Gold Coast Airport

14th September 2004

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

Dear Ms Arblaster

Please find enclosed our submission on Airservices Australia's draft price notification.

Please do not hesitate to contact me or Barrie Briggs, General Manager Aviation on 07 5589 1100 if you have any questions regarding the attached submission.

Yours faithfully

A D Chant
Managing Director

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Gold Coast Airport

Submission To The Australian Competition & Consumer Commission(ACCC) on Airservices Australia's Draft Price Notification

Executive Summary

Gold Coast Airport Ltd (GCAL) welcomes the opportunity to comment on the draft notification submitted by Airservices Australia (AsA) covering pricing for the next 5-year period. GCAL's previous comments supported Location Specific Pricing (LSP) provided that it was within a competitive framework. This remains our position.
In line with the ACCC issues paper of August 2004 calling for comment, we submit the following for consideration.

Consultation

In general GCAL considers that an appropriate degree of consultation has been undertaken by Airservices in this instance and it appears that the consultation process with regard to other Airservices activities is also improving.

Risk Sharing

Providing that any review includes proper consultation with the affected parties then GCAL has no real objection to the risk sharing arrangement proposed.

Operating Costs

GCAL considers that these costs are not truly representative of the value of the service provided, and are the result of the inefficiencies, particularly in the number of staff employed in the non-operational and management areas, often endemic in an organisation where there is no financial incentive to its employees to be more efficient.

GCAL also considers that the estimated costs in the proposal are excessive and that a competitive environment would substantially reduce the cost of supplying ATC and, in particular, ARFFS. GCAL is aware that in line with ICAO requirements, our port will be changing from a Category 8 airport to a category 7 in the near future and requires that the savings generated by change of category be reflected in operating costs.

Incentives

GCAL considers that there is little or no incentive for Airservices to contain or reduce its cost base as it is operating as a monopoly provider. This particularly applies in the provision of ARFFS where the use of external resources on a needs basis would probably result in the more cost-effective provision of services for emergency situations.

It is appreciated that, because of its very specialised nature, the operational workings of Airservices are difficult for an outsider to fully comprehend.

Capital Expenditure Programme

The approach taken by Airservices in incorporating the impact of capital investment into the long term pricing agreement is considered to be the correct approach providing that the capital investments are fully examined and agreed to by the relevant customer base.

Certainly, in the case of the replacement of the Terminal Area Radar (TAR) at Gold Coast Airport, it is considered that a more detailed explanation of the necessity for the provision of this facility is required.

GCAL accepts that the cost of the replacement TAR at $6.03 million is reasonable for a primary and secondary radar installation; however there is doubt as to whether or not it is operationally required. Airservices states that the current equipment is not supportable after 2007 due to a lack of parts and beyond that date it becomes progressively more unreliable; this is an engineering based appraisal not an operational needs assessment.

It is considered that there needs to be an investigation into the operational necessity of a replacement and if that finds in the affirmative, then new technologies available that are direct substitutes for conventional radars also need to be considered.Accordingly, until such an investigation has taken place, it is GCAL's position that the cost of the TAR replacement be removed from the capital programme for our port.

Asset Base

GCAL acknowledges and welcomes the comments from the Hymans report which indicates that the assets reviewed have been implemented with "reasonable and efficient design execution." GCAL agrees that it is essential that Airservices acquires and maintains assets of the highest safety standards together with an efficient economic life.

GCAL notes the proposed increase in the asset base of Airservices. GCAL agrees it is entirely appropriate that the cost of assets employed as part of the business of Airservices are amortised over their effective life and recovered through additional charges. However, GCAL submits that where "original cost" has been fully depreciated and therefore already recovered as part of the charges levied, it is not acceptable that Airservices seek to revalue these assets and subsequently allocate further amortisation costs for recovery through additional charges.

GCAL acknowledges that it is accepted that assets may either have an extended effective life due to an incorrect previous assessment of the effective life or due to the deferral of the deployment of new technology. In this case, any efficiency which results due to the previous higher amortisation should be passed through to the users as opposed to an adjustment to the equity balance of Airservices.

Rate of Return

GCAL has reviewed the assessment of the calculation of the WACC of Airservices. In particular GCAL notes the proposed new target of Airservices across the five year period. In relation to the proposed inputs GCAL has a number of comments.

PWC's recommendation suggests an equity beta of between 1.0 and 1.3. This indicates that compared to the market indices, investors would consider that the equity value of Airservices would respond to market movements with a rise or fall in value more than the market average. GCAL submits that Airservices, given the nature of its business together with its customer base is less susceptible to market movements. Airservices is a "monopolistic" business with very little competitive forces which itself is the reason for the regulation of prices. GCAL submits that an equity beta of below 1.0 would be more appropriate.

The draft price notification indicates a gearing ratio of between 40 and 50%. With the cost of debt less than the cost of equity, GCAL submits that the level of gearing for capital investment should be increased to a sustainable level, which will promote additional efficiencies for users through the reduction of the WACC and ultimately the charges levied.

The price notification suggests that the reduced WACC target will act as a formal incentive to seek additional productivity efficiencies. GCAL submits that such identified efficiencies should be reflected in the current calculations and should always be the responsibility of Airservices without the need for a formal incentive. Any suggestion that continued identified "inefficiencies" is acceptable and will be paid for by users whilst they are ultimately improved is unacceptable. Any identified cost savings should be passed through immediately and not be the goal for the next 5 years.

GCAL recognises the risk that the WACC target is reached through further increases in prices. This is also unacceptable.

Activity Estimates

GCAL agrees with the respondents to the previous consultation process that considered the forecasts to be optimistic in relation to some airports. However, in the case of the Gold Coast Airport there has been a steady increase in activity greater than anticipated and which it considers will continue.

Cost Allocation

The proposed method of cost allocation appears to be appropriate in view of the negative effect that the increases in costs will have on certain classes of operator and on the airports that service them.

This can be considered to be, at least partly, in line with the Air Services Act that requires that the promotion and fostering of aviation should apply to all areas of aviation, not only the corporations' major customers.

Basin Approach

GCAL agrees that it is appropriate and efficient to consider all of the airports in the terminal area of a capital city airport as being one entity, each one dependent on the other for its operations.

Timing of Price Rises

GCAL, whilst not supporting the scale of the increases, agrees that it is appropriate, where increases are of the extent proposed, that they be phased in over the full period.

Cross Subsidisation

GCAL considers, in principle and in the context of the aviation scene in Australia, that cross-subsidisation of other services provided to aviation in Australia is appropriate, although this needs careful policing to ensure that inefficiencies are not perpetuated. This is of course in the context that AsA provide cost efficient services in a competitive environment.

Cross subsidisation of other, non-core, activities within Airservices should not impose any burden on the charges levied to provide services in the core activity.

AA Incentives

Generally the proposed prices do not provide appropriate incentives for Airservices, or their users, to provide services at particular locations. This is particularly the case in the provision of ARFFS.

Impact on users

The likely impact of the proposed prices on the users of regional airports and air traffic control services will be a reduction in the use of the serviced locations and a possible decline in safety of operation.

GCAL considers that general aviation, regional type carriers, will be adversely affected and that will, in turn, impact on the communities that can least afford to lose an air transport connection to vital services. There will also be impact on the airport operators that service these communities.

There should be little effect on the major carriers although some of the smaller operators may schedule movements outside the operating hours of ATC and ARFFS.

There will be a negative flow on effect to other service providers because of the decrease in patronage at the affected airports and of the affected carriers.

Inevitably there will be an increase in airfares, whether it is in the form of a levy, a tax or a plain increase in fares. The regional carriers will be compelled to increase their fares, as they do not have the capacity to contain the increased costs. Many smaller charter operators will be forced out of the business altogether.

Summary

GCAL supports the approach taken by AsA in the provision of costs and their endeavours to be more transparent with their customers. What is difficult to assess is AsA's ability to provide services at a competitive price given that they are a monopoly supplier. As stated, GCAL is supportive of LSP provided that it is within a competitive framework. AsA has a lot of work to do to convince us that at this time this is the case.

Discussion re: Airservices Australia's Draft Price Notification to ACCC

Background

On 12 August 2004, the Australian Competition and Consumer Commission (ACCC) received a draft price notification from Airservices Australia (Airservices) and solicited submissions on the proposal from users and other interested parties.

Airservices is the monopoly provider of aviation en-route navigation, terminal navigation and rescue and fire fighting (ARFF) services in Australia. Under section 95X of the Trade Practices Act 1974, these services are declared to be notified services and Airservices a declared person in relation to the supply of these services.

As a declared entity, Airservices is required to notify the ACCC of proposed increases to the prices of these declared services. The ACCC is then responsible for assessing the proposed price increases, and may either not object to the proposed increases (in effect approving the proposed prices), or not object to increases lower than the proposed prices (in effect approving specified lower prices).

In June 2004, the ACCC made no objection to Airservices maintaining its current prices until 31 December 2004. This decision was made to allow further time for Airservices to develop its longer-term pricing proposal in consultation with its customers and to provide adequate time for the ACCC consideration of the pricing proposal.

Airservices is proposing a long-term pricing arrangement that will apply for the next five years (2004/5 - 2008/9). Its' draft price notification proposes new prices commencing in October 2004 and in a press release dated 12 August 2004 stated 'Subject to the time taken by ACCC to complete its review we anticipate introducing our new prices around the end of October 2004.'

The draft price notification covers all of Airservices' declared services, at each location throughout Australia. The prices proposed vary across both service and location and in each year, but are generally characterised by increases in the prices of terminal navigation and ARFF services, and decreases in the prices charged for en-route navigation services.

While Airservices has proposed particular prices over the five-year period, its proposal contains three scenarios under which it may seek to review these prices within this period. These circumstances are where:

- new regulatory or customer requirements change services levels which result in a net change in costs
- actual capital expenditure varies substantially from the levels agreed
- activity levels deviate materially from the levels contained in the proposal

Airservices also states in its draft notification that it will continue to review pricing structures over the course of the pricing arrangement.

It also states that its draft notification is the outcome of an extensive consultation process, which began in August 2003 involving representatives from the industry. It established an industry steering committee and a smaller working group in developing its pricing plan. Airservices also consulted with representatives of regional and general aviation operators throughout June and July 2004 and has amended its original pricing plan in response to representations it received.

In considering the price notification provided by Airservices the ACCC is required by section 95G(7) of the Trade Practices Act to have particular regard to the following:

- the need to maintain investment and employment, including the influence of profitability on investment and employment
- the need to discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that power in setting prices
- the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

1 GENERAL DISCUSSION

In considering this submission from the Gold Coast Airport Limited (GCAL), the owner and operator of the Gold Coast Airport, it should be borne in mind that the Air Services Act 1995 (amended 2003) contains a function; 'to promote and foster aviation. This is seen in the context not just of the corporation's major customers, but also extending to areas of aviation industry development identified by the government consultation processes'.

In October 1999 the Minister of Transport and Regional Services issued a policy statement entitled, 'A Measured Approach to Aviation Safety Reform' and a Charter Letter which prescribed a number of gradual changes to the operating environment over the next few years. The Minister confirmed the continuation of this existing Charter Letter in September 2002, which, among other things, requires Airservices to "operate in a way that promotes the general health of the aviation industry".

In developing the long term pricing arrangement an Industry Steering Committee was formed to oversee its development. This committee, in turn, formed a working group charged with carrying out the detailed analysis on the Committee's behalf. It is interesting to note that the working group consists of a representative from each of Qantas, Virgin Blue, the Board of Airline Representatives in Australia (BARA), all of whom are major customers of the corporation, and Airservices Australia itself. The Air Services Act, as stated above, indicates that the promotion and fostering of aviation should apply to all areas of aviation, not only the corporations' major customers.

2 RESPONSE TO THE NOTIFIED ITEMS

2.1 CONSULTATION

GCAL appreciates that it is difficult to ensure that consultation is fully effective and all encompassing and sometimes it is almost impossible to differentiate between what is regarded as consultation and what is actually the simple delivery of a proposal, however, within the limitations imposed there was certainly feedback, almost overwhelmingly negative, to the original proposal that resulted in the modified version now being addressed.

> *In general GCAL considers that an appropriate degree of consultation has been undertaken by Airservices in this instance and it appears that the consultation process with regard to other Airservices activities is also improving.*

2.2 RISK SHARING ARRANGEMENTS

Airservices state that a number of risks are relevant in establishing long-term pricing arrangements and it is generally desirable for such risks to be borne by the party to the agreement that is best able (ie the most efficient) to manage such risks. These risks, inherent in any long-term pricing arrangement, include:

- 'market' risks, including changes in activity from forecast and other exogenous shocks;
- the risk of cost over-runs;
- technological risks, such as the timing of uptake of a new technology; and
- the risk of changes to government regulation.

While Airservices has proposed particular prices over the five-year period, its' proposal contains three scenarios under which it may seek to review these prices within the five-year period. These circumstances are where:

- new regulatory or customer requirements change services levels which result in a net change in costs;
- actual capital expenditure varies substantially from the levels agreed; and or
- activity levels deviate materially from the levels contained in the proposal.

Airservices also states in its draft notification that it will continue to review pricing structures over the course of the pricing arrangement and sets out the variations that will trigger the reviews.

> ***Providing that any review includes proper consultation with the affected parties then GCAL has no real objection to the risk sharing arrangement proposed.***

2.3 EFFICIENCY OF SERVICE PROVISION

2.4 ESTIMATED OPERATING COSTS

Whilst GCAL considers that the dual till approach to segregate risks is the correct way to manage the operating costs, as stated in the notification, it is with the costs themselves that we have some objections. These are detailed below.

The individual cost items detailed in the operating costs as supplied to Gold Coast Airport are:

Staff Costs (the costs incurred for staff dedicated to Gold Coast Airport).

ATC estimated at $3.27 million for the first year rising to $3.81 million in the fifth year. (An average of $193,491.12 per staff member in the first year.)

ARFF estimated at $2.44 million for the first year rising to $2.85 million in the fifth year. (An average per staff member of $84137.93 in the first year.)

Supplier and Shared Services Costs (the costs for utilities, cleaning, minor building and equipment repairs and maintenance, insurance, consumables, travel and shared services costs.)

ATC total $0.67 million in the first rising to $0.74 million in the fifth year.

ARFF total $0.48 million in the first rising to $0.54 million in the fifth year.

Asset Costs (Depreciation cost and maintenance of the primary assets supporting the service at Gold Coast Airport.)

ATC total $2.23 million in the first rising to $2.29 million in the fifth year.

ARFF total $0.30 million in the first increasing to $0.38 million in the fifth year.

Distributed Costs (Centralised costs allocated to the service and Gold Coast Airport. These include ATC and ARFF planning and procedures, Pilot Briefing, operational training and recruitment, safety and Quality Assurance, Aeronautical Information Services and data management, Group financial, Human Resources and administrative management,, legal fees, audit, tax management, treasury and corporate office and ARFF fleet management and refurbishment.)

ATC total $1.19 million in the first year rising to $1.34 million in the fifth year.

ARFF total $0.26 million in the first year rising to $0.29 million in the fifth year.

2.4.1.1 COST BREAKDOWN

ATC:

Duty Hours	Staff	Cost per person	Supplier and Shared Services Cost	Asset Costs	Distributed Costs
16	16.9	193,491.12	670,000	2,230,000	1,190,000

ARFFS:

Duty Hours	Staff	Cost per person	Supplier and Shared Services Cost	Asset Costs	Distributed Costs
16	29	84,137.93	480,000	300,000	260,000

Movement Rates (Annual as at July 2004):

Heavy	Medium	Light	Chopper	Unknown Weight	Military	Total
1368	12056	25008	6972	20	176	45598

Cost per aircraft:

ATC	Total Airservices Costs
161.41	237.72

We recognise that the costs have been modified to take into account the capacity of the user to pay however it seems a strange statement for Airservices to make when they aver that " ..if these services were withdrawn, say as a result of price increases driving down demand, these costs would largely continue to be incurred". It is most likely true that the proposed price increases will drive down demand although how the withdrawal of ATC and ARFF at a location would continue to incur costs is difficult to reconcile. GCAL is aware that in line with ICAO requirements that our port will be changing from a Category 8 airport to a category 7 in the near future and that the savings generated by change of category be reflected in operating costs.

GCAL considers that these costs are not truly representative of the value of the service provided, and are the result of the inefficiencies, particularly in the number of staff employed in the non-operational and management areas, often endemic in an organisation where there is no financial incentive to its employees to be more efficient.

GCAL also considers that the estimated costs in the proposal are excessive and that a competitive environment would substantially reduce the cost of supplying ATC and, in particular, ARFFS. GCAL is aware that our port will be *changing from a Category 8 airport to a category 7 in the near future and that the savings generated by change of category be reflected in operating costs.*

2.5 INCENTIVES

Because Airservices itself is a complex technical organisation, historically shrouded in mystery as to its operations, it is extremely difficult for an outside body, such as the ACCC, to fully appreciate the operating environment of the organisation.

Worldwide, until relatively recently, the services provided by organisations such as Airservices were the exclusive province of governments, with the possible exception of the United Kingdom where private provision of ATS has existed for many years in direct competition with the government organisation.

It is only relatively recently that non-government organisations have been introduced into the supply of ATS and ARFFS in other countries and the result has been that costs have been reduced, up to 50% in many instances, without any discernible negative impact on air safety.

It is felt that Airservices' incentives to, and effectiveness in, containing and reducing costs are generally exercises in public relations only with little effective external oversight.

GCAL considers that there is little or no incentive for Airservices to contain or reduce its cost base as it is operating as a monopoly provider. This particularly applies in the provision of ARFFS where the use of external resources on a needs basis would probably result in the more cost-effective provision of services for emergency situations.

2.6 PROPOSED CAPITAL EXPENDITURE PROGRAMME

2.7 CAPITAL PROJECTS

In general terms the facilities provided at most airports are old technology and outdated in the extreme, particularly in the case of Control Towers and their equipment, and it seems to be somewhat unproductive to be replacing the old technologies with old technologies.

The presence and effective coverage of the radars at Mt Hardgrave on North Stradbroke Island, at Amberley and Brisbane suggest that the Mt Somerville radar is not operationally justified and that, therefore, it does not require replacing.

When the radar was installed, as the result of a mid-air collision focussing attention on the traffic situation at Gold Coast Airport, the Approach and Aerodrome Control service were being provided by the same controller based in the Gold Coast Airport Control Tower. Following the commissioning of the radar at Mt. Somerville a Radar Approach Control service was provided from a separate facility in the Tower complex.

The current level of traffic at Gold Coast Airport does not appear to justify a Terminal Area Radar (TAR) dedicated to Gold Coast Approach particularly as this service is provided from the Brisbane Centre. It would appear that a replacement TAR is being considered simply because the old TAR is reaching the end of its useable life and not because it is operationally required.

The approach taken by Airservices in incorporating the impact of capital investment into the long term pricing agreement is considered to be the correct approach providing that the capital investments are fully examined and agreed to by the relevant customer base.

Certainly, in the case of the replacement of the TAR at the Gold Coast Airport, it is considered that a more detailed explanation of the necessity for the provision of this facility is required. Accordingly, until such an investigation has taken place, it is GCAL's position that the cost of the TAR replacement be removed from the capital programme for our port.

2.7.1 COSTS OF CAPITAL PROJECTS

It is considered that greater use of modern technology should be considered in any replacement plan. Alternatives are available and these should be thoroughly investigated, as part of an operational needs assessment rather than an engineering requirement.

GCAL accepts that the cost of the replacement TAR at $6.03 million is reasonable for a primary and secondary radar installation, however there is doubt as to whether or not it is operationally required. Airservices states that the current equipment is not supportable after 2007 due to a lack of parts and beyond that date it becomes progressively more unreliable; this is an engineering based appraisal not an operational needs assessment.

It is considered that there needs to be an investigation into the operational necessity of a replacement and if that finds in the affirmative, then the new technologies available that are direct substitutes for conventional radars also need to be considered. Accordingly, until such an investigation has taken place, it is GCAL's position that the cost of the TAR replacement be removed from the capital programme for our port.

2.7.2 APPROACH TO DETERMINING CAPITAL COSTS

It has been noted that the consultation process in terms of capital equipment costs has improved in the recent past and it is hoped that this process will continue and be expanded in the future.

The approach taken to determining the capital expenditure program over the period covered by the pricing proposal is the correct approach in that it actively involves the various stakeholders in the decision making process.

2.8 ASSET BASE

GCAL acknowledges and welcomes the comments from the Hymans report which indicates that the assets reviewed have been implemented with "reasonable and efficient design execution." GCAL agrees that it is essential that Airservices acquires and maintains assets of the highest safety standards together with an efficient economic life.

GCAL notes the proposed increase in the asset base of Airservices. GCAL agrees it is entirely appropriate that the cost of assets employed as part of the business of Airservices are amortised over their effective life and recovered through additional charges. However, GCAL submits that where "original cost" has been fully depreciated and therefore already recovered as part of the charges levied, it is not acceptable that Airservices seek to revalue these assets and subsequently allocate further amortisation costs for recovery through additional charges.

GCAL acknowledges that it is accepted that assets may either have an extended effective life due to an incorrect previous assessment of the effective life or due to the deferral of the deployment of new technology. In this case, any efficiency which results due to the previous higher amortisation should be passed through to the users as opposed to an adjustment to the equity balance of Airservices.

2.9 RETURN ON CAPITAL

GCAL has reviewed the assessment of the calculation of the WACC of Airservices. In particular GCAL notes the proposed new target of Airservices across the five year period. In relation to the proposed inputs GCAL has a number of comments.

PWC's recommendation suggests an equity beta of between 1.0 and 1.3. This indicates that compared to the market indices, investors would consider that the equity value of Airservices would respond to market movements with a rise or fall in value more than the market average. GCAL submits that Airservices, given the nature of its business together with its customer base is less susceptible to market movements. Airservices is a "monopolistic" business with very little competitive forces which itself is the reason for the regulation of prices. GCAL submits that an equity beta of below 1.0 would be more appropriate.

The draft price notification indicates a gearing ratio of between 40 and 50%. With the cost of debt less than the cost of equity, GCAL submits that the level of gearing for capital investment should be increased to a sustainable level, which will promote additional efficiencies for users through the reduction of the WACC and ultimately the charges levied.

The price notification suggests that the reduced WACC target will act as a formal incentive to seek additional productivity efficiencies. GCAL submits that such identified efficiencies should be reflected in the current calculations and should always be the responsibility of Airservices without the need for a formal incentive. Any suggestion that continued identified "inefficiencies" is acceptable and will be paid for by users whilst they are ultimately improved is unacceptable. Any identified cost savings should be passed through immediately and not be the goal for the next 5 years.

GCAL recognises the risk that the WACC target is reached through further increases in prices. This is also unacceptable.

2.10 ACTIVITY ESTIMATES

The notification stated that, given the difficulty in ascertaining an objective basis for the activity forecast, Airservices Australia agreed to the Industry Steering Committee's recommendation to engage the International Air Transport Association's (IATA) Forecasting and Consulting Unit to develop a forecast for the next five years and to abide by its recommendation. IATA is an organisation that exists to protect the interests of its members, mostly the major airlines, and as such is hardly unbiased and therefore unlikely to provide an objective basis for forecasting activity.

The notification also stated that the consultation with airports and other customers suggested that the regional and GA airport forecasts are optimistic, as significant price increases are likely to result in a contraction in demand. While noting these concerns, Airservices Australia considers that determining the reaction of the market to this pricing proposal in isolation from other changes in input costs for operators, such as fuel costs and airport charges would be extremely difficult. Therefore, the IATA forecasts were retained as an objective basis for pricing.

> *GCAL agrees with the respondents to the previous consultation process that considered the forecasts to be optimistic in relation to some airports. However, in the case of the Gold Coast Airport there has been a steady increase in activity greater than anticipated and which it considers will continue.*

2.11 COST ALLOCATION

It is interesting to note that Airservices previously used an activity based approach in determining the costs at each location to support location specific pricing and that one of the reasons for this was to prepare for the introduction of competitive provision of services. Unfortunately this competition was prevented and Airservices has modified its approach to cost allocation.

The distributed costs, 23% of the total regulated services costs, is an area that needs an independent assessment as to its value and its applicability to the provision of services. Such an assessment would also bring to light the extent of cross-subsidisation, outside of the provision of services to the customers, in areas such as the provision of consultancy and project implementation services. It is also felt that a contributing factor to the high distributed cost percentage is the overheads associated with the maintenance of regional and head offices.

> *The proposed method of cost allocation appears to be appropriate in view of the negative effect that the increases in costs will have on certain classes of operator and on the airports that service them.*
>
> *This can be considered to be, at least partly, in line with the Air Services Act that requires that the promotion and fostering of aviation should apply to all areas of aviation, not only the corporations' major customers.*

2.12 CAPITAL CITY BASIN

Airservices states that the basin charging approach is in recognition of the interdependencies that exist in the operation of such airports, 'where the existence of the secondary location has a significant positive impact on reducing the congestion at the major basin airport'. Airservices also states that an increase in the number of light aircraft operating at major airports would impact on the operations of the major airport and that there are significant levels of shared resources in the management of airports within a common 'basin'.

> ***GCAL agrees that it is appropriate and efficient to consider all of the airports in the terminal area of a capital city airport as being one entity each one dependent on the other for its operations.***

2.13 PHASING IN PERIOD

It is entirely appropriate to phase in increases of the magnitude indicated in the Airservices proposal so as to permit organisations that are operating in a full commercial environment the timescale necessary to avoid financial ruin. The effect on regional operators, and the airports serviced by them, is enormous when viewed in the context of their operating margins and where the service being provided is as much a public necessity as a commercial operation.

> ***GCAL, whilst not supporting the scale of the increases, agrees that it is appropriate, where increases are of the extent proposed, that they be phased in over the full period.***

2.14 CROSS SUBSIDISATION

Airservices lists as one of the aims of its pricing as 'avoiding cross subsidising the costs of other services' and states that 'the impact of removing cross subsidies in service line prices is more significant' than the overall price increase over the five-year period. It also states that the proposed prices will reduce cross-subsidisation between service lines although as the ACCC notes, 'the precise details of this do not appear to be contained in the draft notification'.

The impact of removing the cross subsidies will certainly be more significant for the major airlines than the price increases to other areas of aviation activity.

Whilst there appears to be some effort at avoiding cross subsidies with regard to the various costs in the service areas, en-route viz-a-viz terminal etc. in the process notification, it does not address the full spectrum of cross subsidisation that is most likely occurring within the Airservices organisation.

An independent investigation of the Airservices operation would be necessary to fully satisfy disquiet about their operations and about the efficiency of the organisation as a whole. There are areas in Airservices that are not part of their core business and where they are directly competing with private organisations in Australia and overseas that are not yet viable operations and that are obviously being funded out of the air navigation charges.

GCAL considers, in principle and in the context of the aviation scene in Australia, that cross-subsidisation of other services provided to aviation in Australia is appropriate, although this needs careful policing to ensure that inefficiencies are not perpetuated. This is of course in the context that AsA provide cost efficient services in a competitive environment.

Cross subsidisation of other, non-core, activities within Airservices should not impose any burden on the charges levied to provide services in the core activity

2.15 GENERAL EFFECTS

2.15.1 INCENTIVES

The requirement for services at particular locations is established outside of Airservices, by CASA Regulation in relation to ARFF services, so there is no incentive at all to provide services, and when services are required there is no incentive to provide these at a reasonable cost. This also applies in respect of the users of Airservices services.

Generally the proposed prices do not provide appropriate incentives for Airservices, or their users, to provide services at particular locations.

2.15.2 IMPACT OF PRICE INCREASES

The impact on the users of regional airports and air traffic control services will be a financial negative impact and will severely affect the viability of their operations. The operational effect will be reduced operations at regional airports that are subject to the increased charges and the increased use of aerodromes that do not provide ATS or ARFFS. This natural inclination to avoid any use of ATC services will impact on the possible safety of operations and thus increase risk to passengers and the general public. Many users are already operating on very fine margins and to contain their costs there will be an incentive to cut corners with, again, a possible impact on safety of operation.

There is little doubt that any increase, and certainly the size of the increases proposed, will have a deleterious effect on services generally and in particular to locations that are currently financially marginal. Many of these destinations are more of a public service than a commercial operation and it is here that the effects of the cost increases will have the greatest impact. A case in point will be the effect on the Royal Flying Doctor Service and charter operators providing services to remote communities.

The likely impact of the proposed prices on the users of regional airports and air traffic control services will be a reduction in the use of the serviced locations and a possible decline in safety of operation.

2.15.2.1 DEMAND FOR AIR TRAVEL

There is likely to be a substantial reduction in the use of some services where the increased costs are a major impost although the effect on the major carriers will be less severe as the increases are minimal as a percentage of their operating costs.

GCAL considers that general aviation, regional type carriers, will be adversely affected and that will, in turn, impact on the communities that can least *afford to lose an air transport connection to vital services and also impact on the airport operators that service them.*

2.15.2.2 AIRLINE SCHEDULING DECISIONS

There should be little effect on the major carriers although some of the smaller operators may schedule movements outside of the operating hours of ATC and ARFFS.

2.15.2.3 PROVIDERS OF OTHER AVIATION SERVICES

There will be a negative flow on effect to other service providers because of the decrease in patronage at the affected airports and of the affected carriers.

2.15.2.4 AIRFARES

Inevitably there will be an increase in airfares, whether it be in the form of a levy, a tax or a plain increase in fares. The regional carriers will be compelled to increase their fares, as they do not have the capacity to contain the increased costs. Many smaller charter operators will be forced out of the business altogether.

3 SUMMARY AND COMMENTS

3.1 COMPETITION

As stated in Section 95G(7) of the Trade Practices Act particular regard must be paid to the need to discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that power in setting prices. GCAL considers that the current proposal needs to be carefully assessed by the ACCC in this context and, as previously stated, an independent expert assessment of the internal operation of Airservices may need to be carried out.

Throughout this exercise the one overriding factor that influences everything that Airservices is doing is the lack of competition in any area of their operation. A truly monopolistic situation that elsewhere in the world has been recognised as being unhealthy in a modern aviation environment. The government in Australia also recognised this and introduced the concept of contestability into the provision of air traffic and rescue and firefighting services in the late nineties. The Senate voted against accepting the proposed Civil Aviation Safety Regulations Parts 65, 139H, 143, 171 and 172, covering contestability of ATS and ARFFS, and subsequently the only permitted supplier of these services was Airservices Australia.

In July of this year however an amendment to Civil Aviation Regulation 2 was approved to allow Airservices to sub-contract towers to third parties operating in cooperation with or by arrangement with Airservices Australia. Providing that Airservices agrees this does permit a competitive element into the market, although Airservices are the final arbiter as to whether or not to permit this. Unfortunately this situation does not pertain to ARFFS as this is a service that could readily be sourced outside of Airservices.

3.1.1 ARFFS

Civil Aviation Safety Regulation (CASR) Subpart 139 H specifies the requirements for the provision of aviation rescue and fire fighting services (ARFFS). It also provides the legal framework for the Manual of Standards (MOS), which reflects the International Civil Aviation Organisation (ICAO) and the Standard Operating Procedures applicable to the provision of an Aviation Rescue and Fire Fighting service.

Together, Subpart 139H and the MOS define the standards and criteria for the provision of aviation rescue and fire fighting services, including criteria for the establishment or disestablishment of an ARFF service and the required level of service at each airport.

There are many variables taken into account when assessing the need for, and the scale of, ARFF services, for example the level of service states that "an ARFF service must be provided in accordance with the category requirements of the largest scheduled passenger air service on the date of arrival and/or departure, where the largest aircraft movements are greater than 700 for a 3 month period. Where the largest aircraft movements are less than 700 for a 3-month period, the level of service adopted is one category below the highest category required".

However, as from January 2005 the minimum level of ARFF service provided at each aerodrome will be determined by the largest passenger aircraft scheduled to land at the aerodrome, irrespective of the number of aircraft movements.

By its very nature the ARFFS is a very unproductive service as it exists to provide a service in an emergency situation only; in the modern era that service is very rarely called on, and when it is it is generally of little practical use. If airports were permitted to employ their own ARFFS there would be a greater degree of flexibility built into the employment contract than is currently the case and thus productivity could be considerable enhanced.

We appreciate the fact that the ACCC can do nothing to change the current situation as it is a regulatory matter but we feel that it is important that they are made aware of the situation as once again it is a prime example of a government sponsored monopoly that is not serving the interests of the industry or the public.

3.2 PRICING PROPOSAL

GCAL's previous comments supported Location Specific Pricing provided that it was within a competitive framework. It considers that this version will have the same effect as the original albeit with a slightly more favourable outcome in some areas of the aviation scene than previously. It must be remembered that a monopolistic supplier with no adequate check on its efficiency of operation and has no incentive to be more efficient and cost effective has advanced this proposal. It is also important to remember that Airservices customers are operating in a very competitive environment.

GCAL, as an airport operator, is operating in a very competitive environment, with the major airports, Brisbane International and the Sunshine Coast, and regional airports such as Ballina, in close proximity. It is therefore essential that Airservices costs are apportioned in an even-handed and transparent manner so as to ensure that the competition between airports continues on a 'level playing field' so that the flying public and the local communities serviced by them have the benefit of cost efficient services.

It must be borne in mind that Airservices, and its predecessors, is and were monopoly suppliers of services to aviation in Australia and as such have never had to fully justify their charges to that community in a competitive atmosphere. To ensure that Airservices charges to their customers are commercially realistic an independent assessment into the efficiency of the organisation needs to be undertaken so that a realistic base for future charges can be established.

An independent feasibility study into the future provision of contestable ATS at the Gold Coast Airport undertaken out by PCR Australasia Pty Ltd, and supported by evidence from overseas, indicated that Airservices' cost effectiveness is relatively poor compared to alternative suppliers of air traffic services. The evidence from overseas indicated savings of up to 50% compared to Airservices provision.

There is little doubt that the same, or even greater, degree of savings could be provided by the competitive provision of ARFFS.

With reference to the current proposal GCAL makes the following comments:

In general it considers that an appropriate degree of consultation has been undertaken by Airservices in this instance and that the consultation process with regard to other Airservices activities appears also to be improving.

With regard to risk sharing, provided that any review includes proper consultation with the affected parties, GCAL has no real objection to the arrangement proposed.

In general it considers that Airservices costs are not truly representative of the value of the service provided, and are possibly the result of inefficiencies within the organisation. Inefficiencies are often endemic in organisations such as Airservices where there is no real incentive for its employees to operate in an efficient manner and this is often reflected in the numbers of staff employed in non-operational and management areas.

It is considered that the estimated costs in the proposal are excessive and that a competitive environment would substantially reduce the cost of supplying ARFFS and ATC.

Difficulty was experienced in rationalising cost differences between the original and the subsequent version of the cost explanatory sheets, particularly with regard to the Distributed costs where there was a very wide variation in the figures quoted, in the case of the Gold Coast some $860,000.

There is little or no incentive for Airservices to contain or reduce its cost base as it is operating as a monopoly provider.

It is considered that there is little or no justification for the provision of ARFFS in its current format. It is a service that could quite easily be provided by the individual airport operators in conjunction with local fire and rescue services and utilising other airport staff as and when required to assist.

The approach taken by Airservices in incorporating the impact of capital investment into the long term pricing agreement is considered to be the correct approach providing that the capital investments are properly justified and agreed to by the relevant customer base.

In the case of the replacement of the TAR at the Gold Coast Airport, it is considered that a detailed explanation of the operational necessity for the provision of this facility is required before a final decision is made. The statement that the current equipment is not supportable after 2007 due to a lack of parts and beyond that date it becomes progressively more unreliable, is an engineering, not an operational, assessment.

Whilst accepting that the cost of a replacement TAR at $6.03 million is reasonable for a primary and secondary installation there is some doubt as to whether or not it is operationally required. If an operational needs assessment finds in the affirmative for a replacement, then the new technologies available that are direct substitutes for conventional radars also need to be considered.

The approach taken to determining the capital expenditure program over the period covered by the pricing proposal is the correct approach in that it actively involves the various stakeholders in the decision making process.

GCAL acknowledges and welcomes the comments from the Hymans report which indicates that the assets reviewed have been implemented with "reasonable and efficient design execution." GCAL agrees that it is essential that Airservices acquires and maintains assets of the highest safety standards together with an efficient economic life.

GCAL notes the proposed increase in the asset base of Airservices. GCAL agrees it is entirely appropriate that the cost of assets employed as part of the business of Airservices are amortised over their effective life and recovered through additional charges. However, GCAL submits that where "original cost" has been fully depreciated and therefore already recovered as part of the charges levied, it is not acceptable that Airservices seek to revalue these assets and subsequently allocate further amortisation costs for recovery through additional charges.

GCAL acknowledges that it is accepted that assets may either have an extended effective life due to an incorrect previous assessment of the effective life or due to the deferral of the deployment of new technology. In this case, any efficiency which results due to the previous higher amortisation should be passed through to the users as opposed to an adjustment to the equity balance of Airservices.

GCAL has reviewed the assessment of the calculation of the WACC of Airservices. In particular GCAL notes the proposed new target of Airservices across the five year period. In relation to the proposed inputs GCAL has a number of comments.

PWC's recommendation suggests an equity beta of between 1.0 and 1.3. This indicates that compared to the market indices, investors would consider that the equity value of Airservices would respond to market movements with a rise or fall in value more than the market average. GCAL submits that Airservices, given the nature of its business together with its customer base is less susceptible to market movements. Airservices is a "monopolistic" business with very little competitive forces which itself is the reason for the regulation of prices. GCAL submits that an equity beta of below 1.0 would be more appropriate.

The draft price notification indicates a gearing ratio of between 40 and 50%. With the cost of debt less than the cost of equity, GCAL submits that the level of gearing for capital investment should be increased to a sustainable level, which will promote additional efficiencies for users through the reduction of the WACC and ultimately the charges levied.

The price notification suggests that the reduced WACC target will act as a formal incentive to seek additional productivity efficiencies. GCAL submits that such identified efficiencies should be reflected in the current calculations and should always be the responsibility of Airservices without the need for a formal incentive. Any suggestion that continued identified "inefficiencies" is acceptable and will be paid for by users whilst they are ultimately improved is unacceptable. Any identified cost savings should be passed through immediately and not be the goal for the next 5 years.

GCAL recognises the risk that the WACC target is reached through further increases in prices. This is also unacceptable.

Respondents to the previous consultation process that considered the traffic forecasts to be optimistic in relation to some airports is no doubt true however, in the case of the Gold Coast Airport there has been a steady increase in activity greater than that anticipated and thus the forecasts may well, in this instance, be pessimistic.

The proposed method of cost allocation appears to be appropriate in view of the negative effect that the increases in costs will have on certain classes of operator and on the airports that service them. Thus the allocation can be considered to be, at least partly, in line with the Air Services Act that requires that the promotion and fostering of aviation should apply to all areas of aviation, not only its' major customers.

It is appropriate and efficient for all airports in the terminal area of a capital city airport to be considered as being one entity with each one dependent on the other for its operations.

Whilst not supporting the scale of the increases proposed it is considered appropriate, where increases are of the extent proposed, that they be phased in over the full period.

GCAL considers, in principle and in the context of the aviation scene in Australia, that cross-subsidisation of other services provided to aviation in Australia is appropriate, although this needs careful policing to ensure that inefficiencies are not perpetuated. This is of course in the context that AsA provide cost efficient services in a competitive environment.

Generally the proposed prices do not provide appropriate incentives for Airservices, or their users, to provide services at particular locations and that the likely impact of the proposed prices on the users of regional airports and air traffic control services will be a reduction in the use of the serviced locations and a possible decline in safety of operation.

General aviation, and the smaller regional carriers, will be adversely affected and that will, in turn, impact on the communities that can least afford to lose an air transport connection to vital services and also impact on the airport operators that service them.

There should be little effect on the major carriers although some of the smaller operators may schedule movements outside of the operating hours of ATC and ARFFS again leading to a reduction in safety.

There will be a negative flow on effect to other service providers because of the decrease in patronage at the affected airports and of the affected carriers.