

# Review of Sydney airport aeronautical pricing proposal

## Because of its substantial market power in the Sydney region the Sydney Airports Corporation is subject to economic regulation by the ACCC.

On 3 October 2000 Sydney Airports Corporation Limited (SACL) lodged a revised draft aeronautical pricing proposal with the ACCC proposing revenue increases more than double the current annual rate.

The ACCC then released its own issues paper and called for submissions from airport users and other interested parties. Those received are publicly available on the ACCC website at <http://www.accc.gov.au>.

The Commission also held two discussion forums, the first a technical forum in Melbourne on 13 December, followed by a community forum in Sydney on 18 December.

The ACCC expects to release a draft decision early next year setting out its preliminary conclusions and the reasons for reaching them. Following further public consultation and submissions the ACCC will release its final decision early in the new year.

### The ACCC's role

Unlike some other privatised airports known as core regulated airports, the prices of aeronautical services at SACL are not capped. However, SACL is subject to similar ACCC regulation for quality of service monitoring and price monitoring of aeronautical related services.

SACL must notify the ACCC of price increases for aeronautical services. The ACCC then approves or objects to the proposed prices or alternatively does not object to lower prices that it specifies.

The Prices Surveillance Act requires the ACCC to consider:

- the need to maintain investment and employment; and
- the need to discourage a party with substantial market influence from taking advantage of that power when setting prices.

The ACCC must balance the interests of users, consumers and airport owners.

### Central issues

The SACL proposals involve recalibrating the pricing structures for aeronautical services by:

- reviewing major cost components;
- reviewing the value of assets (including airport land); and
- reassessing the rate of return on assets.

The revised aeronautical charges incorporate a per passenger rate and time-based aircraft parking charges.

The proposals raise many technical, economic and regulatory issues about pricing structures, valuation of assets, efficiency of costs and rates of return. Apart from the issues of investment, employment and discouraging misuses of market power the Commission must balance other factors. These include congestion and the impact on related industries and services.

The main components of the framework under which the SACL proposal is being considered are set out below.

### Economic principles

SACL's proposal drew on the building block approach to pricing as set out in the ACCC's *Draft Statement of Principles for the Regulation of Transmission Revenues* released in May 1999 (available on the ACCC website). Using this approach, allowable revenues are derived on the basis of efficient costs and a rate of return on assets.



## The dual till approach to pricing

SACL has adopted an approach to pricing commonly termed 'dual till'. Under this approach only the costs of providing aeronautical services are used as the basis for assessing allowable revenues. The ACCC has sought comments on the efficiency of this method and the manner in which SACL has applied the dual till approach.

### Asset base

SACL has used:

- an opportunity cost approach in valuing land; and
- optimised and depreciated replacement cost (ODRC) methodology in valuing other assets.

The ACCC has sought comments on this approach and SACL's allocation of asset values between aeronautical and non-aeronautical services.

SACL's final proposal does not provide for ongoing capital expenditure as it relates primarily to the current asset base. Accordingly it is likely that future capital expenditure would give rise to further price increase notifications by SACL to the ACCC.

### Operational efficiency

The ACCC sought comment on the level of operating and maintenance costs in delivering aeronautical services and the proposed allocation between aeronautical and non-aeronautical services.

### Rate of return

This relates to the rate of return methodology and SACL's application of it in deriving a weighted average cost of capital.

## Structure of prices

The restructure would involve the introduction of passenger-based terminal charges and a time-based apron parking charge. The ACCC sought views on how much this truly reflects underlying costs to users and addresses congestion at the airport.

## International comparisons

SACL suggests that charges at Sydney airport are low relative to international operators.

## Impact on users

The impact on consumer demand, airline scheduling and providers of other services at Sydney airport need to be considered.

## Consultants' advice

The ACCC has engaged consultants to provide advice on a number of the issues raised in its consideration of the SACL pricing proposals.

The Network Economic Consulting Group (NECG) has prepared papers on dual till and land valuation. Rohan Pitchford from the ANU has also provided a paper on land valuation and Professor Kevin Davis a paper on the rate of return proposed by SACL. Copies are available on the ACCC website.

## Contact details

Any questions or inquiries about this ACCC review should be directed to David Salisbury on (03) 9290 1919 or Richard Home (03) 9290 1855.

