Board of Airline Representatives of Australia Inc

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Attention David Barratt & ThiThi Nyugen Tran
Infrastructure and Transport – Access & Pricing Branch, Infrastructure Division
Australian Competition and Consumer Commission (ACCC)

By email: David.barrett@accc.gov.au; Thithi.nguyentran@accc.gov.au

Dear David and ThiThi,

Re: BARA Response to Airservices Australia Draft Pricing Notification Issues Paper

The Board of Airline Representatives Australia (BARA) is pleased to have the opportunity to provide input to the ACCCs issue paper on Airservices Australia's (Airservices) pricing proposals. Airservices services are critical for international airlines efficient operations to and from Australia, and their associated charges represent a significant operational cost.

BARA is an industry association representing the majority of the international airlines operating to Australia, with member airlines representing some 60-65% (Source: BITRE) of all international aviation capacity to Australia (a full list of current members is attached). Many of BARAs members have also engaged with Airservices directly and may also be providing direct responses to the ACCC in relation to this issues paper. BARA has ACCC Authorisation (A91466) to undertake non-binding collective bargaining on behalf of BARA members with Airservices as a provider of 'Essential Aviation Services'. As such, BARA maintains an open and ongoing relationship with Airservices covering relevant operational and charging issues in parallel to the pricing notification consultation periods. However, BARA is pleased to provide the following specific input regarding the ACCCs issues paper in relation to Airservices Pricing Notification (PN).

Summary & Suggestions

- BARA recognises and accepts the need for Airservices to recalibrate ANSP charges post the Covid pandemic period but does not consider the proposed increases are supported.
- There are material changes between Airservices original draft Pricing Proposals submitted to airlines around May-2023 and the revised version submitted and updated to the ACCC in Nov-2023.
- Airservices are now proposing to increase charges by the same amount but over a shorter time period, with greater frequency of price changes, and a substantively altered target surplus identified, resulting in the Price Notification being essentially a very different proposal to that which was consulted upon during mid-2023.
- BARA considers that Airservices as a monopoly essential aviation service provider is markedly overstating its volume traffic-risk and associated commercial risk and has relied upon conservative traffic forecasts for the purposes of charges calculation, which elevates the unit charges proposed for airline customers.
- BARA considers Airservices proposed return on capital (Weighted Average Cost of Capital or WACC) is excessive.

- Airservices current operational performance remains below industry standard due to persistent staffing issues as a result of actions taken during the Covid pandemic.
- Airservices is working positively to improve industry engagement however given the need to incorporate new activities into near-term future charges, such as the opening of Western Sydney Airport (WSI), new runways at Melbourne (MEL) and Perth (PER), and the full activation of OneSky amongst others, more open and extensive consultation is required.

BARA suggests: -

- The ACCC consider authorising a 'without precedent' (ie: un-related to Building Block Model (BBM) or Regulated Asset Base (RAB) methodologies) CPI-related increase be applied to Airservices current charges in annual increments (not more frequently) for FY25 and FY26 to enable Airservices some increased cash flow over the proposed PN period and as total traffic continues to recover.
- This can facilitate more comprehensive and collaborative future consultation including a wide-ranging review of both cost allocation & charging methodologies, as well as formalising industry agreed performance metrics and standards, so as to develop a robust longer term 5-year Long Term Pricing Agreement (LTPA) for the industry from (for example) 2027-32.
- This approach would enable matters currently out-of-scope within the current PN such as the opening of WSI, new runways at MEL & PER, the operational and efficiency dividend of OneSky activation, and consideration of the mooted PFAS levy (which FYI BARA rejects on principal as an industry-only cost), to all be fully considered when setting long term Airservices charges.
- BARA considers that airlines need to understand the totality of all these costs as they are critical for evaluating future operating plans. Within the current PN, the lack of clarity around the future cost impost of these significant items, on top of the high proposed increases to current charges, results in the current PN not being acceptable.

Detailed Responses

BARA has provided some more detailed responses to the ACCCs 25 specific questions and grouped these by topic for ease of cross reference to the issues paper.

<u>Section 6.1 - Proposed price increases and scope of the draft notification</u>

Questions 1-5

BARA notes that Airservices first draft pricing proposal (provided May/June-23) was for a flat 6.0% per annum increase from 1-Apr-2024, resulting in a cumulative 19% increase over a 3-year term (2024-27). This was promoted as a shorter term 'interim' agreement before a new longer term pricing agreement could be considered.

BARA provided feedback to Airservices during the Jun-Sept 2023 consultation period that not only did the increases appear high, but further that the flat increase across all service lines was particularly challenging for international carriers, where the en route charges form a larger component of the ultimate total per flight charges (inclusive of Terminal Navigation and ARFF costs). In contrast, BARA observed that the Airservices resources and activity directly required to support an increase of international en-route traffic activity (ie: relatively more oceanic and non-metro airspace flying) was not commensurate with the activity required to support that same traffic growth across the other service lines. BARA was therefore hopeful that Airservices revised pricing proposal would mitigate the proposed en-route increases to better reflect this fact, and result in an overall amelioration of the proposed total charge increases for international airlines.

However, whilst Airservices updated pricing proposal after feedback has separated out charge increases by service line, the quantum and frequency of increases has been changed resulting in the same total overall increase applied over a shortened time period of essentially 2-years (Apr-24 to Jun-26). Positively, the proposed en-route increases were modified resulting in a 12.5% cumulative increase over the 2-year period to Jun-26 (vs ~25% for Terminal Navigation and ARFF charges) – however in practice this is the same increase as originally proposed even for en-route charges over the equivalent 2-year period covered within the first pricing proposal. As such, the initial optics of an improvement of the proposed charges for international carriers in relation to en-route charges vs other service lines does not carry through to final charges.

Given that FY27 has been excluded in the revised pricing proposal and only $165m related to OneSky for 'as incurred' capex added to the RAB, it is an inconsistent approach to consultation that the proposed charges in Airservices revised proposal are for the same increases but incurred over a shorter time period. The increased charges over a shorter period have been supported by including a significant re-adjustment to the planned deficit/surplus that Airservices were prepared to accept in their original proposal to airlines; from a 3-year NPV of -$294m initially proposed as acceptable by Airservices, reduced to -$35m in the formal Draft PN.

Tabel 31, page 54 of the Airservices PN indicates a strong surplus from the growth of en-route charges as traffic continues to recover and then grow from pre-Covid levels, with en-route charges contributing significantly above stand-alone costs. In addition, in spite of significant variances in actual traffic versus forecast for FY24 (see next Section 6.2 – Activity forecasts), the proposed revenues contained within the updated Airservices PN are barely changed from the original proposal, with en-route revenue forecast at just 0.8% greater in FY24 than in the first proposal, and then decling in FY25 and FY26.

BARA considers that these are highly conservative activity and revenue estimates which have a direct impact on the unit prices Airservices needs to charge. These could, unchanged, lead to excessive surpluses to flow from particularly enroute charges throughout the proposed duration of the PN.

As proposed, BARA does not consider that the current PN provides sufficient or acceptable certainty for airline members. As a long-term aviation infrastructure provider, the 2-year period proposed is extremely short, and the proposed 4 increases over a 22-month period (Apr-24 to Jan-26 inclusive), varied by service line, is not consistent with delivering pricing certainty or balancing out volatility.

There remain a significant number of Airservices related issues with further substantial impacts on charges expected over the near term, which Airservices itself acknowledges will be required to be consulted upon before a genuine long-term pricing agreement (LTPA) can be reached. In BARAs view the current PN is seeking to push through significant increases in charges derived from a number of inputs which are contestable, and which BARA is concerned will simply provide a new elevated 'baseline' for Airservices to seek further increases to charges from FY27.

BARA agrees with the principal of users paying for capex only 'as commissioned' – ie: not prefunding assets until they are productive, which is common to pricing agreements with other essential aviation service providers (eg: airports), and hence broadly concurs with the exclusion of pre-productive capex within the pricing models provided. BARA agrees that required Airservices services for WSI, Melbourne & Perth new runways and the increase in unmanned uncrewed aircraft in shared airspace are all issues to be resolved over the next couple of years. Of significant concern however is the time and cost of these activities as forecast by Airservices: OneSky has taken some 10+ years to come to fruition and may now impact the future RAB by as much as $1.5bn (ACCC issues paper, page 26). BARA questions whether had the OneSky project been managed in a more timely and efficient manner, might the cost impact and therefore downstream charges impact which Airservices will now seek to bring forward to the RAB have been materially lower?

BARA acknowledges the need for Airservices to recalibrate charges post the Covid pandemic. However, as an 'Essential Aviation Services' provider wholly owned by the Government, and a supplier over which there is no choice or contestability from the customers' perspective (airlines), BARA considers it is incumbent upon Airservices to calibrate their charges to the reality of the industry recovery at large, and not only to the requirements of Airservices as if it were a commercial organisation (which it is not) over a shorter period of time.

Therefore, BARA can support with airline members a short 2-year 'interim' pricing proposal, which has value in providing time for a more comprehensive evaluation of all issues. BARA does not however consider the proposed charges within this PN are supported or consistent with this obligation to provide an efficient essential aviation service.

Section 6.2 - Activity forecasts

Question 6

BARA is familiar with TFI as their forecasts are used by the majority of Australian airports for traffic forecasting in relation to aeronautical service charge negotiations. BARA considers the TFI forecasting methodology to be overly Australian (domestic) focused, with insufficient weighting or account taken of international economy's performance or (particularly) an assessment of associated international airlines strategies to expand services to Australia in assessing traffic growth. This domestic bias is clearly evident in the significant under-forecast of the TFI traffic estimate provided to Airservices in April/May 2023 versus the actual traffic of 2H 2023, which TFI themselves acknowledge in their Dec-23 update: -

TFI Review of traffic… received 26 November 2023, Page 4: -
"International Air Service Developments The Australian international passenger market is recovering strongly. Australian residents returning from overseas (for short-term travel of less than 12 months) is back to 94% of pre-COVID levels with international visitors (short-term travel) at 81%. Permanent and long-term travel quickly recovered above pre-COVID levels (117% in Aug-23). The outcome for FY23 amounted to 10% above TFI's estimate (5% above for Australian residents and ***21% for visitors reflecting the strong recovery****)."*

A 21% variance (BARA highlighting) in visitor arrivals between actual vs forecast is very substantial, and indicative in BARAs view of methodological issues with TFI forecasting. BARA (and IATA) projects full recovery of international traffic to pre-Covid levels to occur by late 2024 (possibly as early as IATA NW24 season) or early 2025 (NS25). The Airservices activity forecasts for international traffic remain within the PN at below pre-Covid levels in 2026. Once pre-Covid levels have been reached, then real growth in international aviation to Australia will occur. International aviation outcomes such as (for example) the recently announced commencement of flights by Turkish Airlines, the addition of BNE-LAX by American Airlines, or the recommencement of services to Perth by South African Airlines would likely not have been factored into the TFI methodology.

The expectation of continued growth in international traffic provided by foreign carriers through this PN period will directly increase the potential surplus for Airservices from enroute charges. Airservices own forecast of the expected revenue flows and surpluses from the various service lines (Airservices PN page 42) show enroute charges delivering up to 70% of the total Airservices surplus forecast for 2026. BARA does not consider Airservices pricing methodology to be appropriate if the international carriers who will provide the majority of the expected traffic growth are disproportionately contributing to Airservices total surplus.

Section 6.3 - Impact of price changes
Question 7

BARA considers that Table 19 (page 35) of Airservices' PN which details the impact of proposed increases of charges to published airfares is both simplistic and somewhat disingenuous, seeking to minimise the cost impost of Airservices proposed increases to airlines by comparison to select airfares. Passenger airfares are dynamic, based on multiple market-based supply & demand considerations, and are constantly changing. The increase in Airservices costs relative to ticket prices is not a relevant comparison and BARA recommends the ACCC disregard this analysis in their review of the validity of Airservices proposed increases.

Section 6.4 – Building Block Model
Questions 8-12

Questions 8-12 of the ACCC issues paper relate to stakeholder views of the appropriateness of Airservices operating expenditure, opening asset base, capital expenditure and deprecation. As a general principle, BARA is primarily concerned with deliverables and outputs from essential service suppliers. BARA expects to receive for review and critique, and values the disclosure of, forecasted costs and details of accounting practices, but generally takes on face-value the validity of the estimated operating costs provided or required capital expenditure estimates for agreed projects. Airservices has a target to deliver efficient ANSP services at a reducing real cost to airlines, however absent external market pressure it is not clear to BARA how effective are any internal incentives to achieve these outcomes.

With respect to OneSky, as has been previously commented, BARA broadly concurs with the 'as commissioned' approach to infrastructure capital expenditure. For very large projects, such as OneSky, provided there is agreement between all stakeholders, BARA is supportive of a portion of such capex being charged on an 'as incurred' basis where there is some productive output and evidential agreement of implementation, to avoid more pronounced changes in charges when significant capex is rolled into the asset base in future pricing agreements.

Return on capital
Questions 13-14

BARA takes issue with Airservices' proposed rate of return on capital, or WACC, which at the proposed nominal vanilla WACC of 8.93% is higher than that proposed by some individual Australian airports to BARA in negotiations over aeronautical charges. It is simply not plausible for Airservices to claim that their traffic-related risk is even equal, or potentially greater, than an individual privately owned airport, and that the required WACC for Airservices should therefore be equal or higher.

In relation to Table 6.7 of the ACCCs issues paper, please note the following observations: -

- Gearing – Airservices comments (page 22 of PN2) that their actual gearing level (46% FY23) 'represents a very high level of gearing for a privately owned, benchmark efficient firm which is exposed to the sales volume risk that Airservices is exposed to.' However, Airservices is demonstrably neither a privately owned, benchmark efficient firm, nor is the characterisation of a business exposed to high sales volume risk a reality; Airservices exposure to traffic risk is significantly overstated. A 21% gearing level based on the comparator set as proposed for the WACC calculation is low.
- Credit rating – Airservices were re-affirmed by S&P Global Ratings (30-Jan-24) as having a AAA rating with stable outlook, *because* they are a government owned monopoly corporation and not a

competitive regulated infrastructure business. BARA considers that Airservices actual credit rating should be used in calculating an appropriate WACC.

- Asset beta – Airservices own estimation of asset beta for their preliminary pricing proposal was 0.55, which was consistent with previous LTPAs. A recent Dec-2022 McKinsey study (https://www.iata.org/en/iata-repository/publications/economic-reports/understanding-the-pandemics-impact-on-the-aviation-value-chain) estimated asset betas for ANSPs globally to be ~0.4. BARA does not consider there is justification for an increase to the asset beta to 0.70.
- The Risk free and Market Risk Premium rates used should be updated as the global economy continues to normalise post the Covid pandemic.
- The comparator firms selected in the Incenta Economic Consulting analysis are primarily airports which, whilst regional monopolies in their own right, are nonetheless more exposed to commercial risk than ANSPs generally, and Airservices specifically. As such, BARA considers the comparator set is of limited value in ascertaining the appropriate values of input parameters for determining Airservices WACC.
- BARA broadly concurs with the methodology to exclude Covid pandemic era data – inputs from up to end 2019 and from late 2022 onwards are appropriate for consideration.

Overall, with respect to determining a fair WACC for Airservices, BARA considers that by adjusting some of the input parameters as observed, and recognising that Airservices volume traffic risk is low, a more appropriate nominal vanilla WACC should be materially lower than the 8.93% proposed.

Section 6.5 - Allocation of costs & Section 6.6 – Basis of charges

Questions 15-18

The consultation process with Airservices for this PN was limited in terms of time and scope, and with the stated 'interim' nature of the agreement period from the start (3 years now reduced to 2 years) there was no discussion of the merits of the current cost allocation of basis or charges pricing methodology. BARA cannot therefore comment further on the appropriateness of the complex basis of these methodologies.

BARA has already observed in these responses that under this proposed PN, en-route navigation revenues generate the majority of the forecast surplus through to 2026, which appears to disproportionately impact BARAs international carrier members. Furthermore, as over 90% of all international airline arrivals are to the four major airports of BNE, MEL, PER and SYD (which proportion has not changed over 20 years), at which international airlines pay the highest ARFF location-specific charges, it may be appropriate in future consultation to review the basis for ARFF charges between international and domestic services.

In this context, BARA suggests that Airservices charges for the interim 2-year period 2024-26 might be established on a 'without precedent' basis, thereby allowing a full and comprehensive consultation process (which can also consider reviewing cost allocation & pricing methodologies) leading to a genuine long-term pricing agreement for 2027-32.

Section 6.7 - Performance and efficiency

Questions 19-21

The recovery of air traffic both domestic and international immediately post the Covid pandemic was unprecedented in the speed with which it occurred and created operational challenges for all players in the aviation ecosystem. Whilst most airlines, ground handlers and airports have now reached a re-normalisation of services and performance levels, Airservices however continues to struggle with some core performance-related issues, particularly in relation to staffing, which accounts for 75% of Airservices costs. Airservices own overview data provided at the Dec-23 Performance Roundtable showed that Airservices was responsible for more than 15% of all delays due to staffing issues.

BARA recognises that Airservices has worked hard over the last year or more to introduce engagement with industry through a variety of measures, such as conducting quarterly Aviation Network Roundtables, however there remain outstanding numerous issues which appear to keep reoccurring. These include the regular incidence of Traffic Information Broadcast by Aircraft (TIBA) beyond acceptable levels, reduced tower coverage at short notice, and particularly for Sydney (the key gateway for international airlines) suboptimal arrival rates due to Airservices' ongoing resourcing and operational issues.

At Sydney, both domestic and international airlines have sought Airservices' cooperation to make a case to increase cross-wind thresholds for aircraft to reduce the incidence of single runway operations, as one measure to improve both Sydney's direct and by extension Australia's system on-time performance. Whilst BARA acknowledges that such a change may bring potential community and political issues with it as a solution (due to Sydney's specific noise-sharing flight path challenges), nonetheless Airservices' response has been slow, suggesting a lack of imperative to drive more challenging initiatives which could directly improve both their and the industry's operational performance.

Question 22
BARA represents its members within Australia only, and therefore the international ANSP comparisons provided in the Draft PN are of limited value in evaluating Airservices performance or costs versus what they should be. BARA does not consider that there are meaningful conclusions to be drawn from the top-line international comparisons provided.

Section 6.8 - Stakeholder consultation

Questions 23-24
As per the response to Section 6.7, BARA acknowledges the work that Airservices has undertaken to engage both through BARA and with some member airlines directly. BARA would characterise the engagement to date as more focused on information sharing and advising, rather than as collaborative working consultation. BARA is open and hopeful that as we progress collectively to a more robust LTPA (potentially 2027-32) this will balance out.

Section 6.9 - Risk sharing arrangements

Question 25

BARA supports the concept of more equitable risk-sharing arrangements in commercial negotiations with aviation infrastructure providers, however has yet to find a sensitivity formula with any provider which adequately balances this equation. Whilst Airservices strives to meet its published performance goals, it is nonetheless currently immune to the considerable downstream costs born by its customers (the airlines) when it fails to meet these performance targets: a single diversion for an international operator due to a reduced landing rate caused by a lack of controllers might easily incur additional costs for that airline amounting to many thousands of dollars. Finding a way to share risk & reward commercially will require a deeper level of collaboration than currently exists between Airservices and its customers.

BARA appreciates the opportunity to provide these comments to the ACCC, which we trust will be considered alongside those of other industry participants. Please contact BARA should you wish for any further clarification on any point.

Yours sincerely,

Stephen Pearse
Executive Director

Attached: Current list of BARA member airlines

List of BARA member airlines (current at February 2024)

Airline

AIRASIA Aviation Group representing: -
* AIRASIA X
* AIR ASIA Berhad
* INDONESIA AIR ASIA
* PHILIPPINES AIR ASIA
* THAI AIR ASIA X

AIR CANADA
AIR NIUGINI
AIR MAURITIUS
AIR NEW ZEALAND
AIR VANUATU
AIRCALIN
ALL NIPPON AIRWAYS
AMERICAN AIRLINES
ASIANA AIRLINES
CATHAY PACIFIC AIRWAYS
CHINA AIRLINES
CHINA EASTERN
CHINA SOUTHERN AIRLINES
DELTA AIR LINES
ETIHAD AIRWAYS
EVA AIRWAYS
FIJI AIRWAYS
GARUDA INDONESIAN AIRWAYS
HAWAIIAN AIRLINES
JAPAN AIRLINES
LATAM AIRLINES GROUP
MALAYSIA AIRLINES
NAURU AIRLINES
PHILIPPINE AIRLINES
QATAR AIRWAYS
ROYAL BRUNEI AIRLINES
SCOOT (TR)
SINGAPORE AIRLINES
SOLOMON AIRLINES
SOUTH AFRICAN AIRWAYS
SRILANKAN AIRLINES
THAI AIRWAYS INTERNATIONAL
TURKISH AIRLINES
UNITED AIRLINES
VIETNAM AIRLINES
VIRGIN AUSTRALIA