



AIRSERVICES AUSTRALIA

Ms Margaret Arblaster
General Manager-Transport and Prices Oversight
Australian Competition & Consumer Commission
Level 35
360 Elizabeth Street
Melbourne, VIC 3000

Dear Ms Arblaster,

Formal Notification of extension of temporary pricing arrangement

Pursuant to Part VIIA of the Trade Practices Act (TP Act), this notification seeks the endorsement of the Australian Competition and Consumer Commission (Commission) for prices for terminal navigation, aviation rescue and firefighting (ARFF) and en route services as set out in Attachment 1.

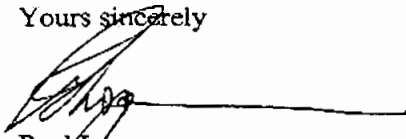
The prices for terminal navigation and enroute services are the same as those set out in the draft price notification, while the prices for ARFF are set at their current levels pending a formal review and consultation process that will determine an appropriate pricing structure for ARFF services. It is expected that this review will take 3 - 4 months to complete and will result in Airservices Australia foregoing some \$8m - \$10m in revenue.

Airservices is pleased that the Commission has recognised its efforts in consulting with industry and resolving what had previously been highly contentious issues. While more consultation is always preferable, we believe that the interests of all sectors of the industry have been identified and debated through this process.

Attached is a response to certain issues that we would like to clarify as a result of the Commission's Preliminary View.

In parallel with this submission, Airservices will advertise contractual amendments in the public notices of newspapers notifying an intention to commence the new pricing arrangement from 1 January 2005. This is not intended to pre-empt the Commission's decision making process, but has been undertaken to mitigate any further revenue losses. Depending on the Commission's final decision, these amendments may be stopped.

Yours sincerely



Paul Logan
Manager Long Term Pricing Project

29 November 2004

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AIRSERVICES AUSTRALIA

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Attachment 1

Proposed Prices for Airways Services

| | Prices (incl GST) | | | | | | Price Change | | | | |
|---------------------------------|-------------------|----------|--------------------------------------|----------|----------|----------|--------------|----------|----------|----------|----------|
| | Current | 1 Jan 05 | 1 Jul 05 | 1 Jul 06 | 1 Jul 07 | 1 Jul 08 | 1 Jan 05 | 1 Jul 05 | 1 Jul 06 | 1 Jul 07 | 1 Jul 08 |
| ARFF** | | | | | | | | | | | |
| Adelaide | \$ 2.69 | \$ 2.69 | | | | | - | | | | |
| Alice Springs | \$ 6.81 | \$ 6.81 | | | | | - | | | | |
| Brisbane | \$ 1.46 | \$ 1.46 | | | | | - | | | | |
| Cairns | \$ 3.83 | \$ 3.83 | | | | | - | | | | |
| Canberra | \$ 3.58 | \$ 3.58 | | | | | - | | | | |
| Coolangatta | \$ 4.24 | \$ 4.24 | | | | | - | | | | |
| Darwin | \$ 7.23 | \$ 7.23 | | | | | - | | | | |
| Hobart | \$ 8.46 | \$ 8.46 | | | | | - | | | | |
| Launceston | \$ 9.30 | \$ 9.30 | | | | | - | | | | |
| Mackay | \$ 9.98 | \$ 9.98 | | | | | - | | | | |
| Melbourne | \$ 1.09 | \$ 1.09 | | | | | - | | | | |
| Perth | \$ 2.40 | \$ 2.40 | | | | | - | | | | |
| Rockhampton | \$ 9.59 | \$ 9.59 | | | | | - | | | | |
| Sydney | \$ 0.69 | \$ 0.69 | | | | | - | | | | |
| Weighted Average ARFF | | | | | | | - | | | | |
| TERMINAL NAVIGATION | | | | | | | | | | | |
| Alice springs | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Hobart | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 9.54 | \$ 9.54 | \$ 9.54 | 16.8% | 10.0% | - | - | - |
| Launceston | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.22 | 16.8% | 10.0% | 10.0% | 10.0% | 5.9% |
| Mackay | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Rockhampton | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Maroochydore | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Coffs Harbour | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Albury | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Tamworth | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Hamilton Island | \$ 5.38 | \$ 6.28 | \$ 6.91 | \$ 7.60 | \$ 8.36 | \$ 9.20 | 16.7% | 10.0% | 10.0% | 10.0% | 10.0% |
| Weighted Average Regional | | | | | | | 16.8% | 10.0% | 7.7% | 7.9% | 7.5% |
| Cairns * | \$ 8.75 | \$ 10.22 | \$ 10.95 | \$ 10.95 | \$ 10.95 | \$ 10.95 | 16.8% | 7.1% | - | - | - |
| Canberra * | \$ 9.50 | \$ 11.10 | \$ 12.21 | \$ 12.66 | \$ 12.66 | \$ 12.66 | 16.8% | 10.0% | 3.7% | - | - |
| Coolangatta * | \$ 9.99 | \$ 10.82 | \$ 10.82 | \$ 10.82 | \$ 10.82 | \$ 10.82 | 8.3% | - | - | - | - |
| Adelaide | \$ 9.74 | \$ 11.38 | \$ 11.43 | \$ 11.43 | \$ 11.43 | \$ 11.43 | 16.8% | 0.4% | - | - | - |
| Parafield (AD Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Brisbane | \$ 4.96 | \$ 5.79 | \$ 5.83 | \$ 5.83 | \$ 5.83 | \$ 5.83 | 16.7% | 0.7% | - | - | - |
| Archerfield (BN Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Melbourne | \$ 3.45 | \$ 4.03 | \$ 4.43 | \$ 4.87 | \$ 5.06 | \$ 5.06 | 16.8% | 9.9% | 9.9% | 3.9% | - |
| Moorabbin (ML Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Essendon (ML Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Perth | \$ 7.49 | \$ 8.63 | \$ 8.63 | \$ 8.63 | \$ 8.63 | \$ 8.63 | 15.2% | - | - | - | - |
| Jandakot (PH Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Sydney | \$ 4.82 | \$ 5.57 | \$ 5.57 | \$ 5.57 | \$ 5.57 | \$ 5.57 | 15.6% | - | - | - | - |
| Bankstown (SY Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Camden (SY Basin) | \$ 7.42 | \$ 8.67 | \$ 9.54 | \$ 10.49 | \$ 11.54 | \$ 12.69 | 16.8% | 10.0% | 10.0% | 10.0% | 10.0% |
| Weighted Average -Capital/Major | | | | | | | 15.8% | 2.7% | 1.9% | 0.8% | 0.2% |
| Darwin | \$ 3.31 | \$ 3.10 | \$ 2.89 | \$ 2.68 | \$ 2.47 | \$ 2.26 | (6.3%) | (6.8%) | (7.3%) | (7.8%) | (8.5%) |
| Townsville | \$ 4.76 | \$ 4.40 | \$ 4.03 | \$ 3.67 | \$ 3.30 | \$ 2.94 | (7.7%) | (8.3%) | (9.0%) | (9.9%) | (11.0%) |
| Weighted Average Navaid Ports | | | | | | | (7.0%) | (7.5%) | (8.1%) | (8.8%) | (9.7%) |
| Weighted Average TN | | | | | | | 15.5% | 3.0% | 2.1% | 1.2% | 0.5% |
| ENROUTE | | | | | | | | | | | |
| Enroute > 20 tonnes | \$ 4.66 | \$ 4.42 | \$ 4.37 | \$ 4.26 | \$ 4.22 | \$ 4.18 | (5.2%) | (1.1%) | (2.5%) | (0.9%) | (0.9%) |
| Enroute < 20 tonnes | \$ 1.04 | \$ 0.99 | \$ 0.98 | \$ 0.95 | \$ 0.94 | \$ 0.93 | (5.2%) | (1.1%) | (2.5%) | (0.9%) | (0.9%) |
| New ARFF Services** | | | | | | | | | | | |
| Ayers Rock | \$ 13.09 | \$ 13.09 | | | | | - | | | | |
| Maroochydore | \$ - | \$ - | Subject to further Review/Submission | | | | | | | | |
| Townsville | \$ - | \$ - | | | | | | | | | |

Notes:

* Cairns, Canberra & Coolangatta aircraft <5.7tonne will be charged at the lower of the capped rate for regional towers or the full price in each year

** The basis of ARFF prices will be reviewed during 2005 and a revised price notification submitted to the ACCC.

Response to the Commission's Preliminary View

Commission's Preliminary View

Airservices is pleased that the Commission has recognised its efforts in consulting with industry and resolving what had previously been highly contentious issues. While more consultation is always preferable, we believe that the interests of all sectors of the industry have been identified and debated through this process.

Based on the Commission's Preliminary View that it would not object to the terminal navigation and enroute prices, Airservices intends to proceed to a formal notification with a view to introducing the long term pricing arrangement for these services from 1 January 2005.

Airservices is extremely disappointed over the Commission's objection to the ARFF pricing structure for new services. The resolution of issues raised by the Commission in relation to these services is complex and will require further review and consultation with affected customers at established as well as new locations. Complexities pertaining to price structure issues were identified by all industry participants at the beginning of our consultation process some 15 months ago and for this reason that it was agreed to defer price structure issues until after a long term arrangement, based on current charging mechanisms, had been implemented. As it is expected that a formal review and consultation process will take 3-4 months, Airservices will seek the Commission's endorsement to maintain the ARFF prices at their current levels until a new structure is determined. This would include maintaining the temporary price at Ayers Rock, and no charge at Maroochydore (commenced September 2004) or Townsville (due to begin in January 2005), which will cost some \$1.2m in revenue foregone per month.

Risk-sharing arrangements

Airservices notes that the Commission is unclear as to whether additional risk is being taken on as a result of the longer term pricing arrangement incorporating review triggers for certain activity and capital expenditure levels. The intention of the review triggers is to mitigate against the risk that a large one-off event or significant change in trend could result in sub-optimal industry outcomes, including the earning of super-normal profits by Airservices.

Within the bounds of the 'price triggers', the long term arrangement significantly increases Airservices financial risk. For example, on the downside, if actual activity levels were 5% (\$160m) below forecast over the 5 year term and costs rise 2% above budgeted levels (\$60m), Airservices would have no recourse to adjusting prices. The resulting financial impact would be a \$220m reduction in revenue levels, with losses being incurred in each of the five years.

This level of risk is clearly higher than in an environment in which prices are adjusted every year.

Airservices also notes the Commission's view that there may be merit in entering into individual risk-sharing arrangements with certain airports with regard to changes in activity.

Airservices will consult with airports and customers on the feasibility of such an arrangement.

Capital expenditure

Airservices capital expenditure plan has received broad industry support. As noted in the draft notification, the need for the surface movement guidance systems planned to be implemented in Brisbane and Melbourne had been questioned. Continuing consultation on this element of the program has now resulted in support for this investment from the major operators and airport owners.

Rate of return

In its 2003 decision, the Commission encouraged Airservices to undertake analytical work with its customers on the return target as part of the development of a longer term arrangement. Based on this decision, Airservices worked with customers to jointly engage a consultant to balance the competing interests. The results were then adopted as the accepted return target for this pricing arrangement.

Given that this jointly negotiated outcome is a reasonable proxy for a competitive environment where both parties are aware of the risks and rewards (noting the above discussion on risk), Airservices believes it is appropriate to adopt the outcome of the review as it stands. If this is not the case, Airservices would need to reconsider whether there was any merit in adopting such a review process in the future.

Structure of pricing

Application of the 'basin concept' in setting prices for TN services

Airservices notes the Commission's desire to more fully develop the basin pricing concept. While there are clear interdependencies, the benefits to the industry at large are not easily captured and quantified. Airservices intends to continue to work with customers and airports to further clarify the interdependencies and benefits.

Prices across services and user groups

As set out in the draft notification, Airservices acknowledges the need to review its pricing structure and, based on an agreement with customers at the beginning of the process, this issue was to be considered after a longer term arrangement was established. However, Airservices notes the Commission's particular concerns with the prices for ARFF services and will now commence a detailed review and consultation process to resolve the concerns the Commission has expressed.

While this process is being undertaken, Airservices proposes to hold ARFF prices at their current levels, including an extension of the temporary pricing arrangement at Ayers Rock and no price for services at Maroochydore and Townsville.

Airservices notes that the Commission agreed to the temporary arrangement for ARFF prices at Ayers Rock pending a longer term arrangement addressing concerns regarding, amongst other things, the efficiency of the cost base, the rate of return target and the structure of the pricing. The cost base and return issues have been addressed in this notification process. However, it was not possible to adequately address the price structure issues within the timeframe for developing this price notification and any "quick fix" solution would pre-empt

the results of the planned formal review. Therefore, Airservices seeks to continue the temporary pricing arrangement until the price structure issue can be satisfactorily resolved.

Given the profile of aircraft operations at Ayers Rock, the impact on users of this extension is not significant. For the major regular public transport operator and charter operators, the temporary arrangement is priced below the full cost levels. The remaining users are low volume or itinerant users, with a monthly bill of less than \$500.