19 October 2006

Review of Price Regulation of Airport Services
Comments on Draft Report

ADELAIDE AIRPORT LTD (AAL)

Draft Recommendation 4.2

AAL queries the rationale for recommending that price monitoring should continue to apply to AAL, as set out on page 62.

The suggestion by the South Australian Government that airlines had a temporary increase in countervailing market power that is now reduced post finalisation of the new terminal facility is without any substance or fact. The common user aspects and design of the new terminal allows significant flexibility to airlines. Adelaide remains one of the most underserviced international ports in the country, and this is clearly not related to price as some of the more significant periods of growth have taken place since 2002.

Rex voiced concerns over airport facilities and the increase in operating margins since 2002 and this is noted by the PC in its' recommendation to continue price monitoring for AAL. Rex was involved in all relevant design and planning issues and signed off on all procedures. It is fair to say Rex did not get everything they insisted on, such is the nature of commercial negotiations and the need to balance other stakeholder demands. Rex is in a dominant market position on many of their routes in South Australia and have recently announced significant profits. Rex enjoy, virtue of AAL's sensitive pricing policy the lowest regional airline charges of any capital city airport in the country. The view that AAL has significant countervailing market power in this context is puzzling.

The PC notes it has received, under the confidentiality carveout, "information that the airport may not be offering a choice of charging regimes in the next round of price negotiations."

AAL was the first capital city airport, and to its knowledge remains the only airport that offers airlines a choice of landing charges, based on landed tonnes or passengers, and allows airlines to make an annual election on their preferred method of being charged.

AAL categorically refutes the assertion that this flexible market oriented offering will not be continued. It is impossible for anybody to be able to have any evidence that this practice will not continue as it is simply untrue. The PC has relied on a statement, obtained under confidentiality, that AAL is unable to challenge as the source is 'protected', to arrive at the recommendation that AAL should remain price monitored.

AAL submits that the case for continued price monitoring at Adelaide Airport has not been made.

Draft Recommendation 5.1

AAL does not agree with the recommendation to further widen the definition of aeronautical services. The PC recommends that there should be a 'line in the sand' with respect to freezing asset values for the purposes of price monitoring, AAL submits that likewise the definition of aero and aero related services should not be 'tinkered' with anymore, in order to provide certainty going forward.

We repeat our initial submission that Direction 27 should be the guiding document and the Airports Act amended accordingly, rather than take the lowest common denominator approach as appears to be the case with the submission by DoTaRs and therefore continuing to widen the definition.

For the reasons stated by both the PC and DoTaRs, AAL agrees with the removal of landside vehicle services from the definition.

Draft Recommendation 5.3

For the reasons set out in our original submission AAL is concerned that quality of service monitoring will continue to have the propensity to be biased due to the small sample sizes.

Any low ratings should be substantiated by the organisation that gives the feedback.

AAL is not convinced that the draft recommendation to undertake price monitoring every two years will achieve any reduction in cost or be more efficient. As we stated in our original submission the cost to AAL of preparing regulatory reports, in the current monitoring regime, is not unduly onerous. However we are concerned that reporting every two years, depending on the reporting format, could potentially increase the cost of reporting as there may be a requirement to consolidate two years of information. This would have consequential effects such as likely increased audit costs.

On the other hand, Quality of Service Monitoring every two years, based on the present ACCC requirements would save expense.

Draft Recommendations 5.5 and 6.1

AAL acknowledges that the proposal for asset valuations to be frozen at June 2005 values for the purposes of price monitoring and providing a 'circuit breaker' to allow airlines and airports to negotiate commercial outcomes for the next pricing quinquennium is a pragmatic compromise.

However we submit that this should be viewed as a moratorium to be considered at the next review. Any long term assessment of returns must be based on maintaining the real value of assets in order to maintain appropriate pricing signals.

AAL set its asset values for aeronautical pricing purposes into a financial model which was made available to airlines in 2002. Airlines did not tender any substantial evidence to the contrary, as an objective basis for setting charges, choosing instead to negotiate ‘a number’. Those asset values are the relevant values for the purposes of future pricing negotiations, irrespective of what the relevant accounting standards of the day mandate must be recorded in the company’s balance sheet.

AAL cautions that, if adopted, the draft recommendation will require considerable effort (and therefore expense) to separately track movements in asset value due to subsequent acquisitions, disposals and accumulated depreciation and relate those movements back to a June 2005 base. AAL assumes that this process will be undertaken by the ACCC. If airports are required to do this there will be a considerable increase in administration and compliance costs.

The continued exclusion of current assets from an asset base in order to calculate returns on investment is not realistic. Working capital, for instance, is an important component of an airports asset base and should be taken into account in determining returns on investment.

AAL is concerned at the draft recommendation that airports must first agree values of new investment with its customers. This creates the potential for airlines to effectively ‘ lock out ’ competitors and further increase their countervailing market power. Airport investment should be viewed as being as much for new market entrants as well as existing ones and all the more so because of the mobile, and sometimes transient, nature of airlines main assets.