



23 September 2011

Dr Wendy Craik
Presiding Commissioner
Economic Regulation of Airport Services
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601
AUSTRALIA

Re: Comments on the Australian Productivity Commission's Draft Report

Dear Dr Craik

IATA thanks the Productivity Commission (PC) for the opportunity to submit further comments in response to the PC's draft report on Economic Regulation of Airport Services. IATA's comments are from an international perspective and are based on the requirements of, and practice in international civil aviation.

Overall, IATA supports some of the PC's findings but is disappointed by the recommendation that a further period of price monitoring at Australia's major airports when the current arrangements end in June 2013. The PC has taken a differing view from the Australian Competition and Consumer Commission's (ACCC) report and the report does not sufficiently address some of the major concerns raised by the airlines and associations. IATA would like, therefore, to emphasize that all the issues listed in its original submission (dated 4 April 2011) to the PC remain valid.

Additionally, IATA would like to provide specific comments on five main recommendations contained in the PC's draft report as follows:

1) IATA supports the "show cause" direction as a first step on the road to more effective regulation.

- The PC believes that there remains a need to make the price regulatory regime more 'active' where the ACCC could direct an airport to show cause why its conduct should not be subject to general competition regulation, including Part VIIA of the Trade Practices Act governing access to essential services.
- IATA supports this approach as it provides a formal process and allows for the ACCC to have a more active role in implementing the prices monitoring regime.
- The PC further recommends that the show cause direction should not only be used on the basis of specific findings provided by the ACCC in any one year. Whilst it is important to set some restrictions, it might be best to allow for several criteria and let the ACCC provide the appropriate arguments for a given airport.
- IATA recommends amending the proposed "show cause" mechanism for cases where the ACCC is dissatisfied with the airport's response. In such cases, the ACCC will have the authority to set a temporary price for aeronautic services until the airport is able to "show cause" or until the initiation and completion of a Part VIIA inquiry. The ACCC may choose not to exercise this authority but having this as an option will make the "show cause" direction resemble the credible threat the PC seeks to establish. In the absence of such an option the 'show cause' threat is of little, if any, difference to the status quo.

- The “show cause” direction, as proposed by the PC, is an ex-post mechanism and while it represents a step in the right direction, it does not address the problems revealed in the submissions (from both airlines and airports) to the PC report related to commercial negotiations between airlines and airports.

2) IATA is concerned with the findings of the PC (9.1 – 9.4) on the lack of effectiveness of commercial negotiations between airports and airlines, which has led to a combative relationship between airlines and airports in Australia. IATA urges the PC to put in place measures that incentivize good faith negotiations.

- Encouraging airports to share additional financial information and more detailed accounts to improve transparency.
- A key area of disagreement during commercial negotiations between airports and airlines relates to passenger traffic forecasts. This can be addressed by encouraging risk sharing and engagement with third party entities to obtain an objective basis for forecasts. For example, Airservices Australia used IATA activity forecasts to determine appropriate activity growth rates.
- Ultimately, IATA strongly believes that an independent appeal body should be available in the event of a dispute between the airports and airline users (see section 2.1.5 of IATA’s 04 April submission).
- The mere existence of an independent appeal body/arbitration mechanism can create incentives for parties to negotiate on a commercial basis. Historical evidence in Australia from non-use of the ACCC arbitration mechanism in airports, which previously had parts of their operations “deemed declared”, suggests that arbitration will not become an alternative to engaging in genuine commercial negotiations. However, to address this concern one could set the cost of arbitration so parties resort to it only under exceptional circumstances.

3) Investment consultations should be further improved by involving airlines to review the costs of the investments and the potential impact they have on airport charges.

- The PC proposes that there is scope to improve the conduct of commercial negotiations through amending the ‘Pricing Principles’ or developing a new voluntary code of conduct in order to address some of the issues raised by airlines regarding the disclosure of additional information around investment programs.
- Airlines in the current system, however, are not always involved when it comes to reviewing the cost-effectiveness of the proposed investments. This would not change with the PC’s recommendations.
- In order to solve this issue, the price monitored airports should consistently involve the airlines when discussions on the costs of the investments take place.
- Each airport should now be required to provide adequate information to determine:
 - The necessity for each of the investment projects
 - That it has been developed in the most cost-effective manner
 - How the investment will be financed
 - The impact it will have on airport charges.

4) There is a need to ensure that a minimum level of service is provided at the price monitored airports against services rendered.

- The most appropriate way for airports and airlines to agree which services and what level of performance should be provided in exchange for the charges paid for their use is through Service Level Agreements (SLAs). However, as clearly mentioned in the PC draft report (page 259), although SLAs are becoming increasingly part of negotiations they are not yet universal.
- There should, therefore, be a requirement for the price monitored airports to standardize their SLAs in order to contribute to the delivery of consistent, appropriate and timely service quality. Additionally, the notion of penalties should be introduced in case the service levels are lower than agreed. This should result in a robust service partnership as key operational targets and accountabilities within airport/airline operations are clarified.

- In addition to standardizing SLAs, airport service delivery should also be monitored through Key Performance Indicators in Australia as clearly expressed in ICAO Doc 9082/8 paragraph 22¹ in order to ensure continuous improvement.
- Regarding the service quality monitoring, the PC recommends that airline surveys should be excluded from the ACCC review when Service Level Agreements are in place with most of the airlines using the facilities at a given airport. This recommendation should be removed as airlines surveys are as important and relevant as airport surveys and should remain publicly available. Additionally, there is a risk that airports will want to introduce a certain type of agreement with the airlines with the aim to have the service quality removed but with no intention of changing their commercial conduct.

5) IATA welcomes the call by the PC to improve effectiveness of monitoring, especially related to measuring and assessing the airports' returns on aeronautic services

- As stated in the 2010 monitoring report of ACCC the data submitted by airports under the monitoring regime does not provide sufficient information to conclusively determine whether or not airports are earning monopoly profits. Enhanced reporting is needed on capital costs, other financial information and detailed accounts.
- However, the ACCC concluded that the monitoring results, when considered within the context of the airport's market power, point to Sydney Airport continuing to earn monopoly rents from services provided to airlines.
- An independent review of the monitored airports' WACC is needed. IATA found distortions in the way Sydney airport has calculated its WACC (see section 2.3 of IATA's April submission), which further points to monopoly rents being earned by Sydney airport.

Furthermore, please find attached our responses to some of the Commission's additional information requests.

Sincerely,

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¹ ICAO Doc 9082/8 paragraph 22: "The council recognizes that performance management is an important management tool for providers, users and regulators. The Council therefore recommends that States, within their economic oversight responsibilities, ensure that providers develop and implement appropriate performance management systems that include:

i) Defining performance objectives with the purpose, as a minimum, to continuously improve performance in four key performance areas (KPA), i.e. safety, quality of service, productivity and cost-effectiveness, it being understood that States may choose additional KPAs according to their objectives and their particular circumstances."

IATA responses to additional information requests

Questions	IATA Position
Market power and regulation	
<p><u>Information request 1:</u> The Commission requests additional information on whether an airport's ability to earn non-aeronautical revenue provides an incentive to constrain aeronautical charges, and if so, to what extent this currently occurs.</p>	<ul style="list-style-type: none"> - There could be a negative impact on investment priorities where airports favour non aeronautical investments.
Airside and terminal: effectiveness of monitoring	
<p><u>Information request 2:</u> The Commission seeks participants' views on the appropriateness of including capital costs, such as the cost of borrowing, in the ACCC's price monitoring program. Are there reliable measures that can be collected with relatively low compliance costs? If so, which is the best measure?</p>	<ul style="list-style-type: none"> - It is most appropriate to include capital costs in the ACCC's pricing monitoring program. - The ACCC could compare profits (including aviation and non aviation) and compare it to a referenced Weighted Average Cost of Capital (WACC).
Airport car parking and land access	
<p><u>Information request 3:</u> The Commission seeks more information on the nature of the off-airport parking market, particularly in Perth and Adelaide.</p>	<ul style="list-style-type: none"> -
Options for future airport regulation	
<p><u>Information request 4:</u> The Commission seeks comment on whether the ACCC should be responsible for both issuing show cause directions and conducting any subsequent Part VIIA inquiry.</p>	<ul style="list-style-type: none"> - Non-issue as the ACCC is an independent entity.
<p><u>Information request 5:</u> The Commission is seeking information on whether guidelines on matters that could improve commercial negotiation – such as information on whether existing assets are being deployed efficiently prior to new investment and processes to facilitate effective service level agreements – should be:</p> <ul style="list-style-type: none"> - devised by the Productivity Commission and incorporated into the Pricing Principles, or - encapsulated within a new voluntary industry code – a committee comprising representatives from the Australian Airport Association, the Board of Airline Representatives of Australia, the Regional Aviation Association of Australia, Qantas, and Virgin Australia (and possibly with guidance from the Australian Competition and Consumer Commission) could be tasked with this. 	<ul style="list-style-type: none"> - To improve commercial negotiations the following is needed: <ul style="list-style-type: none"> o Encouraging airports to share additional information o Encourage risk sharing and engagement with third party entities to obtain an objective basis for passenger forecasts. o Ultimately, establish an independent appeal body
<p><u>Information request 6:</u> The Commission is seeking information on whether there are additional readily accessible financial or other data that would assist the Australian Competition and Consumer Commission to determine if a 'show cause' direction is warranted.</p>	<ul style="list-style-type: none"> -

<p><u>Information request 7:</u> The Commission seeks participants' view on the potential means to standardise passenger survey methodology, such as the use of ACI Airports Service Quality information, without incurring substantial increases in compliance costs.</p>	<ul style="list-style-type: none"> - Importance for the study to be neutral. - One source of study might not be enough. - Check if IATA provides this type of survey now.
<p><u>Information request 8:</u> The Commission invites participants' view on its proposals in relation to airline surveys and service level agreements. In particular, would annual publication of the coverage of, and performance under, service level agreements improve regulatory outcomes?</p>	<ul style="list-style-type: none"> - See point 3 of the IATA letter. - SLAs would improve airline/airport relationships and commercial negotiations.
<p>Land transport access and integration</p>	
<p><u>Information request 9:</u> The Commission is seeking views about the adequacy of communication between airports and the tiers of governments in relation to the provision of information such as estimated traffic volumes, travel time projections and other key performance indicators relevant to the current and future efficiency of access to airports.</p>	<p>-</p>
<p><u>Information request 10:</u> The Commission seeks views on whether an airport should contribute to the cost of infrastructure outside its boundary as a result of future on-airport non-aeronautical development. If funding is viewed as necessary, the Commission also requests information regarding:</p> <ul style="list-style-type: none"> - the basis for funding such infrastructure including the benefits - the form of funding (such as upfront financial contributions, rate of payments or land transfers) - the method of calculating contributions and how the contributions would relate to existing developer charges levied by local governments. - how such funding would align with the conditions under which airport leases were granted. 	<ul style="list-style-type: none"> - Need to ensure that there is zero impact on aeronautical side. - The WACC for the aeronautical side should be lower than for the whole airport group.
<p>Other matters</p>	
<p><u>Information request 11:</u> The Commission seeks information on the potential costs and benefits of extending the Pricing Principles to regional airports. How might the principles be applied, and is the problem of sufficient magnitude to warrant any potential enforcement mechanisms?</p>	<p>-</p>