LINFOX

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10th September 2004

Ms Margaret Arblaster
General Manager – Transport & Prices Oversight
Australian Competition & Consumer Commission
PO Box 520J
MELBOURNE VICTORIA 3001

Dear Ms Arblaster

Re: Airservices Australia - Pricing Proposals

I refer to your letter of the 17 August 2004 regarding the Australian Competition & Consumer Commission's (ACCC) issues paper pertaining to Airservices Australia's proposed pricing regime.

As General General Manager of both Avalon & Essendon Airports in Melbourne I wish to object to this pricing proposal in the strongest terms.

We believe that our Essendon and Avalon Airport facilities are unique in Australia. These properties are only 8 kilometres and 65 kilometres respectively from Tullamarine, our major and powerful competitor. No other smaller airports in Australia have such similar circumstances.

Essendon Airport competes against Tullamarine for corporate jet based activity, whilst Avalon Airport has recently entered the RPT market with passenger flights.

Avalon Airport is not part of Airservices proposed pricing review but will likely be so within the next two years. We believe that Airservices proposal, and general ideology of pricing for the Melbourne market, will be extremely deleterious and anticompetitive to Avalon's RPT activities, and this response will outline that impact in more detail.

In essence, Airservices monopolistic pricing will provide a severe difference in pricing for Essendon Airport and Avalon Airport based customers and will likely strengthen Tullamarine Airport's powerful market position.

As an example, the following disparities for Terminal Navigation Charges (TNC), for a 40 tonne corporate jet would be levied by Airservices by Year 5:

Airservices' Tullamarine Airport TNC for a 40 tonne corporate jet:	$202.40
Airservices' Essendon Airport TNC for a 40 tonne corporate jet:	$507.60

This is a 250% difference and will simply result in more jet air traffic being enticed into Tullamarine Airport at the expense of Essendon Airport. It is impossible to compete with this price disparity, especially as the competitor is only 8 kilometres away.

Within two years, we anticipate that the disparity at Avalon Airport will be significantly worse. We anticipate that our Airservices' TNC and Aviation Rescue and Fire Fighting (ARFF) charges will be similar to Maroochydore Airport, which experiences very comparable aircraft and passenger movements.

Accordingly, the anticipated differential in charges for an A320 aircraft of 77 tonnes will be:

Tullamarine Airport

Airservices Tullamarine TNC Charge	$5.06	(as proposed in Year 5)
Airservices Tullamarine ARFF Charge	$1.41	(as proposed in Year 5)
Total Charge per tonne	$6.47	(as proposed in Year 5)
Total Charge for an A320	$498.19	(as proposed in Year 5)

Avalon Airport (estimated based on Maroochydore Airport charges)

Airservices Avalon TNC Charge	$12.69	(as proposed in Year 5)
Airservices Avalon ARFF Charge	$22.39	(as proposed in Year 5)
Total Charge per tonne	$35.08	(as proposed in Year 5)
Total Charge for an A320	$2,701.16	(as proposed in Year 5)

This is a difference of 542%. These proposals will almost definitely diminish investment and employment at both Avalon and Essendon Airports, particularly Avalon, and will result in the medium-term creation of a complete monopoly of corporate jet and passenger services at Tullamarine Airport.

We continue this paper by outlining our views in accordance with the topics as specified in the *Australian Competition & Consumer Commission - Issues Paper - Airservices Australia Draft Price Notification August 2004.*

Consultation Process

(The ACCC seeks comment on the effectiveness of Airservices Consultation Process and the extent in which the proposal is supported by your organisation.)

We note that Airservices Australia's Price Notification Submission states that an extensive consultation process occurred during June and July 2004.

To my knowledge, one meeting occurred at Essendon Airport on the 18th June 2004. Approximately 6 of the airport's 900 annual aviation users were in attendance.

Airservices advised of a proposal to levy a $59.00 per tonne TNC charge on the airport's operators. No consultation occurred as such.

Representatives of Airservices stated that the ACCC's earlier directive resulted in this proposed ideology and rate. These individuals apologised for the amount but could not enter into any specific discussion on the proposed charge. The meeting then ended.

Subsequently, many operators felt they had not been consulted. As an example, the following comprises part of an email from Mr Guy Pearson, an airport aviation operator and President of the Essendon Airport Chamber of Commerce, which was sent to me as recently as the 26th August 2004:

"It is the view of the Chamber that consultation with the General Aviation industry at large and in particular at Essendon Airport, by ASA is inadequate at best and non existent at worst.

To date, to the best of my knowledge, no general aviation operator based at Essendon has been directly consulted on the proposed changes to the air services charging regime by ASA. This lack of consultation is, in the opinion of the Chamber, not acceptable given the level of the proposed fee increases."

This opinion more precisely outlines the consultation that has occurred.

After a number of media comments pertaining to the proposed 795% TNC charges at Essendon Airport I received many calls from aircraft operators unaware of the proposal. I suspect this is why 600 responses were later received by Airservices. It was an unusual consultation process, to say the least. Senior Airservices personnel themselves informed me they we embarrassed by the consultation process they had conducted.

It was only mid August 2004 that EAPL became aware of this new proposal, via the Internet.

The general industry view is that Airservices proposed an outrageous initial position and then later suggested a 50% increase over five years. I consider this to be a tactic and not an appropriate consultation process. Certainly, there has never been a two-way interaction.

As an example, during the meeting of the 18th June 2004, the 6 operators consulted at Essendon Airport again requested that the airport's hours of ATC provision be reduced to assist in overall cost reduction. It is unclear why Airservices provides up to 16 hours per day of ATC, the highest of any GA airport in Australia. No response from Airservices was received in relation to this matter.

In summary, we do not believe that an appropriate consultation process was followed and our organisation does not support the Pricing Proposal.

Risk Sharing Arrangements
(The ACCC seeks comment on the appropriateness of the risk sharing arrangement embodied in the proposal.)

It is very unclear as to what the Risk Sharing Arrangements will be.

We note that the Industry Committee wishes to reserve the right to review prices during the course of the agreement when:

- New regulatory or customer requirements change service levels;
- Actual capital expenditure varies substantially from levels agreed in the plan; or
- Activity levels deviate.

The report goes on to state that if these issues are triggered the Steering Committee will consult on the best means for dealing with the impact of the event.

An example is also tabled regarding activity levels. Apparently, if these rise or fall by 10% within a 60 day period and/or are forecast to trend 5% above or below the forecast levels, *"the parties will consider the implications and determine the most appropriate means of addressing the situation."* (Whatever that means).

This concept is completely vague and lacks substance. Surely they could undertake some modelling to assess the potential impact in the event that activity levels deviate, or customer requirements change, or if capital expenditure were to vary substantially.

It certainly is not a risk sharing position and it is misleading to refer to it as such.

Operating Costs
(The ACCC seeks comment on the efficiency with which Airservices provides its services, including: the level of estimated operating costs and Airservices effectiveness in reducing costs.)

It is difficult to understand the allocation of costs within Airservices Australia.

As an indication, Airservices published documentation on the 31st May 2004 stating that the operational costs allocated to Essendon Airport were $3,460,000 per annum, being approximately $9,500 per day to operate the Essendon Airport control tower.

In our correspondence of 2nd July 2004 we questioned the accuracy of these costs. By August 2004 the costs were revised to $2,800,000. This represents a drop of 19% ($660,000) within two months.

This indicates to our organisation that there is no proper understanding of costs within Airservices. However, if they did disappear, where did they go and does this mean that Essendon Airport's users have, in the past, been unfairly levied excessive charges, or allocated losses?

In any event, assuming the present costs of $2.8 million per year is accurate, this represents $7,671 per day, every day, to operate the Essendon Airport Control Tower.

However, notwithstanding this high base, Airservices wishes to also propose a 19% cost *increase* over the next five years.

Without wishing to be dramatic, this amount is astonishing.

To our organisation, it is inconceivable that a 1956 built Control Tower, with basic infrastructure and equipment costs $7,671 a day to operate, rising to $9,128 per day in the fifth year.

We strongly object to this position and also wish to briefly comment on the outlined costs.

Airservices Staff Costs of Operating the Essendon Airport Control Tower are $1.39 million per annum

There seven staff working at Essendon Airport's Control Tower. This represents the cost of approximately $200,000 per person of salary costs. Conveniently, the *Draft Price Notification Document* omits comment on salary costs altogether.

However, this is understandable as they are difficult to justify.

The charge of $200,000 per person for Air Traffic Control is offensive to the industry. This indicates a long-term habit of losing control of staff costs and then monopolistically ordering the industry to pay for these excessive amounts. It is likely that these heavy costs include substantial defined-benefit superannuation arrangements that must also be borne by the industry.

Airservices Supplier and Shared Services Costs of Operating the Essendon Airport Control Tower are $580,000 per annum

This allocation is more staggering that the Staff Costs.

It seems that it costs Airservices $1,589 per day for stationary, accounts payable/accounts receivable, telephone calls, water and electricity for a single building. How could this possibly be the case ?

As a comparison, it costs EAPL approximately $300,000 per annum, being almost half the amount, for the same cost structure.

The only difference is that Airservices Australia operates one building, whereas EAPL has 305 hectares, 115 tenants, 900 aviation users, 120,000 square metres of buildings, over five kilometres of roads, a passenger terminal and two cross runways and associated taxiway structure.

It seems strange that it costs Airservices 193% more to operate one building than the whole of Essendon Airport.

Airservices Asset Costs of Operating the Essendon Airport Control Tower are $780,000 per annum

Airservices Asset Costs for Depreciation and Facilities Maintenance & Management of the 1956 era control tower and equipment at Essendon Airport is $780,000.

The complete maintenance and depreciation, as permitted under taxation laws, for the whole of Essendon Airport's hangars, plant and equipment, roads, carparks, airside & landside control, fences, runway lights, gates and all other infrastructure is $1,307,000.

Put plainly, the comparison is preposterous.

Summary of Costs

As a general summary of costs, EAPL is of the view that it is typical of a monopolistic structure that shows no signs of long-term cost-control and then expects industry to pay the amounts.

In the past two months Airservices has advised us that the annual costs of operating the Essendon Airport Control Tower was firstly $3.46 million per annum and then $2.8 million per annum. Either position is difficult to comprehend or defend.

Airservices' incentives to, and effectiveness in, containing costs.

EAPL, and the majority of operators at Essendon Airport, hold the view that Airservices Australia completely over-services Essendon Airport.

For instance, Moorabbin Airport undertakes over 200,000 annual aircraft traffic movements. Although this is 300% more air traffic than Essendon Airport, Essendon has *54% more* hourly ATC coverage. Presently, Moorabbin has 70 hours of ATC per week whilst Essendon has 108 hours. On a yearly basis Airservices Australia provides 1,976 hours more coverage at Essendon Airport than at Moorabbin.

In our opinion, there is no commercial or operational reason to provide this additional coverage, perhaps other than to support Tullamarine Airport's operations. That being the case, it should be paid for by Tullamarine Airport.

By way of example, Essendon's ATC operates until 10.00 pm each night – although very little air traffic is encountered after 6.00 pm (Note: Moorabbin closes its ATC at 6.00pm). For consideration, during the week of the 15 June 2004 – 21 June 2004 between 9.00 pm – 10.00 pm an average of less than 2 aircraft landed during that hour each night. From a commercial view, this is entirely unfeasible. Airservices Australia spends $500 in costs during this one hour each night to generate potentially less than $50 of fees.

As a further example, on the weekend of the 19 – 20 June 2004 during the combined 6-hour period (from 7.00 pm to 10.00 pm on two nights), our records indicate that only 3 aircraft arrived. Based on Airservices Australia's average hourly rate of approximately $500 it cost $3,000 to provide services to generate $126.21 of revenue. These services are provided for no apparent reason. It is unfair that the users of Essendon Airport are then requested to fund these unnecessary costs.

If the ATC at Essendon Airport was operated as a private entity these services would have been reduced years ago. Alternatively, if the ATC's unusually long hours of operation are in place at Essendon Airport purely to support coverage at Tullamarine Airport, then explanation should be given and costs allocated to the users of Tullamarine Airport, not Essendon. Additionally, the TNC costs should be the same as it is essentially the same service.
The overall issue is that there is no incentive to control costs. It is of no consequence to their operations - being a monopoly Airservices know they can simply increase charges without corollary impact. This is a culture within Airservices, developed over many years. The

empirical evidence of this continues with their stated proposal to increase staff costs by 24.6% over the next five years and supplier costs by 22.2%. It is nothing short of remarkable and simply not sustainable in private enterprise.

Capital Expenditure
(ACCC seeks comment on the efficiency of Airservices proposed Capital Expenditure Program, including:

The appropriateness of the capital projects included within the proposal.)

Other than Appendix 3, there is no specific breakdown of the proposed Capital Expenditure Program.

We would imagine that most of these capital works will be undertaken at the major Australian Capital City RPT Airports, with little or no impact on Essendon Airport.

To our knowledge, there has been almost no capital expenditure by Airservices at Essendon Airport for many years. In fact, the existing Essendon Airport Control Tower was a "temporary" facility, erected for the 1956 Olympics. This temporary tower still remains.

This expenditure program does indicate why Airservices Assets Costs at Essendon Airport are $780,000 per annum. In summary, it is fair to assume that many of the costs of the proposed expenditure program will occur at major airports, then allocated partly to the smaller airport facilities, such as Essendon.

Asset Base
(ACCC seeks comment on:

- *the efficiency of Airservices' asset base*
- *the appropriateness of Airservices new values*
- *the appropriateness of revaluing assets which previously had a zero book value)*

EAPL has no view on these matters.

Rate of Return
(ACCC asks comment on:

- *The appropriateness of Airservices proposed return on capital*
- *The proposal to apply a transition to a higher WACC*
- *The extent to which the proposal will act as an incentive to Airservices to achieve increases in productivity.)*

EAPL has no view on these matters.

Activity Forecasts
(The ACCC seeks comment on the reasonableness of Airservice's activity estimates.)

Airservices anticipates that General Aviation Airports will increase activity by 1%, 2%, 2%, 2% and 1.8% in each of the next five years.

It seems strange that Airservices should propose this.

Airservices own published statistics indicate the following trends at all the main General Aviation Airports in Australia in the last two calendar years:

	Calendar Year 2002	Calendar Year 2003	Movement
Bankstown Airport, Sydney	345,268	296,398	(14.15%)
Camden, Sydney	61,780	46,264	(25.11%)
Cambridge, Hobart	29,724	16,804	(43.46%)
Moorabbin Airport, Melbourne	253,102	235,678	(6.88%)
Parafield Airport, Adelaide	143,080	128,180	(10.41%)
Essendon Airport, Melbourne	68,418	64,240	(6.1%)
Jandakot Airport, Perth	314,734	324,462	3.09%

With the exception of Jandakot, which undertakes many aircraft training movements for foreign airline pilots, the smallest movement was *minus* 6.1%. The average of all these airports in the period was *minus* 14.71%.

This clearly indicates the prevailing sentiment in the General Aviation industry at the present time.

For Airservices to believe that this trend will immediately reverse and improve in the next five years with compound growth, albeit small, during an environment where their costs increase by 50%, is somewhat unfathomable.

In summary, we consider that Airservices' activity estimates show a lack of understanding of the General Aviation industry and are incorrect.

Method of Allocation of Indirect Costs
(The ACCC seeks comment on whether the proposed method of cost allocation is appropriate.)

We note that Airservices states it "has adjusted its allocation approach toward one that takes into account users' capacity to pay."

This is not a correct statement. All TNC charges increase across the board by 16.8% in the first year, and then 10% in the years' following. The Capital City Airports of Sydney, Brisbane and Perth are an exception, as they increase in the first year by a lesser amount and their fortunate trend continues in comparison to the smaller airports in the subsequent years.

These are the airports whose traffic movements are *increasing*. They clearly have more capacity to pay, but they are paying less, and the proposed increases are less, than the General Aviation Airports whose activity is *decreasing* (as shown above).

We agree with Airservices comment that those with the capacity to pay more should do so, but they are not following their own advice.

Basin Approach to Terminal Navigation Charges
(The ACCC seeks comment on the appropriateness of efficiency of the application of a capital city basin approach to charging for terminal navigation services.)

Ignore the rhetoric. No basin approach is effectively being proposed under this arrangement.

A proper basin charge would mean that all TNC and ARFFS charges in the Melbourne region, covering Essendon, Avalon, Moorabbin and Tullamarine, would be the same.

Under the proposal, in Melbourne, the TNC charge at Essendon and Moorabbin Airports will reach $12.69 per tonne. At Tullamarine it will reach $5.06 per tonne. How is this a basin charge? Airservices' charge to land a corporate jet at Essendon will be 250% higher. This will certainly entice more corporate jet activity to Tullamarine from Essendon Airport.

As earlier mentioned, in addition to Essendon, our other major concern is that the proposed arrangements will be extremely deleterious on Avalon Airport's operation in the near future.

We believe that without an effective basin charge, Tullamarine Airport will potentially regain its complete monopoly structure in the next 3 – 5 years. Airservices proposal will ensure that corporate jet activity will move from Essendon to Tullamarine and that RPT services at Avalon will be threatened.

This will not be in the long-term interests of the travelling public. Only recently (2nd September 2004), Mr Alan Joyce, Chief Executive of Jetstar Airlines was quoted in the Melbourne Age stating that:

"(Avalon) had created an element of competition in the Melbourne Airport environment. It's helped keep costs lower than if there had been one airport here. Melbourne Airport has been very co-operative since Avalon Airport opened up."

Without a proper basin charge such competition will be threatened. As owners of Avalon Airport, we are working diligently to make the facility a success and are extremely concerned that this government monopoly pricing is unfair, and will price us out of the market, potentially with Airservices' charges at Avalon being 400% – 500% higher than Tullamarine's.

If this present proposal is accepted, it will almost definitely destroy our commercial viability, and adversely impact upon investment and employment at our Avalon and Essendon Airport facilities.

We call upon the ACCC to insist that a fair and reasonable basin charge for TNC and ARFFS charges are put in place by Airservices to enable all parties to compete on a level playing field within the Melbourne Basin.

Our company does not seek preferential treatment, only the chance to compete against Tullamarine Airport within a fair charging ideology and regime. We simply cannot do this under these monopolistic arrangements which so blatantly support Tullamarine Airport.

Timing of Price Increases

(The ACCC seeks comment on the appropriateness of the phasing in of proposed price increases stemming from both changes in the structure of charging and from projected (operating and capital) increases.)

Our company does not support the phasing in of the proposed price increases unless they are uniform and phased in consistently across all airports. We do not believe that a phased in process which will insure that TNC charges at Essendon will be 250% higher than Tullamarine, and Avalon potentially much higher, is acceptable under any circumstances.

Pricing Across Services and User Groups
(The ACCC seeks comment on the appropriate method of achieving Airservices stated aim of avoiding cross subsidies and on the appropriateness of the levels of cross-subsidies between services and user groups.)

The concept of cross-subsidies in the Aviation industry is misguided. Air Traffic Control is in place at all airports to protect airspace issues and the travelling public.

As an example, ATC is used at Essendon Airport to ensure that the travelling public using Tullamarine are protected. If Tullamarine did not exist, there would be no ATC requirement at Essendon.

There is no logic in the view that Essendon Airport users should pay a higher TNC charge as a "user pays" arrangement when, in fact, operators using Tullamarine are receiving a benefit from Essendon's ATC provision. Similarly, the travelling public are also using Essendon Airport's TNC services to ensure that they are protected from airspace incursions.

In our firm view, Essendon Airport has cross-subsidised Tullamarine for many years and this continues under this proposal.

As an example, of the following airports, Essendon does the least amount of traffic, but has the highest amount of ATC hours. It is well known within the industry that Essendon's excessive ATC hours are in place to support Tullamarine's operations.

Essendon Airport has ATC until 10.00pm each night when very few general aviation industry operators are flying. This is clearly a cross-subsidy.

	Aircraft Movements	ATC Hours per Week
Essendon Airport, Melbourne	68,418	108
Bankstown Airport, Sydney	345,268	103
Jandakot Airport, Perth	314,734	80
Moorabbin Airport, Melbourne	253,102	70
Parafield Airport, Adelaide	143,080	50

If Airservices is so user-pays focused, we suggest the ACCC asks them:

> *"why is it that Essendon Airport does only 68,000 movements per year and requires a tower? Point Cook is also close by and does 60,000 movements without a tower. Even Tyabb Airport does 45,000 movements without a tower. This seems inconsistent.*

Can you please explain to the ACCC why the operators into Essendon Airport are so unfairly treated – there are so few movements, but they have to pay for so much ATC?"

If the return answer mentions the provision for service for Tullamarine's air traffic, which it will, this completely discredits their ideology and also supports the basin charge.

Pricing Across Services and User Groups
(The ACCC seeks comment on:

- *Whether the proposed prices provide appropriate incentives for Airservices to provide services at particular locations.)*

Of course! Location specific monopolistic pricing is greatly advantageous to Airservices.

Airservices simply add their excessive staff salaries and superannuation arrangements with their vast operating costs and divide it by the landed tonnage at an airport and charge accordingly. The airport just has to take it as they have no alternative – and Airservices know it ! Their proposal to increase staff costs by 24.6% and supplier costs by 22.2% in the next five years is clear evidence of this.

Maroochydore Airport's recent charge for ARFFS is an excellent example of this.

- *Whether the proposed prices provide appropriate incentives for users of Airservices services to provide services at particular locations.*

No. Airservices fixation on a misguided no-cross-subsidy ideology will ensure that smaller airports will not be able to compete effectively within the aviation environment.

The situation whereby a government owned monopoly has arrangements in place which support capital city airports at the expense of smaller aerodromes is unfair.

Clearly, this submission indicates that the proposal will encourage users to relocate to Tullamarine at the expenses of Avalon and Essendon Airports.

Another similar example is Brisbane and Maroochydore Airports. By 2008, Airservices will charge an A320 operator $1,724 per landing for Fire Fighting Services at Maroochydore Airport. One hour's drive away is Brisbane Airport. The equivalent charge for the same service will be $135 per landing. In other words, the charge at Maroochydore for the same service will be 1,277% higher. Over time, this will diminish demand at Maroochydore as the operator will select the cheaper service. Unfortunately, there are also similar disparities between Brisbane and Maroochydore's TNC charges.

The ACCC seeks comments on the likely impact of the proposed prices on the users of airports and air traffic control services. In particular, the ACCC seeks comment on:

- *The demand for air travel*

We believe that the medium term ramifications of this proposal will ensure that Airservices charges at Essendon and Avalon Airports return Tullamarine Airport into a monopoly.
This will not be advantageous for the travelling public in the longer term.

- *Airline Scheduling decisions*

We have no view on this matter, other than to say airlines schedule operations into airports that offer the lowest cost structure. Clearly, this proposal does not encourage that.

- *Providers of other aviation services*

We have no view on this matter.

- *Airfares*

Further to our comments above, this proposal is anti-competitive for smaller airports. It will strengthen the major airport operators in the longer term and enable them to increase charges.

Also, we do not understand page 32 of Airservices' document. The table on that page states that the proposed charges will increase ticket prices at Essendon by $0.81 cents. We are unsure how that is calculated.

In fact, many airports in that table do not undertake RPT activity. To state that the proposal will increase ticket prices by these small amounts is misleading the ACCC.

We trust this advice clarifies our position in relation to this matter.

Our company cannot over-emphasise that if the proposed charging regime becomes the settled view, then it is likely that Essendon Airport's operations would be adversely effected, and severe complications would arise with our Avalon Airport activities.

This in turn would affect thousands of people drawing their livelihood from these endeavours and simply result in creating monopolistic conditions at a handful of airports in Australia.

Therefore we cannot afford to view this matter with indifference.

Even the present state of indecision and Airservices misguided process of developing this proposal has weakened the industry's confidence. So we trust that this letter, and our recommendations, assist your deliberations in relation to this matter, in the hope that a fairer price regime can be implemented.

We would also request that we be heard in person to express our view and will make contact with your office in the coming weeks.

Yours sincerely

Tim Anderson
General Manager
Avalon Airport Australia Pty Ltd
Essendon Airport Pty Ltd