



**IATA submission in response to the Australian
Competition & Consumer Commission (ACCC) preliminary
views on Airservices Australia's Draft Price Notification
2011-2016**

27 July 2011

This submission presents the response of the International Air Transport Association (IATA). IATA's mission is to represent, lead and serve the airline industry and brings together over 230 member airlines whose flights account for 93% of all international scheduled air traffic.

IATA welcomes this opportunity to submit its comments to ACCC on its preliminary views regarding Airservices Australia's (AsA) Draft Pricing proposal for 2011-2016. IATA's comments are from an international perspective and are based on the requirements of, and practices in, international civil aviation.

Overall, IATA supports the ACCC's preliminary view to object to AsA's proposed increases in TN and ARFF services. As the ACCC rightly points out, there are significant issues linked to the consultation of the capital program, the lack of adequate benchmarking measures as well as the substantially overestimated cost of capital proposed in the Draft Price Notification. These issues need to be amended before the submission of the Final Price Notification.

In this regard, IATA supports the ACCC's proposed solutions to address these concerns such as the provision of detailed information on a project-by-project level and the reduction of the required revenue by about AUD100 million from applying a cost of capital that truly reflects AsA's risks.

Another important contribution from the ACCC is the need to implement an adequate monitoring mechanism on a project-by-project level in order to ensure a prudent and efficient delivery of the capital program. This is necessary as the current capex risk sharing mechanism could provide a perverse incentive to invest in unnecessary projects in order to reach the minimum thresholds.

Finally, IATA supports the ACCC's recommendation to link non-compliance of the charter's KPI's with financial penalties. This will ensure that AsA does not "cut corners" in order to outperform its cost targets.

However, there are some important areas of the ACCC's preliminary views that continue to be of concern to IATA. The key IATA concerns are:

1) Cross subsidies: IATA considers that many airlines, and ultimately the passengers paying for their services, are being significantly and unjustifiably hit by the compounded effect of a number of cross subsidies¹ designed to favor specific segments of users (i.e. General aviation). IATA considers that it should be the State (the ANSP owner) that bears the cost of any desired subsidies to these aviation segments rather than other users. The fair way of achieving this is by forgoing the cost of capital related to the provision of services for these targeted segments.

Moreover, as stated by the ACCC, Ramsey pricing relates to the allocation of common costs (i.e. human resources, finance, etc.) and not to costs across distinct services at different locations. However, there has been no proof that only the common costs have been "redistributed". As a minimum, the ACCC should ensure that the cross subsidies allowed in the Price notification are consistent and follow this principle.

Most importantly, although the cross subsidy among services decreases over the period, the cross subsidy distortion increases among users within the same service (i.e. larger airports

¹ - Subsidies from en route to TN and ARFF services
- Subsidies from oceanic to continental services
- Subsidies from larger TN locations to smaller regional ones
- Subsidies from the application of network pricing at ARFF Category 6 services
- Subsidies from the application of weight based charging formulas

fund a higher portion of the TN costs of subsidized airports over time). This is contrary to the ACCC's statement that it seeks for a gradual shift to site-specific pricing. The ACCC should at least ensure that the value being cross subsidized among users of the same service does not increase by the end of the period.

2) Depreciation: IATA urges the ACCC to review in more detail AsA's actual depreciation versus forecast in the LTPA 2005-09 period as IATA believes that the former has been substantially lower. Given that charges are set on the basis of forecast depreciation, this differential implies that airspace users have been overcharged during the LTPA 2005-09 period potentially by around AUD90 million. This is shown in Table 1.

Table 1: Forecast depreciation LTPA 2005-09 and actual depreciation from the AsA's annual reports

AUD million	2003	2004	2005	2006	2007	2008	2009	Total
LTPA 2005-09			77.1 m	74.4 m	76.8 m	78.6 m	78.3 m	385.2 m
Actuals (Annual reports) ²	47.6 m (2002-2003)	72.2 m (2003-2004)	64.4 m (2004-2005)	53.1 m (2005-2006)	52.1 m (2006-2007)	62.0 m (2007-2008)	61.5 m (2008-2009)	293.0 m
Amount potentially overcharged								92.2 m

It should be noted that neither the Draft notification nor the ACCC documents provide a detailed year-by-year comparison between the actual and forecast levels of depreciation for the LTPA 2005-09 period. Such table is necessary in order to clarify our concerns.

Unlike "operating costs" where differences can allegedly be attributed to outperformance, large changes in depreciation can rarely be considered as such particularly given the fact that the delivered capital expenditure has been similar to that proposed in the LTPA.

As previously stated, there are two options for dealing with this overcharged amount:

- a) Implement a revenue claw back in favor of users, or
- b) Adjust (i.e. reduce) the opening asset base using the notional depreciation values presented at the LTPA 2005-09.

It should also be noted that in other regulatory environments (i.e. UK CAA, AERA), the depreciation used to roll forward the asset base is the one assumed in the previous price determination rather than actual depreciation. This is done precisely in order to avoid any gaming in the forecasting of depreciation.

IATA urges the ACCC to reconsider its views and take the necessary steps in order to compensate users for revenue previously collected to cover costs that did not actually exist.

3) International benchmarking: IATA insists that there is a need for further development of international benchmarking. In our opinion, the current comparisons provided by AsA do not provide the necessary information to determine whether AsA is more or less efficient

² There is a timing mismatch between the LTPA (calendar year) and the annual reports (financial year). The table uses the Jul 2004- June 2009 period as comparator. Had the Jul 2005 -June 2010 period been used as comparator, the overall difference between the annual reports depreciation and the LTPA depreciation is AUD 80 million. Still, this is a considerably high amount.

than its peers. For instance, only a clear separation of costs between continental and oceanic services will provide a relevant base point for comparisons.

Although the ACCC emphasizes the need for internal benchmarking, it has stated its satisfaction with the international benchmarking data provided by AsA. IATA urges the ACCC to reconsider and encourage the development of more accurate external benchmarking tools in conjunction with stakeholders in order to validate any cost targets.

In summary, the ACCC's preliminary views provide some important and welcomed improvements compared to the proposals of the draft price determination. IATA considers that a meaningful consultation, the implementation of relevant and challenging targets, the introduction of penalties on KPI non-compliance, and a cost of capital that truly reflect the risks of the regulated company are some of the key cornerstones of any regulatory process.

However, and as noted above, there are areas where IATA has still some major concerns and urges the ACCC to further develop its views in this regard, mainly:

- The need for a dramatic reversal in the increasing level of subsidies.
- The need to compensate users for any amounts overcharged in the previous period.
- The need to develop appropriate international benchmarking tools.

IATA is ready to engage in any consultation processes as necessary aimed at solving the above-mentioned concerns as soon as possible.

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