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Monday, November 29, 2004

Ms Margaret Arblaster
General Manager – Transport & Prices Oversight
Australian Competition & Consumer Commission
GPO Box 520J
Melbourne Vic 3001

Dear Ms Arblaster,

ACCC PRELIMINARY VIEW - AIRSERVICES AUSTRALIA LONG TERM PRICING
PROPOSAL

We refer to your email of 5 November 2004 enclosing the ACCC's Preliminary View Issues paper regarding Airservices Australia's (AsA's) proposed 5-year price plan for Aviation Rescue Fire Fighting (ARFF) and Air Traffic Control (ATC) services and thank you for the opportunity to respond.

It is noted that the ACCC has agreed 'in principal' with AsA's pricing model for Terminal Navigation and consequently our response will be limited to concerns with AsA's proposed pricing model for Airport Rescue Fire Fighting (ARFF) services, focusing on the three (3) issues of most concern to Council:

- Activity Forecasts
- Pricing Review
- Australian Defence Force (ADF) activity cost recovery

Activity Forecasts

We refer to the ACCC's comments on page 66 of your Preliminary View paper, which stated "*Rockhampton CC submitted that from the information provided in the ATC and ARFF profit and loss statements, it is clear that Airservices' figures for tonnes landed at Rockhampton airport understate the airport management's figures. However, it noted that a portion of this can be explained through the hours of operation of ARFF and ATC. It also noted that Airservices' growth estimates are directly related to the per-tonne charge for its services and therefore, it is critical that these figures are as realistic as possible.*"

The accuracy of AsA's activity forecasts for our airport is a very important issue for Rockhampton Airport. The figures determine AsA's revenue for the ARFF service and as a result, directly control the ARFF per-tonne landing charge at our airport. Rockhampton Airport Management regularly calculates and reviews these figures and we believe that AsA has substantially underestimated the traffic levels at our airport.

Landed tonnes for the month of October 2004 were 19,289 tonnes. Based on this figure we would expect annual landed tonnes to be approximately 230,000.

This estimate is in stark contrast with AsA's forecast of 163,000 tonnes for the financial year 2004/05, a differential of 67,000 tonnes or approximately \$750,000 (i.e. 67,000 x \$11.20 per tonne) in income for the ARFF service.

The abovementioned figures do not reflect new services that commenced in November 2004; including an additional daily Virgin Blue 737-700/800¹ service and two (2) additional QantasLink Dash-8-300 services. These three (3) new services will provide an additional 39,000 to 43,000² tonnes per annum or an additional \$436,000 to \$482,000 in revenue for the Rockhampton ARFF service.

Taking into consideration the new services and the current tonnage differential between AsA's figures and Council's, we estimate that AsA's ARFF service will exceed their budgeted income by \$1.1M.

An increase in income of this magnitude (approximately 60%) should allow AsA to reduce its ARFF charges by approximately 35% or \$4.00 per landed tonne without any change in budgeted operating profit.

Pricing Review

In its Draft Price Notification to the ACCC (dated August 2004), AsA stated *"If activity levels fall or rise by 10% or more within a 60 day period, and/or are forecast to trend 5% above or below the forecast quantitative levels in a financial year, the parties will consider the implications and determine the most appropriate means of addressing the situation. Potential courses of action could include agreement to change cost levels via a change in service levels, a re-scheduling of capital expenditure or to seek a price variation through the normal price notification process."*

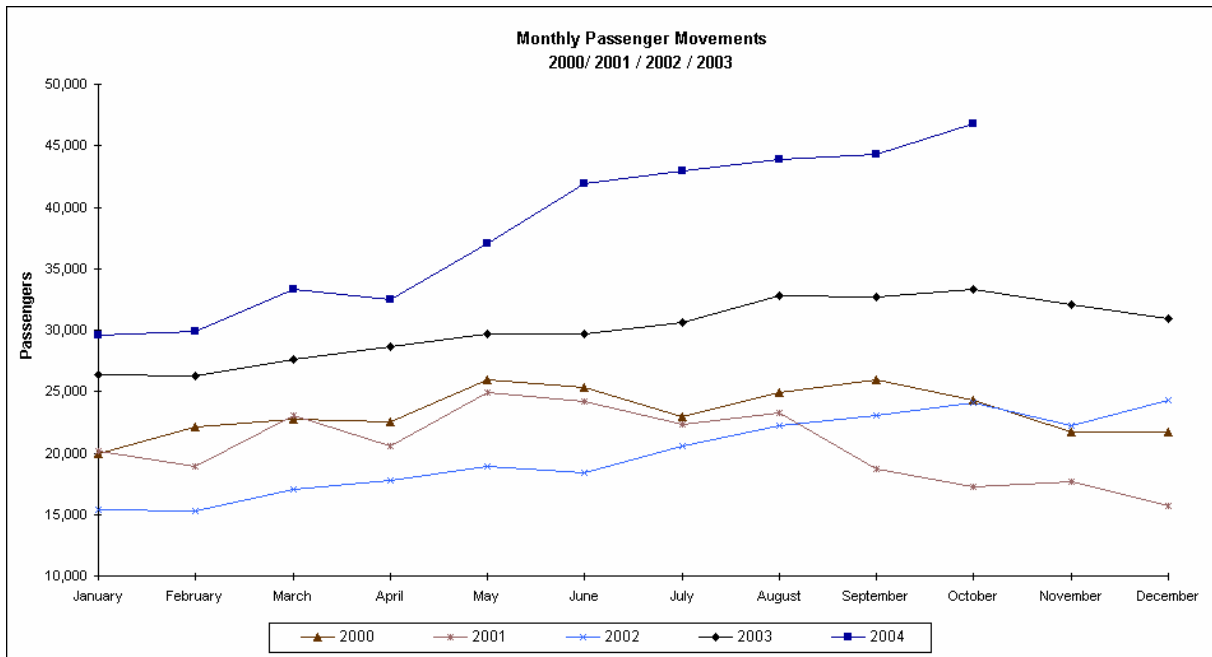
Our primary concern with this issue is the cumbersome and inconsistent review mechanism for issues raised in relation to AsA's projected landed tonne figures.

Our understanding of AsA's review of traffic forecasts and hence prices is that it will not apply to individual airports, rather AsA will only consider the total traffic activity for the whole of AsA's network. It is incomprehensible that the Location Specific Pricing (LSP) model is applied to regional airport services but the review mechanism for these prices is applied to AsA's total network traffic.

¹ Virgin Blue regularly interchanges these two aircraft types for operations at Rockhampton Airport depending on demand and availability.

² Note; the B737-700 weights approx 70 tonnes & B737-800 weights approx 80 tonnes, therefore the ARFF landing fee will vary according to the proportion of aircraft types actually landed.

In an effort to grow our RPT business, Rockhampton Airport has made a significant investment in the development of partnerships with airlines operating at our airport. Figure 1 clearly shows the strong passenger growth that these arrangements have provided. It is extremely unfair that as a result of our focus on growth, AsA (a Government mandated monopoly service provider) will derive a substantial increase in revenue but at the same time not consider a review of its charges.



In our opinion an urgent review of the Activity Forecast for Rockhampton Airport is required. Should it be found that AsA's figures were based on out of date or incorrect data, Council respectively requests an immediate review of the ARFF charges for Rockhampton Airport. We also believe that any Activity Forecast review performed by AsA be carried out on a location specific basis.

Australian Defence Force (ADF) Activity – Cost Recovery

We believe that AsA's inconsistent policy towards cost recovery of its services to the ADF has a significant impact on the income of their ARFF service at Rockhampton Airport. As a result of AsA not recovering the cost of military operations at our airport, it is considered that the ADF is effectively being subsidised by our domestic operations.

Based on historical movement data, we estimate that the domestic 'subsidy' of AsA services at Rockhampton Airport is an annual average of \$240,000 (\$135,000 for ARFF & \$105,000 for ATC). With the introduction of the proposed ARFF charge (\$11.20 per tonne) this will increase to \$280,000 per annum. We contend that this anticompetitive burden on Rockhampton Airport should be removed immediately; either by AsA developing a commercial basis for cost recovery of ADF operations at our airport or the granting of a Community Service Obligation (CSO) to cover the revenue shortfall.

It should be noted that AsA has now developed similar relationships with the ADF; with Townsville's (AsA operated) ARFF service now being provided on a commercial basis to the ADF. At this stage we are unable to identify any impediment to AsA developing a similar commercial relationship for ARFF at Rockhampton Airport.

Summary

Though not a military facility, Rockhampton Airport regularly hosts significant Defence Force exercises. These activities generate a substantial workload for AsA's ATC & ARFF staff. As AsA is currently unwilling to negotiate a commercial agreement for its services with these Forces (like that for AsA's new Townsville ARFF service), our domestic passengers are forced to pay an effective levy of approx \$0.54 per passenger for the privilege of having military operations conducted at our Airport.

AsA's proposed (network based) pricing review model is at odds with the AsA's promoted benefits of LSP over a network based pricing model for its airport services. Under LSP, AsA treats each airport on its commercial merits when setting charges. Ironically AsA now wishes to use a network approach to pricing review, where their (location based) prices will remain fixed for 5 years unless all airports in Australia experience a significant change in activity.

Many regional airports have now embraced new airline operators and worked hard with them to grow their businesses. As a result of this increase in traffic, AsA's location based income receives a significant boost. It is inherently inequitable that AsA sets airport charges on a per-location basis but will not consider a review mechanism that considers individual traffic forecasts and hence per-unit pricing for each airport.

As we are acutely aware of the price elasticity of many of our customers, we have worked very hard to contain and/or reduce our costs to encourage growth (\$4.00 per tonne landing fee – one of the cheapest of all regional airports in Australia). Unfortunately the proposed ATC and ARFF charges combined for our airport total \$19.87 per landed tonne. The result of such a charge structure is a crippling price differential between Rockhampton Airport and all major airports.

Under the current LSP system, regional airports are burdened with highly capital-intensive facilities without the economies of scale available to major airports to recover these costs. In relation to this issue we submit AsA's charter letter³ (written by the current Minister for Transport and Regional Services) that states:

"You will recall from Mr Sharp's charter letter his reference to the importance the Government places on a future for the small businesses dependant on air traffic services, particularly in regional and remote areas. This remains a matter of fundamental significance to me. The Government amended Airservices' legislation in 1998 to reflect it responsibly to promote and foster aviation. I view that part of your legislated responsibility as something which the Board needs to see in the context not just of its major customers, but of the areas of social priority identified by the Government."

³ <http://www.airservicesaustralia.com/profile/annualreports/areport03.pdf>, Appendix 4

It is Council's belief that Rockhampton Airport will be commercially disadvantaged by AsA's current (location based) tonnage pricing methodology. This is compounded by AsA's unwillingness to consider charging for ADF operations at our airport and its incomprehensible traffic forecast review policy.

In an effort to promote tourism growth within the region and for the continued development of Central Queensland, we contend that AsA's charges at Rockhampton Airport can and should be reduced. We urge the ACCC to request AsA to address our abovementioned concerns, prior to considering their proposed ARFF charges.

Yours faithfully

David J Blackwell
General Manager
Rockhampton Airport