Virgin Australia Group of Airlines

Response to Australian Competition & Consumer Commission

Airservices Australia draft price notification

Preliminary view

1 August 2011

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1. General

Virgin Australia Group of Airlines (VAA) welcomes this opportunity to submit further comments to the Australian Competition and Consumer Commission (ACCC) on Airservices Australia's (Airservices) Draft Price notification Preliminary view dated July 2011.

VAA still share a similar concern to the ACCC that Airservices has not undertaken adequate consultation with stakeholders to ensure that its capital expenditure program is being undertaken prudently and efficiently. VAA are of the opinion that the views of interested parties are still not sufficiently captured. Including industry concerns of possible excessive or miss-directed allocation of capital expenditure.

VAA do recognise that the ACCC in its preliminary view have best tried to formulate a decision that suits industry as a whole. VAA being strong advocates of this approach would though continue to question the extent industry can continue to support this type of cost increase, or perhaps more importantly, whether it can justify the inevitable impacts of increases to fares on consumer demand and downstream industries.

VAA acknowledges that Airservices has a statutory obligation to ensure safety and that in order to remain a world class air navigation service provider, significant investment is necessary. However, VAA would strongly encourage the ACCC to recognise that the industry is subject to an increasing variety of other cost burdens which continue to place upward pressure on airfares, and that in this context, every effort should be made to limit the size of the capital expenditure program.

2. Airservices needs to improve its level of consultation with stakeholders to ensure prudency and efficiency of capital expenditure

In note of a number of submissions raising concerns about Airservices consultation process in relation to capital investment projects VAA is still of the opinion that a greater detail of transparency is required. Airservices acceptance in undertaking to present summary business cases for all projects greater than $10million to the PCC is a positive step towards Airservices improving its consultation. VAA also echo the view of the ACCC in that industry needs to be totally satisfied that Airservices has formal mechanisms in place for consultation with users that provide ongoing transparency to, and accountability for, their performance.

If past experience tells us anything Airservices' inability to deliver projects on time and on budget has been questionable. To some extent Airservices' failure to meet industry expectations has reflected a staffing shortfall although the poor outcome has been more likely attributable to the lack of good quality project management.

3. Airservices needs to improve its drivers of efficiency

Performance measurement

VAA is very supportive of Airservices' decision to develop a Services Charter.

VAA are particularly pleased to note that the performance framework within the Services Charter aligns with the ICAO performance objectives which are to establish and measure performance outcomes in order to:

• Design, develop, operate and maintain a system that can meet the expectations of its users;

• Determine that the Air Traffic Management (ATM) system is operating in accordance with its design, and

• Determine when and where action is to be taken to enhance performance levels when the (ATM) system is not meeting, or is predicted not to meet, expectations.

VAA acknowledges Airservices' commitment to industry to strive to deliver an ATM system for its customers which is responsive to airspace users, is focused on improving quality of service, ensures a safe, economic and efficient system that satisfies demand, is globally interoperable, is environmentally sustainable, satisfies the national interest including defence and security, and maintains Australia's status as a best practice model in air traffic management.

Along with other industry stakeholders, VAA recognises that it will take time for the Key Performance Indicators to be refined. VAA has accepted an invitation from Airservices to work collaboratively on developing appropriate KPIs over the next 12 months.

Adoption of technology

VAA supports Airservices' endeavours to adopt the latest technology providing the decision to do so has been arrived at using an ICAO Performance Based strategy i.e. the decision to employ new technology should be driven by an operational requirement supported by a cost benefit study. VAA has previously stated it does not support a strategy driven by technology availability alone.

As a strong advocate for ASTRA, VAA believes that Airservices decision to introduce more efficient processes or to invest in efficiency-increasing technologies over time, should be determined in accordance with the industry agreed consultative processes driven through ASTRA or other appropriate consultative forums.

Airservices' adoption of technology is generally appropriate in comparison to other air navigation and emergency services operators overseas. It should be noted, however, that VAA's experience is that the decision to purchase such technology is not always made in collaboration with industry stakeholders.

4. Airservices needs to review its methodology for estimating its rate of return on capital

VAA had previously submitted that the methodology used by Airservices in calculating the Weighted Average Cost of Capita (WACC) was too high. As Airservices is not exposed to a high level of commercial and competitive risk being a government-owned provider, VAA considered the debt margin used in the WACC calculation too high. VAA welcome the ACCC's decision in not accepting Airservices proposed rate of return on capital as appropriate.

VAA previously submitted that in the calculation of the WACC, the level of debt margin has increased 1.75% since the last agreed LTPA and a further 0.7% since the original proposed pricing issued in December 2010. Whilst VAA recognises that the cost of debt has risen in the short term from the effect of the Global Financial Crisis, VAA would like assurances that a longer term view of debt financing (possibly a seven to 10-year projection) is being used given that to this agreement is being set for the next five years.

5. Un-competitive basis of charging

As previously submitted VAA is strongly opposed to the use of average airline industry MTOWs as the preferred method of charging and would want to reserve the right to review this during the life of the five-year agreement should our internal fleet model change. Average MTOWs are based on all aircraft operations and not operator specific. The average weight charging removes the ability of VAA to manage its fleet capabilities through differing MTOWs and removes any competitive advantage that may be achieved through more efficient fleet planning. Should average weights be desired by Airservices, they should only be implemented as a company average weight and not an industry average weight.

In the draft pricing notification Airservices list the Average MTOW of the B737-700 as 70.0T. VAA is currently the only Australian operator of the -700 and the MTOW stated is greater than our fleet average MTOW which is 66.3T. VAA consider this a fundamental error and request that the ACCC seriously consider this issue as it gravely disadvantages VAA as a basis of charging.

In light of the ACCC's preliminary view VAA feel this decision needs further review.