CAIRNS PORT AUTHORITY

14 September 2004

Ms Margaret Arblaster
General Manager - Transport and Prices Oversight
Australian Competition and Consumer Commission
Box 520J
MELBOURNE VIC 3001

By Email

Dear Ms Arblaster

AIRSERVICES AUSTRALIA DRAFT PRICE NOTIFICATION

Thank you for the opportunity to make a further submission with regard to Airservices Australia's draft price notification to the Commission.

Cairns Port Authority (CPA) previously made a submission based on a consultative meeting between Airservices and CPA conducted at Cairns earlier this year. This submission expands on that submission in a number of key areas. We have adopted the approach of responding to the Commission's Issues Paper (August 2004) and comment in relation to the items raised in that paper for your consideration. Where we have not indicated a response, we have no comment.

Risk Sharing Arrangements

CPA operates the sixth largest airport in Australia and have established commercial agreements with the airlines where CPA accepts both the risk associated with capital delivery and also the volume risk associated with a five-year agreed price path.

CPA supports the mechanism of a variation of price as a result of government regulation where it materially changes the financial model establishing the pricing mechanism. This could be similarly applied to that as applies at major airports.

With regard to the activity trigger mechanisms, Airservices are attempting to establish a location specific pricing model and as such the variations in activity level and as such capital investment may be location specific. It would be CPA's view that with the advent of low cost carriers, various shifts in levels of activity which may be either positive or negative at the medium and smaller airports within Australia could see variations in the level of activity associated with Airservices' model. It is not clear whether Airservices are seeking to use their trigger mechanism in relation to overall activity or on a location specific basis. It would be CPA's view that it would need to be on a location specific basis.

Crn. Grafton and Hartley Sts, PO Box 594, Cairns Qld. 4870 Australia Telephone: (07) 4052 3888 Facsimile: (07) 4052 1493
Int.Tel: 61-7-4052 3888 Int.Fax: 61-7-4052 1493 Email: marketing@cairnsport.com.au Website:www.cairnsport.com.au

CAIRNS PORT AUTHORITY
...shaping the future

Operating Costs

The operating cost submissions by Airservices deal with an overall analysis associated with the provision of services. What is evident from work completed by the Australian Airports Association (AAA) Queensland branch is that there is a significant variation in the operating costs in the provision of Airservices throughout Queensland. It would be CPA's view that under any location specific pricing mechanism there needs to be productivity measures and targets set that take into account the size and scope of an airport and the potential growth in activity at that airport and that the operating costs of the services should be assessed against the location specific measures.

Capital Expenditure

CPA has been provided with a limited amount of information associated with the capital program as it applies to Cairns. The area of concern with regard to the capital program is related to those programs that are national programs that appear to have been apportioned across airports in relation to landed tonnes. Whether this is the appropriate mechanism for the apportionment of the capital cost of these programs is questionable as that apportionment doesn't take into account the condition of existing assets. For example, the national tower upgrade program. CPA has a relatively new tower and we are unable to assess whether the $0.78M is an appropriate level of investment relative to the investment that may be applicable at other locations.

Furthermore, the other programs associated with the Eurocat upgrade and the TAAATS and VSCS, CPA would like additional information in terms of how this capital has been apportioned as we are unsure as to whether this capital has a greater application in the regional management of airspace and the larger towers in Australia than at the smaller towers such is applicable at Cairns. Further clarification needs to be provided where the capital investment is not location specific.

CPA would request that Airservices provide full transparency on the break-up of capital projects between relevant ports and the application of the mechanism by which the capital is apportioned across airports.

Asset Base

CPA supports the concept of the use of financial modelling to determine pricing outcomes. Given this approach, it is accepted that Airservices should be entitled to earn a return on all assets employed in the provision of the services. Accordingly, it may be appropriate for Airservices to revalue assets to fair value at the commencement of the modelling period but only to the extent that such assets are currently fully utilised in the provision of the services. However it is not appropriate for any further revaluations to be brought to account in the modelling.

CPA is not aware of the basis of the September 2003 revaluation and is unable to comment on the appropriateness of the valuation methodology adopted. In respect of the efficiency of Airservices' asset base we refer you to our original submission.

Rate of Return

Our previous submission covered the issue in terms of rate of return and our view has not changed. What is not clear in terms of the proposal is that any trigger mechanism and the application of any review process would be location specific. We anticipate that for higher levels of activity through Cairns over the term of this agreement where our growth exceeds the projected growth by Airservices, we would expect that the price would be less than that proposed by Airservices.

The appropriateness of a 9.75% return given that there is the potential to review capital and also a potential to review volume of activity does appear too high to CPA. However, we would consider that the Commission would be in a better position to assess the appropriateness of that return.

Activity Forecasts

For ease I have restated the comments that we have previously made in terms of activity forecasts for Cairns.

> *"CPA adopts passenger forecasts as its long term forecasts for Cairns. These are provided by Tourism Futures International (TFI) and are Board-endorsed as part of the business planning cycle within CPA. CPA's passenger forecasts represent 3.4% growth across 5 years within the international network and 4% for the domestic network. Although both networks have suffered volatility within the markets over a number of years, this result is relatively consistent when considered as long term forecasts.*
>
> *Airservices' volume forecast is based on aircraft weight. Over recent years Cairns has experienced a reduction in the size of aircraft operating through Cairns, being compensated by increased frequency. This is probably less efficient than the migration to larger aircraft and the percent year on year changes predicted by Airservices when considering 5.5% for 2004/05 over 2003/04 and 4.7% for 2005/06 over 2004/05, and then between 3.6-3.8%, would indicate that this is relatively consistent with passenger growth.*
>
> *We would expect that over the next 5 years the size of the aircraft operating on the Cairns route would migrate to a higher load factor and the movement back towards larger aircraft may produce some efficiency in terms of tonnage as opposed to passenger growth. Therefore, the forecasts associated with Cairns may be marginally high. However, the weight based volume is much harder to predict and is more in the hands of the airlines' commercial activities than simply passenger growth forecasts."*

What I can advise now is that the document that was provided to CPA showed 1.50M landed tonnes for FY03/04. CPA's figure for FY03/04 is 1.55M tonnes, an increase of 3.3%, which would effectively vary the base year on future forecasts.

We are concerned that the introduction of low cost carriers may have the potential to increase landed tonnes at a greater rate than proposed by Airservices. For example, we are experiencing passenger growths into Cairns which are greater than 10%. As Virgin Blue and Jetstar are single aircraft type operations passenger growth is accommodated by increases in aircraft frequency and as such a closer correlation between landed tonnes and passenger growth rate is likely to occur over future years. This may mean that the forecast levels of activity will potentially be higher than Airservices' forecasts. Please note the difference from our previous submission.

This also supports the view that variations in activity on a location specific basis should be used to vary the price at that location.

Timing of Price Increases

CPA believes it is appropriate that the regional airports are phased in relation to the increases that are proposed. This should be viewed in conjunction with a volume and capital review over the same period before moving to a final pricing outcome.

Impact on Users

For the assistance of the Commission we have repeated our views initially expressed in our previous submission already provided.

> *"It is expected that Airservices will be required to compile and publish regulatory accounts, in a manner consistent with those the ACCC has required of the privatised airports. Such accounts will be an integral part of the ongoing monitoring of operational costs and future pricing direction.*
>
> *There has been significant debate and a variety of opinion promulgated on network pricing and location specific pricing. The Federal Government's policy associated with location specific pricing needs to be considered in light of the sustainability of the aviation and tourism industries within regional communities. Significantly pricing tower services and fire fighting services through location specific pricing could have a dramatic impact in low volume destinations to the extent of influencing the local tourism market but also having a significant impact on the overall Australian tourism market.*
>
> *By example, Cairns operates with 40% of its domestic network being used by international travellers. This would not be unusual within the regional destinations of Australia. If the pricing of Airservices' services to regional networks impacts the sustainability of air services into regional ports, it will not be solely the impact of tourism on that destination but also tourism in the overall Australian market that will be impacted.*
>
> *Serious consideration should be given to the appropriate model that takes into account the national interest and contribution to tourism that aviation provides in regional markets.*

> *It is CPA's view that the most appropriate model is neither network pricing or location specific pricing but a model that accommodates the large airports' requirements and some level of cross subsidy that supports and recognises the contribution of regional airports throughout Australia."*

If you have any questions in relation to this submission please contact me on (07) 4052 9701.

Yours sincerely

Ian Robinson
GENERAL MANAGER AIRPORT

Copy: *Brad Geatches, CEO, Cairns Port Authority*

Enquiries: Ian Robinson, (07) 4052 9702
Email: Ian.Robinson@cairnsport.com.au
Our Ref: 10-01-05 IRhw