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Dated 14th July 2004

Submission of Comments on Long Term Pricing Proposal from Airservices Australia – July 2004

Dear Airservices,

In response to your letter dated 31st May 2004, we would like to offer the following comments for you consider in your current long term pricing proposal. I have attempted to follow your suggested heading format in order to assist you.

Brief History on General Aviation Maintenance

General Aviation Maintenance is an Australian owned company with bases in Essendons, Cairns, Brisbane, and Adelaide. Our company is the largest operator of Aero Commander 500S aircraft in the world. The current fleet consists of 28 Company owned aircraft, most of these are the Shrike 500 Commanders, but we also have a number 680 & 690 Commanders, and a Baron 55.

We currently fly into 12 of the 27 airports that will be subject to the new TN and ARFF charges, landing in excess of 30,000 tonnes at these locations each year.

Our two maintenance bases are at Essendon Airport, and Cairns Airport, and we employ more than 80 full time staff, and a further 10 pilots on a casual basis.

The efficiency of our (Air Services') operations

A number of questions need to be answered in relation to this topic. Although the efficiency in which the service is provided is not in question, the way in which the costs have been allocated are.

For example; Staff costs make up 37.5 percent of the total cost of providing terminal navigation, and an average figure of $187,395 per staff member has been used to calculate a total staff cost of 89.5 million. These seem extremely excessive. If the 187K is an average then you must have a large number of controllers on an income in excess of this figure, to which it is very doubtful. Even taking into consideration the additional costs of employees such as work cover, leave loading etc, and the increase super plan most controllers are on, I would be very surprised to find that the average figure per employee would be greater that 140-150K. This need to be clarified as it would have a massive effect on the proposed cost of the service.

The Level of Future Investment

I have no doubt that the expected cost of the future investment is adequate and the fact that is required is also not in question. I am surprise though that Air Services expect to recover this cost over a five-year period. Most capital expenditure, especially of this magnitude, would be spread over a recovery period of at least 10 years, if not 15. Also, once the capital expenditure has been recovered, do we have an assurance that the charge rates would be reduced? I would recommend Airservices look at a 10 year recovery period for the capital expenditure, this could result in a savings of over 25 Million a year.

The Activity Volumes Forecast for our (Airservices') Services

The volume forecast looks to be an expected increase of around 4 percent a year, which appears to be adequate. I am confused though with the expected value of recovery from the services at each airport.

Take Sydney for example with TN charges. A recovery of 58.3 M at $4.82 per tonne equates to 12,100,000 movements expected in 2004/2005, yet your cost analysis report for Sydney (which is where you obtain the expected cost from) lists an expected activity of 13,296,000 for 2004/2005. If you apply the rate of $4.82 per tonne the recovery will be 64 M, an increase of 5.7M. If you look at this further only 8 out of the 27 airports have accurate expectations of revenue, and if you apply the expected activity listed in each airport cost analysis report you will find that the total recovery for TN is actually 201 M, not 186 M as listed. There is also an error in the ARRFF expected recovery, if you apply the same principal to this, the recovery is actually 66M not 60M. Due to the complexity of enroute charges I have been unable to ascertain whether this is accurate, but if the trend on the other areas is something to go by, then we may be looking at another 30M of extra recovery. It may be argued that the expected value of recovery excludes the GST received, but that is inconsistent with the expect costs of the charges, which quite clearly state that they include GST.

This is an area that requires significant research by Airservices to assure the industry that the values they have used are accurate and reasonable.

The Structure of Prices, including Recovery Alternatives

As mentioned in the previous section of this letter, the accuracy of the pricing is at question. Further to this, in your letter you state that the Australian Government has allowed an increase of the capped TN charges to $8.67 subject to ACCC endorsement, so what price are you intending on proposing to the ACCC? The extremely high charges listed in your report? Or the $8.67, which is still a 16 percent increase, more than what the industry could accept.

Also, I have reviewed the submissions submitted to the ACCC in 2003 by Airservices and the subsequent findings, and cannot find anything to substantiate the claim from Airservices that the ACCC will not allow pricing cross subsidies. If you refer to this document, page 8 Para 5 it states.

"Commission had a concern that user charges should not be set at a level that results in the cross subsidisation of Government directed CSO's (Community Service Obligations) "

I read this to imply that the ACCC is not preventing cross subsidisation as a whole, only disallows cross subsidisation of Government Subsidies. Therefore Airservices should still be able to offset the cost of Tower from the Enroute charges as neither of these are Subsidies.

The link to the document is http://www.accc.gov.au/content/index.phtml/itemld324540

There is also some references in the 2003 document that are very similar to those stated in the current document on how the prices have been established, these are

1) Page 6 Para 3 states that this proposal in 2003 was assessed with the "Building Block Model". Stated again on page 9 Para 2.

2) Page 12 Para 3. Airservices Adopts an activity based approach to costs by service and location. This ensures that the prices of specific services and locations align with the philosophy of "user pays"

How can prices vary so much this time when the "building Block Model" and the "User Pays" philosophy has been used in both proposals.

The Rate of Return to be included in the prices

I feel that this is an essential requirement, and well regarded.

The Impact on Users if prices were lifted to Recover the Full Cost per Unit

This question has a number of negative points.

Firstly, taking our company as an example, if the proposed prices were introduced we would incur an increase in Airservices Charges of over 330%. It would result in is having to pass this cost onto our customers and this would have significant effect on whether they would continue to use our services. Due to the fact that our revenue is mainly derived from carrying freight to local and remote areas, this would then result into either a massive reduction in our revenue or our customers having to pass the cost on to the companies and communities that rely on our service.

Secondly, as far as the general industry is concerned, this could also have two separate effects;

1) A reduction in flying directly related to the affordability of landing. This will mean that Airservices projected revenue will be significantly reduced and could result in a loss and failure to recover the money spent on upgrading the equipment.
2) It will make the major airports more attractive and result in congestion at major airports, and a shift in where the revenue is derived. Take Essendon as an example. It is forecasted to land 65,000 tonnes in 04/05. The report indicates that it will need to charge $59 per tonne to recover the 3.4 M it costs to run the tower. If the 5 major companies at Essendon decide to move their landings to Melbourne then Essendon could only land 30% of what they expected. This would be 19500 tonnes at $59 and would only recover 1.15 M, a loss at Essendon of 2.25 M. Further to this, the remaining 70% of landings (45500) would be charged at the Melbourne rate of $3.91, which would only recover $177,905, still over 2 million dollars short of the expectation. Further to this, it would increase activity at the Melbourne by 45,500 movements adding to congestion and could result in flight delays. Add this principal to all the secondary airports in the country and you will find that Airservices stands to lose considerable revenue from the introduction of the proposed charges.

Alternative Ways to Deliver the Services

There have been suggestions that privatising the Towers would bring significant savings to Airservices. This may be true, but at this stage with the cloud hanging around the accuracy of the proposed cost of the towers it would impossible to ascertain whether the savings would be significant enough to have the desired effect in reducing the rates at each non-major airport to an affordable level.

Comments have also been made about whether some towers should be closed. Again, the current inaccuracy of costs will impact on this decision. Also, there have been suggestions made that with close negation with the airport authorities and tenants, reductions in tower hours and staff numbers could be achieved, but I would not be in favour of this being used to bring the charges in line, without the costs themselves being scrutinised and confirmed as accurate first.

Other Issues

Inadequate consultation with the industry

There is a general consensus, especially from the General Aviation community that the level of consultation both prior to the current proposal and after has been extremely inadequate. Again, if I can use Essendon as an example, most of those companies who were invited to the Meeting in June do not recall receiving the invite, this resulted in only a few attending. Also, I believe that consultation meetings with the industry have being carried out up to as recent as last week, leaving only a very short time for submissions to be raised.

Further to this, it was noted in the minutes of the Steering Committee's meeting on the 30th January that they had "concerns that the General Aviation community and Regional airlines had not been represented in this consultation process to date" and "that additional efforts to consult with these sectors will be made throughout February." From the feedback I have received there is no evidence of this being done, and the minutes on the Steering Committee's final meeting on the 27th Feb have not been listed on the Airservices Web site with the previous ones.

Reasoning for the deadline of 14th July

It is surprising to me that Airservices have placed a self-imposed deadline so soon after the previous deadline of 30th June. The ACCC website shows that an extension has been granted to Airservices to maintain the current charges up until the 31st December 2004. It is also interesting to note that the current prices are actually an increase on those in 2002 approved by the ACCC to cover the losses Airservices expected to incur due to the impact of the collapse of Ansett and following the September 11 terrorist attacks. Therefore, now with the introduction of Virgin and Jetstar and the recovery of September 11 we may very well be paying more than is required to cover the cost of the services provided by Airservices.

General Comments

I think it is fair to say that there has been a lot of recent media attention to this issue, which has made it very difficult to ascertain the full impact of the proposed increase in charges. It should also be very clear that the only sector that will gain from this proposal is the major airlines, at the expense of the regional airlines and the General Aviation sector. The proposed charges are in no way sustainable and I believe that this will be supported by a number of rejections to the proposal.

I am concerned though, as stated earlier in the email, at the accuracy of both the costs and expected revenues in this report. If a new long term pricing were to be submitted to the industry for comment then I would recommend that the figures be verified first by an independent auditing body. This may very well add to the costs, but it will certainly help provide justifiability and credibility to the figures.

Finally, I feel that Airservices stand to lose a significant amount of expected revenue from the backlash of reduced flying and shift of landings to major airports. I also believe that the pricing model proposed goes against the principals of the ACCC as it will harm business such as the airport authorities and major aviation customers, and goes against Airservices principals which is the need to "operate in a way that promotes the general health of the aviation industry" and "remaining sensitive to the ongoing plight of the aviation industry".

Conclusion

I do not believe, that at this stage, Airservices are in a position to approach the ACCC with a pricing proposal that is accepted by the industry as a whole or is fair to the industry as a whole.

There are many concerns about the costs and revenue expectation.Correcting this could result in savings in excess of 10 million dollars, and an increase of expected revenue of at least 20 million dollars but could be as high as 50 million.

A change in the way Airservices recover the capital expenditure could also reduce the expected costs per year by another 20M, which could even result in Airservices recovering enough revenue to cover costs without any government subsidy, and may even result in the ability of Airservices to revert back to the 2002 prices as required by the ACCC, and still recover enough revenue to be in the black.

Airservices should also consider commiting to further reductions in operating costs over the next 5 years. This should be easily achieveable with close consultation with airport authorites and would be highly regarded by the industry.

With all this said, if after the costs and revenues of Airservices has been confirmed as correct (and this has been audited independently), and that a price increase is still inevitable, then I would suggest that Airservices conduct further consultation with the industry, especially the Regional and General Aviation sectors with the view to develop a fairer pricing model for all sectors.

I have been working on a number of alternative pricing models that include both area specific cost allocation and major airport traffic considerations that result in substantial reductions to those charges proposed by Airservices at non major airports while maintaining reasonably attractive rates for the major airports. I would welcome the opportunity to work with Airservices in developing either one of these models or to provide input on any other suggested models to help ensure that we can maintain a profitable industry for both Airservices and the Aviation customers it relies upon.

If you require anything further I can be contacted on the numbers at the beginning of the letter or via email at craigbradley@gamgroup.net . General Aviation Maintenance appreciate the opportunity to offer our comments and look forward to your feedback.

Thankyou

Craig Bradley
Business Manager