



ROYAL FLYING DOCTOR SERVICE
OF AUSTRALIA

RFDS Western Operations

ABN 29 067 077 696

Corporate Office

SUBMISSION TO ACCC ON AIRSERVICES AUSTRALIA PRICING PROPOSAL

EXECUTIVE SUMMARY

RFDS Western Operations is a non-profit organisation dependent upon funding from the State and Commonwealth Governments and community support. The increase in Terminal Navigation charges proposed for aviation operators at Jandakot will have serious ramifications for our operations and for all operators at Jandakot.

The level of increases in Terminal Navigation charges is disproportionate to other aviation charges and CPI and does not reflect the value of the service to the operator.

Introduction of the 'basin' approach to pricing has merit but it has not been appropriately applied in the Airservices' Pricing Proposal, producing inconsistent rates within the assigned basin with a clear bias towards the larger players in the industry.

The Airservices' Pricing Proposal is not at all consistent with a "user pays" principle given the massive level of cross-subsidisation that will result in favour of the Flying Training organisations at smaller airports like Jandakot. This cross-subsidy was in the past borne by the whole industry not by those smaller participants least able to pay.

If the pricing model proposed is implemented RFDS Western Operations will suffer ongoing cost overruns which are most likely to be borne by our major funding providers the Commonwealth of Australia and the Health Department of WA. Alternatively the existing service will be downgraded to fit the level of funding available which will have serious ramifications within the already burdened health system.

RFDS Western Operations recommends further consideration of other pricing structures including a network-wide charge or a staggered range of prices applied according to set thresholds of Tonnes Landed, as is applied to En Route charges and postage stamps. If the proposed model of pricing is the only option, we request reinstatement of the location specific subsidy in support of regional airports and General Aviation operators.

If you wish to discuss our submission or have any queries, please contact the following:

Liane Papaelias
Director of Corporate Services
Phone: 9417 6300
Email: liane.papaelias@rfdswestops.com.au

Stephen Lansell
Manager of Aviation and Communications
Phone: 9417 6300
Email: stephen.lansell@rfdswestops.com.au

CONSULTATION PROCESS

Effectiveness of Airservices' consultation processes in its development of the draft price notification and the extent to which the proposal is supported by you or your organisation.

Airservices consultation process did not include representatives from General Aviation, The Royal Flying Doctor Service or any other minority member of the aviation industry from the commencement of the process. The first meeting minuted is 27th August 2003 and the participants outside Airservices Australia included Qantas, Virgin Blue, Singapore Airlines, IATA and the ACCC.

Consultation with General Aviation began on receipt of notification of the Pricing Proposal, a day before the first meeting on 14th July. The letter was dated 30 June 2004 and was sent to our accounts office and a number of our regional bases instead of being addressed to our Chief Executive Officer. The original intended deadline for submissions of 30th June 2004 was extended to some time in July and we were able to forward our submission by 14th July. It should be noted that this was a submission for a price change that was theoretically to apply from 1 July 2004.

The deadline for introduction of the price change was moved out to October and the outcome of the submissions was a reduction in the proposed level of pricing. However, introduction of the price increase from 1 October allows little time for any business to adjust their budgets and to seek additional funding or revenue to cover that cost.

The proposal presented by Airservices Australia is not supported by RFDS Western Operations in its present form. Absence of smaller operators from the initial consultation phase, followed by brief consultation phases in the last three months does little to enhance the relationship that Airservices may wish to have with General Aviation participants. It would also appear that the larger players in the industry have dominated the consultation process.

RISK SHARING ARRANGEMENTS

The appropriateness of the risk sharing arrangements embodied in the proposal, in particular relating to the activity trigger mechanism, the approach taken to changes in Airservices' capital expenditure program and changes in regulation.

Market risk does not affect RFDS Western Operations directly due to the funding models used by the State and Commonwealth Government to support the Service.

But the risk of cost over-runs has an ongoing effect on RFDS Western Operations and its supporters. Each of the mechanisms considered would have an impact on the costs for RFDS Western Operations with little opportunity for cost control due to the nature of the service provided. The use of passenger numbers as a mechanism may provide some additional incentive for multiple evacuations, but this incentive already exists with fuel and other aviation costs.

For En Route charges there are different rates applied for aircraft under 20 Tonnes and aircraft over 20 Tonnes. The calculation of charges is not applied consistently between the two categories placing a greater burden on the lighter aircraft.

The approach taken to changes in Airservices' capital expenditure program appears to include a long term planning approach and includes an element of consultation and review. This approach should minimise risk with regard to cost over-runs and technology.

RFDS Western Operations is affected by the regulatory environments of both the Health and Aviation industries. Changes are often immediate and require a rapid response. The Airservices pricing proposal does little to affect this situation, nor does it contribute to an improvement.

OPERATING COSTS

The efficiency with which Airservices provides its services including the level of operating costs reflected in Airservices' proposal.

In an overall sense, we believe that the services are efficiently provided. The level of operating costs for Jandakot Airport increase at a rate that outstrips the projected activity and CPI index projections.

We note that there is a significant increase in costs projected for 2004/2005 and this is justified by the addition of new and upgraded services and increased depreciation arising from the revaluation of assets. There seems to be no acknowledgement of efficiencies arising from new investments such as the implementation of ADS-B technology.

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

Airservices continues to be a monopoly service provider with little incentive to improve productivity or cost restraint. The efficiencies derived from proposed capital projects do not appear to be built into projected operating costs.

CAPITAL EXPENDITURE

Appropriateness of the capital projects included within the proposal

The proposed level of future investment in Control Tower facilities at Jandakot and Perth Airport would appear to be reasonable. Once ADS-B is fully implemented, there should be a significant reduction in the number of Air Traffic Controllers required for enroute services. As a result of ADS-B, aircraft will be easily able to self-separate and the workload of the remaining controllers will be much reduced as they will be able to apply radar separation standards rather than the current procedural standards that apply over much of Australia. We would therefore expect to see a significant reduction in the cost of providing enroute ATC which is not currently reflected in the pricing projections.

Tower services, such as those provided by Jandakot Airport, which rely on controllers actually seeing aircraft are not slated for major development within this proposal.

We note that some of the capital projects planned appear to be outdated in terms of the technology available. For example the HF Network and the Navaid Replacement Program.

The level of the estimated costs of the capital expenditure proposed

We have no comment on the level of estimated costs of proposed capital expenditure, but we do question whether the intended efficiency resulting from planned capital projects has been reflected in operating costs.

The approach taken to determine the capital expenditure program over the period covered by the pricing proposal.

The approach taken to changes in Airservices' capital expenditure program appears to include a long term strategic planning approach and includes an element of consultation and review.

ASSET BASE

The efficiency of Airservices' asset base.

RFDS Western Operations has no comment to make about the efficiency of Airservices' asset base.

The appropriateness of Airservices' new values for its asset base

Airservices' asset values comprise a reversal of a write down in 1999 of almost \$100m to reduce the value of assets at loss making locations to zero in accordance with accounting standards. We question the validity of reversing a write-down of five years ago which at the time fulfilled accounting standards and anticipated redundancy. It is unclear what circumstances could now have led to the stated regeneration of positive financial returns from these assets.

The impact is a higher depreciation cost and a higher rate of return which is built into the pricing model inflating the price increases beyond CPI.

The appropriateness of revaluing assets which previously had a zero written down book value.

We consider it inappropriate to revalue assets on the basis of a reversal of a decision taken five years ago, particularly when you consider that much of the equipment and investments made in this industry can so rapidly become obsolete due to technological innovation.

As the asset value forms the basis of the return on capital and depreciation costs, both built into the pricing model, it could be argued that the revaluation has served as a mechanism to inflate the target revenue sought from the industry and forming the basis of increased prices.

RATE OF RETURN

RFDS Western Operations has no comment to make on the rate of return within the Airservices Australia pricing proposal.

ACTIVITY FORECASTS

The reasonableness of Airservices' activity estimates.

Airservices' activity estimates for General Aviation Airports sit at between 1.0% and 2.0% which is relatively low when compared to growth rates of up to 5.6% for other airports. Activity for the Royal Flying Doctor Service as an emergency aero-medical service provider is dictated by population and need. There is no alternative in the short to medium term to us continuing to operate out of Jandakot at whatever level is dictated to by the demand for our service. For the financial year to 30 June 2005 we estimate a 4% increase in activity for RFDS Western Operations based on trends over the past 6 years.

However, if the price increase proposed for Jandakot Airport proceeds, the overall forecasted activity volumes have the potential to decline as General Aviation operators based at Jandakot either move to alternative airports where the fees are similar to those currently charged (eg. Perth Airport) or non-existent, scale down their activity or close their business due to unavailability. The same is likely to occur at all other Capital City Secondary airports and the regional airports facing similar increases together with RFFS price hikes.

COST ALLOCATION

The appropriateness of the proposed method of cost allocation.

Allocation of distributed costs is based on the chargeable units underpinning the service (ie tonnes landed). This method of allocation would be acceptable if it were applied consistently. But the Enroute charges policy places a greater burden on the low capacity aircraft since the charge up to 20 tonnes landed is proportional to the weight of the aircraft, whereas for aircraft over 20 tonnes landed it is proportional to the square root of the weight of the aircraft.

The Research and development overhead component almost entirely relates to the development of En Route services (GNSS, ADS-B and ATM) therefore should be allocated to this area solely, not spread across the services.

BASIN APPROACH TO TERMINAL NAVIGATION CHARGES

The appropriateness and efficiency of the application of a capital city 'basin approach to charging for terminal navigation services.

Airservices Australia has presented the 'basin' approach as a means of spreading the cost of airports co-located within the major capital city 'basins'. However, in its current application within the pricing proposal this does not appear to have occurred.

Airservices Australia has applied the 'basin' approach using a targeted level of revenue for each metropolitan city basin as a whole in lieu of individual airport targets, however this same methodology has not been applied in the distribution of costs or even in the setting of rates.

There appears to be no correlation in the price between airports in the same basin. The same national charge for Terminal Navigation appears to apply to all General Aviation airports. For the Perth Metropolitan area, the prices set for Perth Airport rise 15.2% in 2004/2005 and then remain fixed. In contrast, prices for Terminal Navigation charges at Jandakot increase by 16.8% in 2004/2005 and continue to increase at the rate of 10% each year for the period projected. Consequently, for the Perth Basin, Jandakot Airport has been penalised with higher and rising charges for Terminal Navigation than Perth Airport to achieve a pooled level of revenue for the Basin.

If the 'basin' charging mechanism is appropriate from 2004/2005, it should apply in future years. In our view the charges for the airports in the 'basin' should continue to be supported by the Capital City primary airports at the same rate.

The assessment of location specific pricing and terminal charges is questionable. In the Perth metropolitan area for example, it appears that the Perth Airport terminal charge includes the cost of staffing for the Terminal Control Unit (TCU). The TCU provides an approach control service to all airports in the Perth area including the military, not just Perth Airport itself and should not be described as a cost that is location specific.

This is just one cost that would be more appropriately applied network wide, in the same way as En Route charges. If this cost was more appropriately assigned to En Route charges, the En Route Charge "surplus" would disappear.

In our view the 'basin' approach has been inappropriately and inconsistently applied, penalising GA airports in favour of Capital City airports and the larger airlines.

TIMING OF PRICE INCREASES

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

Airservices Australia stated within its proposal that initial notifications were sent to General Aviation operators on 31 May 2004. However, the first notification of these proposals to this office was dated 30th June 2004 for a price increase that was proposed to take effect from 1 July 2004.

There was insufficient notification for a proposed price increase and to support a full consultation process. Even now we are looking at an increase that is proposed to take effect in October 2004 and is only now (in September) being fully addressed. None of the information received to date has allowed proper planning for the change for our operations or for discussion with the State and Commonwealth Governments as funding providers.

Any price increase of this magnitude should be properly planned, finalised and notified with sufficient time to alter budgets, formulate new pricing schedules and to advise stakeholders.

PRICING ACROSS SERVICES AND USER GROUPS

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 between user groups contained in the pricing proposal.

The current and proposed Airservices pricing policy contains numerous inequities and in some cases creates additional cross subsidies.

The proposed Terminal Navigation charges represent a massive cross-subsidy to the Flying Training element operating at Jandakot. Currently these operators only pay for one landing during a circuit training session when typically 6 landings may take place. Under the current charging arrangements, this cross-subsidy is shared across the majority of the industry. This is seen as much more equitable as all elements of the industry make use sooner or later of the pilots trained by the Flying Schools. It should be noted that aviation education currently does not receive any direct education subsidies unlike most other areas of vocational training.

Recognition should be given to the cost of training pilots which predominantly occurs at the smaller airports like Jandakot. The Royal Flying Doctor Service does not have the capability to train its own pilots and commercial training colleges have indicated their concerns about viability if this pricing proposal proceeds.

En Route charges are applied inconsistently according to the weight as described under "Cost Allocation".

The objective of removing cross-subsidy is at odds with the nature of services provided by Airservices Australia which in the main are not location specific and which represent the provision of infrastructure and control by Government. The activity of Airservices Australia has been likened by many to the service provided by Australia Post in that a consistent flat rate is applied to a postage stamp without regard to the distance it travels within the country or the destination. In the US Terminal Control Tower charges are paid for by taxpayer on the basis of an airspace model which is now being proposed for Australia.

Whether the proposed prices provide appropriate incentives for Airservices to provide services at particular locations

RFDS Western Operations has no comment as to whether the proposed prices provide appropriate incentives for Airservices to provide services at particular locations.

IMPACT ON USERS

The likely impact on:

- *Demand for air travel*
- *Airline Scheduling decisions*
- *Providers of other aviation services*
- *Airfares*

RFDS Western Operations provides primary medical evacuations and inter-hospital transfers of patients throughout the State. The vast majority of cases are retrieved from regional and remote areas of the State to Perth metropolitan hospitals and consequently most of our flights land at Jandakot Airport. The proposed pricing therefore is further disadvantaging the people living in these areas.

If the Government is unable to increase funding to meet costs to a sufficient level, the Royal Flying Doctor Service in this State will be required to consider downgrading the level of service. This could lead to the closure of bases, diverting less critical patients to Perth Airport where there are no medical support facilities, limiting the number of cases that we respond to or a lengthening of response times. If patient transfers are declined, the patients will still need to be transported to Perth typically by road ambulance at significant additional discomfort and risk to the patient and also to the detriment of road ambulance services available to the rest of the community.

The increase from current charges is significant and will impose a higher level of costs across all our activities. For RFDS Western Operations, the increase in Terminal Navigation charges is estimated to add approximately \$203,000 over the five year period derived from a 71% increase in the rate. The longer term position has not yet been outlined. Coupled with the loss of the En Route Charge Subsidy this creates a significant gap in our funding.

RFDS does not charge patients for the service provided other than for Motor Vehicle and Workers Compensation victims which represent less than 5% of the patients transferred. There is no avenue available therefore to recover costs directly. Any increase in Terminal Navigation charges will increase our demand for funding from Government agencies as well as supportive volunteers and will create a further drain on resources for health.

The proposed pricing increases, without subsidy, penalise small to medium sized aviation businesses on the basis of Tonnes Landed. Most smaller operators maintain aircraft fleet of 5.7 tonnes or lighter and as a consequence of the level of traffic and the lower weight of aircraft each operator is hit with a much higher charge despite the dollar value of operating costs being comparatively low.

In the past this has been alleviated by standardised pricing and the subsidy provided by the Commonwealth Government, but the removal of this subsidy will create an unfair burden on those participants in the aviation industry least able to meet the full cost.

If other operators move from Jandakot, many of the firms providing support services would also consider such a move. If we were to stay at Jandakot Airport our operations would be severely compromised by the resulting lack of support services and infrastructure.