



Australian
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Commission

Airservices Australia price notification for a terminal navigation service at Avalon aerodrome

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The ACCC's decision

The ACCC's decision is to *not object* to Airservices Australia's proposed price of \$5.49 (incl. GST) per tonne for a terminal navigation service provided to aircraft landing at Avalon aerodrome.

This decision responds to a proposal from Airservices Australia to commence charging for a terminal navigation service at Avalon aerodrome from 1 February 2010. Under Part VIIA of the *Trade Practices Act 1974* Airservices is required to notify the ACCC of proposed price increases. The ACCC must then assess the proposed price and decide whether or not to object.

This document sets out the reasons for the ACCC's decision.

1 Airservices Australia's proposal

Airservices Australia (Airservices) proposes to commence charging for a terminal navigation service that will apply to aircraft landing at Avalon aerodrome (Avalon) from 1 February 2010 at a price of \$5.49 (incl. GST) per tonne.¹ Airservices' standard terms and conditions will apply for this service. Airservices proposes that unless activity levels change dramatically in the meantime this charge will be fixed until at least June 2011, when Airservices intends to implement a new long-term pricing arrangement that will cover all services.²

Airservices' proposal for the terminal navigation service follows two recent aeronautical studies by the Civil Aviation Safety Authority (CASA) of Avalon in 2008 and 2009 (section 1.1). Both of these studies resulted in CASA determining that Airservices must provide a terminal navigation service at Avalon.

Airservices' proposed price for this service was calculated using the building block model to estimate maximum allowable revenue divided by a chargeable unit (in this case, tonnes landed) activity forecast (section 1.2).

1.1 The requirement for terminal navigation services at Avalon

On 15 May 2008, CASA's Office of Airspace Regulation (OAR) released an aeronautical study of Avalon determining that a Class C airspace—with the associated air traffic control services³—should be activated around Avalon.⁴ As a result of this

¹ The notification is available on the ACCC's website at www.accc.gov.au (For regulated industries > Aviation and airports > Airservices Australia > Price notifications).

² Airservices current long-term pricing arrangement has applied since 2004–05.

³ Air traffic control services include area control service, approach control service and aerodrome control service.

⁴ Office of Airspace Regulation 2008, *Aeronautical study of Avalon*, May 2008.

study, in December 2008, a direction was provided to Airservices to provide a Class C aerodrome control service at Avalon.⁵

On 17 March 2009, Airservices commenced a Class C non-radar aerodrome control and approach control service provided from Avalon Tower. Airservices is currently providing this service at no charge to users. Airservices estimates the costs of providing the service at around \$1.8 million per annum.

In August 2009, the OAR commenced a Post Implementation Review (PIR) of changes to airspace architecture and air traffic services in the vicinity of the Avalon aerodrome. The PIR was completed on 21 December 2009. Significantly, the PIR found that there had been a recent decrease of almost 50 per cent in the number of high capacity aircraft movements at Avalon. Although the OAR estimates that there is likely to be a significant increase in high capacity aircraft movements in 2010–2011, a lower level of activity affects the aerodrome control service level required at Avalon.⁶

Airservices' price notification is based on the OAR's proposal to change the Avalon terminal navigation requirement from Class C to Class D.⁷ CASA is currently consulting industry on this proposal and has requested submissions by 29 January 2010. Stakeholders consulted by the ACCC expect that, as a result of the OAR's proposal, CASA will formally direct Airservices to provide a Class D terminal navigation service at Avalon Airport from 3 June 2010.

In the event CASA was to direct Airservices to provide a higher level of terminal navigation service, the cost to Airservices from providing the service would increase.⁸ The implications for Airservices' price notification would be that the proposed price might not generate revenues sufficient to recover the costs of providing the higher level of service.

⁵ A Class C aerodrome control service requires all aircraft to get airways clearance and to communicate with air traffic control.

⁶ Office of Airspace Regulation 2009, *Post implementation review of Avalon airspace*, December 2009.

⁷ This paper refers generally to the current airspace requirement as Class C and the proposed airspace requirement as Class D. More specifically, each class of requirement comprises two aspects: a volume of airspace extending upwards from ground or water to a specified altitude called a control *zone*, and a volume of airspace extending upwards from a specified altitude is a control *area*. References in this paper to Class C and Class D refer to the control *zones*. In the case of the Avalon proposal, a Class C *zone* is attached to a Class C *area*, and the Class D *zone* has an associated Class E *area*.

⁸ Under a Class C Aerodrome Control service, instrument flight rules (IFR) aircraft are positively separated from both IFR and visual flight rules (VFR) aircraft. VFR aircraft are provided traffic information on other VFR aircraft. In contrast, under a Class D Aerodrome Control service, IFR aircraft are positively separated from other IFR aircraft only, but are provided with traffic information on all VFR aircraft. VFR aircraft are still provided traffic information on other VFR aircraft. Therefore, the level of information, staff required and, thus, cost to Airservices from providing the service is higher for a Class C terminal navigation service.

In contrast, a direction by CASA allowing Airservices to provide a lower level of service would result in Airservices no longer being required to provide a terminal navigation service at Avalon Airport. Given the general view of stakeholders that this outcome is unlikely, the ACCC has assessed Airservices' price notification on the basis that a class of tower navigation service will be required at Avalon.

1.2 Estimates of costs, activity and price

Airservices has provided an estimate of costs based on implementing a Class D terminal navigation service at Avalon airport.

The building block parameters applied by Airservices of weighted average cost of capital, gearing, cost of debt, tax and dividend imputations credits are the same as those endorsed by the ACCC in the 2004 price notification containing long term price paths. Airservices states in this notification that asset values have been estimated based on the approach used in the 2004 price paths, with the addition of relevant actual capital expenditure incurred over the last five years.⁹ Estimated maximum allowable revenue is calculated as the sum of operating costs, depreciation, a return on the value of the assets and taxes.

Airservices' forecast for demand is used to determine a proposed price that is expected to achieve revenue sufficient to recover costs. The activity volume forecast was estimated by Airservices using recent historical data. Activity estimates are based on annualised IFR (Instrument Flight Rules) flight data for the five months ending November 2009 (table 1), adjusted for VFR (Visual Flight Rules) flights (1.6 per cent) and potential growth in 2010–11 (10 per cent over 6 months).

Table 1: Avalon Airport Flight Activity and Tonnes Landed

2009	MTOW Total	Number of flights
July	22 601	325
August	17 672	268
September	22 477	329
October	21 980	309
November	15 922	229
Total (5 months)	100 651	1 460
Annualised activity	240 116	

Note: MTOW (maximum takeoff weight) for December 2009 was 13 074 based on 218 flights.

Source: Attachment A: Avalon Airport Flight Activity and Tonnes Landed, of Airservices' letter to the ACCC dated 11 January 2010.

⁹ The asset values reflect the cost of the project to refurbish the existing tower infrastructure, including the consol and communications equipment.

In 2009–10 for a terminal navigation service at Avalon, Airservices estimates:

- operating and maintenance costs of \$1 161 678
- return on capital of \$103 681
- allowable revenue of \$1 277 620
- activity-tonnes landed of 256 000¹⁰
- price of \$5.49 (GST incl).

A comparison of Avalon with other airports offering a comparable level of service (Class D) is shown in table 2. While the basic tower costs are similar, the extent to which the service provided (for example, hours of coverage), the location (for example, whether staff need to be engaged on a fly-in-fly-out basis) and the asset base (for example, size of the tower or number of navigation aids) can dramatically impact on the cost and, therefore, the price.

Airservices submits that Avalon tower as a Class D tower compares most closely to the Class D towers at Albury and Coffs Harbour where the cost bases are at similar levels.¹¹ The main difference between these services and other Class D towers is the level of infrastructure. Albury and Coffs Harbour have instrument landing systems and surveillance systems such as radar. Also, there is some variation in operational staff numbers where there are different local operating rules in place, which are specific to the complexity of the mix of traffic operations or geography at those locations. However, ultimately the greatest driver of price variation is the number of movements of heavy aircraft.

Table 2: Comparison of Avalon with other services

Terminal Navigation Service	Costs (\$m)	Assets (\$m)	Activity (mil tonnes)	Price (\$)	Revenue (\$m)
Avalon	1.2	1.2	0.3	5.49	1.3
Albury	1.5	0.3	0.1	12.69	0.8
Alice Springs	2.9	1.2	0.3	12.69	2.9
Coffs Harbour	1.6	0.7	0.1	12.69	0.9
Hamilton Island	1.0	0.1	0.1	9.20	1.0
Hobart	2.8	5.1	0.4	9.54	3.4

¹⁰ The forecast tonnage of 256 000 equates to approximately nine A320 arrival landings a day.

¹¹ Airservices Australia, 'Price notification—terminal navigation services at Avalon Airport', letter to the ACCC, 11 January 2010.

Launceston	2.3	1.8	0.2	12.22	2.5
Mackay	2.3	1.7	0.2	12.69	2.2
Maroochydore	2.1	0.6	0.1	12.69	1.7
Rockhampton	2.3	2.3	0.2	12.69	2.1
Tamworth	2.4	1.0	0.1	12.69	0.9

Note: Avalon costs, assets and prices are estimated 2009–10 annual costs. For the other airports, Airservices provided data which it used in its 2004 Price Notification to estimate outcomes for the 2008–09 financial year.

Source: Airservices Australia, *Price Notification — Terminal Navigation services at Avalon*, ‘Table 1: Comparison of Avalon with Other Services’, 21 December 2009.

2 Legislative framework for price notifications

Airservices is a statutory monopoly established under the *Air Services Act 1995* (ASA). It is a commercial authority responsible for a range of functions including safe and environmentally sound air traffic management and related services. It also has a responsibility under the ASA to promote and foster aviation.

Airservices’ three main services are:

- airport rescue and fire-fighting—an emergency service provided at certain airports
- terminal navigation—air traffic control services provided at an airport to aircraft in close proximity to that airport
- en-route navigation—air traffic control services provided to aircraft travelling through Australian air space but not within terminal navigation range.

These services are declared under Declaration no. 66 of the *Prices Surveillance Act 1983* (carried over to have effect under the *Trade Practices Act 1974* (TPA)). The effect of Declaration no. 66 is to require Airservices to notify the ACCC of proposed increases to the prices of these declared services. The ACCC is then responsible for assessing the proposed price increase, and can decide to:

- not object to the notified price increase, or
- not object to an increase lower than that proposed, or
- object to the notified price increase.

Under the provisions of Part VIIA of the TPA, the ACCC has 21 days from receiving a notification to make its decision (the applicable period). Pursuant to section 95ZB(2) of the TPA, the ACCC may, with the consent of the person who gave the price notification, extend the applicable period.

Part VIIA provides that if the ACCC decides to not object to the proposed price increase, Airservices may implement a price up to that which is specified in the notification.

If the ACCC decides to not object to a price that is lower than the proposed price, Airservices may choose to implement the price that the ACCC has nominated. Alternatively, after a period of fourteen days, Airservices is not restricted from implementing its proposed (higher) price.

If Airservices subsequently wishes to implement a price higher than that already notified to the ACCC, it will be required to notify the ACCC anew.

Significantly, the provisions of Part VIIA of the TPA covering price notifications only require Airservices to notify the ACCC of increases in price. The TPA does not place an obligation on Airservices to notify prices that it proposes to decrease.

The statutory criteria for assessing a notification are set out in section 95G(7) of the TPA. In exercising its powers and performing its functions under this Part, the ACCC must have particular regard to the need to:

- maintain investment and employment, including the influence of profitability on investment and employment
- 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
- discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

3 Process of assessment

On 21 December 2009, the ACCC received the price notification from Airservices for the pricing of a terminal navigation service that will apply to aircraft landing at Avalon aerodrome. Airservices chose to submit a formal notification which initially required the ACCC to make its decision within 21 days, with the last day being 11 January 2010.

As 21 days can be insufficient time to publicly consult and scrutinise a price notification, the ACCC would normally expect Airservices to follow an informal process of lodging a draft price notification prior to submitting a formal price notification. Details of this approach are set out in the ACCC's *Statement of regulatory approach to assessing price notifications – June 2009*.

Price notifications can raise complex issues and the ACCC's assessment is assisted by the provision of information by the declared firm at an early stage (and preferably prior to the formal notification being submitted). In the current matter, Airservices only provided information on the day it lodged the notification (21 December 2009) and advised customers of the intended price after notifying the ACCC. Further, consultation

was limited because the timing of the price notification meant this occurred over the Christmas and New Year holiday period.

The ACCC's initial consultation with stakeholders—including users and potential users of Avalon Airport, industry associations, government agencies and other interested parties—revealed a range of views about future activity levels, and about the degree to which they had been consulted by Airservices. Accordingly, the ACCC advised Airservices that it would find it difficult to not object to a proposal on which affected parties have had insufficient opportunity to comment.

On 11 January 2010, Airservices proposed that the period for consideration be extended until the 28 January 2010 to allow interested parties to be appropriately consulted. The ACCC accepted Airservices' proposed extension of time on the basis that additional information was to be provided in order for stakeholders to properly comment on Airservices' demand forecast. This information was provided by Airservices and is also available on the ACCC's website.

The views of stakeholders were taken into account by the ACCC in its consideration of Airservices' price notification.

While the extended time allowed the ACCC to conduct a consultation with stakeholders on Airservices' proposal, it did not involve public submissions as that would not have been practicable within this timeframe.

Further, even with the extended time, a detailed investigation of the costs that Airservices has attributed to Avalon is not practicable. The ACCC has therefore drawn on benchmarks of costs and prices provided by Airservices for other locations, and has noted the use of certain approaches (to estimating weighted average cost of capital for example) which the ACCC has accepted in previous decisions. Using these indicators the ACCC can consider whether there are compelling reasons to find that the proposed price is unreasonable.

4 The ACCC's assessment

The ACCC has responsibility for assessing Airservices' price notification under Division 4 of Part VIIA of the TPA. The ACCC must assess the proposed price and decide whether or not to object.

Airservices is currently subject to a CASA direction to provide a terminal navigation service at Avalon Airport for a Class C terminal navigation service. Airservices estimates that the costs for this level of service are around \$1.8 million per annum. The ACCC's assessment, however, is based on CASA's December 2009 proposal that Airservices provide a Class D service at Avalon from 3 June 2010. In comparison, Airservices estimates that the costs for this level of service are about \$1.3 million per annum.

The ACCC recognises that Airservices will be required to provide a higher level of service (Class C) between 1 February and 3 June 2010 than it is proposing to charge for (Class D). Therefore, Airservices does not propose to recover additional costs incurred during that period.

The ACCC also notes that Airservices has been providing a terminal navigation service, as directed by CASA, at no charge since 17 March 2009. It has been open to Airservices to introduce a charge since that time, but it has chosen not to do so. The price notification does not propose that Airservices recover the costs of operating since March 2009.

The building block methodology applied by Airservices to estimate allowable revenue is consistent with the ACCC's preferred approach. Also, the estimation of Airservices weighted average cost of capital (WACC) is consistent with previous ACCC decisions. Even though those decisions are now somewhat dated, the ACCC expects that a review of Airservices' WACC will form part of a broad-based review of all charges prior to June 2011.

Airservices advises in the notification that, in estimating costs, it has applied the same principles of attribution as were applied in the price notification endorsed by the ACCC in the long-term pricing notification in 2004. The most significant costs for Airservices relate to staffing and the refurbishment of the existing tower, which are largely driven by the level of service that CASA directs Airservices to provide. The limited assessment period provided for did not allow for a detailed investigation of costs attributed to Avalon. However, the ACCC notes Airservices' advice that its cost estimation has followed an approach that ACCC has previously approved. Furthermore, at a broad level, the cost estimation does not appear to be significantly higher than other Class D locations that Airservices regards as comparable. As with the WACC, the ACCC also expects Airservices to revisit the costing of all services prior to June 2011.

Given that there is not currently an opportunity for the ACCC to conduct a full review of costs specific to Avalon, the ACCC has directed its inquiries towards seeking information that would indicate whether the costs and price that Airservices proposed are unreasonable. The ACCC has not identified information that indicates Airservices' estimation of the cost of providing the services at Avalon is unreasonable. This is based on benchmarking of costs and prices against comparable locations and previous ACCC decisions which have involved a detailed investigation of the efficiency of Airservices' costs and prices.

The ACCC has however identified some concerns about the activity volume forecast. Airservices' forecast for demand is used to determine a proposed price that is expected to achieve revenue sufficient to recover costs. In the event that the forecast proves to be too low, the consequent price would be higher than necessary to provide Airservices with a reasonable return and could potentially discourage efficient use of Avalon Airport. Significantly, under Part VIIA of the TPA, Airservices is under no obligation to lower its prices should its demand forecasts turn out to be understated.

4.1 Consultation by Airservices Australia would have better informed the demand forecast

The ACCC acknowledges that forecasting demand can be a complex and difficult exercise. Given that there is currently a single large operator (Jetstar) with low frequencies operating at Avalon Airport, a small change in passenger jet operations can result in a large change in the activity volume. To further complicate matters, a significant increase or decrease in traffic at Avalon could trigger another review of the aerodrome control service level requirements by CASA.

Considering the uncertainty of future demand at Avalon, it is important that the views of the industry (including both current users and potential users) on potential growth in traffic levels are sought. The ACCC is concerned that Airservices did not seek the views of all stakeholders (especially potential future users) on the likely growth in traffic levels. In addition, it would have assisted the ACCC's consultation process if Airservices had included in the public version of its price notification greater detail about the assumptions underlying its demand forecast.

4.2 Stakeholders' views on Airservices' demand forecast

Several industry participants suggested to the ACCC that actual demand for services at Avalon Airport could prove to be significantly above or below Airservices' activity forecast. Some participants observed that both the level and growth rate appear to be too high, based on observations of current schedules and the absence of any announcements about new scheduled services.

Stakeholders also raised concerns about Airservices' assumption that there will be no reduction in demand as a result of the service being provided at a price of \$5.49 per tonne landed, rather than at no charge to users. Stakeholders claimed that such a change would be a relevant consideration (among others) in choosing whether or not to use Avalon Airport. As noted by Airservices, '...Jetstar and Avalon Airport expressed concerns about the viability of services at Avalon if the cost of the Tower Service [estimated to be \$1.8 million at the time] was to be funded from operations at Avalon.'¹²

That said, there were a range of views as to whether the terminal navigation charge would affect demand and, therefore, the appropriate price level. Airservices states that it was difficult to determine whether the new charge—which Airservices estimates to be a small component of the operating costs for a large domestic aircraft operation—could be absorbed by the airlines or added to the fare without impacting demand.¹³

4.3 ACCC's view on Airservices' demand forecast

The ACCC's view is that there is no compelling reason to find that Airservices has not taken a reasonable approach to forecasting activity. This view is based on the ACCC's consultation with stakeholders and a comparison of historical trends.

The accuracy of any forecast is limited by the quality and quantity of information available when the forecast is made. Airservices has based its traffic forecast of activity on an historical five-month average to November 2009 with an allowance for growth. The question therefore is whether the five months of historical data represent the most appropriate basis for forecasting activity for the period from February 2010 until June 2011.

¹² Airservices Australia, 'Further information: price notification for Avalon', letter to the ACCC, 14 January 2010, p. 2.

¹³ *ibid.*

Over the last two years, Jetstar has operated up to 13 landings per day at Avalon. However, Jetstar's operations at Avalon have fallen to 6 landings per day in both November and December 2009. Airservices estimates that if it were to forecast tonnage based on the current Jetstar schedule alone, this would imply annualised tonnage of around 170 000 tonnes—compared to Airservices' current estimate of 256 000 tonnes.¹⁴

This illustrates how the low frequencies operating at Avalon Airport make forecasting problematic. On balance, it is the view of the ACCC that the set of historical values used to form the basis for Airservices' forecast and the assumptions underlying the demand forecast (such as the growth rate) provide an activity forecast that is a more likely outcome than any of the alternatives put to the ACCC.

5 The ACCC's decision

Based on its consultation with stakeholders and its benchmarking of costs and prices, the ACCC has no compelling reason to find Airservices proposed price unreasonable. Therefore, under Part VIIA, the ACCC's decision is to not object to Airservices' proposed price of \$5.49 (incl. GST) per tonne for a terminal navigation service provided to aircraft landing at Avalon aerodrome.

As outlined in the ACCC's *Statement of regulatory approach to assessing price notifications*, in applying the statutory criteria in subsection 95G(7) of the TPA, the ACCC has considered the efficiency of the level of costs claimed, as well as the reasonableness of the rate of return on capital sought. While the extent of the ACCC's investigation has been limited by the short timespan available, the ACCC also notes that the risk that the price would be sustained at a higher level than necessary to provide Airservices with a reasonable return is low for the following reasons.

Although there is considerable uncertainty surrounding future demand at Avalon Airport, Airservices' assumption of around 10 per cent growth on the activity levels experienced in the five months ending November 2009 seems reasonable. The ACCC also considered that Airservices' long-term pricing proposal is due to be submitted to the ACCC in 2010–11 at which time the pricing of services at Avalon will be reviewed again as part of that process.

Further, as suggested by the OAR in its PIR, if there is a significant increase in traffic at Avalon in the future, this could trigger another review of the aerodrome control service level requirements by CASA—the outcome of which would likely increase Airservices' costs of providing the service. Alternatively, if there is a significant decrease in passenger jet activity levels at Avalon, this would likely result in Airservices no longer providing a terminal navigation service at Avalon. Therefore, the risk that Airservices' proposed price would be higher than necessary if demand were to change significantly in the future appears to be low.

Finally, the ACCC, in its consultations with stakeholders was presented with a range of alternative future scenarios, including some that would result in significantly higher

¹⁴ Airservices Australia, 'Price notification—terminal navigation services at Avalon Airport', letter to the ACCC, 11 January 2010, p. 2.

levels of activity than Airservices has forecast in its notification. In response to concerns identified by the ACCC, Airservices has advised that:

given that this is a new service and the price is sensitive to very small volume changes and uncertainty exists on forecast activity as the airport establishes its operation, Airservices will review the price should the activity at the location change dramatically over the next twelve months or if at anytime CASA reviews the airspace classification.

The ACCC's view is that Airservices' statement sufficiently addresses any concerns in respect of the risk of over-recovery if activity were to increase substantially beyond Airservices' forecast levels ahead of Airservices' proposed introduction of new prices in July 2011.