



# **Final decision**

**Airservices Australia**

**Price notification**

**Aviation rescue and fire fighting services**

December 2005

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# Background

Airservices Australia (Airservices) submitted a formal price notification<sup>1</sup> to the Australian Competition and Consumer Commission (ACCC) on 14 December 2005. The notification relates to the prices charged for aviation rescue and fire fighting (ARFF) services provided by Airservices at airports throughout Australia, for the period 1 January 2006 to 30 June 2009.

The lodgement of the proposal follows the ACCC's preliminary view to not object to the prices proposed by Airservices in its draft price notification, providing that the changes to the revenue allowed in the ACCC's 2004 decision are removed (except for the increases in revenue for new services).

Airservices has removed these changes to revenue in its formal price notification. Airservices' draft and formal price notifications are available on the ACCC's website at [www.accc.gov.au](http://www.accc.gov.au).

In 2004, Airservices proposed a five-year price path for all of its regulated services: en route navigation, terminal navigation (TN) and ARFF. In its preliminary view on that proposal<sup>2</sup> the ACCC accepted the overall revenue amounts underlying Airservices' proposed long-term pricing arrangements; however it expressed concern with the basis of ARFF charges, whereby aircraft were charged on the basis of their maximum take-off weight (MTOW), with a minimum threshold of 2.5 tonnes. The ACCC considered that the basis for imposing charges was not likely to be efficient or equitable and that introduction of new ARFF services using the existing basis of charging was likely to have large impacts on particular user groups. The ACCC considered that Airservices should address this issue of its charging structure before introducing long-term pricing arrangements.

Airservices decided not to address this issue as part of its formal price notification lodged in November 2004. Instead it removed the proposed ARFF price increases from its proposal. In June 2005, the ACCC did not object to temporary price increases for ARFF services, pending Airservices' review of the structure of ARFF charges. Airservices' temporary price notification sought to address the ACCC's concerns about the basis of charging in the short term by adjusting charging thresholds to allocate a greater proportion of ARFF charges to regular public transport (RPT) operators, while reducing the burden of charging on smaller operators.

Airservices reviewed the structure of ARFF charges with its customers during August and September this year. As part of this review Airservices developed an options paper<sup>3</sup>

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<sup>1</sup> Locality notice provided pursuant to subsection 95Z(5) of the Trade Practices Act.

<sup>2</sup> ACCC, *Preliminary view Airservices Australia Draft price notification*, November 2004, available from the ACCC's website at <http://www.accc.gov.au>

<sup>3</sup> Airservices Australia, *Aviation Rescue and Fire Fighting Services Options for Charging*, available on the ACCC's website at <http://www.accc.gov.au>

which set out a number of alternative pricing structures, on which the ACCC has received submissions from interested parties.

Airservices subsequently submitted a draft price notification after holding consultation meetings with stakeholders in Cairns, Brisbane, Sydney, Melbourne, Adelaide and Perth airports and considering the submissions made to its options paper.

## Airservices' formal price notification

In its formal price notification, Airservices proposes to set a long-term set of prices for ARFF services in the period 1 January 2006 to 30 June 2009. It also sets new prices for the new ARFF services at Avalon and Hamilton Island airports.

Table 1 outlines Airservices' proposed prices (in \$ per tonne of MTOW for aircraft landings) for the six month period between 1 January and 30 June 2006. Appendix A contains the full list of prices for the period of the proposal.

**Table 1: Airservices' proposed prices for the six months between 1 January and 30 June 2006**

1 January to 31 July 2006 Proposed Price per tonne (MTOW)				
ARFF Location	Aircraft Category			
	9	8	7	6
ADELAIDE	\$ 9.18	\$ 9.18	\$ 2.23	\$ 1.68
ALICE SPRINGS	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
AVALON	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
AYERS ROCK	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
BRISBANE	\$ 3.49	\$ 2.57	\$ 1.81	\$ 1.68
CAIRNS	\$ 4.68	\$ 4.68	\$ 2.18	\$ 1.68
CANBERRA	\$ 7.85	\$ 7.85	\$ 7.85	\$ 1.68
COOLANGATTA	\$ 3.69	\$ 3.69	\$ 3.69	\$ 1.68
DARWIN	\$ 14.72	\$ 14.72	\$ 3.17	\$ 1.68
HAMILTON ISLAND	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
HOBART	\$ 5.86	\$ 5.86	\$ 5.86	\$ 1.68
LAUNCESTON	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
MACKAY	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
MAROOCHYDORE	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
MELBOURNE	\$ 2.76	\$ 2.17	\$ 1.76	\$ 1.68
PERTH	\$ 4.82	\$ 3.03	\$ 1.90	\$ 1.68
ROCKHAMPTON	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
SYDNEY	\$ 2.27	\$ 1.96	\$ 1.73	\$ 1.68
TOWNSVILLE	\$ 8.16	\$ 8.16	\$ 8.16	\$ 1.68

Airservices' formal price notification also seeks to establish a new charging structure for ARFF services. The main features of this charging structure are:

- Aircraft below 5.7 tonnes pay no ARFF charges.
- Aircraft between 5.7 – 15.1 tonnes pay the category 6 charge if they carry fare-paying passengers.

- Aircraft above 15.1 tonnes pay a price per tonne based on the category of aircraft. Category 6 aircraft pay the same price (\$1.68 per tonne) at all airports with an ARFF service. Higher category aircraft pay a higher price per tonne, which varies from airport to airport.

## **Process of assessment**

The provision of air traffic control and ARFF services by Airservices are notified services for the purposes of Part VIIA of the *Trade Practices Act 1974*. This means that, to avoid contravening section 95Z of the Trade Practices Act, Airservices is required to notify the ACCC of proposed price increases in these declared services. The ACCC is then responsible for assessing the proposed price increases and can then either object or not object to the proposed.

In assessing price notifications, the ACCC is required to have particular regard to the matters set out in subsection 95G(7) of the Trade Practices Act. The ACCC applies this legal framework according to the concepts and procedures outlined in its *Statement of Regulatory Approach to Assessing Price Notifications*, available on the ACCC's website. The ACCC approach to applying this framework in the context of the current price notification is outlined in the ACCC's preliminary view.

## **The ACCC's preliminary view**

In summary, while the ACCC accepted Airservices' proposed increase in maximum allowable revenue (MAR) to recover the cost of the establishment of new ARFF services at Avalon and Hamilton Island airports, it did not consider that Airservices should alter its MAR to reflect recent changes in operating costs. The ACCC considered that this would undermine Airservices' incentive to minimise the costs of providing ARFF services over the course of the long-term pricing proposal.

Given Airservices' recent review of alternative pricing structures for ARFF services and proposal to introduce a new pricing structure for these services, the ACCC's assessment focused on the economic efficiency of Airservices' proposed pricing structure.

The ACCC assessed the economic efficiency of Airservices' proposal in the absence of competitive entry given that it appeared unlikely that competition would be introduced into the supply of ARFF services during the period of the price notification.

The ACCC considered that, in the absence of competition in the provision of ARFF services, Airservices' proposal was a reasonable compromise between reducing the distortions to activity where costs are to a large extent fixed (marginal costs of additional landings are negligible) and signalling the cost of new investment (such as a category change) to users.

## Views of interested parties

The ACCC received 24 submissions from interested parties in response to the preliminary view. Broadly, while regional airports and regional and domestic airlines support the proposal, some major metropolitan airports, a coach service operator, and the Board of Airline Representatives of Australia Inc (BARA) and the International Air Transport Association (IATA) object to the proposal.

Qantas and Virgin Blue<sup>4</sup> have expressed support for the proposal. Regional Express (Rex) supports the basic concept behind the pricing proposal while raising issues about the basic price. The Department of Transport and Regional Services (DoTARS) also supports Airservices' proposal.

Particular issues raised by submissions are discussed below.

### **Productive efficiency**

Both BARA and Australia Pacific Airports Corporation Ltd (Australia Pacific Airports) argue that Airservices will face reduced incentives to be productively efficient under Airservices' preferred charging option.

BARA contends that because intermodal competition is strongest at regional locations, and therefore airports, airlines and Airservices all have a market-based incentive to minimise the cost and unit price of providing ARFF services at regional locations under a location specific pricing approach. It considers that this incentive will be largely removed under Airservices' proposed charging option.

Further, Australia Pacific Airports and BARA submit airports will face reduced incentives to work co-operatively with Airservices to help it reduce its costs because the bulk of the benefits will be distributed to other airports.

Australia Pacific Airports noted that the disclosure of costs is the only way in which it can be satisfied that Airservices is providing ARFF services in an efficient manner. Disclosure of costs over a period of time will assist in the ultimate delivery of contestability which must be seen as a positive for productive efficiency.

### ***ACCC's view***

As outlined below, the ACCC does not consider that Airservices' proposal will have a significant impact on intermodal competition. Having said that, given the weak substitutability between air travel and other modes of transport, intermodal competition would only have a small impact on Airservices incentives to incur costs efficiently. The ACCC also considers that any incentives placed on Airservices to incur its costs efficiently though the monitoring of location specific costs by airports would be small.

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<sup>4</sup> While Virgin Blue has decided not to make a submission in response to the ACCC's preliminary view, it has indicated to the ACCC that it does not object to the proposal.

The ACCC considers that the primary incentive Airservices' faces to reduce costs (in the absence of competition for ARFF services) is the incentive built into the long-term pricing path, which enables it to keep the value of any cost savings it makes in the period.

The ACCC agrees that disclosure of Airservices' costs is important, and notes Airservices' commitment to hold annual on-site expenditure forecast reviews at each location to ensure that both aircraft operators and airport owners have greater visibility of Airservices' costs.

### **Allocative efficiency**

Australia Pacific Airports and BARA argue that the approach the ACCC has taken to assessing Airservices' proposal differs from the approach the ACCC has taken in regulating other industries.

In addition, interested parties expressed different views about the extent to which Airservices' proposed prices would promote allocative efficiency. In particular, Brisbane Airport Corporation (BAC) argue that Airservices' pricing structure promotes an inefficient market, and would have the potential to cause airlines to re-route services to bypass major airports in favour of smaller regional airports which are unfairly subsidised by airports such as Brisbane.

Sydney Airport Corporation Limited (SACL) considers that Airservices' network charges are an imperfect form of price discrimination between distinct geographical locations because ARFF services cannot be consumed independently of airport airside services. It notes that in the case of ARFF, the services provided at a particular airport are not generally substitutes for those provided at another airport as they service distinct markets, so price discrimination would act to distort consumption of different products rather than optimise consumption of a particular product.

In contrast, DoTARS considers that, on balance, while Airservices' charging structure does not effectively signal the incremental costs, it is a reasonable proposal at this time to deal with the network distortions created by the regulatory requirements and a full location specific approach.

Australia Pacific Airports also argues that Airservices' proposed prices are not consistent with Ramsey pricing principles. It also considered that there were some exceptions to the ACCC's view about the relative demand elasticities. In particular, it noted that the elasticity of demand at Cairns airport is higher than at Canberra airport due to the predominance of leisure travel, and at Melbourne airport due to the higher proportion of international travellers. It also considers that Perth has a lower elasticity of demand than Canberra, because it is serviced by a wider range of aircraft.

Further, Australia Pacific Airports argue that the view expressed by the ACCC regarding the cross price effects between airports is inconsistent with views that the ACCC has previously expressed to the PC in its submission to the PC's inquiry into the Price Regulation of Airport Services in 2001.

### *ACCC's view*

Interested parties have expressed concern that the approach that the ACCC has taken in assessing Airservices' draft price notification differs from the approach the ACCC takes in other industries by applying mark-ups above marginal cost rather than incremental cost.

The ACCC would normally have concerns about prices that are lower than (average) incremental cost or above (average) stand alone cost because such prices may:

- distort entry decisions or
- create distortions in other markets.

In this case, the ACCC is satisfied that entry is unlikely (and in the event it does occur is not necessarily incompatible with Airservices' proposal<sup>5</sup>) and will not have significant impact on downstream markets. These issues are addressed in the "Impact of Airservices' proposal of competition for ARFF services" and "Impact of Airservices' proposal on intermodal competition" sections below.

Interested parties have also expressed concern about the extent to which Airservices' proposal promotes allocative efficiency. In its preliminary view, the ACCC used Ramsey pricing as a framework for assessing the extent to which the current pricing methodology and Airservices' proposed charging methodology would promote allocative efficiency.

As outlined in the preliminary view, the ACCC considers the nature of ARFF costs to be fixed<sup>6</sup> for a given category of service, because changes in the number of aircraft landings do not appear to affect the level of Airservices' costs. Where the marginal cost of an additional landing is zero, it is desirable, from an economic point of view, to minimise any distortions to activity that may result from charging above marginal cost, in order to recover Airservices' total cost of operations. In order to minimise these distortions across all airports, the mark-ups to recover fixed costs should be guided by the Ramsey Principle which involves mark-ups being set in inverse proportion to the price elasticity of demand for each air service landing at each airport.

Although it is difficult to secure precise measures of demand price elasticities for all air services in its preliminary view, the ACCC formed the view that, by and large, these elasticities are higher for air services landing at regional airports. This view is supported by general properties of demand.<sup>7</sup>

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<sup>5</sup> See pages 31–36 of the ACCC's Preliminary View (appendix C).

<sup>6</sup> The fixed costs for a category are also "joint" costs for all aircraft/users within that category. This further reinforces the role of Ramsey Principles in their least distortive recovery.

<sup>7</sup> In general, price elasticity of demand is higher at higher prices along the same demand schedule and at the smaller quantities of a demand schedule that, by its nature, is "positioned" closer to the price axis. It follows that a relatively large price change at higher prices is likely to have a relatively larger impact (as at low volume airports with high average ARFF category 6 costs) than a relatively small price change at large quantities (as at high volume airports with low average ARFF category 6 costs).



The ACCC also noted that at the capital city airports, the relative size of ARFF charges in relation to an average ticket cost is very small under both the existing location specific charging and Airservices' proposal and therefore the proposed price increases would not be expected to have any significant effect on activity at these airports. On the other hand, at small, low volume airports, the relative size of ARFF charges under the existing charging structure may be a significant proportion of ticket prices, and could have a significant impact on usage.

The ACCC also considered that the proposed common price for category 6 planes, charged on the basis of MTOW, results in a higher mark up above marginal cost at the larger capital city airports and a lesser mark up at regional and GA airports. This is because larger aircraft landing at capital city airports will pay the common price applied per tonne, in addition to the incremental charges applicable to higher category planes.

On this basis, the ACCC remains of the view that the common category 6 element of Airservices' preferred charging methodology better promotes allocative efficiency than Airservices' existing location specific pricing structure.

In response to Australia Pacific Airports' views about relative demand elasticities, the ACCC notes that in its preliminary view, it listed a number of factors it considered influence the elasticity of demand to land at airports. In light of those factors, it does not appear likely that Cairns airport faces a relatively less elastic demand than Melbourne airport. Further, it is unclear whether the wide range of aircraft at Perth airport is entirely determinative of its elasticity of demand relative to Canberra airport.

There is more merit to the argument that Cairns airport faces a relatively higher elasticity of demand than Canberra airport. However, in any event, Airservices' pricing proposal is not based on this assessment, rather it is based on the assumption that the elasticity of demand is the same at all airports.

Australia Pacific Airports' contention about relative demand elasticities is not necessarily inconsistent with the ACCC's assessment of this issue in the preliminary view. The ACCC considered that it, in light of the information available, it seems more reasonable to draw the conclusion that passengers' elasticity of demand to land at capital city airports is lower than passenger's demand to land at regional airports rather than that all passengers face the same elasticity of demand to land at all airports.

In addition, the ACCC does not agree with Australia Pacific Airports' contention that the ACCC's view that for most of Airservices' users the cross price effects would be small is inconsistent with the views expressed in its submission to the Productivity Commission (PC). In that submission, the ACCC argued that there were limited supply side substitution possibilities for a number of Australian airports. It noted:

In particular, the Commission considers that Sydney, Melbourne, Brisbane, Perth, Adelaide and Canberra operate as monopoly providers in geographically and functionally distinct markets. This distinction need not be symmetric; for example while Brisbane is geographically and functionally distinct from Coolangatta, the reverse does not apply. That is Coolangatta

faces competition from Brisbane, but Brisbane is not necessarily constrained in its pricing by the proximity of Coolangatta, given the capacity limitations of the latter.<sup>8</sup>

In a supplementary submission, Australia Pacific Airports argue that the ACCC should take into account the findings of the Australian Competition Tribunal in its recent decision to declare airside services at Sydney airport.<sup>9</sup> In particular, it argues that the Tribunal considers that there is competition between Melbourne and Avalon airport for the provision of airside services. It argues that providing the ARFF service below incremental/avoidable cost at Avalon is an exercise of market power that will affect competition in the market for airside services and in the dependant market (the market for airline services) in the same way that the Tribunal has determined SACL's exercise of market power in Sydney has affected competition in the dependant market in Sydney.

The ACCC does not agree that its consideration of Airservices' proposal is analogous with the Tribunal's decision with respect to the declaration of airside services at Sydney airport or that parallels can necessarily be drawn between the behaviour of SACL and Airservices.

In considering Airservices' price notification, the ACCC is required to give consideration to the matters outlined in section 95G(7). These criteria are distinct from those that the Tribunal was required to consider in deciding whether airside services should be declared.

Further, the ACCC does not accept Australia Pacific Airports' contention that the ACCC has failed to give consideration to the factors it is required to have regard to under subsection 95G(7)(b) of the Trade Practices Act.

As noted in the ACCC's *Statement of Regulatory Approach to Assessing Price Notifications*, the criteria in subsection 95G(7) can generally be met by economically efficient prices which reflect:

- An efficient cost base; and
- A reasonable return on capital.

Including a reasonable rate of return on capital employed in prices addresses the criterion in subsection 95G(7)(a) in relation to the service provider's industry by providing incentives to maintain profitable investment. At the same time, by discouraging prices above that reasonable rate of return, it addresses the criterion in subsection 95G(7)(b).

The ACCC has assessed these issues in its assessment of Airservices' 2004 long-term price notification and in this price notification for Airservices' recently established

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<sup>8</sup> ACCC, *Submission to the Productivity Commission's Inquiry into Price Regulation of Airport Services*, May 2001, p. 68.

<sup>9</sup> Virgin Blue Airlines Pty Ltd [2005] ACompT5

ARFF services, and is satisfied with the efficiency of Airservices' cost base and the reasonableness of Airservices' return on capital.

As outlined in its preliminary view, the ACCC has also considered the efficiency of the structure of Airservices' proposed prices. It considers that the proposed prices will result in lower distortions to usage at airports than Airservices' existing pricing structure and thus, better promotes allocative efficiency.

### **Impact of Airservices' proposal on competition for ARFF services**

A number of interested parties expressed concerns about scope for the cross subsidies within Airservices' proposed prices to distort entry decisions if ARFF services were opened up to competition.

IATA submits that cross subsidisation would have the potential to create a barrier to entry in the event competition is introduced into ARFF services.

Delta Fire Service states that it understands the burden disproportionate pricing has and has a range of solutions which will address and mitigate the problems currently experienced by airport operators located in regional Australia. It submits that if cross subsidies are allowed to occur then the issue of competition will be stifled to a large extent.

Broome Airport Services (BAS) notes that, based on current annual passenger forecasts, it expects that Broome international airport will reach the establishment criteria in 2007. It notes that it will be unable to compete with Airservices under Airservices' preferred charging option, and requests that BAS be allowed to introduce a competitive service should it desire to in the future.

BAS submit that this may take the form of an independent tendering process and subsequent underwriting of costs which would still ensure that the users of Broome International Airport are not disadvantaged as compared to other Australian Airports.

In contrast, DoTARS submits that it does not consider that Airservices' charging structure for this period of the price notification will distort future entry decisions while the appropriate contestability framework is being determined.

Further, DoTARS has noted its intention to continue work to implement the Government's policy to, where feasible, introduce a contestable market for ARFF over the period of this pricing proposal. It is currently preparing a discussion paper on ARFF policy and contestability issues that it expects to circulate for comment to the aviation industry as part of a consultation process in the first half of 2006.

### ***ACCC's view***

In its preliminary view, the ACCC considered that it did not appear likely that ARFF services would be opened up to competition in the short term, covering the period of Airservices' price notification. It considered that while it has been government policy for a number of years to introduce competition in the markets for various services provided by Airservices, a number of important issues need to be addressed before competitors to Airservices can compete for these markets.

DoTARS appears to support this view, and its submission makes clear the government's intention to consider the issues to be addressed before competition can be introduced into ARFF services during the course of the price notification. It also considers that Airservices' proposal would not distort entry decisions while the appropriate framework for contestability is determined.

The ACCC remains of the view that it appears unlikely that the market for ARFF services will be opened up to competition in the short-term, covering the period of Airservices' price notification, and supports DoTARS' consultation on policy and contestability issues for ARFF services.

### **Impact of Airservices' proposal on intermodal competition**

Both Australia Pacific Airports and BARA expressed a concern that while the ACCC appeared to have had regard to the markets for ARFF services and for air travel, it had not adequately considered the impact that Airservices' proposal would have on other markets for transport services.

Australia Pacific Airport submits that the relevant market for consideration in this matter is the market for transport services, that is, the carriage of people between locations.

BARA contend that subsidising the provision of ARFF services necessary to provide Regional Airport Passenger Trips does not promote efficient outcomes in regional passenger transport markets. It argues that due to intermodal competition, the outcome is actually a shift in resources away from competing forms of transport to the airlines and airports serving regional locations.

Further, BARA considers that in the long-run, passengers are likely to be worse off under Airservices' proposal as competing forms of transport either reduce capacity or exit markets completely, lowering the overall level of competition and consumer choice.

Further, Greyhound Australia (Greyhound) argue that the cross-subsidies within Airservices' proposal will have a significant adverse effect on Greyhound's relative competitive position in the market for passenger transport services to regional destinations. It also notes that the principal source of income to Greyhound is derived from services operating between regional destinations within mainland Australia, and many of these destinations are also serviced by regional airlines.

Airservices submit that Greyhound may be overestimating the materiality of intermodal substitution as a result of ARFF pricing changes. It questions the degree of substitutability between air and coach transport, and argues that while there appears to be some substitution at the margin it appears unlikely that coach transport and air travel are in the same market.

In addition, Airservices argue that any intermodal substitution that does occur is likely to be efficient, and that consequently the ACCC was correct not to treat the possibility of such substitution as a 'cost' in its analysis. It notes that the ACCC's analysis showed that the costs to Airservices of providing ARFF services to increased passenger numbers was close to zero. It argues that it is therefore in the interests of the economy

generally, and the travelling public in particular, not to discourage passenger throughput at those airports.

### *ACCC's view*

The ACCC has previously considered the degree of substitutability between air travel and other modes of travel in its submission to the Productivity Commission's Inquiry Report into Price Regulation of Airport services:

The alternative transport options available to travellers include road (car and bus) and rail transport, and potentially shipping. In general, these appear to be weak substitutes for air travel. For business travellers the convenience of air travel is vastly superior to the alternatives. It is likely that for this customer group, location is primarily determined by factors other than airport pricing, and that time constraints are a critical element of the travel decision. In such circumstances, there are no viable substitutes to flying to a particular destination; the choice is simply between travelling and not travelling.<sup>10</sup>

Given that air travel for business travellers is unlikely to be substitutable for other forms of transport, any impact of Airservices' proposal would be limited to domestic, non-business travel, particularly tourists.

In relation to domestic tourists the ACCC has previously noted:

For tourists, particularly domestic tourists, the alternatives [to air travel] may be more palatable. While the available substitutes are imperfect, the differences in the cost between air travel and other forms of transport may be large enough to compensate consumers for the associated disutility of using the inferior mode of transport.

...

As journey distances increase, alternative transport options become less attractive for two reasons. Firstly, the difference in journey times between air transport and the alternatives increase rapidly. Secondly, the cost differential between air transport and any alternative form of transport may narrow as the distance increases.<sup>11</sup>

The degree to which alternative forms of transport are substitutable also depends on the relative cost of the transport modes.

In its working paper on Regional Public Transport in Australia, the Bureau of Regional and Transport Economics (BTRE) assessed the cost of regional passenger travel, and the relative cost of travel to and from regional areas for each of the main public transport modes and private car travel. The BTRE considered:

The data shows that, generally, air is the most expensive model of travel. Rail and coach are generally the next most expensive, while private car travel, based on an 'avoidable cost' measure, divided by the average vehicle occupancy for non-urban car travel, is generally the lowest cost transport mode, for full-fare-paying adults.

The general points to note from these figures are:

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<sup>10</sup> ACCC, *Productivity Commission's Inquiry into Price Regulation of Airport Services*, 2001, p. 63.

<sup>11</sup> *Ibid*, p. 63-64.

- Air fares are generally higher than the cost of other modes of transport, often around four times as much as the ‘avoidable’ cost of private car travel.
- Rail and coach fares are generally very similar to each other; and
- The direct costs of private vehicle travel (assuming a large family car as the standard vehicle), for the same journey, is generally below the cost of a coach or rail fare.<sup>12</sup>

In light of the concerns expressed by Greyhound, the ACCC has also considered the relative prices of coach travel and air travel between regional airports between Sydney and Cairns. It appears that there are substantial differences in the relative price of air travel and coach travel, and in travel times between regional airports.

A comparison of Airservices’ proposal with the ‘location specific incremental cost’ charging methodology in Airservices’ charging options paper indicates that there will be large decreases in ARFF charges at Ayers Rock, Hamilton Island, and Avalon airports and smaller decreases in the ARFF charges at other regional locations. Given the distance associated with travelling to the locations where the price decreases will be largest, it appears that Airservices’ proposal is unlikely to have a significant impact on the cost of flying relative to the full costs (including money and time) of other modes of transport between regional locations.

Therefore, the ACCC does not consider that Airservices’ proposal will have a significant impact on intermodal competition between regional airports, or intermodal competition more broadly.

In addition, the issue of the impact of Airservices’ charging structure on intermodal competition aside, the ACCC does not necessarily consider that it should restrain itself from not objecting to Airservices’ proposal on the basis that it may affect an operator in another market.<sup>13</sup>

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<sup>12</sup> Bureau of Regional Transport Economics, *Working Paper 51 – Regional Public Transport in Australia: Long Distance Services, Trends, and Projections*, 2002, p. 31.

<sup>13</sup> The consequences for intermodal competition cannot simply be judged by second best ARFF prices (as an input to air services) in isolation of the efficiency of the prices, including for inputs, of competing modes. The full consequences are shaped by:

- i. The extent of the departure from marginal social costs of the prices for the competing modes in each relevant transport market; and
- ii. The degree to of substitution (or complimentarily) between the modes.

In the case of ARFF, the ACCC has not delved into the relative efficiency of the prices for competing modes of transport. This would be a major undertaking, and the ACCC considers such an exercise unwarranted given its view that Airservices’ proposal will not have a significant impact on intermodal competition between regional airports, or intermodal competition more broadly.

## **Competitive neutrality**

BARA, Australia Pacific Airports and Greyhound all express concern about the extent to which Airservices' proposed prices would be consistent with the government's competitive neutrality policy.

Airservices submits that the competitive neutrality concerns appear to relate to indirect downstream impacts of ARFF pricing rather than to competitive neutrality in the provision of ARFF services. It argues that it is drawing an extremely 'long bow' to assume that Airservices competes with Greyhound. It notes that Airservices provides an input into an industry (airline travel) that might have some small substitutability with another industry (coach travel), but if this 'competition' is covered by competitive neutrality guidelines then so must be competition between government roads and airlines.

### *ACCC's view*

The ACCC referred this issue to the Australian Government Competitive Neutrality Complaints Office (AGCNCO). The AGCNCO noted that in the absence of a formal complaint it had no comment to make in relation to the current pricing arrangement, or on the proposed pricing approach.

However, it noted that in considering the application of competitive neutrality to government businesses, a business test is usually applied using the following criteria:

- there must be charging for goods or services
- there must be actual or potential competitors, that is, purchasers are not restricted by law or policy from choosing alternative sources of supply
- managers of the activity must have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.

While, under current arrangements, the provision of ARFF services by Airservices appears to satisfy the first and third criteria for the application of competitive neutrality, those arrangements do not meet the second criteria at the present time.<sup>14</sup>

The ACCC is therefore satisfied that, in the absence the introduction of competition into the supply of ARFF services, competitive neutrality pricing principles are unlikely to be a relevant consideration in assessing Airservices' proposal.

## **Other issues**

Rex has expressed the concern about the changes in the spread of charges between Airservices' initial charging options paper, and Airservices' draft price notification. In particular, it expressed concern about the increase in the category 6 price for the six-month period to 30 June 2006 from \$1.45 per landed tonne in Airservices' options for

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<sup>14</sup> While Broome and Norfolk supply ARFF services, they do not appear to do so in competition with Airservices.

charging paper to \$1.69.<sup>15</sup> It considered that this meant costs have significantly moved from higher categories to category 6.

While IATA submits that it accepts that larger aircraft should pay more, it submits that there are no arguments that support the Airservices' "double-charging" mechanism of higher rates for higher categories coupled with a higher basis (MTOW) for larger aircraft. IATA supports a 'category' charging model, which involves a fixed charge per flight.

SACL argued that the exemption for aircraft non RPT aircraft under 15.1 tonnes should not apply because these aircraft are at least as likely to require attendance by ARFF in the course of their operations at an airport.

Qantas has also reiterated its belief that all potential users of ARFF services, not only the airlines, should contribute to its cost. It submits that this is because they act as a safety net used by and for the benefit of a wide class of airport users, which include not only airlines operating scheduled services to an airport, to all other aircraft using the airport, airport owners and other airport users such as aviation related service providers and retail/commercial tenants.

#### *ACCC's view*

In response to Rex's concern, the ACCC notes that Airservices constructed a number of indicative prices under a number of alternative charging options for ARFF services in its charging options paper. The category 6 price under the 'base level service charge plus incremental category cost' charging option has increased between the charging options paper and Airservices' draft price notification for a number of reasons, including an increase due to the allocation of overheads being moved into the category 6 cost pool, and revisions to the process Airservices' previously used to allocate these costs between the category cost pools. The ACCC is satisfied that these changes are reasonable.

While Airservices' proposed prices are increasing in both the MTOW of aircraft and in aircraft category, it does not agree with IATA's contention that this will result in the "double-charging" of aircraft. In its preliminary view the ACCC considered that Airservices' category charges would be desirable in signalling the costs imposed by higher category aircraft landing at airports.

In relation to SACL and Qantas' concerns, the ACCC notes it agreed with Airservices' decision to levy charges directly on fare-paying passengers because they influence Airservices' costs and directly benefit from the provision of the service.

The ACCC also noted while there a range of users that may benefit from the provision of an ARFF service, it passenger numbers that trigger the provision of an ARFF service, and the regulations require Airservices to give preference to rescuing persons and property from an aircraft that has crashed or caught fire and to controlling and

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<sup>15</sup> In light of the ACCC's preliminary view to object to changes in Airservices operating costs, and changes to the category at Coolangatta and Darwin airports, the prices for category 6 services for the six months to 30 June 2006 reduced to \$1.68 in Airservices formal price notification.



extinguishing fires on the aerodrome. For these reasons, the ACCC does not consider that non-RPT aircraft below 15.1 tonnes should be levied charges for the service, or that other parties that benefit from use of the service should be levied charges for ARFF services.

## **Conclusion**

The ACCC considers that its preliminary views regarding the efficiency of Airservices' proposal remain unchanged in light of the issues raised by interested parties. Thus, the ACCC has decided to not object to prices proposed by Airservices for its ARFF services in its formal price notification.

## Appendix A – Airservices’ proposed prices

Tables 2 to 4 specify the prices to apply to ARFF services from 1 January 2006 to 30 June 2009.

**Table 2: Proposed prices for the six-month period from 1 January 2006 to 30 June 2006**

ARFF Location	2005/06 Proposed Price per tonne (MTOW)			
	Aircraft Category			
	9	8	7	6
ADELAIDE	\$ 9.18	\$ 9.18	\$ 2.23	\$ 1.68
ALICE SPRINGS	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
AVALON	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
AYERS ROCK	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
BRISBANE	\$ 3.49	\$ 2.57	\$ 1.81	\$ 1.68
CAIRNS	\$ 4.68	\$ 4.68	\$ 2.18	\$ 1.68
CANBERRA	\$ 7.85	\$ 7.85	\$ 7.85	\$ 1.68
COOLANGATTA	\$ 3.69	\$ 3.69	\$ 3.69	\$ 1.68
DARWIN	\$ 14.72	\$ 14.72	\$ 3.17	\$ 1.68
HAMILTON ISLAND	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
HOBART	\$ 5.86	\$ 5.86	\$ 5.86	\$ 1.68
LAUNCESTON	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
MACKAY	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
MAROOCHYDORE	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
MELBOURNE	\$ 2.76	\$ 2.17	\$ 1.76	\$ 1.68
PERTH	\$ 4.82	\$ 3.03	\$ 1.90	\$ 1.68
ROCKHAMPTON	\$ 1.68	\$ 1.68	\$ 1.68	\$ 1.68
SYDNEY	\$ 2.27	\$ 1.96	\$ 1.73	\$ 1.68
TOWNSVILLE	\$ 8.16	\$ 8.16	\$ 8.16	\$ 1.68

**Table 3: Proposed prices for the period between 1 July 2006 and 30 June 2007**

ARFF Location	2006/07 Price Per Tonne (MTOW)			
	Aircraft Category			
	9	8	7	6
ADELAIDE	\$ 9.27	\$ 9.27	\$ 2.28	\$ 1.73
ALICE SPRINGS	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
AVALON	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
AYERS ROCK	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
BRISBANE	\$ 3.58	\$ 2.60	\$ 1.86	\$ 1.73
CAIRNS	\$ 4.74	\$ 4.74	\$ 2.23	\$ 1.73
CANBERRA	\$ 7.95	\$ 7.95	\$ 7.95	\$ 1.73
COOLANGATTA	\$ 3.74	\$ 3.74	\$ 3.74	\$ 1.73
DARWIN	\$ 14.98	\$ 14.98	\$ 3.22	\$ 1.73
HAMILTON ISLAND	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
HOBART	\$ 5.97	\$ 5.97	\$ 5.97	\$ 1.73
LAUNCESTON	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
MACKAY	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
MAROOCHYDORE	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
MELBOURNE	\$ 2.87	\$ 2.22	\$ 1.81	\$ 1.73
PERTH	\$ 4.97	\$ 3.04	\$ 1.95	\$ 1.73
ROCKHAMPTON	\$ 1.73	\$ 1.73	\$ 1.73	\$ 1.73
SYDNEY	\$ 2.36	\$ 2.02	\$ 1.78	\$ 1.73
TOWNSVILLE	\$ 8.15	\$ 8.15	\$ 8.15	\$ 1.73

**Table 4: Proposed prices for the period between 1 July 2007 to 30 June 2008**

ARFF Location	2007/08 Price Per Tonne (MTOW)			
	Aircraft Category			
	9	8	7	6
ADELAIDE	\$ 9.00	\$ 9.00	\$ 2.44	\$ 1.78
ALICE SPRINGS	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
AVALON	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
AYERS ROCK	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
BRISBANE	\$ 3.64	\$ 2.60	\$ 1.93	\$ 1.78
CAIRNS	\$ 4.74	\$ 4.74	\$ 2.38	\$ 1.78
CANBERRA	\$ 7.98	\$ 7.98	\$ 7.98	\$ 1.78
COOLANGATTA	\$ 3.97	\$ 3.97	\$ 3.97	\$ 1.78
DARWIN	\$ 14.90	\$ 14.90	\$ 3.62	\$ 1.78
HAMILTON ISLAND	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
HOBART	\$ 6.56	\$ 6.56	\$ 6.56	\$ 1.78
LAUNCESTON	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
MACKAY	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
MAROOCHYDORE	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
MELBOURNE	\$ 2.99	\$ 2.27	\$ 1.88	\$ 1.78
PERTH	\$ 5.08	\$ 3.03	\$ 2.03	\$ 1.78
ROCKHAMPTON	\$ 1.78	\$ 1.78	\$ 1.78	\$ 1.78
SYDNEY	\$ 2.41	\$ 2.05	\$ 1.84	\$ 1.78
TOWNSVILLE	\$ 8.29	\$ 8.29	\$ 8.29	\$ 1.78

**Table 5: Proposed prices for the period between 1 July 2008 to 30 June 2009**

ARFF Location	2008/09 Price Per Tonne (MTOW)			
	Aircraft Category			
	9	8	7	6
ADELAIDE	\$ 9.12	\$ 9.12	\$ 2.33	\$ 1.81
ALICE SPRINGS	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
AVALON	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
AYERS ROCK	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
BRISBANE	\$ 3.70	\$ 2.62	\$ 1.93	\$ 1.81
CAIRNS	\$ 4.76	\$ 4.76	\$ 2.29	\$ 1.81
CANBERRA	\$ 7.91	\$ 7.91	\$ 7.91	\$ 1.81
COOLANGATTA	\$ 4.01	\$ 4.01	\$ 4.01	\$ 1.81
DARWIN	\$ 16.06	\$ 16.06	\$ 3.39	\$ 1.81
HAMILTON ISLAND	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
HOBART	\$ 6.73	\$ 6.73	\$ 6.73	\$ 1.81
LAUNCESTON	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
MACKAY	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
MAROOCHYDORE	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
MELBOURNE	\$ 3.03	\$ 2.29	\$ 1.89	\$ 1.81
PERTH	\$ 5.08	\$ 3.01	\$ 2.01	\$ 1.81
ROCKHAMPTON	\$ 1.81	\$ 1.81	\$ 1.81	\$ 1.81
SYDNEY	\$ 2.45	\$ 2.08	\$ 1.86	\$ 1.81
TOWNSVILLE	\$ 8.47	\$ 8.47	\$ 8.47	\$ 1.81

## **Appendix B – List of submissions**

The ACCC received 24 submissions in response to its preliminary view. These submissions are available on the ACCC's website.

Aeromil

Airservices Australia

Australia Pacific Airports Corporation Ltd (Australia Pacific Airports)

Avalon Airport Australia (Avalon Airport)

Board of Airline Representatives of Australia Inc (BARA)

Brisbane Airport Corporation (BAC)

Broome Airport Services (BAS)

Delta Fire Service

Department of Transport and Regional Services (DoTARS)

International Air Transport Association (IATA)

Gold Coast Airport Limited (GCAL)

Greyhound Australia (Greyhound)

Hamilton Island

Mackay Port Authority

Maroochy Shire Council

Qantas

Regional Aviation Association of Australia (RAAA)

Regional Express – Australiawide Airlines Ltd (Rex)

Rockhampton City Council

Sydney Airport Corporation Limited (SACL)

Voyages Hotels and Resorts (Voyages)

## **Appendix C – The ACCC’s preliminary view**



# **Preliminary view**

**Airservices Australia**

**Draft price notification**

**Aviation rescue and fire fighting services**

**November 2005**

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## Abbreviations and glossary of terms

ACCC	Australian Competition and Consumer Commission
Airservices	Airservices Australia
ARFF	aviation rescue and fire fighting
BARA	Board of Airline Representatives of Australia Inc
CASA	Civil Aviation Safety Authority
CASR	Civil Aviation Safety Regulations
DoTARS	Department of Transport and Regional Services
IATA	International Air Transport Association
MAR	maximum allowable revenue
marginal cost	the change in total costs of production which results when output is varied by one unit
MTOW	maximum take-off weight of a specific aircraft type
PC	Productivity Commission
price elasticity of demand	the degree of responsiveness of the quantity demanded of a good or service to changes in its price, measured by the percentage change in the quantity demanded divided by the percentage change in price
RAAA	Regional Aviation Association of Australia
Ramsey-based prices	prices with mark-ups above marginal cost inversely proportional to the own price elasticity of demand
RFDS	Royal Flying Doctor Service
RPT	regular public transport
TN	terminal navigation



## Summary

This preliminary view relates to a draft price notification from Airservices Australia (Airservices) for its aviation rescue and fire fighting (ARFF) services for the period 1 January 2006–30 June 2009. The Australian Competition and Consumer Commission (ACCC) expects Airservices to lodge a formal price notification under the provisions of Part VIIA of the *Trade Practices Act 1974* in December 2005, on which the ACCC will form a final view.

The revenue underlying Airservices' provision of ARFF services for the period 2004–05 to 2008–09 was considered by the ACCC in its 2004 consideration of Airservices' long-term price notification, which covered all of Airservices' declared services. This notification relates to the structure of ARFF charges and is in response to concerns expressed by the ACCC that Airservices' charging structure, whereby aircraft were charged on the basis of maximum take-off weight (MTOW), with a threshold of 2.5 tonnes, was not likely to be efficient or equitable. The ACCC had immediate concerns that the introduction of new ARFF services using the existing basis of charging was likely to have large impacts on particular user groups and that the charging structure should be reviewed prior to introducing long-term prices.

Airservices sought to address the ACCC's primary concerns in the short term in a temporary price notification, which the ACCC did not object to, which adjusted the charging thresholds. In August 2005, Airservices released an options paper for consultation, in which it outlined a number of alternative charging structures for ARFF services. The ACCC released an issues paper and sought comments on the options suggested by Airservices. Airservices considered the submissions made in forming a decision about its preferred charging option and the ACCC has also considered these submissions in forming its preliminary view on Airservices' preferred charging option.

Airservices, as the monopoly provider of ARFF services in Australia, is subject to the price notification provisions of the Trade Practices Act. These provisions, which also apply to the monopoly components of Australia Post's activities and, to a limited extent, Sydney airport, apply only to those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers.

A critical and threshold issue in the ACCC's consideration of the efficiency and sustainability of the proposed price structure for ARFF services is whether ARFF services are open to competitors entering the market. It does not appear that markets for ARFF services will be opened up to competition in the short term, covering the period of this price notification. While it has been Government policy for a number of years to introduce greater competition in the markets for various services currently provided by Airservices, including ARFF, it appears to the ACCC that a number of important issues need to be addressed before competitors to Airservices can compete for these markets.

These issues include the form that competition would take, the coverage of airports, and arrangements for Airservices' existing sunk assets at those locations.<sup>16</sup>

As highlighted by the ACCC in its 2004 decision, cross subsidies in Airservices' existing pricing arrangements would be of immediate concern if there is scope for competitive entry. The ACCC found that there appeared to be a degree of cross-subsidisation of terminal navigation (TN) and ARFF services at regional and general aviation (GA) airports by its en route and TN services at larger airports. Airservices' proposal increases the degree of cross-subsidisation by increasing ARFF prices at larger airports and reducing them at regional and GA airports. However, given the ACCC's view that it does not appear that ARFF services will be opened up to competition during the period of this price notification, the proposed pricing structure would not distort entry decisions.

Airservices' proposal is to charge a common price of \$1.69 per tonne to all aircraft above 5.7 tonnes that carry fare-paying passengers and land at airports with an ARFF service. Higher charges for higher category aircraft also apply at airports that have an ARFF service that is of a higher category than the base level service. These charges vary depending on the category of aircraft and on the levels of landings of aircraft at particular airports.

In the absence of competitive entry into the provision of ARFF services, the ACCC has considered the efficiency of the proposed price structure.

The ACCC considers the nature of ARFF costs to be fixed for a given category of service, because changes in the number of aircraft landings at a particular airport do not appear to affect the level of Airservices' costs. Where the marginal cost of an additional landing is zero, it is desirable, from an economic point of view, to minimise any distortions to activity that may result from charging above marginal cost, in order to recover Airservices' total costs of operations. Distortions are minimised by applying such mark-ups in a way so that prices are highest for those users where this is unlikely to have a large impact on activity, and prices are lowest for those users where any price increase is more likely to reduce activity. The ACCC considers that the evidence on levels of price sensitivity indicates that landings at the larger airports in Australia are less sensitive to price increases than are those at regional and GA airports.

However, there are instances where changes in activity would be likely to affect the level of Airservices' costs. One such example is Hobart airport, which has a category 7 ARFF service, but has only a small number of category 7 and above aircraft landing. At this airport, it may be feasible that a small reduction in category 7 and above aircraft landing could result in Airservices being able to downgrade the ARFF service to a category 6 service, thereby reducing costs. Airservices' proposal levies higher charges for category 7 and above aircraft landing at Hobart airport.

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<sup>16</sup> Such competition would be *for* the market, still resulting in a single monopoly provider of ARFF services at an airport, in comparison with, for example, downstream competitors gaining access to a monopoly bottleneck facility.

While Airservices admits that its proposal is not perfect in terms of signalling all of its incremental costs, the ACCC considers that it represents a reasonable compromise between minimising the distortions associated with charging above marginal cost and signalling the costs of users' activity at individual airports.

Airservices has increased the overall amounts of revenue underlying its proposed prices from those considered by the ACCC in 2004, largely in respect of providing new services at Avalon and Hamilton Island airports. While the ACCC accepts the adjustments to recover the costs of providing new services at Avalon and Hamilton Island airports, it does not consider that other proposed amendments to the underlying revenue amounts should be made. Subject to Airservices removing these amendments from its proposal, the ACCC's preliminary view is to not oppose the price increases proposed.

The ACCC is now seeking comments on its preliminary view. Submissions should reach the ACCC by close of business on 7 December 2005. Airservices' proposal and submissions are available on the ACCC's website, at <http://www.accc.gov.au>.

# Introduction

Airservices Australia (Airservices) submitted a draft price notification to the Australian Competition and Consumer Commission (ACCC) on 30 September 2005. The notification relates to the prices charged for aviation rescue and fire fighting (ARFF) services provided by Airservices at airports throughout Australia, for the period 1 January 2006 to 30 June 2009.

The lodgement of the proposal follows preliminary discussions with the ACCC and Airservices intends to lodge a formal notification of a proposed increase in prices pursuant to Part VIIA of the *Trade Practices Act 1974* in December 2005. The proposal is available on the ACCC's website at [www.accc.gov.au](http://www.accc.gov.au).

This proposal focuses on the *structure* of the charges for ARFF services, rather than the underlying revenue expected to be recovered from those charges. Therefore, some charges are proposed to increase while other charges are proposed to fall. The ACCC considered the underlying revenue for the provision of ARFF services in its 2004 decision on Airservices' price notification.<sup>17</sup>

Airservices has made some adjustments to these underlying revenue amounts in this proposal, primarily relating to newly introduced or expected services at Avalon and Hamilton Island airports.

In 2004, Airservices proposed a five-year price path for all of its regulated services: en route navigation, terminal navigation (TN) and ARFF. In its preliminary view,<sup>18</sup> while the ACCC accepted the overall revenue amounts underlying Airservices' proposed long-term pricing arrangements, it expressed concern with the basis of ARFF charges, whereby aircraft were charged on the basis of their maximum take-off weight (MTOW), with a threshold of 2.5 tonnes. The ACCC considered that the basis for imposing charges was not likely to be efficient or equitable and that introduction of new ARFF services using the existing basis of charging was likely to have large impacts on particular user groups. The ACCC considered that Airservices should address this issue of its charging structure before introducing long-term pricing arrangements.

Airservices decided not to address this issue as part of its formal price notification lodged in November 2004, and removed the proposed ARFF price increases from its proposal. In June 2005, the ACCC did not object to temporary price increases for ARFF services, pending Airservices' review of the structure of ARFF charges.

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<sup>17</sup> ACCC, *Final decision Airservices Australia Price notification*, December 2004, available from the ACCC's website at <http://www.accc.gov.au>

<sup>18</sup> ACCC, *Preliminary view Airservices Australia Draft price notification*, November 2004, available from the ACCC's website at <http://www.accc.gov.au>

Airservices' temporary price notification sought to address the ACCC's concerns about the basis of charging in the short term by adjusting charging thresholds to allocate a greater proportion of ARFF charges to regular public transport (RPT) operators, while reducing the burden of charging on smaller operators.

The ACCC's decision to not object to the interim prices proposed by Airservices established the following charging arrangements:

- Aircraft are charged on the basis of landed weight per tonne, with an exemption for aircraft weighing less than 5.7 tonnes MTOW.
- Between 5.7 tonnes and 15.1 tonnes, operators pay pre-existing charges. (The 15.1 tonne threshold is designed to distinguish between RPT and non-RPT operators.)
- Above 15.1 tonnes, operators pay the prices proposed for 2005-06 in Airservices' 2004 long-term price notification.

As part of Airservices' review into the ARFF charging structure, Airservices developed an options paper<sup>19</sup> which set out a number of alternatives, on which the ACCC has received submissions from interested parties. A list of the submissions is contained in attachment A. Airservices subsequently submitted a draft price notification, after holding consultation meetings with stakeholders in Cairns, Brisbane, Sydney, Melbourne, Adelaide and Perth airports and considering the submissions made to its options paper.

The main features of Airservices' proposed charging structure are:

- Aircraft above 15.1 tonnes pay a price per tonne based on the category of aircraft. Category 6 aircraft pay the same price (\$1.69 per tonne) at all airports with an ARFF service. Higher category aircraft pay a higher price per tonne, varying by airport.
- Aircraft below 5.7 tonnes pay no ARFF charges.
- Aircraft between 5.7 – 15.1 tonnes pay the category 6 charge if they carry fare-paying passengers.

Part A of this document gives background on Airservices and ARFF services and summarises the charging options in Airservices' options paper, together with the views of interested parties. Part B outlines the legislative framework governing the ACCC's consideration of price notifications, summarises Airservices' proposal and provides the ACCC's preliminary views.

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<sup>19</sup> Airservices Australia, *Aviation Rescue and Fire Fighting Services Options for Charging*, available on the ACCC's website, at <http://www.accc.gov.au>

## **Part A: Background**

This part of the paper gives information about Airservices and its ARFF services, followed by a discussion of the different charging options considered in Airservices' options paper, including respondents' views.

### **About Airservices**

Airservices is a body corporate, established under the *Air Services Act 1995*. It is wholly owned by the Australian Government. Under the Air Services Act, it has specified functions, including providing safe and environmentally-sound air traffic management services and ARFF services. Airservices is required to provide its services in accordance with Civil Aviation Safety Authority (CASA) regulations.

### **Setting charges**

Under s. 53 of the Air Services Act, the Board of Airservices may set charges for services provided by Airservices. Under s. 54, however, the Board must give the Minister written notice of the proposed charges and the Minister may disapprove of such charges. Under s. 55 of the Air Services Act, these provisions have effect subject to the provisions of Part VIIA of the Trade Practices Act.

Under Part VIIA of the Trade Practices Act, the provision of air traffic control and ARFF services are declared services. Under s. 95Z of the Trade Practices Act, Airservices is required to notify the ACCC of proposed price increases for these declared services. The ACCC is then responsible for assessing these proposed price increases and for deciding either to object or not to object to the proposed price increases.

### **ARFF services**

Airservices provides ARFF services at 18 aerodromes around Australia, and Airservices expects to begin providing services at Hamilton island airport during 2006.

The Civil Aviation Safety Regulations 1998 (CASR) specify that the functions of an ARFF service at an aerodrome are:

- to rescue persons and property from an aircraft that has crashed or caught fire during landing or take-off
- to control and extinguish, and to protect persons and property threatened by, a fire on the aerodrome, whether or not in an aircraft.<sup>20</sup>

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<sup>20</sup> Sub-regulation 139.710(1).

The regulations also specify that, while nothing prevents an ARFF service provider from performing fire control services or rescue services elsewhere than on an aerodrome, the provider must give priority to its responsibilities mentioned above.<sup>21</sup>

Part 14 of the *Airports Act 1996* provides that Airservices will generally oversee the provision of ARFF services at airports. Section 216 of the *Airports Act* provides that an airport operator must not provide ARFF services or permit ARFF services to be provided unless:

- the services are provided by Airservices
- the services are provided in accordance with an arrangement between Airservices and a third person, or
- the services are provided in accordance with an arrangement approved by the Minister.

Regulation 139.711 provides that a person must not provide an ARFF service at an aerodrome unless the person is approved to provide the ARFF service. A person must be listed in the regulations before they are eligible to apply for approval as an ARFF service provider at those airports which they are listed against in the regulations. Once a person is listed in the regulations, they may apply to CASA for approval. Airservices is listed in the regulations in respect of any airport and Broome Airport Services Pty Ltd and the Administration of Norfolk Island are listed against those respective airports.

The criteria for establishment and disestablishment of ARFF services is set out in the Manual of Standards for Part 139H of the CASR. The manual specifies that a level 1 ARFF service should be provided at:

- an aerodrome from or to which an international passenger service operates
- any domestic aerodrome through which more than 350 000 passengers passed through on air transport flights during the previous financial year.

Airservices states that the passenger throughput of 350 000 has been established to ensure that an ARFF service is provided to cover at least 95 per cent of the travelling public.

The manual of standards specifies that the disestablishment of an ARFF service may be considered when the number of annual passengers on air transport falls below 300 000 and remains below this level for a 12-month period. The ARFF service provider is required to provide CASA with a safety case that justifies the closure of the ARFF service.

While the establishment criteria determines when Airservices will incur the cost of providing an ARFF service at a location, under the manual of standards, the category of

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<sup>21</sup> Sub-regulation 139.710(2)

the aircraft flying into a location determines the cost that Airservices faces in providing the service.

For example, an aerodrome serving category 6 aircraft requires an ARFF service that has two fire vehicles (which have a capacity of 7900 litres and a discharge rate of 4000 litres per minute) and a minimum shift size of five staff. In contrast, an aerodrome serving category 9 aircraft requires an ARFF service that has three fire vehicles (which have a capacity of 24 300 litres and a discharge rate of 9000 litres per minute) and a minimum shift size of 10 staff.

The required service category changes as the category of the ‘critical aircraft’ at the airport changes. The ‘critical aircraft’ is the longest aircraft that reaches 700 movements within the busiest three months of the airport in the previous 12-month period.

The category of an aircraft depends on its size. The length of an aircraft is the primary determinant of an aircraft’s category, but its width can lead to the aircraft being classified as one category higher.

## **Airservices’ charging options paper**

Airservices’ charging options paper presents and discusses alternative methodologies for determining prices for ARFF services. It contains indicative prices under the alternative models, for each airport. The ACCC’s options paper sought comment on the charging options presented in this paper, including the compatibility of the options with the Government’s policy of introducing competition for the provision of ARFF services.

The submissions provided to the ACCC, in combination with Airservices’ consultation process with its customers, informed Airservices’ choice of charging option for this draft price notification.

This section summarises Airservices’ views and the views of interested parties.

### **Who should pay for ARFF services and on what basis?**

#### ***Background***

As mentioned above, in its preliminary view, the ACCC objected to the increases in ARFF charges proposed by Airservices in its 2004 long-term pricing proposal because it had concerns about the basis of charging for these services.

Amongst other things, the ACCC considered that Airservices’ proposal to levy charges on the basis of MTOW, with a minimum threshold of 2.5 tonnes. did not appear to be related to Airservices’ cost drivers.

The ACCC recommended that Airservices review with its customers the basis of charging for ARFF services before introducing long-term charging arrangements for ARFF services.



In its June 2005 interim price notification, Airservices identified that charges should be levied on aircraft carrying passengers, and sought to address the ACCC's concerns by strengthening the link between the basis of charging and passengers. To achieve this, Airservices increased the 2.5 tonne threshold to 5.7 tonnes, and held charges constant for aircraft below 15.1 tonnes.

Airservices considered that 15.1 tonnes was an appropriate cut-off point between RPT aircraft operators and other aircraft operators, because this threshold was just below the MTOW of Dash 8 aircraft, and Airservices' analysis of the fleet of aircraft using ARFF services in the six-month period to December 2004 showed that 97 per cent of passengers travelling on an aircraft of 30 seats or more were captured by using this threshold.

The ACCC accepted the introduction of this threshold, noting that the majority of passengers would be captured by its application. However, it expressed concerns about the scope for its application to affect competition between aircraft just above and below of threshold.

#### *Airservices' view*

Airservices revisits this issue in its charging options paper. It considers three alternative bases on which it could levy charges for ARFF services:

- category of aircraft
- passenger numbers
- MTOW.

Airservices rejects the use of aircraft category as a base for levying ARFF charges because it considers that levying per category charges may break the correlation between MTOW and passengers, which would result in smaller aircraft within each category incurring a higher cost per passenger.

Airservices considers that using passenger numbers would provide a comparative pricing base between smaller regional operators and the larger airlines. However, it considers that this option is impractical because of issues surrounding the availability and integrity of relevant passenger and load factor information, and logistical issues around data collection which would lead to increased administration costs.

Airservices considers that MTOW should be used as a base for levying charges because it is a simple and transparent basis of charging, and that above a certain threshold, tonnes is a reasonable proxy for passenger numbers. In particular, Airservices submits that the correlation between persons-on-board and an aircraft's landed weight indicates that 92.5 per cent of tonnes landed equates to approximately 90 per cent of persons-on-board.

#### *Views of interested parties*

Virgin Blue Airlines Pty Ltd (Virgin Blue) supports the use of MTOW as the basis of ARFF charging. It submits that MTOW provides a direct correlation between the driver of ARFF costs and the basis of charging these services to the consumer, by allocating

the incremental cost of providing a higher level of service to those aircraft generating the requirement for a higher level of service.

Tony Taggart, Emirates Group (Emirates) and International Air Transport Association (IATA) object to the use of MTOW as the basis of charging for ARFF services.

Emirates submits that the Boeing 777s and Airbus A340s that it flies into Australia have unusually high MTOWs (340 and 372 tonnes respectively). Emirates states that this is a result of the unusually long mission lengths these aircraft are required to undertake, which require additional fuel.

Tony Taggart considers that the MTOW of the aircraft is irrelevant to the cost of providing services and has no bearing on how that cost should be allocated. IATA expresses concern that the application of MTOW would lead to aircraft of the same category paying different prices, and double charging for higher category aircraft.

IATA and Emirates express the view that charges should be set on a per landing basis, with different prices for different categories of service.

In contrast, Regional Express—Australiawide Airlines Ltd (Rex) opposes any model based on a per landing charge because it is concerned that this would significantly increase prices faced by smaller operators, and render some routes unviable.

Both the Government of South Australia – Department for Transport, Energy and Infrastructure (SA Government) and Adelaide Airport Limited (Adelaide airport) consider that prices should be based on passenger numbers. The SA Government notes that a large number of airports have elected, usually under pressure from aircraft operators, to base infrastructure charges on passenger numbers rather than aircraft weight.

Virgin Blue opposes the use of passenger numbers. It notes that while passengers determine whether an ARFF service will be provided at an airport, it is the size of the aircraft operating at that airport which determines the level of ARFF services required at that airport and the cost of providing the ARFF services at that airport.

Qantas Airways Limited (Qantas) states that only eight per cent of ARFF responses in 2004–05 were related to aircraft incidents, which implies that the majority of ARFF responses were to emergency calls at landside and off-airport facilities, such as retail shops in the terminal and nearby commercial premises. It considers that there is a set of users that benefit from the supply of ARFF services but are not required to pay for them, such as the airport and non-airline users.

### **Location specific pricing**

Location specific pricing is currently used by Airservices to recover the costs of providing TN and ARFF services. This involves dividing Airservices' allowed revenue (or 'maximum allowed revenue' (MAR)) allocated to a particular location for a particular service by activity (in Airservices' case, forecast tonnes) to determine a price at that location.

Prices determined using this methodology are lower at high-volume locations and higher at low-volume locations.

### *Airservices' view*

Airservices considers that the existing location specific charging methodology could be modified to address the concerns that the ACCC has previously expressed about its application.

For example, it states that the weight-based threshold could be further developed, to address the concern about the impact of the charge on non-RPT users. Concerns about the impact of the charging methodology on start-up airports could be addressed through risk-sharing arrangements, as well as activity triggers and transitional pricing.

Airservices outlines two location specific models in the charging options paper—one in which charges are constant per unit of activity, and one in which charges increase on the basis of category of aircraft.

Airservices submits that in order to properly signal the fact that higher category aircraft require Airservices to invest in higher category services, these aircraft should face higher prices. The 'location specific, incremental cost, aircraft category charge' option sets higher per tonne prices for higher category aircraft.

Airservices cites the example of Coolangatta airport, which is just on the threshold of being a category 8 airport. Airservices notes that the avoidable costs of category 8 aircraft landings are higher than the avoidable costs of category 7 and below landings. This is because a small reduction in the number of category 8 landings would result in Coolangatta airport being downgraded to a category 7 airport. Airservices considers that the cost of category 8 landings is better signalled under the 'incremental cost, aircraft category charge' option, under which category 8 aircraft face higher prices.

However, Airservices expresses concern about the mark-ups over incremental/avoidable costs for the same category of service across airports within this charging option. Airservices notes the significant difference in the mark-ups over avoidable cost between Darwin and Sydney airports (the mark-up at Darwin airport would be 11 times greater than that at Sydney airport). Airservices contends that such a difference would only be efficient if demand to land aircraft at Darwin airport was 11 times less responsive to price than at Sydney airport.

Airservices also notes that while the location specific pricing model could be considered 'fair' under a user pays concept of equity, it states that it could be argued that this concept of equity has less weight where users are required by the Government to purchase services.

### *Views of interested parties*

Australia Pacific Airports Corporation Ltd (Australia Pacific Airports), Board of Airline Representatives of Australia Inc (BARA), and Virgin Blue support the application of the existing location specific pricing methodology.

Australia Pacific Airports sees no reason to believe that Airservices has not been conducting its businesses in a productively efficient way, and considers that one of the best ways to ensure that this continues is to persist with location specific pricing.

BARA considers that a single location specific price is simple to administer and relatively economically efficient, given that it generally reflects the cost of providing services.

Virgin Blue believes that a single location specific pricing methodology leads to the fairest and most equitable pricing methodology, as it reflects the cost of providing the particular services at a particular location.

Both Emirates and IATA support the location specific pricing methodology with incremental category charges, with some qualifications.

Emirates' support is contingent on the pricing structure having rapidly diminishing marginal increases in charges for each category. IATA supports the model on the basis that charges are levied on a per landing basis, and that the incremental category charges are based on the MAR at each location, rather than an averaging approach.

In contrast, while Qantas supports the rationale for location specific charges, it considers that its application to ARFF services at new (secondary and regional) airports will create inefficient outcomes and distort investment.

Qantas considers that the current location specific pricing methodology creates a 'pricing shield' for major airports such as Melbourne, Sydney and Brisbane, because there are more users at major airports to share the localised cost. It considers that the charging structure is likely to result in a disincentive to use new, secondary and regional airports as soon as new ARFF charges are imposed.

#### *Transitional arrangements should be established for new ARFF services*

Both BARA and Qantas consider that, if a location specific pricing methodology were to be retained, transitional arrangements should be established for new ARFF services. Qantas suggests that transitional arrangements could involve capping charges and taking a long-term view to recovering costs at the airport as capacity grows, or accepting a lower rate of return at airports with new ARFF services.

#### *Airservices' approach to calculating incremental category cost charges*

BARA and IATA express concern with Airservices' approach to determining the incremental cost category charges. They do not agree with the averaging approach and consider that the incremental charges should reflect the actual cost of providing that category of service at each location.

BARA is concerned that Airservices' methodology overestimates the incremental cost of providing higher category services at individual locations, and underestimates the costs that should be recovered from all users at a location. BARA states that the costs of providing a particular category of service differ between locations. As an example, BARA cites Sydney airport, which has water rescue boats and two fire stations. BARA also states that Airservices provides a dedicated fire truck and staff for terminal call outs at many major airports.

### *The effect of price differentials on competitive outcomes*

A number of airports and other interested parties argue that the price differentials created by location specific pricing affect competition between airports (and thus volumes of activity between locations), because the cost of landing at a particular location is an important consideration for airlines in determining routes.

Avalon Airport Australia Pty Ltd (Avalon airport) considers that this issue is significant because Melbourne airport is such a powerful competitor, which services the same market and is only 50 kilometres away. It considers that location specific pricing would increase ticket prices and reduce demand for travel through Avalon airport and result in a suspension of investment at Avalon airport.

Similarly, Gold Coast Airport Limited (Gold Coast airport) considers that the price difference between it and Brisbane airport would provide a distinct advantage to Brisbane airport, which is a major competitor to it and is less than one hour away by road. The Mackay Port Authority considers that location specific charges would result in reduced activity at Mackay airport.

Hamilton Island Limited (Hamilton Island) considers that location specific prices may have a detrimental effect on the choice of the Whitsundays as a tourist destination and could cause the number of passengers travelling through the airport to fall below 300 000.

### **Location specific and category pricing**

Airservices outlines two models which contain features of both location specific and category pricing.

The 'location specific for ports with > 6 million passengers' model sets 'location specific, incremental cost, category charges' at all airports with more than six million passengers, and sets an average price for all other categories of service at all other airports.

The 'base level service charge plus incremental category cost' is Airservices' preferred model. This model sets an average price for the category 6 service at all airports. The higher category charges are location specific, in that they are based on the MAR at individual locations.

### ***Airservices' view***

Airservices considers that these two options address some of what it considers are the pricing anomalies caused by the application of location specific charges at low volume airports.

### ***The 'location specific for ports with > 6 million passengers' charging option***

Airservices considers that this model tends to accentuate the difference in prices between the largest airports and all other airports. It considers that to the extent that this does not reflect differences in incremental/avoidable costs, it is likely to be inefficient. It states that the model reduces the extremely high prices at small airports, which may be efficient if such high prices would over signal the costs Airservices would avoid if it

withdrew the service, given the existence of sunk costs and the cost to Airservices of withdrawing a service.

*The 'base level service charge plus incremental category cost' charging option*

Airservices submits that this option accurately signals differences in the location specific incremental/avoidable costs of providing higher category services. It argues that if the incremental/avoidable costs of providing different services at different locations are identical, then reduction of price differentials may have useful efficiency properties.

However, Airservices notes that location specific costs are not signalled at category 6 airports and that this may have some efficiency costs if:

- setting full location specific prices would cause passenger throughput at the airport to fall below 300 000, thereby allowing Airservices to remove the ARFF service
- full location specific pricing reflects avoidable cost (i.e. if there are few sunk costs in providing ARFF services).

*Views of interested parties*

Qantas, the Queensland Government – Aviation Steering Committee (Qld Government), Rockhampton City Council, Voyages Hotels & Resorts Pty Ltd (Voyages) and Rex support the 'base level service charge plus incremental category cost' charging option.

Qantas notes the unique position in Australia where ARFF charges are levied independently of other Airservices' charges, and the fact that ARFF services exhibit strong network features as reasons which justify a departure from the standard location specific pricing approach. It considers that this option provides the best trade-off between price signalling of costs and avoiding competitive disadvantages between airports.

Qantas argues that, unlike other services provided by Airservices, ARFF services display network features. It argues that it is very difficult to establish a direct relationship between the normal operation of a flight and the subsequent need for the provision of an ARFF service at a particular location.

Hamilton Island submits that either of these charging options is feasible and the increase in the ticket price is unlikely to have any detrimental effect on activity.

Maroochy Shire Council supports the 'location specific pricing for ports with >6 million passenger movements' option and considers that the resulting prices can be absorbed by airlines and not dramatically affect activity at Maroochydore airport.

Rockhampton City Council considers that the location specific for ports with > 6 million passengers charging option provides a more equitable distribution of the operational costs associated with the provision of the service, while still apportioning charges for cost increases associated with the larger aircraft services.

In contrast, BARA objects to a return to network pricing as a way of reducing the average prices paid by users at smaller regional locations. It considers that this would:

- undermine and unwind the efficiency and transparency benefits obtained by location specific pricing
- encourage unwarranted expenditure and cost inefficiency at ‘subsidised’ locations with the knowledge that ‘it will only cost a few cents per tonne’ at the major airports.

IATA opposes the ‘base level service charge plus incremental category cost’ option because it argues that the cost of setting up category 6 services differs between airports, so that a uniform charge for all category 6 airports lacks a sound basis.

IATA opposes charging options other than location specific charging because:

- There is little correlation to the cost of establishing and providing different categories of service at different locations. While there are fixed guidelines to the minimum service and equipment levels for a particular category, the actual cost of establishment varies with the layout and other characteristics of the airport.
- There is a detrimental effect on Airservices’ investment decisions due to the limited relationship between the cost and revenue recovery at particular locations, which can lead to excessive investment at lower volume locations.
- There is an inconsistent effect on activity levels, as increased investments at a given location will lead to increased charges (and thus potentially lower activity levels) at other locations.

### **Category pricing**

A full category pricing model sets average prices for all ARFF categories across all airports. The estimated costs of providing category 6 services at all airports is recovered from all flights and the additional costs of providing category 7 and above services are recovered from category 7 and above aircraft landing at any airport where an ARFF service is provided.

#### ***Airservices’ view***

Airservices considers that the move away from location specific pricing has both positive and negative efficiency implications.

Airservices contends that setting the same price per category tends to promote economic efficiency because Airservices’ incremental/avoidable costs associated with most aircraft landings are the same (i.e. zero). Setting the same price for services with the same cost is economically efficient unless there are material differences in elasticity of demand.

However, Airservices notes that in some circumstances there may be material incremental/avoidable costs as a result of a change in activity. This is because the

averaging of prices across locations may disguise differences in incremental/avoidable costs across airports.

Airservices notes that the averaging of prices in a category based model may disguise differences in incremental/avoidable costs across airports.

Airservices cites the example of Coolangatta airport, at which under this pricing model the category 8 price would fall from \$21.49 (under the 'location specific incremental cost category' model) to \$2.50 per tonne. Airservices considers that an accurate reflection of Coolangatta airport's category 8 avoidable costs would probably involve prices rising.

Airservices states that the same may be true at airports where there is a realistic probability of the service not being provided. It gives the case of Avalon airport, which would have a \$21.62 charge under the location specific charging model and a \$1.45 charge under full category pricing. If the location specific charge reflected avoidable costs, Airservices argues that it would be efficient to charge this price at Avalon airport, but inefficient if Airservices' avoidable costs were lower than this.

Airservices argues that the most efficient outcome would be for Airservices to charge for the ARFF service before establishing the ARFF service at Avalon airport, because that would signal the costs of providing the service before the costs were actually sunk.

### ***Views of interested parties***

Avalon airport, Adelaide airport, Mackay Port Authority, AAL (Townsville) Pty Limited (AAL Townsville), the Regional Aviation Association of Australia (RAAA), Hamilton Island, Gold Coast airport, and the SA Government support this charging option.

Avalon airport considers that a category charging model is allocatively efficient because it allocates costs on a fair and reasonable basis, whilst maintaining competition. It also considers that it is closely aligned with dynamic efficiency because under this model, Avalon airport would continue to have appropriate incentives to invest, innovate and improve quality and reduce costs over time.

Mackay Port Authority, AAL Townsville, and the Qld Government consider that this option addresses the anomaly where the ARFF price is less at capital city airports, where passengers are less price elastic and more able to absorb higher costs due to the large proportion of business travellers, than at regional airports, where passengers are more price elastic.

Adelaide airport contends that a charging methodology that can amortise fixed costs over a larger base is preferable to one that penalises specific locations that have a relatively higher fixed cost to operate a smaller sized facility that is capable of taking higher volumes.

Mackay Port Authority argues that this option more clearly relates to the increased cost of providing the increased level of service for higher category aircraft, so there is no discrimination in terms of different costs to provide the same level of safety at different airports.



Avalon airport contends that it would allow Avalon and Melbourne airports to compete on a head to head basis, and not be distorted by alternative cost structures, which cannot be controlled by either airport. Hamilton Island considers that it provides a 'level playing field' for all airports requiring an ARFF service.

Singapore Flying College – Maroochydore (Singapore Flying College) argues that, whilst this option may appear to distribute the cost more effectively to the aircraft that drives the level of service provided, it may also encourage more frequent flights with smaller aircraft to avoid the higher charges for the higher categories.

### **Full network pricing**

A full network price establishes one price regardless of location or incremental costs of providing services at particular locations.

#### ***Airservices' view***

Airservices states that this model would consist of a single charge of \$2.55 per tonne, regardless of location, and would be applied to all category aircraft above, say, 15.1 tonnes, regardless of where they land. However, Airservices states that such an approach has been discounted by the ACCC in the past and it does not consider the option further in its options paper.

Airservices states that concerns previously raised were that this option is unlikely to advance either efficient or equitable outcomes and that it would likely exacerbate productive inefficiency because the costs of providing services would not be targeted directly to those using the service. Additionally, equity issues were raised against customers paying more than the cost of providing the service to them.

#### ***Views of interested parties***

While a number of interested parties favour this option, many do not comment on this option because it is not considered fully in Airservices' options paper. However, BARA objects to a network charge. It argues that the provision of ARFF services does not exhibit the key characteristics of a network and the provision of ARFF services at any one location is not dependent upon a complementary service at another location.

BARA also rejects the consumption-based arguments for network pricing and argues that the provision of ARFF services for diverted aircraft represents a very small minority of ARFF 'call outs'. BARA argues that economies of scale that Airservices may enjoy from providing all the services, compared with a number of providers, do not justify a network charge.

## **Part B: The ACCC's preliminary assessment**

This part of the paper first outlines the legislative framework governing the ACCC's consideration of price notifications, then summarises Airservices' proposal and provides the ACCC's preliminary views.

### **Legislative framework for assessing price notifications**

The provision of air traffic control and ARFF services by Airservices is declared under s. 95X of the Trade Practices Act.<sup>22</sup> Under s. 95Z, Airservices is required to notify the ACCC of proposed increases in prices of these declared services. The ACCC is then responsible for assessing the proposed price increases and can either not object to the increases, not object to increases lower than those proposed or object to the proposed increases.

Subsection 95G(7) sets out matters the ACCC must have particular regard to in assessing a notification; namely, 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.

The ACCC believes that an important consideration regarding these first two criteria is that efficient provision of services underpins investment and employment opportunity in an open and competitive market economy. Investment and employment in the national economy will be promoted when firms produce goods or services efficiently and charge prices which do not incorporate monopoly rents.

Monopoly suppliers do not necessarily produce goods or services at efficient cost levels or at competitive prices. If higher than efficient prices for intermediate services and products are passed on to the rest of the economy, there is a resultant loss in economic efficiency and potentially therefore in investment and employment opportunity.

The ACCC believes that only allowing price increases that stem from an efficient cost base and involve returns aligned with the risk incurred by the firm go some way to reducing the scope for prices to be free of monopoly rents.

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<sup>22</sup> Declaration 66 originally had effect under the *Prices Surveillance Act 1983*, but now has effect under Part VIIA of the Trade Practices Act.

Thus, in assessing price notifications, the ACCC will generally consider:

- the efficiency of the cost base that the declared company is working from to earn a return
- the reasonableness of the rate of return that the declared company is seeking.

The ACCC may also be concerned with the structure of relative prices for individual goods or services. In assessing the structure of prices in a price notification, the ACCC will, when relevant, consider the extent to which the pricing structure promotes the objectives of efficiency.

The third criterion outlined in para. 95G(7)(c) does not appear to be directly relevant to this price notification.

More detail on these and other aspects of the ACCC's approach to price notifications is contained in its *Statement of regulatory approach to price notifications*.<sup>23</sup>

## **Airservices' proposal**

In contrast with the existing location specific pricing methodology in which Airservices levies a uniform charge based on the total costs of providing an ARFF service at an airport, Airservices' proposed charging option involves two components:

- a base level service charge
- incremental category cost charges.

Table 1 outlines Airservices' proposed prices for 2005–06. The proposed prices for the remainder of the period of the price notification are outlined in attachment B.

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<sup>23</sup> ACCC, *Statement of regulatory approach to assessing price notifications*, July 2005, available at <http://www.accc.gov.au>

**Table 1: Proposed prices for 2005–06**

2005–06	Price per tonne of MTOW Aircraft category			
	9	8	7	6
Adelaide	\$ 7.07	\$ 7.07	\$ 3.12	\$ 1.69
Alice Springs	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Avalon	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Brisbane	\$ 3.51	\$ 2.30	\$ 1.96	\$ 1.69
Cairns	\$ 4.41	\$ 4.41	\$ 2.98	\$ 1.69
Canberra	\$ 8.39	\$ 8.39	\$ 8.39	\$ 1.69
Coolangatta	\$ 12.53	\$ 12.53	\$ 3.92	\$ 1.69
Darwin	\$ 5.18	\$ 5.18	\$ 5.18	\$ 1.69
Hamilton Island	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Hobart	\$ 5.87	\$ 5.87	\$ 5.87	\$ 1.69
Launceston	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Mackay	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Maroochydore	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Melbourne	\$ 2.82	\$ 2.04	\$ 1.85	\$ 1.69
Perth	\$ 5.01	\$ 2.65	\$ 2.15	\$ 1.69
Rockhampton	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69
Sydney	\$ 2.26	\$ 1.89	\$ 1.79	\$ 1.69
Townsville	\$ 8.17	\$ 8.17	\$ 8.17	\$ 1.69
Yulara	\$ 1.69	\$ 1.69	\$ 1.69	\$ 1.69

The base level service charge is an average price (per tonne MTOW) that recovers the total cost of providing category 6 services from all aircraft across all airports. The incremental category cost charges recover the costs of providing greater than category 6 services on a location-specific basis. Airservices submits that the incremental category cost charges reflect the incremental/avoidable cost of higher category landings.

The base level service and incremental category cost charges are calculated by separating the total cost of providing ARFF services into a number of cost pools. Airservices adopts this approach because it does not have detailed ARFF costs by category by location, but only the total ARFF costs for all categories by location.

The base level service charge cost pool is composed of the total cost of providing category 6 ARFF services. The incremental category cost pools are composed of the incremental/avoidable costs of providing greater than category 6 services at each airport.

Table 2 illustrates how these costs pools are used to determine Airservices' base level service and incremental category cost charges.

**Table 2: Base level service charge and incremental category cost charges**

Base level service charge  Incremental category cost charges for airport i	$P^6 = \frac{\text{Category 6 cost pool}}{\text{Total activity}}$
	$P_i^7 = P^6 + \frac{\text{Category 7 cost pool at airport i}}{\text{Total category 7 and above activity at airport i}}$
	$P_i^8 = P_i^7 + \frac{\text{Category 8 cost pool at airport i}}{\text{Total category 8 and above activity at airport i}}$
	$P_i^9 = P_i^8 + \frac{\text{Category 9 cost pool at airport i}}{\text{Total category 9 activity at airport i}}$

While Airservices' proposed charges increase with both the weight and category of an aircraft, it levies charges uniformly within each category cost pool. Airservices proposes to retain the use of MTOW as the activity measure on which to levy charges.

Underlying the pricing model, Airservices has:

- used 2004–05 activity as the base
- applied the growth rates used in its 2004 long-term pricing plan
- incorporated revenue from the Department of Defence, thereby reducing MAR.

**How are the cost pools calculated?**

*Proportion of costs allocated to the category 6 cost pool*

Airservices determines the proportion of total costs at an airport allocated to the category 6 pool as shown in table 3, which differs from the approach outlined in its charging options paper.

**Table 3: Proportion of costs allocated to the category 6 cost pool**

Category	Proportion of costs allocated to category 6
9	45%
8	60%
7	80%
6	100%

Airservices devised these proportions after examining the proportions of average category 6 costs to the average costs of each higher category, using 2005–06 costs.

Airservices also increased the proportion of category 9 costs allocated to the category 6 cost pool to 45 per cent. This is because it considers that the provision of ARFF services at such locations to be more complex and costly to operate. Airservices submits that as a validation, the highest category 6 station costs at Yulara (\$3.2 million) are approximately 46 per cent of the average category 9 cost.

*Proportion of costs allocated to the incremental category cost pools*

Airservices estimates the incremental/avoidable costs of providing greater than category 6 services at each airport by allocating the remaining costs to categories based on a series of proportions which reflect the average costs of providing each category of service in proportion to the average cost of providing higher than category 6 services.

Submissions to the charging options paper raise a concern about the extent to which Airservices' approach to estimating the incremental category cost charges at airports accurately reflects the avoidable/incremental costs of providing different categories of service at different airports.

In its submission in response to the charging options paper, BARA does not recommend the application of location specific category cost charges because of the complexity and difficulty in ensuring that the calculation of incremental costs associated with the provision of particular categories of service is accurate. It submits that Airservices' approach implicitly overestimates the incremental cost of providing higher category services at individual locations.

IATA submits that the calculation of the incremental category cost at a particular location should be based on MAR for that location only and should not take into account averages across all airports, in order to be truly location specific.

In response, in its draft price notification, Airservices acknowledges that the calculation of incremental cost between category and location can be complex, while it notes that costs at the same category locations tend to be similar, particularly when assuming the same operational context.

Airservices submits that it does not pretend that this pricing methodology is a perfect reflection of realistically avoided costs for all higher category plane landings at all airports, but it feels that it yields a reasonable incremental price.

Table 4 provides an example of how Airservices allocates costs into incremental category cost pools for a hypothetical category 9 airport. The proportion of costs attributable to a category is determined in proportion to the average difference in average MAR between categories as a proportion of the total incremental category cost at that location.

**Table 4: Proportion of category 9 costs allocated to incremental category cost pools**

Incremental category	Proportion of category 9 costs allocated to incremental category
9	$\frac{\text{Average category 9 costs} - \text{Average category 8 costs}}{\text{Average category 9 costs} - \text{Average category 6 costs}}$
8	$\frac{\text{Average category 8 costs} - \text{Average category 7 costs}}{\text{Average category 9 costs} - \text{Average category 6 costs}}$
7	$\frac{\text{Average category 7 costs} - \text{Average category 6 costs}}{\text{Average category 9 costs} - \text{Average category 6 costs}}$

In contrast to the method of allocating costs to the category 6 cost pool, these proportions are determined in accordance with the option described in Airservices' charging options paper.

## The ACCC's preliminary views

### Introduction

As mentioned above, ordinarily the ACCC's assessment of a price notification would focus on:

- the efficiency of the declared firm's cost base
- the reasonableness of the rate of return the declared company is seeking.

However, given that Airservices has recently reviewed the basis of charging for ARFF services with its customers, and that it proposes to introduce a new charging methodology for these services, the ACCC's assessment focuses on the efficiency of the proposed pricing structure.

The ACCC also assesses the costs that Airservices seeks to recover over the course of the price notification, but for most locations it relies on its preliminary view in relation to Airservices' 2004 long-term price notification. In that preliminary view, the ACCC considered that the quantum of revenue that Airservices sought to recover over the period 2004–05 to 2008–09 through prices was reasonable.

The ACCC's assessment of Airservices' costs focuses on the reasonableness of the costs that Airservices seeks to recover at locations at which Airservices proposes to establish new ARFF services, and on changes to the timing and quantum of operating costs that Airservices sought to recover in its 2004 price notification.

This section of the report first assesses the amount of revenue sought by Airservices and then assesses the efficiency of the proposed charging methodology, in the context of the Government’s policy of introducing competition into the provision of ARFF services.

**Airservices’ costs**

The ACCC’s assessment of Airservices’ estimated costs focuses on:

- changes in the quantum and timing of operating expenditure at existing locations (services established at the time of Airservices’ 2004 long-term pricing proposal)
- the reasonableness of the cost estimates used for newly established ARFF services.

***Changes in the quantum and timing of operating expenditure at existing locations***

*Airservices’ view*

Table 5 outlines Airservices’ proposed changes to the quantum and timing of its operating costs over the course of the pricing proposal.

**Table 5: Proposed changes to the quantum and timing of Airservices’ operating costs at existing locations**

<b>Amendment</b>	<b>Location</b>	<b>2005/06</b>	<b>2006/07</b>	<b>2007/08</b>	<b>2008/09</b>
<b>Increasing service to 24 hour operations</b>	Canberra	\$324,153	\$339,456	\$355,371	\$371,924
	Sydney	\$(495,203)	\$(1,029,948)	\$(535,538)	0
<b>Deferral of A380 aircraft service</b>	Melbourne	0	\$(173,677)	\$(541,874)	0
	Launceston	0	\$182,026	\$189,292	\$196,850
<b>Increase in station category</b>	Rockhampton	0	\$544,976	\$588,176	\$588,176
	<b>Total amendments</b>		<b>\$(171,049)</b>	<b>\$(137,166)</b>	<b>\$55,431</b>

Airservices states that, for simplicity, it has limited the modifications to revenue sought to staff costs, and states that this will enable it to recover the majority of costs.

Airservices states that it will increase the hours of the ARFF service at Canberra airport because activity levels have increased and aircraft are continuing to land after the scheduled closure of the ARFF station. To cater for this, Airservices intends to increase its staffing levels at Canberra airport by four.

Airservices has reduced staff costs due to delay in the introduction of the Airbus A380 at Sydney and Melbourne airports in the three-year period between 2005–06 and 2007–08.



Airservices has increased staff costs at Launceston and Rockhampton airports. It argues that increased activity has resulted in a need for longer hours of operation at these airports. It states that the current flight profiles indicate that an increase in category is not, however, warranted.

#### *ACCC's views*

As stated earlier, the focus of this assessment is on the charging *structure* and related methodology Airservices is proposing for ARFF services, rather than the underlying revenue. The ACCC assessed the revenue Airservices sought to recover in its pricing over the period 2004–05 to 2008–09 in its 2004 assessment. Airservices has acknowledged this in its communications with stakeholders, in which it has said that the total amount of revenue, including the rate of return sought, has been previously agreed.<sup>24</sup>

The ACCC is not persuaded therefore to agree to any amendments in revenue for the 2005–06 to 2008–09 period. This is reinforced by the benefits obtained in Airservices' move to a longer-term pricing approach.

In part, Airservices developed a long-term pricing proposal in response to the ACCC's decision to object to Airservices' 2003 price notification. The main reason for the ACCC's objection was that Airservices had failed to address the ACCC's previously expressed preference for a longer-term approach to pricing; instead Airservices had sought to temporarily increase prices on the basis of short-term costs and activity forecasts.

A longer-term approach to pricing promotes productive efficiency by encouraging Airservices to provide services at the lowest possible cost. This is because a long-term approach to pricing allows Airservices to retain the gains associated with improvements in the efficiency of its operations, and requires Airservices to cover any increases in its forecast costs.

Similarly, dynamic efficiency is enhanced because pricing cannot be simply adjusted to provide returns on investments the year after they are made. Rather, by sharing with users the risks associated with changes in demand, Airservices should face better incentives to time investments efficiently. Dynamic efficiency is also reinforced by reflecting the costs of investment, such as upgrading to a higher ARFF category at a specific location, in associated prices.

Airservices' proposed changes to the quantum and timing of costs are relatively small in comparison with total annual ARFF costs, and are unlikely to have a substantial impact on Airservices' prices.

However, the ACCC considers that enabling Airservices to revisit the costs it proposed to recover in its 2004 long-term pricing arrangement in this price notification would reduce Airservices' incentives to be productively efficient during the course of the long-term pricing period.

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<sup>24</sup> See, for example, Airservices Australia's letter to stakeholders, *Developing an Alternative Charging Basis for ARFF*, 20 July 2005.

It may also set a precedent of accepting modifications to forecast costs during the agreed pricing period, which may reduce pricing certainty for users, as well as increasing regulatory costs.

The ACCC therefore does not consider that Airservices' underlying costs should be increased in relation to the operating costs for existing ARFF services.

***The efficiency of the costs at newly established locations***

Airservices has included proposed ARFF prices at two new locations—Avalon and Hamilton Island airports. No prices are currently in place at these airports and the ACCC has not previously assessed the cost estimates for the provision of these services.

*Airservices' view*

Airservices has estimated costs for the provision of the two new services which are less than the average costs of existing category 6 stations.

Airservices attributes this to the nature of its engagement with the airport operators before the commencement of the services. It states that Hamilton Island airport is likely to contribute to the cost of the fire station infrastructure and that Avalon airport has an existing facility in place which Airservices will modify.

Airservices submits that older fire vehicles within the ARFF fleet, with minimal or nil written down value will be used at the new ARFF locations, although some refurbishment to older vehicles is required at Hamilton Island airport.

Airservices states that it has taken conservative estimates of capital costs and will refine these estimates before submitting the final price notification. In particular, the amount of costs that Airservices seeks to recover for fire trucks may change because Airservices is currently reviewing a business case for additional vehicles to replace the aging fleet that it has been unable to retire due to increasing demand for services.

*ACCC's views*

The ACCC considers it appropriate to include additional amounts in Airservices' MAR in order to cover the efficient costs of providing *new* services at Avalon and Hamilton Island airports. Airservices has used the same rate of return as allowed for its existing services, which has already been the subject of the ACCC's assessment. Therefore, the focus of the ACCC's assessment is on the efficiency of the cost base Airservices is seeking.

It is important that the cost base includes only the costs associated with efficient provision of the new services, in order to prevent inappropriately high prices.

The level of costs that Airservices expects to incur over the course of the pricing proposal is relatively low compared with estimated costs at other category 6 locations. However, as stated in the ACCC's 2004 assessment, the information provided by Airservices does not fully enable the ACCC to make an assessment of whether Airservices' estimated costs are at efficient levels. The ACCC did accept the cost

estimates in Airservices' 2004 proposal, however, on the basis of limited benchmarking information and submissions from Airservices' major customers.

The ACCC stated in its 2004 decision that the long-term pricing agreement would provide some incentive properties for Airservices to reduce costs and would also provide a benchmark against which its customers can assess Airservices' performance.

In light of these considerations, the ACCC accepts the cost estimates that Airservices proposes to recover at Hamilton Island and Avalon airports. However, the ACCC will need to reassess this issue if Airservices revises its forecast capital expenditure in the final price notification.

### **Who should pay for ARFF services and on what basis?**

#### ***Airservices' view***

As stated in Part A of this report, Airservices favours retaining the use of MTOW as the basis for levying ARFF charges. In order to strengthen the link to fare-paying passengers, Airservices proposes that aircraft between 5.7 and 15.1 tonnes will only be subject to the category 6 price if they carry fare-paying passengers.<sup>25</sup> Moreover, it will not levy charges on aircraft under 5.7 tonnes.<sup>26</sup>

Airservices submits that while it gave some thought to whether operators under the threshold and not carrying fare-paying passengers should be required to pay a nominal call-out fee or a flat annual charge, it has decided against this because:

- it wants to encourage safe practices; i.e. notification of potential incidents
- the financial contribution would be small
- some operators may not fly into ARFF-serviced ports.

#### ***The ACCC's views***

Charges levied for ARFF services should be levied on those users that both drive its costs, and benefit from the supply of the service. Once the users who should be charged are identified, the base on which charges are levied needs to be linked to those users.

The ACCC agrees with Airservices' decision to levy charges for ARFF services on fare-paying passengers because they influence Airservices' costs and they directly benefit from the provision of the service.<sup>27</sup>

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<sup>25</sup> Airservices defines a fare-paying passenger as a passenger that has hired (including charters), paid a fee, or purchased a ticket to travel in aircraft, for the purpose of travelling between different locations or in and out of the same location. Therefore, it does not include crew, crew under instruction, or non-paying passengers.

<sup>26</sup> As indicated by Airservices, the 15.1 tonne threshold covers the Dash 8 aircraft and 91 per cent of all aircraft types in 2004–05 using ARFF facilities.

<sup>27</sup> Airservices also notes that the MTOW is a very good proxy for passengers-on-board (especially above the 15.1 tonnes threshold), with a strong correlation between these two measures.

Passengers influence the costs that Airservices incurs in providing ARFF services through the establishment criteria. Amongst other things, the establishment criteria require that an ARFF service be provided when there are more than 350 000 passenger movements through an aerodrome.

Passengers also directly benefit from the provision of the service, because the regulations require Airservices to give preference to rescuing persons and property from an aircraft that has crashed or caught fire and to controlling and extinguishing fires on the aerodrome. While Qantas points out that other parties, such as the airport and non-airline users may benefit from the ARFF service, the parties driving Airservices' costs and benefiting from Airservices giving priority to attending to aircraft and aerodrome incidents, are passengers.

Airservices' proposal to apply charges only to aircraft carrying fare-paying passengers addresses the ACCC's concerns expressed in relation to Airservices' interim price notification, that there was potential for some operators under the threshold to enjoy a competitive advantage.

The ACCC therefore considers that the proposed application of MTOW in Airservices' proposal is reasonable. However, it does note the point made by Emirates, that to the extent that MTOW is not a reasonable proxy for passenger numbers, passengers travelling on aircraft with different passenger to weight ratios will implicitly pay different prices for ARFF services.

### **The efficiency of the proposed charging option**

In considering whether Airservices' preferred charging option is economically efficient, the ACCC has regard to the different elements of economic efficiency, as outlined in its *Statement of regulatory approach to assessing price notifications*.

Economic efficiency encompasses the following elements:

- *productive efficiency*, which occurs when firms produce goods or services at least cost
- *allocative efficiency*, which occurs when resources are used in areas where they provide the greatest value to society as a whole
- *dynamic efficiency*, which occurs when firms have appropriate incentives to invest, innovate and improve quality or reduce costs over time.

The assessment of the efficiency and sustainability of Airservices' proposed charging structure depends critically on whether ARFF services are open to competitors entering the market. Therefore, the following section contains a discussion of the extent to which ARFF services are currently open to competition, followed by a discussion of the efficiency of the proposed charging option.

### ***Extent to which ARFF services are open to competition***

#### *Airservices' view*

In its charging options paper, Airservices notes that, 'It is currently Government policy that, where efficient and feasible, the contestable supply of ARFF services should be

introduced.’ It submits that there are a number of different models under which contestability could be introduced, and some of these models would require adjustment mechanisms to be established.

In its draft price notification, Airservices notes that contestability could be introduced under its preferred charging model without affecting the set prices; for example, through the selection of tenders by an independent agency on the basis of lowest cost at each location.

However, Airservices submits that as the final contestable model has yet to be articulated, it requires an adjustment mechanism to allow for re-pricing, depending on the final competition outcome. In particular, Airservices indicates that it may seek to reset its prices during the period of the price notification if a change in the regulations, including the implementation of the Government’s competition policy, is likely to have a significant effect on its asset base and recurrent costs.

In a further submission,<sup>28</sup> Airservices submits that location-specific pricing is not a necessary pre-requisite to the introduction of contestability and that contestability itself need not impact on a regulated price.

Airservices states that, under contestability, it would price differently to the approach taken under any set of regulated prices. It states that this is because the prices currently include an allocation of common overhead costs plus recovery of sunk (unavoidable) costs at a location, while under competition, providers would be bidding down to actual (incremental) costs at any given location. Airservices states that, if it is not allowed this flexibility, then it is likely that contestability will result in ‘inefficient cherry picking’ by new entrants.

Airservices expands on the statements made in its draft price notification and considers that there is a range of ways that contestability could be achieved under its preferred charging option. Airservices submits that one model divorces the prices at individual airports from the costs at those airports, by establishing an independent body, potentially run by airlines, which would have responsibility for selecting all ARFF suppliers across all locations. Airservices considers that under this model the independent body would have the incentive to choose the lowest cost providers and regulated ARFF revenues would fall to reflect lower overall costs.

However, Airservices states that there would be no requirement that revenues at each contested location would fall to reflect bids to supply that location. Rather, it states that any new entrant would be paid out of total ARFF revenues with any revealed cost savings from contestability shared between locations ‘in any manner that the ACCC saw fit to approve’.

#### *Views of interested parties*

The Department of Transport and Regional Services (DoTARS) confirms that it is Government policy to introduce greater competition in the services currently provided

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<sup>28</sup> Airservices Australia, *Draft price notification—aviation rescue & fire fighting*, 7 November 2005, available on the ACCC’s website at <http://www.accc.gov.au>

by Airservices, including ARFF. It submits that over time with contestability there is expected to be more than one ARFF service provider.

The SA Government considers that contestability can be achieved under network pricing through tendering for the provision of ARFF services at each location for a defined period. It states that the tenders and contracts could be managed by a central agency and revenue collected on a national basis such that total revenue covers all costs.

In contrast, Australia Pacific Airports and IATA consider that network pricing is inconsistent with contestability. IATA considers that the entry of a competitor in a network charging environment would have disparate effects on Airservices' costs and revenues and could lead to substantial and unpredictable fluctuations in charges at remaining Airservices' locations, especially if the location is a high volume airport. IATA argues that a new entrant at a low volume location will not be in a position to recover costs from the network, leading to a competitive disadvantage.

Mackay Port Authority and Rockhampton City Council consider that it would be difficult for new entry to occur because of significant establishment costs. Mackay Port Authority considers that Airservices has a large advantage of established systems and facilities which have a lower written down value and therefore don't need the same return on assets as a new entrant. The SA Government also considers that Airservices enjoys very large economies of scale. It considers that the nature of the regulation may limit opportunities to innovate and introduce efficiencies.

Qantas supports opening up the provision of ARFF services to potential private suppliers in order to ensure that the most cost efficient and effective outcome is achieved in the delivery of this service. It states that whilst it is not clear how contestability will be introduced, one option is to establish a government or industry panel which would be responsible for tendering out the provision of ARFF services.

Both Mackay Port Authority and Rockhampton City Council consider that competition could be introduced by enabling alternative providers to access Airservices' existing infrastructure and equipment. Rockhampton City Council considers that the issue of ownership of Airservices' assets must be resolved prior to any decision about contestability being made.

Mackay Port Authority considers that this would encourage Airservices to examine the amount of head office overheads charged to ARFF services and look at ways to utilise its own station staff for administrative services such as payroll, human resources, and budget control and processing.

Delta Fire & Rescue Service states that it is well advanced in being certified as a provider of ARFF services, and that its aim is to provide a competitive alternative to Airservices. Delta Fire & Rescue Service states that it has recently been informed by CASA that it meets the requirements and is only weeks from being accredited.

Delta Fire & Rescue Service plans to provide an alternative at secondary airports located throughout regional Australia, and considers it could provide a highly efficient and effective alternative solution to the one currently provided by Airservices.

In a subsequent letter to the ACCC,<sup>29</sup> DoTARS refers to Delta Fire & Rescue Service's submission and states that an ARFF service provider would need to be fully compliant with the CASR and the associated manual of standards before it can be approved and certified by CASA. DoTARS states that a proposed amendment to the CASR, which would allow Delta Fire & Rescue Service to apply for certification by CASA, is currently being considered by the Minister.

*The ACCC's views*

Allowing competition in the provision of ARFF services would provide Airservices with an additional incentive to incur costs efficiently above the existing incentive within the long-term pricing proposal.

However, it does not appear that markets for ARFF services will be opened up to competition in the short term, covering the period of this price notification. At this stage, apart from Broome Airport Services Pty Ltd and the Administration of Norfolk Island, Airservices is the sole provider of ARFF services at airports across Australia.

While it has been Government policy for a number of years to introduce greater competition in the markets for various services currently provided by Airservices, including ARFF, it appears to the ACCC that a number of important issues need to be addressed before competitors to Airservices can compete for these markets.

Under the provisions of the Airports Act, the approval of the Minister is necessary before a provider other than Airservices can actually supply ARFF services. This is in addition to the regulations being amended to list other providers in relation to specified airports and certification by CASA. While Delta Fire & Rescue Service submits that it is close to being approved as an ARFF service provider, at the time of the ACCC's deliberations, the regulations have not yet been amended to name Delta Fire & Rescue Service.

As stated by the ACCC in its decision on Airservices' 2004 long-term price notification, cross subsidies in Airservices' existing pricing arrangements would be of immediate concern if there was scope for competitive entry, because such prices may lead to inefficient entry. The ACCC found that there appeared to be a degree of cross-subsidisation of TN and ARFF services at regional and GA locations by en route and TN services at radar locations (a larger category including capital city airports).<sup>30</sup> The ACCC considered that the pricing of ARFF services by Airservices is an important issue which should be considered by the Government in the context of introducing competition for the provision of ARFF services, to ensure that Airservices' pricing does not create a barrier to entry or distort entry decisions.

The current process of considering the structure of ARFF pricing does not disturb the overall revenue amounts for the en route or TN services. In the main, Airservices'

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<sup>29</sup> DoTARS, *Certification of an Aviation Rescue and Fire Fighting Services Provider*, 2 November 2005, available on the ACCC's website at <http://www.accc.gov.au>

<sup>30</sup> As noted in the ACCC's 2004 decision, this result needs to be treated with caution, to the extent that the services at regional and GA airports and at other airports are substitutes in demand.

proposal incorporates the total revenue amount for ARFF services as assessed in the ACCC's 2004 decision. Therefore, regardless of the pricing structure agreed through this process, the ACCC's comments made in 2004 are still relevant.

While there is theoretical scope for competitors to Airservices to enter the market for the provision of ARFF services, it is not entirely clear on what basis Airservices and Delta Fire & Rescue Service would compete.

If Delta Fire & Rescue Service were to enter the market under existing arrangements, it would compete with Airservices on the basis of price. However, as mentioned, under any charging structure for ARFF services, there is the potential for Airservices' pricing to pose a barrier to entry. Under the existing location specific prices, entry may be deterred at regional and general aviation airports, because Airservices recovers less than its fully attributable costs of providing the services.

Airservices currently recovers more than the incremental costs of providing ARFF services at radar locations, which has the potential to encourage competitors who may not necessarily be more efficient than Airservices. However, as Airservices has stated, it would revise its pricing approach under the threat of entry. For proposed price increases, Airservices would need to submit a price notification for the ACCC's assessment and the ACCC is not expressing a view on Airservices' proposals to revise its prices in the event of competition in this process.

Airservices' proposed charging regime for ARFF services would increase the degree of cross-subsidisation of regional and GA airports from radar locations. A model for introducing competition on the basis of price may deter a relatively efficient competitor from entering at airports where Airservices recovers less than its incremental costs (newly established and regional locations). Conversely, there may be an incentive for entry by an equally or less efficient entrant at radar locations. However, these responses depend on the entry and competition institutional arrangements.

Airservices' preferred charging option is not necessarily incompatible with introducing competition in the supply of ARFF services. As mentioned by the SA Government, Qantas, and Airservices, it would be possible to introduce competition for ARFF services on the basis of costs through an independent tendering process. Such a model for introducing competition would provide an incentive for Airservices to incur its costs efficiently, and would be independent of any charging option chosen to recover the total costs of providing ARFF services.

There are some sunk costs in the provision of existing ARFF services, in the form of existing fire stations and possibly fire trucks. Without making some arrangements to allow transfer of these assets to a competing provider, the provision of existing ARFF services are less than fully 'contestable' in the economic sense.

Therefore, in making a decision on the model of competition that should be applied to ARFF services, as well as the practical issues associated with proposals to possibly set up an independent body to conduct tenders and handle payments, the Government may wish to consider the extent of competition that it will introduce (i.e. at some airports only, or at all airports), pricing principles which should apply to Airservices in



competing against potential alternative suppliers, and what arrangements should be made for Airservices' sunk assets.

While Airservices' submission assumes that the ACCC would have jurisdiction to approve reallocations of costs resulting from cost savings, this is not necessarily the case. The ACCC's jurisdiction in relation to pricing for ARFF services is limited to assessing proposed price increases from Airservices. Under current arrangements, it does not extend to any other provider of ARFF services and it would not cover the administration of transfers of ARFF revenues.

In conclusion, it appears unlikely that ARFF services will be opened up to competition in the short term, covering the period of this price notification, the end of which coincides with the pricing arrangements for the en route and TN services.

The existing charging arrangements for ARFF services have the potential to create a barrier to entry because it appears that radar locations cross subsidise regional and GA locations. The extent of cross-subsidisation is increased under Airservices' proposal. This is an important consideration for the Government in considering what form it wants competition for ARFF services to take. Submissions to this process have suggested possible forms for introducing competition and also raised the issue of Airservices' sunk costs, which could affect the contestability of entry. For the purpose of assessing the efficiency of the price structure proposed in this notification, the ACCC assumes that competitive entry in the short term is not a factor.

### ***Efficiency of the proposed price structure***

#### *Airservices' view*

Airservices notes that allocative efficiency is maximised when businesses internalise the marginal costs that their actions impose on society. It submits that this sends a signal that businesses should only engage in an activity if the value to them is more than the cost to society of accommodating that activity.

Airservices understands that 'if non-marginal costs are to be recovered through marginal prices it is most efficient to set an absolute mark up above marginal cost that is inversely proportional to the price sensitivity<sup>31</sup> of landing a particular aircraft at an airport'.

Airservices considers that, if the following assumptions hold, then it follows that all tonnes landed should pay the same base price:

- the price sensitivity to land tonnes (which is a proxy for passenger numbers) at all airports is the same
- the marginal cost of landing tonnes at all airports is the same.

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<sup>31</sup> Airservices contends that in the context of the draft price notification it is discussing an absolute mark-up on marginal cost and, as such, the relevant measure of 'price sensitivity' is the percentage change in demand for an absolute change in price (rather than a percentage change in price).

Airservices argues that the preferred charging option is broadly consistent with the established economic theory of optimal pricing in the context of fixed costs.

Further, Airservices argues that the incremental category cost charges are justified in the following way:

- on equity grounds, higher category aircraft require Airservices to provide a higher category of ARFF service, which increases Airservices' costs
- on efficiency grounds, Airservices' avoidable costs should be signalled in prices, and at some airports, the avoidable cost of higher category landings is high.

Airservices considers that the primary incentive for cost efficiency comes from its ability to keep any financial benefit from reducing its costs over the course of the regulatory period. Airservices considers that this incentive is the same irrespective of which charging option is implemented and that its major customers would continue to have the incentive to monitor its total costs under its proposed charging methodology.

Airservices also considers that airports' incentives to monitor location specific costs are weak even under location specific pricing and are a 'third order' consideration compared with Airservices' incentives to minimise costs.

Airservices notes that because the costs it incurs in providing an ARFF services are determined by the regulations, the only real scope for it to save costs is in its price negotiations with input suppliers and in its overheads.

However, Airservices states that it has determined for the initial provision of an ARFF service, that it will minimise the capital investment to a level which would sustain the operation at least for the first 12 months whilst a final station requirement is determined. Airservices undertakes 'to discuss the development of any new or replacement fire station with the airport owner / airline operators such that they have input into the overall placement, footprint, and design, the combination of which clearly impact on cost and consequently overall price.' Airservices also states that, 'in order to ensure aircraft operators and airport owners have greater visibility of ASA's costs, it is also proposed that annual on-site expenditure forecast reviews will be undertaken at each location.'

#### *The ACCC's views*

##### The nature of ARFF costs

The costs Airservices faces in providing an ARFF service can be considered to be fixed for a given category of service because variations in activity levels do not influence its costs in the short term. Thus, the marginal cost of additional landings is zero within a particular category of ARFF service.

However, significant variations in activity levels and in activity of a particular category can influence Airservices' costs. For example, Airservices is required to provide an ARFF service at an airport when the relevant activity thresholds are triggered, and an ARFF service can be disestablished at an airport when the number of annual passengers falls below 300 000 and remains at that level for a 12-month period. Airservices'

obligation to provide a particular category of ARFF service also changes as the category of the ‘critical aircraft’ at the airport changes.

Airservices’ fixed costs can be split into two categories:

- fixed common costs—such as corporate overheads
- fixed separable costs—the costs largely prescribed by regulation that are attributable to providing a particular category service at a location.

The costs of providing a category 6 service, which is the basic level of service, are common to the provision of all users of ARFF services at a location. That is, the costs of providing a category 6 service are common to all users of Sydney airport (a category 9 service), because once the base level of service is provided, it is available and used to provide services to all landings.

Given that the marginal cost of additional landings in the majority of instances appears to be zero, ‘first best’ pricing (in which prices are set to marginal cost) will not recover from passengers Airservices’ total costs of providing ARFF services.

However, any pricing methodology which recovers fixed costs through mark-ups above marginal cost will cause a loss in allocative efficiency, because some customers who have a value greater or equal to marginal cost may choose not to purchase the service (i.e. land at the airport) at the marked-up price.

The primary point of difference between Airservices’ preferred charging model and the current location specific pricing methodology is that Airservices’ preferred charging model recovers all fixed common costs and the fixed separable costs attributable to category 6 services from all users in the base level service charge.

Airservices also proposes to levy incremental category cost charges which recover the location specific cost of providing higher category services at the higher category airports.

#### Consistency of Airservices’ preferred charging methodology with Ramsey pricing

Airservices argues that its proposed approach is consistent with the Ramsey taxation formula (commonly referred to as Ramsey pricing). Ramsey pricing involves establishing a set of prices which minimises the distortion due to impact on usage (loss to allocative efficiency), subject to a constraint that fixed costs are recovered.

Where the demands to land at different airports are independent, the guiding principle of this minimisation problem is that prices for particular services should be a percentage mark up above marginal cost in inverse proportion to the elasticity of demand for that service.<sup>32</sup>

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<sup>32</sup> This guiding principle, expressed in this way, becomes impractical to implement if marginal costs are very small (or taken as zero), since all mark-ups (above zero) approach 100 per cent. However, while the general inverse price elasticity influence is still at work, the price levels are shaped directly by the specific demand conditions. So, for example, if demands are approximated by linear

Where the demands are related, altering the mark-up on one service will impact demand for another service. In this case, mark-ups should take into account both own price effects, and cross price<sup>33</sup> effects. However, for most of Airservices' users, these cross price effects will be quite small.<sup>34</sup>

It does not seem likely that Airservices' assumption, that the price elasticity of demand to land is the same at all locations, holds. In general, the price elasticity of demand to land at a location is likely to be smaller (i.e. landings will be less responsive to price increases):

- the larger the size of the market
- the larger the aircraft or the greater the number of passengers on board
- the greater the share of long-haul / international traffic at that location
- the greater the extent to which the trip is non-discretionary (for example, for business)
- the lower the level of the price.

There are also a number of sources of information about the price elasticity of demand to land at airports which indicate that passengers' elasticities of demand<sup>35</sup> to travel to a location are not identical.

Airservices refers to a number of elasticity studies for Australian airlines, noting that estimates vary. These studies indicate that the elasticity of demand for business travellers is lower than for leisure travel and that the elasticity of demand for short and medium haul routes is lower than for 'summer holiday' and 'winter sunspot' routes.

In its report on the *Price Regulation on Airport Services*,<sup>36</sup> the Productivity Commission (PC) assessed the elasticity of demand to travel to Australian airports in the context of

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relationships, then price levels across services should be set so that they are in direct proportion to the maximum or limit prices of ARFF services, or equivalently, such that all quantity levels demanded are reduced by the same proportion below maximum levels (quantities demanded at a zero price). Typically, these guidelines correspond to the same factors that shape inverse elasticity.

<sup>33</sup> While the own price elasticity of a service is a measure of the sensitivity of the demand to changes in its own price, the cross-price elasticity of one service (A) is a measure of the effect on demand of another service (B) of a (percentage) change in the price of that service (A).

<sup>34</sup> The cross-price effect may be incorporated by adding (reducing for ARFF services/airports that are substitutes) the 'own price elasticity' by the amount of the cross price elasticity to yield a 'net' elasticity. (Summed over all relevant demands, weighted by revenue shares, this is referred to as a 'super' elasticity.) In the case of Melbourne, Melbourne and Avalon airports are ('weak') substitutes—for airlines and passengers. But even for these two airports, the effect of say a change in the price of using Melbourne (landing charges via ARFF charges) on the demand for landings at Avalon is likely to be small. There may be a limit price in landing charges above which an airline would switch airports but typically other business strategy considerations dominate.

<sup>35</sup> Obviously, for RPT services, the demand of an airline to land at a particular location is determined by passengers' demand to travel to that particular location.

<sup>36</sup> Productivity Commission, *Price Regulation of Airport Services: Inquiry Report*, 23 January 2002.

providing indicators of the degree of market power at different airports. The PC noted that while each market segment has substitution possibilities, these possibilities are higher for holiday travellers. Therefore, destinations with a greater proportion of leisure traffic are likely to be more susceptible to competition from other destinations. On the other hand, the higher the proportion of business traffic, the less price sensitive travellers to a destination are likely to be.

In light of information on the proportions of business and holiday travel to other reasons for travel, the PC considered that substitution possibilities and hence demand elasticities (assuming that mean elasticity is an appropriate measure of price sensitivity) for destinations such as Adelaide, Brisbane, Canberra, Melbourne, Perth and Sydney will be lower than for the other destinations considered.<sup>37</sup>

Qantas also submits elasticity estimates for selected regional and trunk routes flown by Qantas and Jetstar. These estimates broadly indicate that elasticity of demand for routes to capital city airports are lower than for travel to other locations. Qantas submits that the different elasticities highlight the price sensitivity of regional markets, where ARFF services constitute a much greater percentage of the total cost of operations.

Given this information, it seems more reasonable to draw the conclusion that passengers' elasticity of demand to land at capital city airports is lower than passengers' demand to land at regional airports, rather than that all passengers face the same elasticity of demand to land at all airports.

It follows that applying Ramsey pricing principles would suggest applying higher mark-ups above marginal cost for ARFF services at capital city airports than at other locations. This is possible because Airservices has available to it the ability to recover costs from its ARFF services at all airports at which it is the provider, and in doing so to keep as small as possible the distortions to activity which may result when price is set above marginal cost. At the capital city airports, the relative size of ARFF charges in relation to an average ticket cost is very small under both the existing location specific charging and Airservices' proposal and therefore the proposed price increases would not be expected to have any significant effect on activity at these airports. On the other hand, at small, low volume airports, the relative size of ARFF charges under the existing charging structure may be a significant proportion of ticket prices, and could have a significant impact on usage.

The proposed common price for category 6 planes (\$1.69 per tonne), charged on the basis of MTOW, results in a higher mark up above marginal cost (and other landing charges) at the larger capital city airports and a lesser mark up at regional and GA airports. This is because larger aircraft landing at capital city airports will pay the common price applied per tonne, in addition to the incremental charges applicable to higher category planes. More substantially, the total charges for landings collected at larger airports will be higher, typically for all categories. This can be expected to be in line with Ramsey pricing principles and less distortionary, in terms of allocative efficiency, than the existing location specific pricing structure.

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<sup>37</sup> Unless business frequency / number of landings is highly price elastic.

Under the existing location specific charging methodology, the combination of similar fixed costs by category at all locations but vastly different levels of landings by location results in very large differences in ARFF charges across locations (by category). For example, landings at Maroochydore airport are subject to a single price of \$16.82 per tonne. This compares with a charge of 88 cents per tonne at Sydney airport. The impact on usage of the \$16.82 per tonne (or of the order of \$1209 for a category 7, Boeing 373-800 aircraft) is likely to have a substantially greater impact on usage of Maroochydore than the 88 cents (or of the order of \$63) at Sydney.

The implementation of a location specific charging methodology results in lower per passenger mark ups over marginal cost at locations with high levels of activity (such as at capital city airports) and high mark-ups over marginal cost at locations with low levels of activity (such as regional airports and newly established ARFF services). These price differences arise because under the location specific pricing options, the prices at a location are driven by average fixed costs and hence the larger the airport the smaller the breakeven price than can be set.

The Mackay Port Authority, AAL Townsville, and the Qld Government all note that Airservices' location specific pricing structure results in ARFF prices that are less at capital city airports, where passengers are less price elastic and more able to absorb higher costs, partly due to the larger proportion of business travellers, than at regional airports, where passengers are more price elastic. But in addition to this possible capital city-regional price elasticity difference, price elasticities are just typically higher at much higher price levels.

The ACCC therefore considers that the common category 6 element of Airservices' preferred charging methodology better promotes allocative efficiency than Airservices' location specific charging methodology.

However, Airservices does propose to recover the incremental costs of providing higher category services from higher category aircraft on a location specific basis. This approach results in higher mark ups above marginal cost at smaller airports and lower mark-ups above marginal cost at capital city airports. At the extreme, a category 9 plane landing at Coolangatta airport would pay \$12.53 per tonne, whereas the same type of plane landing at Sydney airport would pay \$2.26 per tonne. This does not seem to be desirable on allocative efficiency grounds.

The above discussion applying the principles of Ramsey pricing is relevant in the context of fixed sunk costs. However, in cases where Airservices has not yet invested and there is a likelihood that new investment will be required to either provide a new service or upgrade an existing service, it is desirable on productive and dynamic efficiency grounds that the incremental costs are effectively signalled in advance to those users that may cause the incremental costs. This is discussed in the following section.

#### Airservices' incentives to invest in new ARFF services and categories

As stated above, Airservices justifies the incremental category charges on the basis that higher category aircraft require Airservices to provide a higher category of ARFF

service, which increases its costs, and that the avoidable costs of higher category landings are high at some airports, and this should be signalled in prices.

In relation to proposed new category of services, such as category 6, Airservices considers that it would be efficient to signal the avoidable costs of being required to provide a new category 6 ARFF station (including the fixed costs of building and equipping a fire station) before the service is established and most of the capital costs are sunk. However, Airservices submits that levying avoidable costs on aircraft operators before a new service is established is not an option available to it. A difficulty here is that the obligations of Airservices to provide (or upgrade) ARFF services of a given category at a location are determined by threshold levels based upon past use (in the previous 12 months) at that location. A further difficulty is that a levy to recover the fixed costs of providing a category may impact on usage and allocative efficiency if it is based on use (per tonne landed).

At the same time, if ARFF charges could have a substantial impact on aircraft operators' decisions to land at airports, signalling the avoidable costs of establishing new ARFF services or categories through prices would deter landings at that airport where the avoidable cost of the ARFF service is greater than aircraft operators' demand (aggregate willingness to pay on an all or nothing basis) to land at an airport. This would avoid inefficient investments in ARFF services and serve dynamic efficiency.

By adopting only usage-based charges to recover sunk fixed costs or attempt to signal avoidable incremental fixed costs (of a new category), Airservices is faced with the need to balance efficiency in use (calling for prices towards zero marginal costs) and efficiency in new investment (calling for prices towards average incremental fixed costs of a higher category should its threshold be reached).<sup>38</sup> With respect to established category 6 services, this balance is struck in favour of allocative efficiency, by adopting a common basic service approach, bearing in mind the higher price sensitivity of the low volume activity locations. For higher categories, the location specific incremental cost approach is taken, bearing in mind the typically lower price sensitivities at those locations.

While the ACCC shares the concerns expressed by BARA and IATA about the method by which Airservices has estimated the 'average' incremental costs of upgrading the category of ARFF service at particular airports, it considers that the approach will result in desirable signalling of the costs imposed by aircraft landing at particular locations.

BARA and IATA object to Airservices' preferred option and consider that it will encourage unwarranted expenditure and cost inefficiency at smaller airports, because the costs of such operations are not fully passed on to the users of the ARFF service at

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<sup>38</sup> Airservices does not consider the use of a non-linear price structure in its options paper, such as a two-part tariff, with a fixed charge (per year) and a charge based on use. Such a structure allows the fixed charge to be oriented to the fixed costs of a service and the variable use charges to be oriented to its marginal costs. For ARFF, in theory this boils down to fixed charges alone. Presumably, Airservices has judged, understandably, that such fixed 'club entry fee' type charges would be difficult to design and administer, especially as signals for the incremental costs of higher categories.

those locations. The ACCC has also expressed similar concerns in the past in the context of arguments for a network-based charge.

However, the ACCC agrees with Airservices that the primary incentive it faces to reduce costs, in the absence of competition, is the incentive built into the long-term pricing path, which enables it to keep the value of any cost savings it makes in the period. The ACCC also supports Airservices' commitments in relation to minimising the level of capital investment for new services and to holding annual expenditure reviews at each location.

While the proposal may not result in fully efficient signalling of the incremental costs of introducing new services and may incorporate 'unnecessarily high' mark ups above marginal cost at airports where there is no likelihood of changes to the level of service provided, the ACCC considers that it represents a reasonable compromise between the sometimes conflicting objectives of allocative efficiency and dynamic and productive efficiency.

### **The ACCC's preliminary view**

The ACCC does not consider that Airservices should change the quantum and timing of operating costs that it sought to recover in its 2004 long-term pricing proposal in this notification. Allowing Airservices to adjust the costs it seeks to recover undermines the incentive for Airservices to minimise the costs of providing ARFF services over the course of the long-term pricing proposal. However, the impact of this on the proposed price increases is small.

The major focus of the ACCC's assessment of this proposal is the proposed *structure* of charging.

In the absence of competition in the provision of ARFF services, which appears to the ACCC to be the likely situation for the period of this pricing proposal, the ACCC considers the proposal to represent a reasonable compromise between reducing the distortions to activity where costs are to a large extent fixed and signalling the cost of new investment to users.

If the Government was to introduce competition on the basis of price, Airservices' preferred charging methodology would deter efficient entry at locations where it under recovers the stand-alone cost of an ARFF service, and may encourage inefficient entry at those locations where it recovers more than its stand-alone costs.

However, there are other potential models that the Government may apply in introducing competition, which may be neutral in terms of the incentives on Airservices to be productively efficient. At this stage, given that the model for introducing competition for the provision of ARFF services has not been announced, and that Airservices has stated that it would revise its pricing structure in the event of the potential entry of a competitor, the ACCC does not consider it appropriate to oppose the proposal on the basis that it is inconsistent with competitive entry.



## Process of assessment

The ACCC received Airservices' draft price notification on 30 September 2005. Airservices' draft price notification, including submissions made in response to the ACCC's issues paper are available on the ACCC's website at [www.accc.gov.au](http://www.accc.gov.au).

On the basis of information provided by Airservices, including responses it has received on its proposal, the ACCC has formed a preliminary view to not object to Airservices' proposal, provided that the changes to the revenue allowed in the ACCC's 2004 decision are removed (except for the increases in revenue for new services). The ACCC is now seeking comments on this preliminary view.

The ACCC prefers that all written submissions be publicly available to foster an informed, robust and consultative process. Accordingly, submissions will be treated as public documents unless otherwise specified.

It is preferred that where industry participants wish to submit confidential information they should provide confidential and non-confidential versions of their submission. In such circumstances, the confidential version will need to highlight any such information.

The ACCC will place non-confidential submissions on its website.

Submissions should be received by the ACCC by close of business on **7 December 2005**.

Submissions should be forwarded by email to:

[transport.prices-oversight@acc.gov.au](mailto:transport.prices-oversight@acc.gov.au)

Alternatively submissions can be made by mail to:

Margaret Arblaster  
General Manager, Transport and Prices Oversight  
Regulatory Affairs Division  
Australian Competition and Consumer Commission  
GPO Box 520  
MELBOURNE VIC 3001

## **Attachment A: List of submissions**

The ACCC received 27 submissions in response to its issues paper seeking comment on the charging options in Airservices' options paper, including one confidential submission. The non-confidential submissions are listed below.

AAL (Townsville) Pty Limited (AAL Townsville)

Aeromil (Australia) Pty Limited (Aeromil)

Adelaide Airport Limited (Adelaide airport)

Airport Development Group Pty Ltd (Airport Development Group)

Australia Pacific Airports Corporation Ltd (Australia Pacific Airports)

Avalon Airport Australia Pty Ltd (Avalon airport)

Board of Airline Representatives of Australia Inc (BARA)

Delta Fire & Rescue Service

Department of Transport and Regional Services (DoTARS)

Emirates Group (Emirates)

Gold Coast Airport Limited (Gold Coast airport)

Government of South Australia – Department for Transport, Energy and Infrastructure (SA Government)

Hamilton Island Limited (Hamilton Island)

International Air Transport Association (IATA)

Mackay Port Authority

Maroochy Shire Council

Qantas Airways Limited (Qantas)

Queensland Government – Aviation Steering Committee (Qld Government)

Regional Aviation Association of Australia (RAAA)

Regional Express—Australiawide Airlines Ltd (Rex)

RFDS Western Operations

Rockhampton City Council

Singapore Flying College – Maroochydore (Singapore Flying College)

Tony Taggart

Virgin Blue Airlines Pty Ltd (Virgin Blue)

Voyages Hotels & Resorts Pty Ltd (Voyages)

## Attachment B: Airservices' proposed prices

Tables 6 to 8 outline the prices to apply to ARFF services from 1 January 2006 to 30 June 2009.

**Table 6: Proposed prices for 2006–07**

2006–07	Price per tonne Aircraft category			
	9	8	7	6
Adelaide	\$ 7.34	\$ 7.34	\$ 3.11	\$ 1.75
Alice Springs	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Avalon	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Brisbane	\$ 3.61	\$ 2.36	\$ 2.01	\$ 1.75
Cairns	\$ 4.50	\$ 4.50	\$ 2.98	\$ 1.75
Canberra	\$ 8.51	\$ 8.51	\$ 8.51	\$ 1.75
Coolangatta	\$ 13.05	\$ 13.05	\$ 3.86	\$ 1.75
Darwin	\$ 5.29	\$ 5.29	\$ 5.29	\$ 1.75
Hamilton Island	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Hobart	\$ 6.00	\$ 6.00	\$ 6.00	\$ 1.75
Launceston	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Mackay	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Maroochydore	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Melbourne	\$ 2.91	\$ 2.10	\$ 1.91	\$ 1.75
Perth	\$ 5.15	\$ 2.71	\$ 2.18	\$ 1.75
Rockhampton	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75
Sydney	\$ 2.33	\$ 1.95	\$ 1.85	\$ 1.75
Townsville	\$ 8.17	\$ 8.17	\$ 8.17	\$ 1.75
Yulara	\$ 1.75	\$ 1.75	\$ 1.75	\$ 1.75

**Table 7: proposed prices for 2007–08**

2007–08	Price per tonne Aircraft category			
	9	8	7	6
Adelaide	\$7.36	\$7.36	\$3.15	\$1.80
Alice Springs	\$1.80	\$1.80	\$1.80	\$1.80
Avalon	\$1.80	\$1.80	\$1.80	\$1.80
Brisbane	\$3.67	\$2.41	\$2.05	\$1.80
Cairns	\$4.54	\$4.54	\$3.02	\$1.80
Canberra	\$8.54	\$8.54	\$8.54	\$1.80
Coolangatta	\$14.13	\$14.13	\$4.09	\$1.80
Darwin	\$5.40	\$5.40	\$5.40	\$1.80
Hamilton Island	\$1.80	\$1.80	\$1.80	\$1.80
Hobart	\$6.58	\$6.58	\$6.58	\$1.80
Launceston	\$1.80	\$1.80	\$1.80	\$1.80
Mackay	\$1.80	\$1.80	\$1.80	\$1.80
Maroochydore	\$1.80	\$1.80	\$1.80	\$1.80
Melbourne	\$2.97	\$2.15	\$1.95	\$1.80
Perth	\$5.23	\$2.76	\$2.23	\$1.80
Rockhampton	\$1.80	\$1.80	\$1.80	\$1.80
Sydney	\$2.41	\$2.01	\$1.90	\$1.80
Townsville	\$8.31	\$8.31	\$8.31	\$1.80
Yulara	\$1.80	\$1.80	\$1.80	\$1.80

**Table 8: Proposed prices for 2008–09**

2008–09	Price per tonne Aircraft category			
	9	8	7	6
Adelaide	\$7.20	\$7.20	\$3.18	\$1.84
Alice Springs	\$1.84	\$1.84	\$1.84	\$1.84
Avalon	\$1.84	\$1.84	\$1.84	\$1.84
Brisbane	\$3.77	\$2.37	\$2.07	\$1.84
Cairns	\$4.53	\$4.53	\$3.07	\$1.84
Canberra	\$8.49	\$8.49	\$8.49	\$1.84
Coolangatta	\$14.04	\$14.04	\$4.18	\$1.84
Darwin	\$5.64	\$5.64	\$5.64	\$1.84
Hamilton Island	\$1.84	\$1.84	\$1.84	\$1.84
Hobart	\$6.77	\$6.77	\$6.77	\$1.84
Launceston	\$1.84	\$1.84	\$1.84	\$1.84
Mackay	\$1.84	\$1.84	\$1.84	\$1.84
Maroochydore	\$1.84	\$1.84	\$1.84	\$1.84
Melbourne	\$3.13	\$2.17	\$1.99	\$1.84
Perth	\$5.33	\$2.66	\$2.22	\$1.84
Rockhampton	\$1.84	\$1.84	\$1.84	\$1.84
Sydney	\$2.51	\$2.03	\$1.94	\$1.84
Townsville	\$8.50	\$8.50	\$8.50	\$1.84
Yulara	\$1.84	\$1.84	\$1.84	\$1.84