

Airservices Australia price notification 2011

Additional information request no. 2

Note: Airservices' responses to the following questions will be treated as non-confidential and may be made publicly available by the ACCC unless specifically marked as confidential.

1. Activity forecasts

Airservices' draft price notification states that 'working from an aggregate level of growth that is linked to national economic growth, implied location forecasts have been derived ... the detail of Airservices' activity forecasts is set out in the separate report by IATA consulting'.¹

However, comparison of Airservices' activity forecasts in appendix 1 of its draft price notification with IATA's activity forecasts found the following differences:

Table	Year	Airservices	IATA
Major International Enroute Traffic – MTOW growth	2012	5.0%	5.5%
	2013	3.9%	4.4%
8 Major Airports (aggregated) – MTOW growth	2011	4.7%	4.2%
	2012	5.0%	5.4%
	2013	3.2%	3.3%
	2016	3.9%	3.7%
Regional Airports (aggregated) – MTOW growth	2011	7.7%	1.0%
	2012	1.9%	2.5%
	2013	3.4%	4.1%
	2014	3.6%	4.3%
	2015	3.5%	4.3%
Brisbane Airport – MTOW growth	2012	6.0%	6.2%
	2013	3.7%	3.9%
Melbourne Airport – MTOW growth	2012	5.3%	5.6%
	2016	4.5%	3.8%
Perth Airport – MTOW growth	2012	5.7%	5.9%
	2013	4.2%	4.4%
Sydney Airport – MTOW growth	2012	4.5%	5.1%

Note: Airservices has previously advised that its current internal forecasts for Cairns and Gold Coast airports for 2010-11 are materially higher than IATA's and have therefore not been included in this table..

Further, Airservices' draft price notification and supporting information does not provide details on how the activity forecasts are then used to calculate location and service specific activity forecasts.

- Can Airservices provide reasons for the adjustments made to IATA's activity forecasts for its draft price notification that resulted in the differences identified in the table above?
- To what extent do Airservices' adjustments to the IATA's activity forecasts affect the level of prices and revenue received by Airservices?
- Has Airservices consulted on its own activity forecasts with key stakeholders?

¹ Airservices Australia, *Draft price proposal*, March 2011, p. 13.

- How does Airservices use the activity forecasts used to calculate location and service specific activity forecasts?
- Airservices' financial model links through to an excel spreadsheet titled 'Activity Workings'. Can Airservices provide this excel spreadsheet to show how the location and service specific activity forecasts are calculated?

A full reconciliation comparing airways activity levels reported in IATA's review to activity levels supplied in Airservices Draft Price Notification has been attached (see attachment 1).

The following summarises the adjustments that were made to the IATA report:

A380 weight capping – adjustments were made to reduce the level of activity relating to A380 aircraft due to a reduction in the chargeable weight from 570 tonnes to 500 tonnes. This affected International enroute traffic and major airport traffic where A380 aircraft operate.

Secondary Capital City and RAAF airports – Regional airport traffic levels were adjusted to include secondary capital city ports and military ports that were not taken into account in IATA's review. These airports included, Archerfield, Bankstown, Camden, Essendon, Jandakot, Moorabbin, Parafield, Darwin and Townsville.

High growth airports – to address feedback received through consultation Airservices revised traffic forecasts for Cairns and Gold Coast airports.

2. Building block model

2.1 Operating costs

In the draft price notification, Airservices states that increases in staff costs are partly attributable to training new recruits to replace a rapidly ageing workforce.²

- Can Airservices provide further explanation of the timing of the replacement of the ageing workforce? For example, over what length of time is it expected that the ageing workforce will be replaced?
- Further, can Airservices provide an explanation of the extent to which the replacement of the ageing workforce may affect the level of operating costs over the next five years compared to future periods? For example, are operating costs higher than normal over the next five years? How has Airservices considered this in its long term pricing plan?

A copy of Airservices current workforce plan has been attached (see attachment 2). This outlines the profile of retirements over the next four years for Airservices major Groups.

The major unknown factor affecting the rate of replacement is the actual retirement profile of ATC staff. The assumption in the workforce plan is that ATCs will retire at the age of 60 generating a projected turnover rate of 59 to 79 ATC staff per annum.

To replace these staff, the number of trainees in the academy has increased in recent years to 100-130 trainees (depending on the timing of training courses

² Airservices Australia, *Draft price notification*, March 2011, p. 29

which typically have 12-24 in an individual course). This additional training load has increased costs in the academy which is likely to be sustained for the foreseeable future, but we have not increased the numbers of operational ATCs. As a consequence, we are bearing some risk that the numbers of ATCs coming out of the college will exceed the retirement rate leading to additional unplanned costs.

In addition, we are still to identify the impact of the ATC Future System Project on the ATC workforce and future recruitment and training plans over the longer term. The introduction of new technologies likely to result in a different mix of skills and capabilities over the medium term which is expected to continue to require training costs to be maintained at current levels over the next 10 years.

The net increase in ATC trainees, along with Technical trainees and additional ARFF training courses has increased operating costs by \$10m per annum compared to the 2004 notification as noted in table 6 of our Draft Notification.

2.2 Efficiency measures

In its final decision on Airservices' 2004-05 long term pricing agreement (LTPA), the ACCC expressed concern with the lack of formal efficiency targets and encouraged Airservices to develop this aspect of its future pricing proposals.

In the draft price notification,³ Airservices refers to price reductions of more than 30 per cent in real terms over the past 15 years, and a reduction in real terms of 8 per cent over the period of the proposal.

- What measures has Airservices taken to bring about those price reductions? Can the price reductions be linked to improvements in efficiency?
- What proportion of the price reductions can be attributed to industry growth and improved productivity of capital assets?
- Can Airservices identify areas in which costs have been (or will be) reduced and the ways in which each of Airservices' stakeholder or user groups have been (or will be) affected by those cost reductions? Can Airservices identify which, if any, stakeholders or user groups, have been the primary beneficiaries of any increases in productivity?

The current draft price notification refers to continuous business improvement and efficiency initiatives⁴ in managing more traffic and improving cost effectiveness, and to whole of business cost reform.⁵

- Can Airservices provide details of these initiatives?

The current draft price notification also notes Airservices' benchmarking activities such as CANSO benchmarking and specific reviews undertaken by or for other ANSPs.⁶

- Can Airservices provide the CANSO benchmarking study to which it refers in its draft price notification? Further, can Airservices provide an outline of the indicators it has used to determine its comparative ANSPs? For example, what factors has Airservices used to determine that Canada, New Zealand and South Africa are its most relevant comparators?

³ Airservices Australia, *Draft price notification*, March 2011, p. 12.

⁴ Airservices Australia, *Draft price notification*, March 2011, p. 33.

⁵ Airservices Australia, *Draft price notification*, March 2011, p. 34.

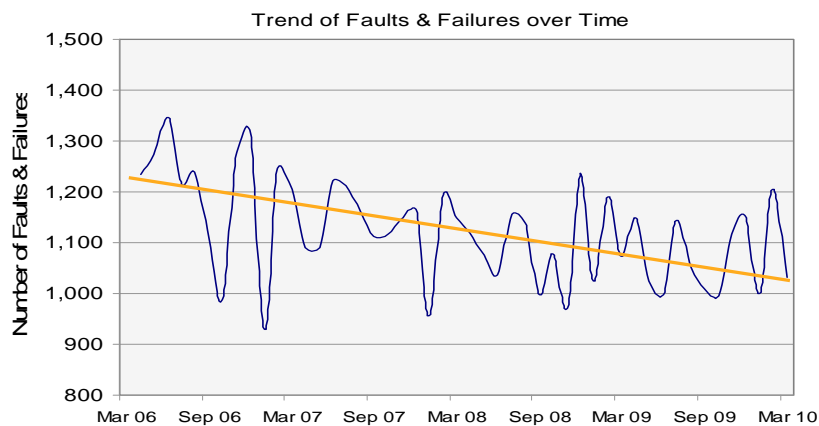
⁶ Airservices Australia, *Draft price notification*, March 2011, p. 35.

Airservices draft pricing proposal provides for real price reductions. This recognises resource efficiency and some improved productivity of capital assets.

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In relation to the impact of new capital assets on productivity, most of the new capital assets are 'enablers' of service delivery, but do not deliver services of themselves. That is, the telecommunications, surveillance, navigation aid and building infrastructure investment have mainly replaced existing end-of-life infrastructure. These have avoided forecast cost increases from higher maintenance and obsolescence that would have occurred if the assets had not been replaced and have provided additional capacity in supporting systems to allow for the higher levels of traffic to be processed more efficiently (eg. increased voice and data transmissions, increased surveillance to improve safety and increase flight operating efficiency).

From a maintenance cost perspective, over the last six years growth in costs for national airways infrastructure repairs and maintenance have averaged 1.6% per annum, representing a real saving of 6.4%. This statistic is despite overall unit growth in airways equipment installations, technologies and services and is evidenced in a downward trend in airways equipment faults and failures over the last 5 years.



Reform to ARFF training has provided savings of 18% in training costs since 2006 and savings in foam usage of nearly 35%, despite the introduction of four new fire services.

With the modernisation of the ARFF vehicle fleet, unit fire vehicle repair costs have remained constant since 2006, providing real savings of 16%.

In international benchmarking studies, overall cost effectiveness for an ANSP is assessed by ATC costs on a per flight hour basis. Based on CANSO studies, internationally Airservices compares well as shown in the table below:

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A copy of the public CANSO Global ANS Performance Report 2010 can be found at the following address:

<http://www.canso.org/cms/streambin.aspx?requestid=7E70A64F-B7BA-40E8-AD9E-A4E896F5E63E>

In making comparisons to international peers, such as Canada, New Zealand and South Africa Airservices takes into account similarities in traffic levels, geography and traffic complexity, as well as its business model, which contrasts to some other ANSP's which are government funded.

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All users operating instrument flight rules (IFR) benefit from the efficiencies we have generated in the enroute environment. Where we have introduced new surveillance and navigational technologies operators have also benefitted, allowing them to operate more safely with more efficient flight paths/trajectories. Upgrades to our ATM platform have also enabled ATC's to dynamically manage airspace according to user demand, allowing more efficient allocation of resources as demand levels change.

2.3 Opening asset base

Airservices has provided a description of how the opening asset base for the current draft price notification has been calculated. However, Airservices has not provided a reconciliation of the opening asset base for the current draft price notification with the closing asset base for 2009 modelled in the 2004-05 LTPA.

- Can Airservices provide an excel spreadsheet showing how the opening asset base for the current draft price notification has been reconciled with the asset base modelled in the 2004-05 LTPA?

LTPA Asset Values movements 2004 - 2011

Regulated Assets (\$mil)	DORC 30/09/2004	Capex 2004 - 2011	Depreciation 2004 - 2011	Writtend Down Value 30/06/2011
Existing Assets as per Hymans Valuation 30/09/04	338			
Capital Expenditure & WIP 2003/04		99	(317)	120
Capital Expenditure 2005 - 2009		567	(145)	422
Capital Expenditure 2010 - 2011		356	(33)	323
Regulated Assets WDV 30/06/2011				865

It is important to note that some of the growth in the asset base, depreciation and the capital program is a result of differing assumptions around DORC valuations that were calculated in 2004 versus actual costs that Airservices have incurred when acquiring assets over the last 5 years.

The below table provides some examples highlighting some difference between the 2004 DORC and the cost incurred when Airservices has gone to market:

Example of Selected Airservices Assets

2004 Asset ORC v Actual Market Tested Asset Values

Description	Original LTP ORC	Original LTP Annual Depreciation	Actual Asset Value after going to Market	Annual Depreciation	Increase in Asset Value (\$)	Increase in Depreciation (\$)
TOWER 1	7,200,000	207,455	15,475,000	773,750	8,275,000	566,295
TOWER 2	7,200,000	206,936	15,475,000	773,750	8,275,000	566,814
SECONDARY RADAR 1	4,000,000	269,949	7,000,000	466,667	3,000,000	196,718
SURFACE MOVEMENT RADAR	1,903,638	126,971	4,309,685	287,312	2,406,047	160,341
FIRE STATION 1	1,900,000	53,846	8,700,000	351,000	6,800,000	297,154
TOWER 3	1,450,000	36,602	15,475,000	773,750	14,025,000	737,148
FIRE VEHICLE	870,000	44,153	1,100,000	76,000	230,000	31,848
COMBINED FIRE STATION & CONTROL TOWER	0	0	13,950,355	964,072	13,950,355	964,072
TOTAL EXAMPLES	24,523,638	945,912	81,485,040	4,466,301	56,961,402	3,520,389

5 YEAR IMPACT (8 Assets only)	(\$)
ADDITIONAL DEPRECIATION RECOVERED	17,601,946
ADDITIONAL RETURN ON ASSETS	24,059,963
ADDITIONAL ALLOWABLE REVENUE	41,661,909

* assumes all assets are commissioned in year 1 of pricing agreement.

2.4 Capital expenditure

Pre-funding

Airservices' response to our first additional information request states that 'the magnitude of pre-funding [is] not material'.⁷ Airservices' capital expenditure pre-funding analysis (based on December 2010) provided in attachment 1 to its response is also noted.

- Has the capital expenditure pre-funding analysis changed since it was undertaken in December 2010?
- Can Airservices explain how the rolling programs noted in the attachment are determined? For example, does CASA or some other regulatory body require Airservices to undertake such programs and stipulate the time period or is this at Airservices' discretion?
- Where Airservices has discretion in determining the rolling program, can Airservices explain the process it undertakes to determine the most appropriate program? For example, does Airservices consider a range of different options and then consult with interested parties on the most appropriate option?
- Can Airservices explain what the 'commissionings' item in the table titled 'Major Capital Expenditure Projects with Pre-Funding' relates to? For example, is this the amount of the project that is no longer pre-funded because it has been completed and is available for use by users? (DN: I think this is pretty obvious and would therefore be happy to delete this question, but have included in draft for completeness)
- How has Airservices accounted for the monetary benefits it receives as a result of pre-funding? For example, how has Airservices recognised the interest received on pre-funding monies held in the bank and/or the reduction in costs (such as interest expense) as a result of pre-funding?

There has been a minor change to the pre-funding analysis with the revision to the capital program. Based on the revised program the ATC Future System project now follows a system upgrade path of continuous commissionings of component parts therefore minimising pre-funding impacts.

The rolling programs excluded from the pre-funding analysis include such things as ongoing modernisation of the fire vehicle fleet and the replacement of aged control towers. Rolling capital programs are established to help smooth cash flows over longer periods of time, to align with average asset lives, where there is no need for a single "platform" type from a maintenance or support perspective. The section below describes CASA's impact on capital expenditure requirements.

Given that the pre-funding impacts are not significant Airservices does not separately account for them. Instead Airservices debt management program is managed at an organisational level and takes into consideration daily working capital requirements and capital investment payments schedules.

⁷ Airservices Australia, *Response to ACCC's questions*, April 2011. p. 4.

Capital expenditure program

Airservices' response to our first additional information request states that 'CASA typically sets out the requirements [for a service] in a number of ways, including outcomes ... and/or prescription in terms of technology, the number of staff required to be on duty while services are provided, the amount of consumables ... to be available etc. The specifics for a service are set out in safety reviews that CASA undertakes'.⁸

However, Airservices has not fully explained the extent to which, following CASA's stipulation, it has discretion in meeting the requirements and, therefore, the extent to which it has discretion over its level of operating costs.

- Using the capital expenditure program provided in confidential appendix 6 of the draft price notification, can Airservices explain which of the projects are prescribed by CASA? To what extent has CASA prescribed the timing and level of expenditure of these projects?
- Where Airservices has discretion in meeting its regulatory requirements, can Airservices explain the process it undertakes to determine how it will do so? Further, how does Airservices go about ensuring that its expenditure is efficient? For example, does Airservices consider a range of different options and then consult with interested parties on the most appropriate option?

The draft price notification,⁹ refers to the ACCC's request for further information on the processes in place for transparency and effectiveness of decision-making for capital expenditure in its final decision on the 2005 LTPA, mentions detailed examples to be provided separately to the ACCC.

- Can Airservices provide the examples referred to in the price notification regarding processes for efficient investment?

The regulatory standards that Airservices Australia must meet are prescribed under Civil Aviation Safety Regulations (CASR) Parts 139H, 171, 172 and 173, and the associated Manual of Standards (MOS). In addition to this Airservices must also meet the requirements of International Civil Aviation Organisation (ICAO) Annex 11, PANS-ATM Doc 4444 Chapter 2 Section 3, which is applicable to Air Traffic Service (ATS) providers.

As a means of ensuring that the services delivered conform to the safety regulatory requirements and standards the Civil Aviation Safety Authority (CASA) requires Airservices Australia to document and maintain a Safety Management System (SMS).

As a requirement of our SMS all changes that have an impact on the safety of the services provided by Airservices Australia require a formal Safety assessment to be completed and approved by the relevant authority(s) prior to any change implementation.

From its overarching governance role CASA certifies all the technology that Airservices employs. In instances where a large component of the capital program is about the replacement of assets which have already been assessed by CASA the timing of rolling and other asset replacements programs is largely at Airservices discretion and is not explicitly prescribed by CASA.

⁸ Airservices Australia, *Response to ACCC's questions*, April 2011, p. 2.

⁹ Airservices Australia, *Draft price notification*, March 2011, p. 12.

In these cases capital expenditure is driven by Airservices asset management plans which take into account asset useful lives, services reliability and operational cost efficiency.

Where expenditure is required to establish new services CASA will stipulate the timing and functional outcomes of key assets (e.g. the amount of foam and water that must be carried/discharged, the introduction of surveillance services), but may not specify the technology required. In other instances CASA may prescribe the type of technology required, e.g. surveillance coverage using radar sensors, where it deems it is essential.

In addition to the safety management process Airservices also applies a standard procurement governance and project management framework to support its capital program. This ensures decision making around value for money, strategic alignment and commercial risk are all addressed. From a consultative and financial accountability perspective the nature and value of the project triggers the level of the decision making authority and approval processes required.

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3. Financial model (excel spreadsheets)

Note: It would be appreciated if Airservices could provide us with the excel spreadsheets mentioned below by COB Monday 2 May so that we can consider and discuss them prior to the site visit scheduled for Thursday 5 May.

Airservices' response to our first additional information request states that 'the financial model previously provided to the ACCC links through to 6 spreadsheets ... A copy of the two main working spreadsheets which drive the model have been attached ... it would be worthwhile for us to sit down with [the ACCC] to walk through each spreadsheet'.¹⁰

However, the additional spreadsheets provided link through to other spreadsheets and, therefore, calculations are not internally resolved.

- Firstly, we would like to take up the opportunity for Airservices to walk through each spreadsheet. We would like to discuss this as soon as possible (i.e. prior to the site visit in May).
- It is noted that the additional spreadsheets provided by Airservices link through to other spreadsheets. This makes it difficult to trace the calculations and follow Airservices' methodology. Can Airservices provide those additional spreadsheets?
- What is the rationale for a significant over-recovery of total revenue planned for the first period (i.e. \$14.6 million) with an under-recovery planned for subsequent periods?
- Can Airservices provide an explanation as to why staff & supplier costs outlined in table 5 (p. 29) of its draft price notification are different to those in the 'SL Summary' of its financial model?
- To assist in understanding Airservices' calculations for depreciation of its assets for the regulatory asset base, can Airservices provide details of the standard economic life and remaining life of its assets?

¹⁰ Airservices Australia, *Response to ACCC's questions*, April 2011. p. 4

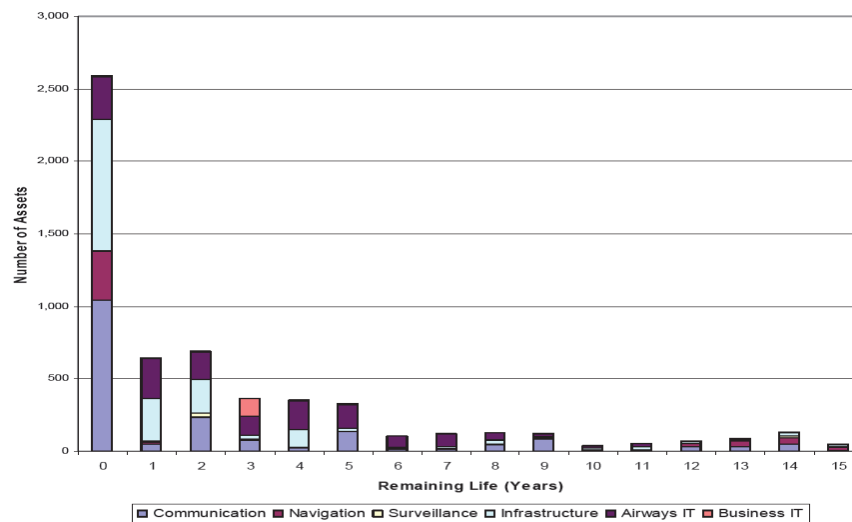
- Further, can Airservices provide details of the standard life and remaining life of its assets for tax purposes?

Airservices pricing proposal endeavours to follow a single direction pricing path that achieves full service cost recovery by the end of year 5, 2016. This pricing principle avoids unwanted see-sawing prices and spikes that would otherwise occur if prices were completely re-calibrated in year one to wash out differences in costs and traffic volumes that have arisen since 2004 LTPA forecast were established.

The staff costs detailed in the financial model only relate to operational staff (i.e. ATC and Fire Fighters). This compares to the staff costs quoted in the Draft Notification which captures all staffing related costs across the business, both operational and non-operational.

Attachment 5 details the standard lives it applies to its assets for both accounting and taxation purposes. The chart below plots the remaining lives of technical assets across the business at the end of 2009. This shows a high concentration of assets approaching end of life. If further detail is required on each of the asset groups, individual asset management plans can be provided.

Technical Asset Remaining Lives (FY 2009)



4. Pricing and structure of prices

4.1 Basin approach to terminal navigation charges

In its 2004 preliminary decision the ACCC stated that it saw merit in the basin pricing concept to the extent that it takes account of shared resources and interdependencies of the basin airports. However, the ACCC was not able to assess the extent to which the application of the basin concept accurately took those factors into account.

We note that the prices for TN services at the secondary basin airports are set at the capped TN prices, which are also applicable to some regional airports. However, we are interested in the magnitude of the positive externalities that secondary airports confer on primary airports, and how this compares with the price differentials based on the TN capped rates.

Can Airservices estimate the net financial benefits to the users of basin airports (that is, the primary and secondary airports in each basin) that can be attributed to their close location, which may take into account:

- the estimated cost savings to users of primary airports that can be attributed to reduced congestion (notionally, that is, in the absence of the priority sequencing programs), based on the level of activity that would otherwise utilise the primary airport
- the extent to which resources are shared and the method of cost allocation of those resources. To provide context: in its preliminary view of Airservices' 2004-05 LTPA (p. 83), the ACCC considered Airservices' method of cost allocation for shared resources was broadly reflective of the use of their use, subject to qualifications regarding the actual usage of equipment
- the costs of ATC coordination in the basins
- any other relevant factor that confers costs or benefits on basin airport users as a result of their close location.

To be provided.