the expense of others. AsA has little information or incentive to use its price setting power consistent with maximising economic efficiency.

BARA considers that AsA's proposed prices are not consistent with the matters the ACCC is supposed to have regard to in exercising its powers under the CCA. The ACCC's *Preliminary View* contains a number of statements that, in BARA's opinion, contradict its legislative obligation to discourage AsA from using its market power in setting TN and ARFF prices at major international airports. In particular, the ACCC states that:

The ACCC is required to examine Airservices draft price notification taking the policy parameters in which it operates as given...Under section 46 of the Airservices Act, Airservices is required to operate as a commercial entity, with the expectation that it will provide an annual dividend to the Government. Implicit in this is a requirement to recover costs of the entire business, that is, that the Government does not have a policy that any use of the services will be taxpayer funded.¹

and:

As an economic regulator, the ACCC's role in assessing price structure proposed by a declared firm under Part VIIA of the CCA focuses on those situations where there is evidence that a proposed pricing structure issue is likely to create distortions in demand or where there are clear opportunities for more equitable outcomes through pricing without creating such distortions.²

The first quote indicates that the ACCC is placing the implicit financial obligations contained in the *Airservices Act 1995* before its own legislative objectives, as contained in the CCA. That is, the ACCC is allowing AsA to use its market power in the setting of TN and ARFF services at major international airports so it can fulfill an implicit policy objective of aggregate cost recovery. It would be useful for the ACCC in its Final Decision to provide some further information and legal opinion on the extent to which its own legislative objectives can be put to one side to accommodate the implicit objectives contained in the *Airservices Act 1995*.

BARA also questions the ACCC's implicit assertion that given 'the Government does not have a policy that any use of the services will be taxpayer funded', it is entitled to earn its full WACC on the value of its assets. BARA would argue that if the Australian Government chooses to allow (or has unofficially directed) AsA to price TN and ARFF services at regional and GA airports below cost but without taxpayer funding, then this should be funded internally through AsA earning a lower rate of return on its assets.

¹ Preliminary View, p. 57.

² Preliminary View, p. 58.

At a minimum, AsA's allowable revenues should be reduced by setting the WACC earned on the assets at loss making locations at zero. The impact of not allowing AsA to earn a rate of return on loss making assets would be about \$10 million to \$12 million per year. AsA could still make a dividend payment to the Australian Government and earn a rate of return (in fact an excessive rate on average) on its profitable activities, while at least having some regard to its policy of pricing TN and ARFF services below cost at many regional and GA airports.

In the second quote, the ACCC seems to be defining those situations in which it will actually seek to discourage AsA's market power in price setting. In particular, where the proposed prices may cause 'distortions' in demand. The legislative obligation contained in the CCA, however, provides for no such regulatory discretion with regard to a person taking advantage of its market power. Again, BARA would appreciate receiving more information and legal opinion on how the ACCC considers that it has such regulatory discretion under the prices notification provisions of the CCA.

Finally, it should also be noted that the 'market' here cannot be defined as the market for TN or ARFF services across all airports. The services provided are specific to the markets served at individual airports. Broader market definitions are unsustainable under any standard analysis of the product, geographic and functional dimensions of TN and ARFF services across airports.

Unfortunately, there is lack of appeal rights associated with prices notification, compared to Part IIIA under the CCA. BARA is very confident that, if such appeal rights existed, the ACCC's position could be quickly overturned by the Australian Competition Tribunal. However, without these rights, international airlines have limited ability to obtain pricing outcomes consistent with well understood and commonly applied economic pricing principles.

Price reductions in recovering lower total costs

BARA considers that the reduction in allowable revenues through a lower WACC should be realised through a reduction in en-route prices. AsA's proposed prices result in international airlines being overcharged by many tens of millions of dollars to fund an increasing deficit on the services provided at regional and general aviation (GA) airports. Importantly, in proposing prices for TN and ARFF services at regional and GA airports, AsA has stated that the price increases are limited to 'affordable year-on-year changes at or around inflation'. If the proposed prices at regional and GA airports are considered 'affordable', then there is no reason to reduce them given the prices usually fail to recover total location specific costs.

By reducing the en-route price, it ensures that a greater proportion of the allowable revenue reduction benefits those who are overcharged the most, namely international airlines. This proposal does not mean that BARA accepts the proposed structure of TN or ARFF prices as reasonable. Rather, it represents a practical compromise given the existing economic regulatory arrangements, especially the lack of appeal rights compared to Part IIIA.

Operating and capital efficiency

BARA notes that the ACCC has raised concerns with AsA about the lack of effective consultation with users over its operating costs and capital expenditure. BARA has previously written to AsA expressing its frustration with the current process. This problem has been well understood for a number of years. In BARA's opinion, AsA simply ignored this deficiency in the knowledge that the ACCC had no ability to object to its proposed prices due to a lack of effective consultation. The ability for AsA simply to ignore the ACCC's key recommendations brings into question the value of the ACCC's review process if no meaningful changes occur from its review and recommendations.

Nevertheless, BARA again welcomes the opportunity to engage in meaningful consultations with AsA over its capital expenditure and operating costs. BARA has written to AsA offering to establish a more formal approach to receiving and providing input into AsA's capital program. Whether AsA actually chooses to engage in meaningful consultation is a decision of its Executive and Board. It is possible that the ACCC's Preliminary View and Final Decision could influence the AsA Executive's and Board's decision on this matter.

Yours sincerely

A handwritten signature in dark ink, appearing to read "Warren Bennett". The signature is fluid and cursive, with the first name "Warren" being more prominent than the last name "Bennett".

Warren Bennett
Executive Director