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Dear Dr Bryon

Brisbane Airport Supplementary Submission to the Productivity Commission Review of Price Regulation of Airport Services

Introduction

The purpose of this submission is to build on Brisbane Airport Corporation Limited's (BAC) earlier submission provided to the Commission in March 2001, as well as comment on a number of issues raised to this Review by other parties since the Commission's hearings in April 2001.

BAC has now had the opportunity to review the transcripts of the Commission's hearings and analyse the Australian Competition and Consumer Commission's (ACCC) submission to the Review. On review of these documents BAC are concerned about the interpretation placed on various issues by the ACCC and the airline industry, and as such, we have prepared this submission to succinctly express our views with respect to these issues.

Definition of aeronautical, aero-related and non-aeronautical services

The ACCC has noted that it has some concerns that the current definition of aeronautical services has not been based on a rigorous assessment of market power¹. That is, the ACCC considers that in many cases the set of services currently defined as 'aeronautical' is too narrow for price regulation to be fully effective².

In BAC's earlier submission to the Commission we considered the set of services and activities offered by airports in the context of market power, and concluded that in most cases BAC agree with the ACCC's assessment of the likelihood of declaration as

¹ ACCC, Submission to the Productivity Commission's Inquiry into Price Regulation of Airport Services, May 2001, p.71

² ACCC, op.cit, p.77

contained in their paper on Section 192 of the Airports Act³. However, we now note that in their recent submission to the Commission, the ACCC has reviewed its position with respect to some services, and specifically domestic passenger processing facilities and car parking.

BAC disagrees with the arguments presented by ACCC with respect to airport operators having a significant degree of market power with respect to car parking services at airports. That is, in the context of Sydney Airport (but noted it extended to other airports) the ACCC has argued that short term parking at airports,

- Generates high reported profits;
- Faces limited competition;
- Sustains prices above competitors; and
- Is not discretionary.

BAC considers these arguments fundamentally flawed for the following reasons,

- Car parking activities at airports generate no greater profits than car parking businesses elsewhere that exhibit locational rents, such as car parks at hospitals and CBD locations. Further, the ACCC based this statement on a flawed financial evaluation of Sydney Airport car parking activities. It failed to appropriately value the underlying asset of the car park, and it inappropriately compared the returns of the (contestable) car parking business against the (non-contestable) aeronautical business – two fundamentally different types of businesses.
- Car parking at airports is a discretionary activity in the delivery of aeronautical services at airports. Clearly, there are many other supply side options instead of on-airport car parking available to airline passengers, from public transport to off-airport car parking. BAC has recently experienced such an increase in competition through the introduction of the AirTrain, which offers rail services from Brisbane Airport to the Brisbane CBD and Gold Coast.
- Prices for car parking at Brisbane Airport is established based on competitive off-airport car parks and the cost of alternative forms of transport to the airport. This competitive approach to pricing ensures Brisbane Airport cannot be accused of taking advantage of its position.

BAC consider that the ACCC are interpreting Declaration No.'s 87,88 and 89 and Direction No.'s 18 and 21 beyond their stated intention by the Commonwealth Government and the Minister for Financial Services and Regulation (the Minister), and in doing so, are advocating a pricing methodology that inappropriately transfers wealth away from one market participant (being airport owners) to another (being airlines) rather than a pricing methodology that is focussed on economic efficiency.

³ ACCC, Draft guide to declaration of airport services – Section 192 of the Airports Act, Oct 1998

It is absolutely clear in Declaration No.'s 87,88 and 89 that aeronautical services, being only aircraft movement facilities and activities and passenger processing facilities and activities, are declared for regulatory purposes. Further, the Minister explicitly identifies, amongst others, aircraft refuelling and public and staff car parks, as external to the declared aeronautical services. Given the 'black and white' nature of the contents of these documents, BAC find it difficult to comprehend how the ACCC could interpret that it should be taking into account costs and revenues associated with any airport services other than those specifically prescribed by the Minister.

Due to the approach undertaken by the ACCC in its Draft Decision on the Sydney Airport Aeronautical Pricing Proposal, it was necessary for the Minister for Finance to issue Direction 22 which expressly noted that the ACCC 'should not take into account the revenues generated, or costs incurred, in the provision of services other than aeronautical services'.

In addition to these statutory documents, the Commonwealth Government has identified on numerous occasions its intention that airport pricing be determined on a dual till basis, and that revenue from non-aeronautical services (including car parking and aircraft refuelling) were explicitly not to be considered within aeronautical services for pricing purposes. For example, the Department of Transport and Regional Services (DoTRS) in its paper *Ground Access Fees and the CPI-X Price Cap*, December 1998, clearly states that

'... car parks are considered an aeronautical-related services, as defined by the ACCC and the Department (DoTRS). They are price monitored. In our view, it is not essential to park one's car at an airport in order to use the airport, given the alternative methods of travel to and from airports. The Declarations currently in place clearly place car parks outside the price cap'.

BAC considers that it is obvious, through both statutory documents and other official reports, that the Commonwealth Government intended revenues associated with car parking and aircraft refuelling activities (as well as other stated activities) to be outside of the aeronautical services price cap. Therefore, any deviation away from this framework clearly is in contravention to stated Commonwealth Government policy.

One of the major achievements of privatisation has been to create a (largely) clearly understood definition of aeronautical activity. This has started to create a climate in which airports and airlines can conduct normal commercial arrangements and any further confusion would simply put this process back further contrary to stated Government policy.

Further, any change away from the Government's intended definition of aeronautical, aero-related and non-aeronautical activities for whatever reason, would likely result in a massive reduction in the value of the privatised airports from an investors viewpoint. Were this to occur successful bidders would rightfully feel 'conned' by the Commonwealth Government, and the investment community would need to carefully appraise representations made to them in any future Commonwealth Government privatisation process.

Definitional changes - fuel throughput levies and ground facilities fees

BAC has already seen examples of where the ACCC has attempted and successfully (from its point of view) amended the definition of aeronautical services that are subject to the price cap, thereby decreasing the shareholder value of airport investments post privatisation.

As mentioned in our earlier submission, representations were made to all airport bidders during the privatisation process that fuel throughput levies and ground facilities fees would be considered non-aeronautical in nature, and therefore excluded from price cap. Specifically,

- Fuel throughput arrangements were negotiated on a commercial basis between the FAC and aircraft refuelling companies prior to the privatisation process occurring. Bidders were specifically told they were contractually entitled to activate the charging mechanism, and that this revenue stream would be outside of the aeronautical price cap; and
- Ground facilities were confirmed to be outside of the aeronautical price cap by the DoTRS. The DoTRS has again reiterated its position with respect to ground facilities fees being outside of the price cap in its recent submission to the Commission. The DoTRS noted that the ACCC report released in December 1998 on this matter was 'particularly contentious in that it utilised an interpretation of the meaning of Section 17 (b) of the Prices Surveillance Act 1983 to infer that a revenue cap on airport operators was intended when clearly that was not the case under the (airport specific) prices oversight framework'.⁴

Despite these representations of Commonwealth Government intentions and policy, the ACCC has continued to pursue these revenue streams as aeronautical for pricing purposes, which is again reiterated in their submission to the Commission.

⁴ DoTRS, Submission to the Productivity Commission Review of Price Regulation of Airport Services, June 2001, p.14

BAC contend that while the ACCC is publicly acknowledging the benefits of dual till pricing, it is striving for single till outcomes through trying to achieve definitional changes of what is aeronautical and what is non-aeronautical for regulatory pricing purposes. In a recent speech by Commissioner John Martin, he noted,

‘One of the most important, yet understated, aspects of the Commission’s approach to airport regulation is determined by the fact that it operates within the bounds set by the legislative framework formulated by the Government. This limits considerably the discretion of the Commission.’⁵

From the examples provided of how the Minister had to formally direct the ACCC with regard to the Sydney Airport pricing decision, as well as its approach with respect to car parking, fuel throughput levies and ground facilities fees, it is easy to conclude that the ACCC does not consider itself bound by the legislative framework or stated policy intentions set by the Commonwealth Government. Rather, the ACCC pursues policy outcomes consistent with its own internal objectives, whatever they may be.

ACCC Interpretation of KPMG Consulting’s Review of Airports’ Regulatory Accounts

BAC contend that the ACCC has inappropriately represented KPMG Consulting’s Review of Airports’ Regulatory Accounts to insinuate that airports are earning normal, or above normal, rates of return.

The KPMG Consulting analysis presents various business ratio’s, with the ACCC choosing to highlight operating profit on tangible non-current assets as a representation of investment returns. The ACCC failed to point out in its submission, media releases and public speeches that the numbers quoted represented operating profit on aeronautical and non-aeronautical tangible non-current assets, and that the analysis based on aeronautical activities – being **only** those aspects of airport services the ACCC is statutorily required to regulate – provides a much different result.

Table 1			
Operating Return (pre interest) on Tangible Non-Current Assets			
Aeronautical Services			
Airport	1997/98	1998/99	1999/2000
Melbourne	2.9%	2.9%	3.7%
Brisbane	1.2%	1.0%	0.0%
Perth	0.7%	0.6%	3.1%
Sydney		0.7%	-0.4%

Source: KPMG Consulting, May 2001

⁵ The ACCC Role in Sydney Airport Regulation, presented to Australian Airport Association on 14 June 2001

The above table clearly shows that the Phase 1 airports and Sydney Airport have not earned monopoly returns on their aeronautical assets, let alone normal returns. Rather, the shareholder value associated with the aeronautical aspects of some airports has reduced since privatisation.

Further, given that post tax return to equity is the indicator targeted in the ACCC Necessary New Investment process, BAC contend that this ratio should have been quoted by the ACCC as representing returns to airport investors.

Table 2			
Post tax return on equity			
Airport	1997/98	1998/99	1999/2000
Melbourne	-42.0%	-71.8%	-98.4%
Brisbane	-4.8%	-8.9%	-6.3%
Perth	-22.9%	-30.6%	-33.1%
Sydney		2.5%	2.2%

Source: KPMG Consulting, May 2001

Again, airport investors have not been earning monopoly profits, or normal returns, in either their aeronautical activities or across total airport activities.

BAC reiterate that the current aeronautical charges at Australian airports are so far below fair levels that any concerns held by regulators regarding airports earning monopoly profits is completed unwarranted. Rather, it is imperative that a new pricing framework be established to deliver fairer commercial outcomes for airport investors than those achieved under the current regulatory framework.

If airport investors are not in a position to earn a fair return across the airports total asset base, they are unlikely to support any future capital investments at the airport requiring their equity participation. They will instead allocate their investment funds towards those opportunities that provide, at least, a fair return relative to the underlying risk of the opportunity.

ACCC Proposed Model

Starting Point Prices

The ACCC has noted that it believes that prices from the current regulatory framework should be carried over to form the starting point for a new price cap, and that any alternatives are likely to result in significant increases or decreases in charges, with the main effect of such a change being a distributional one.⁶

⁶ ACCC, op.cit, p.10

BAC consider such an argument to be incorrect, especially in the context of the ACCC recently accepting price changes at Sydney Airport based on the fact that existing prices were inefficient. The same argument can be easily mounted for other Australian airports, especially given that the starting point prices at the time of privatisation were not set with any regard to assets utilised and consumption. This is shown in the previous tables where operating returns on (adjusted) aeronautical assets is extremely poor.

Further, BAC consider that it is imperative to recalculate starting point prices based on the fact that both CPI and demand for aeronautical services has been lower than anticipated, with the cumulative effects of these factors resulting in current prices being significantly lower than economically efficient prices. To carry existing prices forward into the next regulatory period would therefore only exacerbate the discrepancy between actual and efficient prices for aeronautical services.

BAC also contend that by adopting the approach advocated by the ACCC with respect to starting point prices, the ACCC are again supporting a 'single till' approach to airport pricing. That is, by not allowing prices for aeronautical services to increase to an efficient level, airport owners will remain wholly reliant on non-aeronautical services to provide their investment returns.

The ACCC has also noted in its submission to the Commission that there was nothing to suggest that any commitments were made to airport bidders during the sales process to reset prices. Again, such a statement by the ACCC is an example of it choosing to misinterpret stated Commonwealth Government policy.

It is clearly stated within the DoTR's *Pricing Policy Paper* that,

- The first five years of the scheme is viewed essentially as a period of transition;
- Toward the end of the first five years the prices oversight arrangements for airports will be reviewed;
- The review will be based on the premise that the price cap applied to aeronautical charges during the first five years will no longer operate;
- The Government will not mandate the use of a single till approach to airport pricing;
- It is intended that airport operators and aviation users will have maximum incentive to develop normal commercial relationships over the first five years; and
- Such a commercial environment will improve the efficient operations of the airports, and reduce the compliance costs of regulation on the industry as a whole.

While BAC agree that the synopsis above does not specifically dictate that prices could be reset at the end of the first five years, it contends that the intention of the Commonwealth Government was that prices would be able to adjust (over time) to their efficient commercial levels, and that the framework established for the first five years was only a transitional one.

X-factor efficiency gains

The ACCC correctly acknowledges in its submission to the Commission that 'X' values are supposed to represent 'general productivity improvements which can be made in the delivery of aeronautical services at each airport'⁷. The ACCC also acknowledges that, in conjunction with BZW, it completed modelling exercises with respect to establishing 'X' values. However, in a draft report⁸ dated May 1996, the ACCC acknowledged that in nearly all scenarios modelled 'X' values at Sydney, Melbourne, Brisbane and Perth should be positive – and therefore generate real increases in aeronautical charges - in order for investor acceptable rates of return to be achieved. It was only under a single till approach that the major airports could achieve an acceptable rate of return with a negative 'X' value.

Given the existence of this analysis, and given the ACCC has acknowledged that it did provide advice to the Commonwealth Government on the setting of 'X' values, BAC find it surprising that the 'X' values recommended by the Commonwealth Government were all negative. This would suggest that the ACCC has:

- Implicitly approached price regulation of airports from a 'single till' approach despite the clearly stated Government policy of a dual till approach;
- Utilised the 'X' value as a mechanism by which to limit the returns to airport investors, rather than as a mechanism to achieve productivity improvements in airport operations; and
- Understood that airport investors would earn negative returns on aeronautical activities, even though it has always been the intention of the Commonwealth Government to allow airport owners to earn a fair commercial return on their aeronautical and non-aeronautical activities (independently).

BAC contends that the basis for determining the original 'X' factors did not relate to estimating the efficiency potential within each airport. Given this, it is not appropriate that these values be carried over into the next regulatory framework.

⁷ ACCC, op.cit, p.110

⁸ ACCC, The Inclusion of Non-Aeronautical Contributions and their Impact on the Level of Price Cap – Options for Consideration, May 1996

Form of future regulation

In our earlier submission to the Commission, BAC noted that it had yet to finalise its position with respect to what type, if any, of prices regulation it considers appropriate for the airport industry in Australia. Since preparing this earlier submission, BAC has now had the opportunity to discuss internally options for regulation, review other stakeholder's recommendations and consider the ACCC submission.

BAC's view is that the current form of regulation is inappropriate, and the current regulator is excessively interventionist. It is acknowledged by both Government and industry that:

- Major airport operators have not abused the market power they possess;
- The price cap regime currently in existence has not caused this outcome;
- Airlines do have a significant degree of countervailing market power, especially at the margin; and
- Even in the absence of countervailing market power, it is not in the interests of airport operators to abuse their market power as it would be at the expense of incremental non-aeronautical business activity.

BAC agrees with the DoTRS that the current regulatory structure is unlikely to promote efficient market outcomes, and therefore should be avoided if possible. BAC also strongly agrees with the DoTRS conclusion that the current regulatory framework has allowed for the 'shadow management of Airport businesses by the regulator without appropriate regard to achieving higher order efficiency gains in the aviation market from facilitating structural adjustment and competition in the airline industry'.⁹

BAC conclude that the most appropriate regulatory framework for airports in Australia is one where action is taken on the basis of an actual abuse of market power, rather than the 'big stick' approach currently adopted by the ACCC. Further, the framework should also require the regulator to prove the existence of market power based on a set of criteria that cannot be liberally interpreted by the regulation.

Conclusion

BAC advocate the abolition of the current interventionist regulatory framework and the adoption of a more 'light handed' regulatory model that encourages airports to reach commercially negotiated outcomes with their users. BAC consider that interventionist economic regulation should only occur in those circumstances where an abuse of market power can be proved by a regulator.

⁹ DoTRS, op.cit, p.13

BAC has reached this conclusion based on its experiences in working within the current regulatory framework. BAC also agrees with the independent conclusions of the DoTRS with respect its view as to how the regulatory framework has been implemented by the ACCC. Rather, it appears that the ACCC seem to be more interested in 'massaging' the framework to meet its own objectives (whatever they may be) rather than the objectives of the Commonwealth Government, being a more efficient airport and airline industry in Australia.

Should you have any queries regarding this supplementary submission, please feel free to contact me on 07 3406 3022.

Yours sincerely

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