

**Submission to the Productivity
Commission on**

**Price Regulation of Airport
Services**

March 2001



**Australian Airports
(Townsville) Pty Limited**

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1. Executive Summary

Australian Airports (Townsville) Pty Limited (AAL) leases Townsville airport from the Commonwealth. Townsville airport is a civil/military joint user facility and is the main domestic airport servicing the North Queensland region.

Airport privatisation has resulted in some of the former Federal airports being subject to prices regulation due to the Government's perception that airports possess significant market power in the provision of certain aeronautical and aeronautical related activities.

AAL is supportive of airport specific regulation however rather than the potential for abuse of market power being the rationale for this, issues such as regulatory certainty, consistency in approach and an informed arbitrator must be considered as being other rationale.

AAL believes that future regulation should be specifically tailored to the airports sector rather than reliance on more general regulation. In adopting airport specific pricing regulation AAL supports the following approach:

- ✧ A broad CPI based price cap set for some airport services prices with scope for pricing reviews for new investment or other special circumstances and no other prices surveillance or monitoring.

The following aeronautical services should be covered by price regulation:

- ✧ Runways, Taxiways, Aprons; and
- ✧ Airfield Lighting and Viz Aids.

AAL believes that there are many lessons to be learnt from the application of the current legislation with the main one being that ambiguities exist between the intent of the legislation as expressed by the government and interpretation of the legislation by the ACCC and other parties.

One ongoing concern with the current administration of the legislation relates particularly to the understanding of relative elasticity of demand and pricing for airports.

AAL purports that there is limited sensitivity to airport charges for, and quality of, airport services and contends that demand for airport services is related to:

- ✧ Customer perception of value in terms of the changes in ticket prices charged by the airlines; and
- ✧ Customer demand for services based on what the destination has to offer.

This comment is underlined by the impact of new entrant airlines into the market with fare reductions of up to 70% off the previous full economy tariffs.

Unlike airports the airline and GA consumer is able to enter or leave the market based on competing demand and yield opportunities within its total market. There is no evidence that airlines have ceased operations through an airport solely due to airport charges.

The end consumer also has alternatives to air travel and hence the use of air transport and airport services is relative to the type of passenger and to the value of time and the distance that must be travelled.

Quality of service whilst an important component of the operations of an airport does not play a role in the sensitivity of demand for airport services.

In turn, AAL believes that any perceived competition between Australian airports is related to the destinations and not the airports. That is the strength of the destination relative to:

- ✧ Airline yields;
- ✧ Market demand;
- ✧ Economic strength of a region; and
- ✧ Government intervention through subsidies and/or funding.

An appropriate benchmark is a set of prices that allocates demand efficiently and promotes efficient investment and which over time, gives (efficient) airport operators a 'normal' rate of return. Having said this, AAL does not believe that it is possible to determine an appropriate benchmark due to wide disparity in demand for, and quality of, services amongst airports.

AAL believes that the objectives stated in the federal governments Pricing Policy Paper are appropriate. AAL supports the Government's regulatory policy but has serious issue with the price starting point which needs to be resolved prior to the commencement of the new regulations. In the first instance price levels should be adjusted to ensure that they commence from the correct base.

Airports tend to have requirements for periodic lumpy investments specifically relating to the provision of runways, taxiways, aprons and terminal expansion, which due to diseconomies of scales for smaller airports tend to result in what could be perceived as inefficient production. However, over time, as the airport's throughput increases, the economies of scale begin to balance and inefficiencies are minimised. This is until there is a need to further increase in capacity to meet current and forecast future demand.

AAL believes that an appropriate and efficient charging structure would be a two-part system comprising of the following, which separates airline services and passenger facilities services:

- An aeronautical charge for the use of aeronautical infrastructure, such as runways, taxiways, and aprons based on charge related to MTOW; and
- A passenger facility charge for the provision of additional passenger related facilities such as aerobridges and other terminal facilities, which are not already subject to commercial lease or licence arrangements, based on passenger throughput.

AAL also supports the objective that airport operators and their customers should negotiate directly on aeronautical charges and to resolve prices between themselves rather than involve the Government of the day. However we do believe that the balance of market power, at least in the case of Regional airports lies with the major airlines, and for that reason advocate recourse to an informed arbitrator. The arbitrator should promote this consultation with redress to a regulatory regime being available as a last resort.

In proposing and supporting airport specific regulations, AAL also supports sunset/review arrangements to assess the success or otherwise of the regulation. Reviews allow appropriate amendments to be made to business operations to ensure that efficient decisions are being made.

2. Introduction

On 11 June 1998 Townsville Airport was leased to Australian Airports (Townsville) Pty Limited (AAL) by the Commonwealth for a period of 50 years with an option for a further 49 years.

Since its inception, AAL has upgraded the general amenity and infrastructure of Townsville airport, investing over \$1.607 million since June 1998 (Appendix A). Investment is expected to continue over the coming years and is presently focused on the development of offices for the Civil Aviation Safety Authority (CASA), apron extensions to cater for increased services and upgrading of aircraft and passenger terminal services and facilities. It is proposed that an estimated \$11.402 million (Appendix B) in capital expenditure will be spent over the next four years in improving services and the infrastructure of the airport.

Privatisation has proven to be successful at Townsville airport where it has enabled investment and pricing decisions to become more focused on individual aeronautical services such as amending the General Aviation Infrastructure Tariff (GAIT). Airports now have the flexibility to determine the most suitable methodology for pricing aeronautical services as a consequence of regulatory discretion. As part of the FAC network, the needs of Townsville airport were not the major focus of the company and thus privatisation has resulted in the focus of business development becoming more specific to Townsville airport's markets.

Townsville airport is a civil/military joint user facility and is the main domestic airport servicing the North Queensland region. As such AAL shares the joint use area with the RAAF. Those areas include the runways and taxiways and associated guidance landing systems. There is an allocation of responsibilities between AAL and the RAAF with an agreed allotment of maintenance costs. The contribution to the ongoing cyclical maintenance is based on AAL's annual aircraft movements greater than 5,700 kg as a percentage of the total annual aircraft movements at the airport greater than 5,700 kg. This has equated to be an 80% contribution to the joint user area costs by AAL.

The airport is situated approximately 350 km from Cairns to the north and 400 km from Mackay to the south.

In business planning terms, the key objectives for AAL are to improve service quality, lower service costs and increase the overall financial and operational efficiency. The objectives are stated in AAL's 2018 Master Plan, which was approved by the Minister for Transport and Regional Services on 2 September 1999.

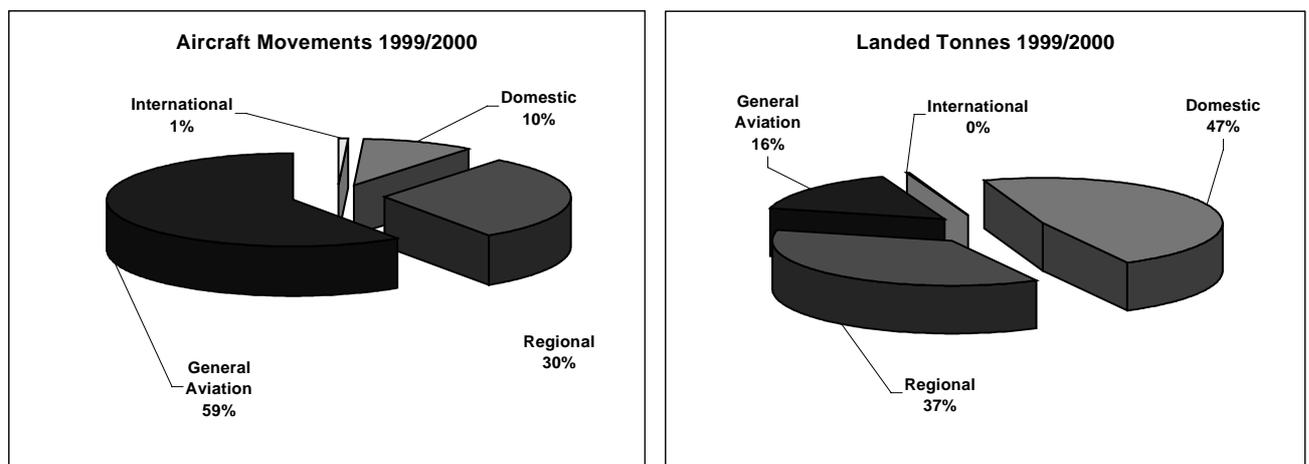
AAL's five-year business plan also embraces important objectives which are central to the privatisation process including the need for AAL and its contractors to maintain and improve service and value to airlines, passengers and tenants.

For the 2000/2001 financial year the airport will handle approximately 800,000 domestic passengers, an increase of some 2.3% over the prior year and approximately 57,200 aircraft movements, an increase of 1% over the prior year, which can be broken down as follows:

- 5,600 domestic Regular Public Transport (RPT) movements;
- 18,000 regional RPT (inclusive of freight movements) movements; and
- 33,600 General Aviation (GA) movements.

Whilst GA comprises approximately 59% of the annual aircraft movements the sector contributes only 16% of the total landed tonnes. Domestic RPT contributes 47% whilst other RPT contributes 37% of the total landed tonnes as demonstrated in Figure 1.

Figure 1 Allocation of Aeronautical Movements and Landed Tonnes



The population of the region that Townsville airport serves is in the vicinity of 197,000 persons. This strong regional population has contributed to the growth of the passenger throughput of the airport, which has averaged 4% over the past five years (1995/1996 to 1999/2000).

Townsville's economic strength is derived from its port, refineries, transport facilities, role as a commercial and distribution centre, connection with the primary industries of North Queensland (NQ) and additionally its importance as the centre for State Government administration in NQ and as an educational centre and defence base. This is reflected in the high number of business travellers through Townsville airport. A business traveller is defined as a person who is specifically travelling for the purpose of undertaking business. Recent surveys conducted internally by AAL indicate that approximately 49% of the total passenger movements relate to the business traveller.

3.1 Market Power of Airports and the Provision of Aeronautical Services

Airports are an essential component of the regional economy for which they serve through their contribution to income growth and because of the nature of the activities themselves. They are an intermediate service in the supply chain. Airports primarily provide intermediate services to the aviation industry with additional services such as parking, cafes/bistros, retail and public amenities being provided to passengers and other airport users. Airport privatisation has resulted in some of the former Federal airports being subject to prices regulation due to the Government's perception that airports possess significant market power in the provision of certain aeronautical and aeronautical related activities.

3.1.1 Perceived Market Power at Airports

Most pricing regulation for services seeks to address market failure. However in the case of Regional airports, AAL purports that there is now ample evidence from the performance of regulated airports and unregulated airports to indicate that there has in fact been no market failure by airport operators.

The ultimate outcome of regulation for governments is to improve the welfare of the society as a whole. It is not apparent to AAL that the current regulatory regime involving compliance with a price cap has been entirely successful in achieving this outcome for society. Experience to date of the regulatory process is that the benefits have not necessarily been passed through to the end consumer and that the process is onerous. Tables 6 and 8 of the submission suggest that the airlines rather than the end consumer have captured the benefits.

While AAL supports airport specific regulations, rather than the potential for abuse of market power being the rationale for this, issues such as regulatory certainty, consistency in approach and an informed arbitrator must be considered as being other rationale.

The Pricing Policy Paper issued by the then Department of Transport and Regional Development in November 1996 outlines the arrangements for pricing oversight as part of the Government's public interest regulatory regime for leased Federal airports. Pricing oversight arrangements at such airports were intended to achieve an appropriate balance between public interest and private sector commercial objectives. Pricing oversight arrangements were also intended to promote operation of the airports in as an efficient and commercial manner as possible.

Pricing is fundamental to the efficient use of airport infrastructure. It is in the interests of airport users in particular, and the national economy in general, that commercially driven decisions be made about maintaining existing airport infrastructure and building new infrastructure.

Market power as defined by the Butterworths Concise Australian Legal Dictionary is the ability of an organisation to raise prices above the supply cost without rivals taking away customers in due course. Alternatively it can be viewed as a position of economic strength where a body's market power may be measured by the extent to which it's

operation in a market is constrained by the behaviour of its competitors or potential competitors and by its suppliers or acquirers. The misuse of such market power is the impermissible use of market power to harm the competition process. It is important to note in the definition of market power above is the reference to the measurement of market power of a body to the extent its operations in a market is constrained by its suppliers or acquirers. In the case of airports the market power is constrained by that of the major airlines. We will refer later in this submission to the relative power of the acquirers of the services, the airlines versus airports.

The Trade Practices Act (TPA) currently exists to ensure that there is no abuse of market power as defined under Section 46. AAL believes this legislation, however is too broad and potentially involves costly and lengthy legal processes, which are beyond the resources of Regional airports.

Moving specifically to the practical application of pricing and market power at Australian airports. Within Australia there are some 480 airports of which approximately 49 airports or 10% are located in Queensland. Of those 49 airports only three, Brisbane, Coolangatta and Townsville are regulated by the Price Cap under the Prices Surveillance Act 1983 (PS Act). Two airports, Cairns and Mackay are government owned corporations and the other airports, with the exception of Mount Isa and Archerfield, which are privately owned, are owned and operated by local government. These statistics do not include the airports that service island resorts such as Hamilton Island and Dunk Island, which are also privately owned.

To our knowledge there does not appear to be any evidence of abuse of perceived market power at the aforementioned unregulated airports. There are however, substantial differentials in aeronautical and passenger service charges levied for each of these airports. Appendix C provides a summary of airport and passenger service charges at surrounding regional Queensland airports including Cairns, Mackay, Hamilton Island and Rockhampton. In essence, the potential for abuse of market power is clearly not seen to be an issue for the vast majority of Queensland airports and AAL argues that the same market and community issues are relevant when considering the 'potential for abuse' by the ex FAC privatised airports.

Townsville Airport derived \$2.02 million specifically from aeronautical landings during 1999/2000, which equates to 38% of total revenue. Total revenue for the same period equated to \$5.8 million. When looking at the scenario of market power and the balance of power a simple exercise can be undertaken by comparing the financial results of AAL and Qantas for 1999/2000, to put this into perspective (Table 1)

Table 1 Comparison of Financial Performance between Qantas and AAL

	AAL 1999/2000 (in Millions)	Qantas 1999/2000 (in Millions)
Operating Revenue	\$5.8	\$9,106.8
Net Profit After Tax	\$0.2	\$517.9
Operating Profit Before Tax and Abnormals	\$0.5	\$705.0

Source

AAL Annual Report 1999/2000
Qantas Annual Report 1999/2000

Airports are an essential component of the regional economy for which they serve through their contribution to income growth and because of the nature of the activities themselves. They do not supply an end product but are an intermediate service in the supply chain. In order for the airport to sustain its position in the economy, and as an essential element of regional development it is critical to work with the local business community in both promoting the region, and by providing the appropriate infrastructure at an appropriate price.

The local community also plays a major role in terms of market power restraint of airports. The community has expectations and subsequent demands as to the level and quality of services to be provided by the airport as well as the fee that they are willing to pay for these. The community is able to exert pressure on the airport operator to ensure that service levels are appropriate and that prices are at a level that supports economic goals and development within the region the airport serves.

3.1.2 Sensitivity of Demand for Airport Services

AAL purports that there is limited sensitivity to airport charges for, and quality of, airport services and contends that demand for airport services is related to:

- ➔ Customer perception of value in terms of the changes in ticket prices charged by the airlines; and
- ➔ Customer demand for services based on what the destination has to offer.

Clearly sensitivity of demand is relative to the ticket price and is underlined by the impact of new entrant airlines into the market with fare reductions of up to 70% off the previous full economy tariffs. Virgin Blue commenced services to and from Townsville on 15 March 2001. The landing charges at the airport are the same for Virgin Blue as for the other airline carriers. However, Virgin Blue is offering substantially cheaper air fares than their competitors. Indications from other airports serviced by Virgin Blue such as Brisbane and Adelaide are that Virgin has stimulated the market and increased the number of people travelling. Previously these people would have either not travelled due to the affordability of airfares or taken alternate transport modes. When it comes to common use charges for the terminal, should Virgin Blue increase the passenger throughput at the airport as anticipated, the commercial charges for the handling agent (Ansett) and all other users will decrease on a per passenger basis.

It will be interesting to see if there are any significant changes in travel patterns of visitors to the Northern Region following the introduction of Virgin Blue into the market.

Airports have a diverse portfolio of services that they sell at the airport either on a commercial or regulated price basis. These range from:

- ✧ Aeronautical related services such as:
 - ✧ Provision of runways, taxiways and aprons for operation of aircraft;

- ✧ Provision of infrastructure such terminal facilities for passenger processing;
- ✧ Provision of hangars or other buildings for aircraft operators to undertake their business such as, aircraft maintenance, airline administration, hangarage of aircraft and airline catering.
- ✧ Provision of land for aeronautically related businesses to be operated from, such as freight facilities.

- ✧ Non-aeronautically related services such as:
 - ✧ Provision of commercial properties to operate a business from;
 - ✧ Public and staff car parks;
 - ✧ Advertising mediums;
 - ✧ On-selling of utilities;
 - ✧ Car rental businesses;
 - ✧ Consultancy services to other airports;
 - ✧ Retail concessionaires;
 - ✧ Provision of vacant land that can be leased and developed for oil companies, car rental companies, offices and accommodation.

An overview of the classification of aeronautical and non-aeronautical services provided by the airport and the assessed degree of market power that airports have in providing the service is set out in Appendix D.

In the Northern Region of Queensland for which the airport of Townsville is located, a report prepared by the Australian Economic Consultants (AEC) Group, ‘Report on Townsville Regional Economy 1999’, shows that many modes of transport is used to visit the Queensland. The report illustrates that domestic air travel accounted for 28.1% in the Whitsunday’s, 26.9% in the Far North Region and only 10.5% in the Northern Region, the region in which Townsville airport is located (Figures 2 and 3). Both the Whitsunday’s and the Far North Region have substantially higher airport charges than Townsville (Appendix C).

Figure 2 Transport Mode of Visitors by Region 1996-97

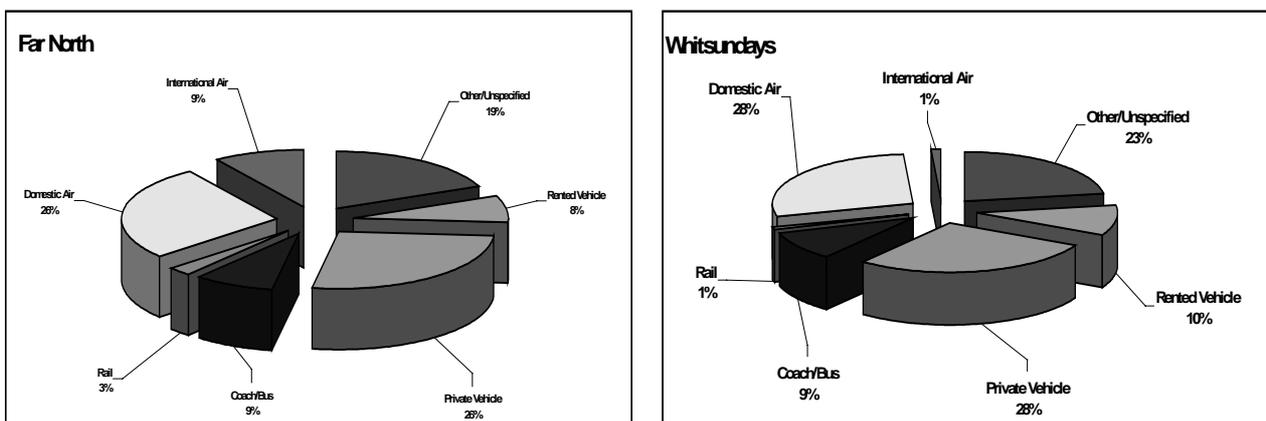
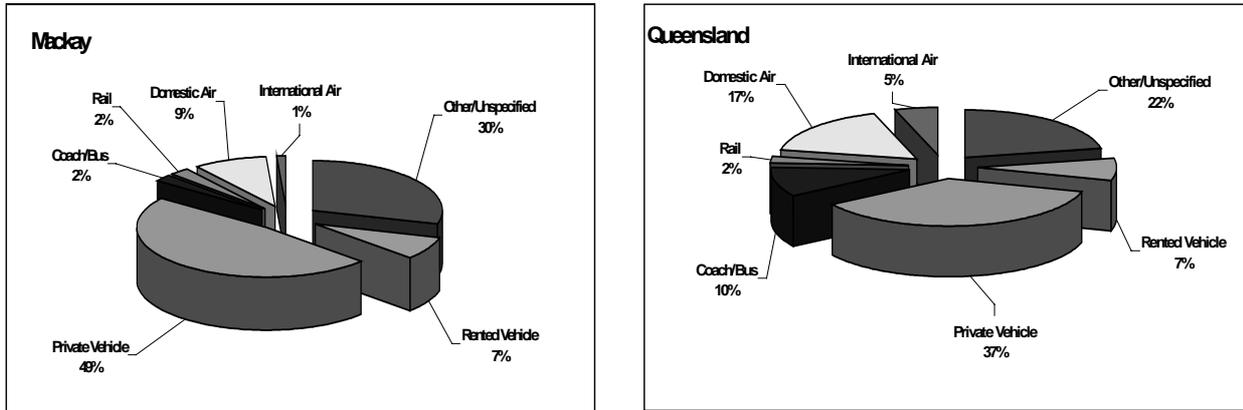


Figure 2 Transport Mode of Visitors by Region 1996-97 (Continued...)



Source AEC Report on Townsville Regional Economy 1999

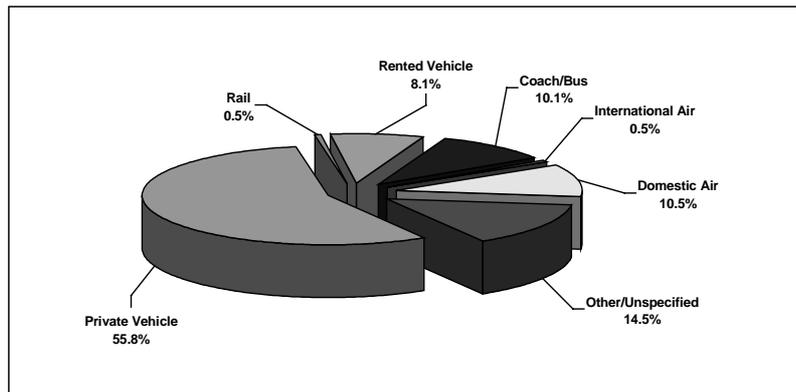
3.1.3 Alternative Modes of Transport for Consumers

The airline and GA consumer is able to enter or leave the market based on competing demand and yield opportunities within its total market. It has the ultimate option of either modifying or withdrawing its capacity relatively quickly. There is no evidence that airlines have ceased operations through an airport solely due to airport charges.

The alternatives that the end consumer has to air travel and hence use of air transport and airport services is relative to the type of passenger and to the value of time and the distance that must be travelled. For regional north Queensland, the alternate for the business traveller is telecommunications, whether that be by way of telephone link up or video conferencing. For the tourist traveller, there are greater alternatives to travel.

Based on the Report prepared by the AEC Group, Figure 3 illustrates that only 10.5% of visitors to the Northern Region arrived by domestic air, while only 0.5% arrived by international air. Over half (55.8%) of visitors travelled to the Northern Region by private vehicle whilst 10.1% of visitors arrived in the Northern region by coach or bus.

Figure 3 Transport Mode of Visitors Northern Region 1996-97



Source AEC Report on Townsville Regional Economy 1999

Data collated by Townsville Enterprise Limited (TEL) shows that visitors from the eastern seaboard states of Queensland, New South Wales and Victoria represent the largest domestic market to the North Queensland region. Of international visitors to the area the highest proportion originates from the United Kingdom, Ireland, Europe and the United States of America and Canada. The North Queensland tourism market is strongly dominated by the domestic holiday/visiting friends and relatives market, which accounts for over half of the total number of visitors to the region. TEL believe that as Townsville increases its presence in the meetings and corporate market the region will witness solid growth in this sector.

3.1.4 Price Elasticity of Demand

There is no evidence that airlines have ceased operations through an airport solely due to airport charges, either short, medium or long term.

Airports could have the cheapest charges in the world, however if the destination is not attractive to airlines they will not serve the airport. There are many examples both domestically and internationally which demonstrate the fact.

If prices were ‘unbundled’, that is separate charges were applied for apron capacity, aerobridge use, baggage handling facilities and so forth, airlines would be expected to acquire only those services directly required in support of their operation and the service requirements of its customer. To that extent there is sensitivity at the margin.

Budget or cut-price airlines do not require certain services and thus would be expected to minimise their cost structure by only selecting those services, which are imperative to their operational requirements.

For domestic airlines, the decision to service an airport or not, is relative to the yield and demand strength of the destination. The structure of airfares and packages offered by the airlines, differ from region to region and the price elasticity of airport charges in the context of total airline operating costs appears to be relatively wide.

3.1.5 Sensitivity of Demand and the Quality of Airport Services

Quality of service is an important component of the operations of an airport. However, AAL does not believe that sensitivity of demand for airport services in terms of quality are major decision points in whether an airline operates its services to an airport. AAL believes that quality of service is more relative to airport rentals than sensitivity of demand.

A case in point is Mount Isa airport, which AAL also owns and operates. Customer surveys undertaken by a major airline indicated that the quality of the terminal services was unacceptable. The airline advised AAL of the demands and expectations of their customers and in turn advised AAL that the rental structure for the facility was inappropriate given the poor condition of the infrastructure. The airline requested that either a rental reduction be negotiated or the facilities be upgraded. At no time did they

indicate that the quality of the services might involve a decision to discontinue operations at the airport.

3.1.6 Competition between Australian airports (Price and Quality)

AAL does not believe that there is serious competition between Australian airports domestically based on either price or quality. Any perceived competition is related to the destinations and not the airports. In order for the airport to sustain its position within the regional economy it is critical to work with the local business community in supporting the region and in timing the development of the appropriate infrastructure to meet demand for air travel created by wider economic interests.

Although both quality and price are important to the airport operator and the end consumer, the use of airport facilities by airlines is not governed by these factors to any significant extent.

Competitive airport charges are a minor decision factor for airlines servicing an airport. Higher priced airports such as Cairns attract greater passenger and aircraft throughput than Townsville. This is due to the relative attractiveness of Cairns as a tourist destination compared to that of Townsville's tourist market, which is not as well developed as a tourist attraction.

Competition within the domestic market between airports for airline operators is not expected to change in the future. This is because there are many factors other than perceived competition between airports that influence airline decisions to operate to and from an airport. Some of these are:

- ✧ Airline yields;
- ✧ Market demand;
- ✧ Economic strength of a region; and
- ✧ Government intervention through subsidies and/or funding.

AAL is a small private company which focuses on providing quality services at a low cost whilst returning value to the company and its shareholders. Its approach to competition *vis a vis* other airports is directed at supporting its local business community in attracting new development to the region. In that regard we offer a service that is priced below the 'competition' and to that extent should support local community economic goals.

3.1.7 Extent of Market Power and an Efficient Pricing Benchmark

An appropriate benchmark is a set of prices that allocates demand efficiently and promotes efficient investment and which over time, gives (efficient) airport operators a 'normal' rate of return.

As airport investment is lumpy, efficient prices may generate high profits when facilities are congested, rationing limited capacity and signalling the need for new investment. When facilities are not congested, lower prices may be appropriate (Price Regulation of Airport Services, Productivity Commission January 2001).

Additionally an appropriate benchmark is one, which applies to all airports whether they are regulated, or not. Elements of an appropriate benchmark price could include the recovery of aeronautical costs associated with infrastructure and service provision including depreciation, maintenance, cost of funds and the risk premium to be shared between the users and providers of such services. Notwithstanding the above, AAL does not believe it is possible to determine an appropriate benchmark for airports due to wide disparity in demand for, and quality of, services amongst airports.

Finding the appropriate comparators and corresponding data is absolutely critical for the quality of any benchmarking exercise. Although airports may have similar characteristics with respect to infrastructure each will have different passenger/airline populations, operational characteristics and commercial revenue streams and opportunities. Airports differ in the range of services they offer, depending upon demand characteristics and quality differentiation.

A Consultation Paper prepared by the Civil Aviation Authority of the United Kingdom titled “The Use of Benchmarking in Airport Reviews (December 2000)” addresses the issue of benchmarking of airports. The Paper considers the likelihood of benchmarking as a potentially alternative approach to the application of regulatory constraints of BAA London Airports and Manchester Airport with respect to a price cap. The Paper outlines four quantitative steps necessary for airport benchmarking in assessing relative efficiency including:

Step 1

- Discussion of cost and revenue drivers.
- Definition of airport outputs.
- Discussion of appropriate airports to compare.

Step 2

- Collection of airport data.
- Data plausibility and quality check.

Step 3

- Model development and estimation based on different methodologies.
- Sensitivity analysis.

Step 4

- Explanation of differences in airport efficiency.
- Judgement on relative efficiency.

The Paper identifies many difficulties, which need to be addressed in benchmarking airports or in interpreting the results of partial benchmarking. The key problems that are commonly raised are:

- Appropriate outputs have to be defined, which also have to reflect the quality dimension of the different airport services;
- Availability of airport data is in most cases limited. This can constrain the choice of methods and approaches as well as the meaningfulness and robustness of derived conclusions;
- Even if company outputs are relatively homogeneous, data adjustments have to be made that take differences in the operational environment and the legal framework into account. In doing so, a degree of judgement is sometimes unavoidable;
- Airports have different strategic objectives. The definition of inputs and outputs would therefore, for example, need to take airport quality parameters and demand characteristics into account (for example peak traffic);
- Airports are faced with lumpy investment and the different airport investment cycles distort any efficiency comparison if they are not properly taken into account;
- There is a risk associated with benchmarking to interpret any unexplained difference in the performance of compared companies as an efficiency gap. While this may be valid, input and output factors, which have not been properly specified might also be responsible for the unexplained difference; and
- Airports rely heavily on the strength and demographics of the regional market they serve for their success. Tourist based economies will return different results than industrial based economies.

When benchmarking aeronautical charges (inclusive of GST) currently levied at Townsville Airport to those operating at other regional airports within Queensland it is clearly evident that benchmarking is meaningless (Appendix C). For example a Boeing 737 with a 70% load factor landing at Townsville Airport would incur a charge of \$408.79 whilst the same plane landing at Maroochydore Airport would be charged \$2,202.17 (an increase of some 438%). Landing at Cairns Airport the plane would incur a charge of \$904.48 (an increase of some 121%).

3.1.8 Efficient Pricing Policy

AAL believes that an appropriate and efficient charging structure would be a two-part system. First of all an aeronautical charge for the use of aeronautical infrastructure such as runways, taxiways, and aprons based on a charge related MTOW. Secondly, a passenger facility charge for the provision of additional passenger related facilities such as aerobridges and other terminal facilities, which are not already subject to commercial

lease or licence arrangements, based on passenger throughput. This separates airline and passenger services.

An appropriate pricing structure would be one is based on the following characteristics:

- ✎ The level of the charge for aeronautical infrastructure should then be structured to ensure that the airport operator is receiving a reasonable return on the infrastructure that takes into account the total cost for the provision and upkeep of the facility; and
- ✎ Passenger processing facilities, on the other hand are facilities that may be used selectively by the customers and can be provided to the level of quality to meet the customers and end consumers needs. The fee to be shared between the users on a passenger throughput basis would be commensurate with the level of investment and once again would take into account the total costs for the provision and upkeep of the facility.

3.1.9 Countervailing Power of Users of Airport Services

In addressing this matter it is important to identify where the balance of power is. AAL believes that the balance of power is with airlines by virtue of their size relative to most Australian airports and especially small Australian Regional airports.

One major requirement of airlines is that airports offer to their competitors and in particular to new entrants, no less favourable terms than those applicable or already negotiated in the market place. In terms of countervailing market power, this is a major disincentive to providing start up assistance to new entrants.

Airlines have substantial countervailing power in terms of exercising options to transfer seats to other locations where demand and yield are higher. The more marginal a route the more power an airline has in terms of extracting cost relief from airports and/or other subsidy providers.

An example in Australia where airlines have demonstrated countervailing buying power relates to a recent example where as a result of the privatisation of the Federal airports in Australia, Australian Protective Services (APS) charges increased to a level of full cost recovery at Townsville and other airports. The airlines had earlier been successful in having the APS cost recovery charge arbitrarily reduced to 75% of incurred costs under the FAC regime. When reviewing airports on an individual basis under the FAC operating environment airports such as Townsville under-recovered APS charges to the value of approximately 82% whilst airports such as Sydney over-recovered APS charges. This was predominantly attributable to economies of scale and the volume of traffic incurred at each airport.

Although the airlines were required to pay for the services of APS they refused to pay the charges. In addition, they successfully lobbied the government to have government regulation changed and APS services withdrawn at certain domestic airports where there had been a requirement previously. The provision of APS services ceased at Townsville on 15 March 1999.

3.1.10 Analysis of Major Airport Services

In order to gauge the magnitude of potential efficiency losses and income redistribution effects arising from the abuse of any market power at Townsville airport a comparison must be undertaken in relation to the quantities sold per year of major airport services and their prices. Major airport services specifically reflect the aeronautical charges in operation at the airport. Such a comparison is represented in Table 2, which reflects the periods 1 July 1995 to 30 June 2001.

Table 2 Major Airport Services and the Quantity Sold

Type of airport service	1996 (Actual)	1997 (Actual)	1998 (Actual)	1999 (Actual)	2000 (Actual)
International RPT Landings					
→ Quantity Sold	1,477	664	309	2,745	1,590
→ Price per Unit	\$5.72	\$5.72	\$5.72	\$5.72/\$5.75	\$5.75
→ Income	\$4,827	\$11,382	\$5,643	\$15,750	\$9,140
Domestic RPT Landings					
→ Quantity Sold	172,324	162,753	163,315	173,631	177,571
→ Price per Unit	\$5.72	\$5.72	\$5.72	\$5.72/\$5.75	\$5.75
→ Income	\$981,890	\$968,773	\$916,902	\$1,023,846	\$1,030,040
Other RPT Landings					
→ Quantity Sold	83,471	96,174	104,589	130,717	132,817
→ Price per Unit	\$5.72	\$5.72	\$5.72	\$5.72/\$5.75	\$5.75
→ Income	\$491,104	\$553,607	\$553,941	\$723,555	\$743,799
General Aviation Landings					
→ Quantity Sold	45,233	52,678	57,722	8,910	13,243
→ Price per Unit	\$5.72/\$5.34	\$5.72/\$5.34	\$5.72/\$5.34	\$5.72/\$5.75	\$5.75
→ Income	\$125,071	\$131,299	\$152,545	\$51,094	\$76,146
Daily GAIT Charges					
→ Quantity Sold	N/A	N/A	N/A	56,273	46,386
→ Price per Unit				\$2.00/\$3.00	\$2.00/\$3.00
→ Income				\$172,845	\$158,956

Source FAC Annual Reports 1996 to 1998
AAL Annual Reports 1999 to 2000

Notes
 1. The price per unit is 1,000 Kg per MTOW
 2. Under FAC there was no separation between GA and GAIT
 3. GA and GAIT were charged separately \$5.72 for GA and \$5.34 for GAIT
 4. The results for 1999 reflect the period 11 June 1998 to 30 June 1999

3.1.11 Airport Market Power and Discrimination

Airports, irrespective of their perceived market power, are generally able to structure their prices to their customer groups to suit their business objectives. However this approach is not unique to airports. This is a standard commercial practice where the seller enters into negotiations with the buyer. And like any other commercial business there are rules by which the commercial negotiations are played out. Should one party be dissatisfied with the negotiations, there is normally recourse to a nominated arbitrator agreed between the parties and recognised as an expert in the field. The current prices regulation was intended to operate on the premise with recourse to the ACCC as the arbitrator in the event that negotiations break down.

Different price structures are not precluded by the regulation, however, due to the ACCC requirement that the airport operator prepare publicly available statutory reports these arrangements are not 'commercial in confidence' between the two parties. We see this as a disincentive against competition in pricing.

In practice, airports produce a schedule of aeronautical charges, which allow for discounts/incentives should an airline operator meet specific criteria. The criteria may relate to matters such as opening up a new route or increasing capacity on an existing route.

Although these discounts are offered, AAL does not believe that price is a major consideration of airlines in their decision to commence or increase operations to a destination. There is no history of pricing discounts/incentives being a catalyst for any increase in operations at Townsville. The quality of the destination, its yield and passenger mix are the principal considerations of the airline.

3.1.12 Airports and Production Efficiencies

Airports tend to have requirements for periodic lumpy investment specifically relating to the provision of runways, taxiways, aprons and terminal expansion, which due to diseconomies of scales for smaller airports tend to result in what could be perceived as inefficient production. However, over time, as the airport's throughput increases, the economies of scale begin to balance and inefficiencies are minimised. This is until there is a need to further increase in capacity to meet current and forecast future demand.

With respect to passenger facilities such as terminals, there is a fine line between congestion standards and efficient use of space. Nevertheless in passenger terminal design congestion is not a planned state and runs counter to efficiency standards. Designers have needed to introduce a degree of sensitivity into the processes of design and capacity analysis for transport facilities. This is provided by the concept of level of service, initially developed in the area of highway analysis.

In passenger handling, the International Air Transport Association (IATA) has published a set of space design standards based on the level of service concept, where level A is excellent, level D is desirably the lowest level achieved in peak operations and level F is the point of system breakdown or congestion.

From this it follows that the size of the terminal depends on the current and forecast number of passengers, aircraft movements and meeters/greeters during the peak hours. In order to ensure that airports do not under or over invest in these facilities, these busy hour statistics are then applied to the services and planning standards outlined above to arrive at individual facility requirements. The quality of the facility is based on the expectations and demands of the end consumer.

Townsville airport could be deemed to be inefficient in production. That is, the international terminal facilities are unused as there is no current requirement, the RPT apron is at its design and operational capacity, some passenger domestic terminal services (specifically aerobridges) are below community expectations and the domestic terminal facilities are larger than is required for the next ten years based on forecasted passenger growth. These are however historical defects inherited by AAL, which are presently being addressed.

3.1.13 Performance of Regulated Airports versus Unregulated Airports

AAL owns and manages both Townsville and Mount Isa airports. Townsville is a core-regulated airport for the price cap whereas Mount Isa is an unregulated airport. In purchasing the airports, infrastructure and productivity needs were identified by the shareholders. At Mount Isa airport infrastructure had degraded and our customers had indicated that this did not meet their expectations or demands.

Discussions were held with the business community to gauge their support for an introduction of a passenger charge that would allow AAL to meet the expectations of the customers. Whilst the community did not want to see charges increase unnecessarily they accepted the increase as necessary to achieve the benefits of increased quality of service. Through liaison with the appropriate parties and negotiations with the airlines, a passenger head charge was agreed and introduced at Mount Isa airport on 1 August 1998. Although unregulated, aeronautical charges to the users of Mount Isa have remained at pre-FAC rates.

Mount Isa airport has invested approximately \$1.45 million since 11 June 1998 (Appendix A). The investment has included the erection of a perimeter fence to protect the airfield from animal hazards, rejuvenation treatment of the airport pavements and a major upgrade of the terminal. AAL has proposed more investment in the future relating to the need to overlay the runway and taxiways. The estimated cost for this is \$0.285 million (Appendix B). The aforementioned investments were either safety related requirements or community related expectations.

3.1.14 Airports versus Other Regulated Industries

Airports differ from other regulated industries, which are characterised by a small number of large providers servicing a large diverse range of customers in the provision of key services and utilities that are considered as basic consumer necessities. Airports on the other hand provide intermediate support services that constitute a minor part of the prices paid by the ultimate customer that is the travelling public.

3.2 Current Prices Regulation

The current regulatory regime for the privatised airport companies comprises three major pieces of legislation namely, the Airports Act 1996, the PS Act and the TPA. The Airports Act is the legal basis for much of the regulatory framework including the regulatory reporting requirements and quality of service monitoring. The Pricing Instruments (Declaration 88, Direction 17 and Direction 19) issued pursuant to the PS Act provide a legal foundation for the price cap on aeronautical revenue and price monitoring arrangements for certain aeronautical related services. The TPA is a critical element in the access arrangements applying to core regulated airports in conjunction with the provisions in the Airports Act. Section 192 of the Airports Act is a specific application of Part IIIA of the TPA.

3.2.1 *The Starting Point for the Price Cap*

AAL believes that the objectives stated in the federal governments Pricing Policy Paper are appropriate. AAL supports the Government's regulatory policy but has serious issue with the price starting point which needs to be resolved prior to the commencement of the new regulations. In the first instance price levels should be adjusted to ensure that they commence from the correct base.

AAL also supports the objective that airport operators and their customers should negotiate directly on aeronautical charges and to resolve prices between themselves rather than involve the Government of the day. However, we do believe that the balance of market power at least in the case of Regional airports lies with the major airlines, and for that reason advocate recourse to an informed arbitrator. The arbitrator should promote this consultation with redress to a regulatory regime should be available as a last resort.

The intention of CPI-X regulation was that prices could be set entirely without reference to the firm's costs. Prices would be set at the then current levels, allowing for lower real prices due to expected productivity increases (Peter Forsyth, Department of Economics Monash University).

In setting the starting point for the Price Cap the ACCC therefore applied the existing FAC aeronautical charges effective prior to the privatisation of Phase I airports to all privatised airports, including Townsville. This was not an effective starting point for Townsville airport.

Under the FAC and through the implementation of an Activity Based Costing Model, it was assessed that Townsville over the period of 1993/94 to 1997/98 should apply an average landing charge of \$6.83. Several regulated airports, including Townsville airport in preparing the annual ACCC Regulatory Accounts currently apply this model either in its original format or an abridged version.

As a consequence of starting from a lower base point at Townsville airport, this has effectively delivered a saving to the consumer of \$1.11 per 1,000 Kg MTOW, being the difference in the arbitrary set starting base of \$5.72 per 1,000 Kg MTOW rather than \$6.83 per 1,000 Kg MTOW.

The general landing charge of \$5.72 per 1,000 kg Maximum Takeoff Weight (MTOW) applied under the FAC and relevant to Townsville Airport, had not been increased since 1991 as indicated in Table 3. The Table highlights aeronautical charges applicable from 1 January 1988 to 1 July 1995 at which point in the time the charges remained constant until privatisation.

Table 3 Movement of FAC Aeronautical Charges since 1 January 1988

Aeronautical Charge Type Per 1,000 Kg MTOW	Date and Rate									
	01.01.88	01.07.88	01.04.89	01.04.90	01.01.91	01.04.91	01.07.91	01.01.93	01.01.94	01.07.95
General Landing Charge	\$4.40	\$4.55	\$5.00	\$5.35	\$5.35	\$5.72	\$5.72	\$5.72	\$5.72	\$5.72
Terminal Use Charge								\$0.60	\$1.05	\$1.05
APS Security Charge							\$0.60	\$0.60	\$0.60	\$0.55
GA Infrastructure Tariff										
Day			\$3.80	\$4.18	\$4.18	\$4.60	\$4.60	\$4.85	\$5.34	\$5.34
Month			\$80.00	\$88.00	\$88.00	\$97.00	\$97.00	\$102.00	\$112.00	\$112.00
Six Months			\$350.00	\$385.00	\$385.00	\$423.00	\$423.00	\$446.00	\$490.00	\$490.00
Year			\$500.00	\$550.00	\$550.00	\$605.00	\$605.00	\$638.00	\$702.00	\$702.00

3.3 Effects of Current Prices Regulation

The two key objectives of prices regulation of airport services relate to the efficiency of airport operations and the protection of the interests of users. As discussed previously AAL does not believe that a regional airport, such as Townsville has adequate market power nor the ability to abuse such power due to its size, demographics and position within the region.

3.3.1 Prices, profitability and efficiency

Privatisation has yielded benefits in the terms of efficiency gains and improved earnings before interest, tax, depreciation and abnormal items (EBITDA). These benefits relate to self-sufficiency and the subsequent removal of Corporate office overheads. However the downside has been increased costs in insurance premiums, general council rates, ex gratia land tax, consultancy fees for professional expertise which was previously provided by the Corporate office and debt servicing costs.

Table 4 provides an insight into how the profitability structure of Townsville airport has changed. The figures for 1999 reflect the period 11 June 1998 to 30 June 1999 as a consequence of being privatised prior to 1 July 1998.

Table 4 Financial Performance of Townsville Airport (Annual Reports)

	1996	1997	1998	1999	2000
	\$'000	\$'000	\$'000	\$'000	\$'000
Operating Revenue	4,607	4,443	4,552	5,728	5,799
Operating Expenses	3,007	3,141	3,450	3,459	3,145
EBITDA	1,600	1,302	1,102	2,269	2,654
Depreciation	2,334	2,121	1,976	1,265	1,122
Total Expenses	5,341	5,262	5,426	4,724	4,267
EBIT	(734)	(819)	(874)	1,004	1,532
EBIT Margin	(0.16%)	(0.18%)	(0.19%)	0.18%	0.26%
% Change in EBIT	N/A	11.6%	6.7%	214.9%	52.6%
Total Passengers	662,976	682,984	618,066	788,141	781,689
Revenue/Passenger	\$6.95	\$6.51	\$7.36	\$7.27	\$7.42
Operating Expenses/Passenger	\$4.45	\$4.60	\$5.58	\$4.39	\$4.02
Landed Tonnes	302,505	312,269	325,935	372,276	371,607
Revenue/Landed Tonnes	\$15.23	\$14.23	\$13.97	\$15.37	\$15.61

Source FAC Annual Reports 1996 to 1998
AAL Annual Reports 1999 to 2000

Notes 1. The financial results for 1998 reflect the period 1 July 1997 to 10 June 1998
2. The financial results for 1999 reflect the period 11 June 1998 to 30 June 1999

When analysing Townsville airport's performance adopting the methodology applied in preparing the regulatory accounts and breaking down all relevant financial streams the following profitability structure for 1999 and 2000 is achieved (Table 5).

Table 5 Financial Performance of Townsville Airport (Regulatory Reports)

	1999	2000
	Aero	Aero
Operating Revenue	2,635	2,188
Operating Expenses	2,614	1,891
EBITDA	(21)	297
Depreciation	965	856
Total Expenses	3,579	2,747
EBIT	(944)	(559)
EBIT Margin	(0.35%)	(0.26%)
% Change	N/A	40.78%

**Table 5 Financial Performance of Townsville Airport (Regulatory Reports)
(Continued...)**

	1999 Aero	2000 Aero
Total Passengers	788,141	781,689
Revenue/Passenger	\$3.34	\$2.80
Operating Expenses/Passenger	\$3.31	\$2.41
Return on Total Assets	(7.5%)	(4.9%)
Total Landed Tonnes	372,276	371,607
Revenue/Tonne	\$7.07	\$5.90

Source ACCC Regulatory Reports 1999 to 2000

Notes 1. The financial results for 1999 reflect the period 11 June 1998 to 30 June 1999

Townsville Airport was privatised on 11 June 1998. Since that date the cost of a full economy return airfare from Townsville to Brisbane has increased by some 9.6% (Table 6) whilst business class has increased by only 3.1% (Table 7). The withdrawal of the Australian Protective Services (APS) at the Airport, occurred during this period.

Recent passenger surveys undertaken by AAL indicate that, on average, the majority of passengers (93%) travel by economy class whilst the actual passenger mix represents approximately an equal distribution between those travelling for pleasure and those travelling for business purposes. Hence the significant increase in economy airfares compared to that of business class. Business class seats are typically 3% of total available seats. Passenger movements since June 1998 to 30 June 2000 have grown on average by 6.2%.

Table 6 Full Economy Class Return Airfares (Townsville/Brisbane Return)

Date	Notes	Full Economy (Return) Pre GST	Full Economy (Return) Post GST	% Increase	\$ Increase
Jun 1998		\$748	\$0	0.0%	0.00
Oct 1998		\$792	\$0	5.9%	\$44.00
May 2000		\$820	\$0	3.5%	\$28.00
Jul 2000	1.	\$802	\$882	(2.2%)	(\$18.00)
Nov 2000	2.	\$820	\$902	2.2%	\$18.00
Overall % Increase since June 1998 (Exclusive of GST)				9.6%	\$72.00

1. Cost of Airfare for comparative purposes excludes GST
2. A Fuel Surcharge of \$9.00 (one way) was introduced in November 2000

Table 7 Business Class Return Airfares (Townsville/Brisbane Return)

Date	Notes	Business Class (Return) Pre GST	Business Class (Return) Post GST	% Increase	\$ Increase
Jun 1998		\$980	\$0	0.0%	\$0.00
Oct 1998		\$980	\$0	0.0%	\$0.00
May 2000		\$1,016	\$0	3.7%	\$36.00
Jul 2000	1.	\$992	\$1,091	(2.4%)	(\$24.00)
Nov 2000	2.	\$1,010	\$1,111	1.8%	\$18.00
Overall % Increase since June 1998 (Exclusive of GST)				3.1%	\$30.00

1. Cost of Airfare for comparative purposes excludes GST
2. A Fuel Surcharge of \$9.00 (one way) was introduced in November 2000

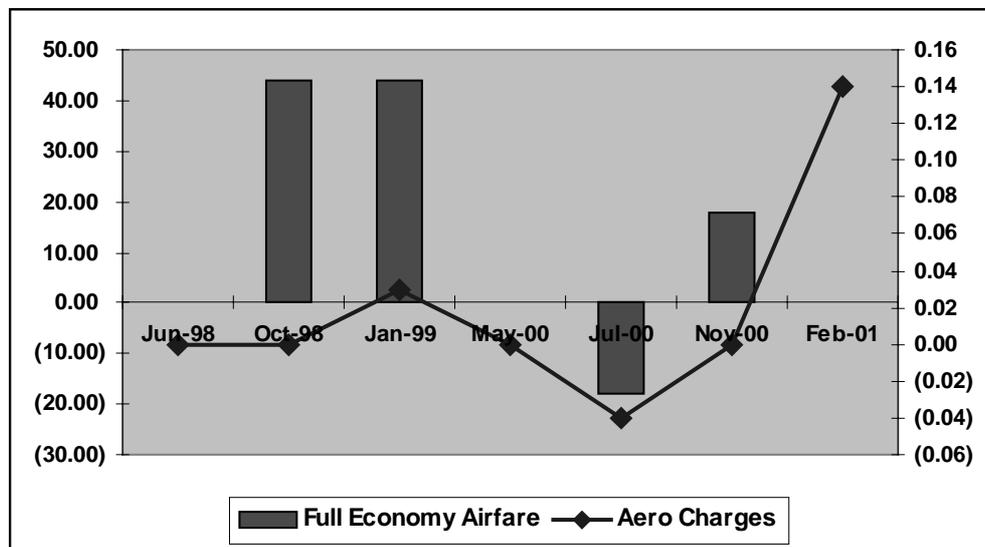
During the same period the general landing charges applicable at Townsville airport has increased by 2.3% or 13 cents per tonne (Table 8) whilst observing compliance with the price cap. In fact the 1999/2000 Regulatory Report which is yet to be released, demonstrates that the Airport has under recovered aeronautical revenue to the value of \$15,800 (rounded) over the past two years.

Table 8 General Landing Charges at Townsville Airport

Date	Notes	Landing Charges Pre GST	Landing Charges Post GST	% Increase	\$ Increase
Jun 1998	1.	\$5.72	\$0	0.0%	\$0.00
Jan 1999	1.	\$5.75	\$0	0.5%	\$0.03
Jul 2000	1.	\$5.71	\$6.28	(0.69%)	(\$0.04)
Feb 2001	1.	\$5.85	\$6.44	2.4%	\$0.14
Overall % Increase since June 1998 (Exclusive of GST)				2.3%	\$0.13

1. Per 1,000 Kg Maximum Take Off Weight

The level of dollar changes in full economy return airfares compared to that of the aeronautical charges in operation at Townsville airport since privatisation to February 2001 is depicted in the graphic presentation at Figure 4.

Figure 4 Dollar Changes in Full Economy Airfares to Aeronautical Charges

3.3.2 Quality

Service, quality and consumers perceptions of image are important. Quality of service at privatised airports falls under the umbrella of the ACCC under Part 8 of the Airports Act 1996 (the Act). Part 8 of the Act specifically provides for:

- Quality of service indicators to be specified in regulations;
- The ACCC to monitor and evaluate the quality of airport services and facilities against specified indicators and other such criteria as the ACCC determines in writing;
- Records to be kept in relation to quality of service and annual reports to be provided to the ACCC by airport operators and other relevant parties, including airlines;
- Certification by statutory declaration of information provided; and
- The ACCC to publish reports on monitoring and evaluation of quality of service against the present indicators.

In its Paper titled “Quality of Service Monitoring for Airports Post-Leasing February 1997” the ACCC state that in administering its monitoring program it will focus on facilities or services which are provided by, or whose provision can be influenced by, an airport operator. The monitoring program will not involve an assessment of airline performance or the quality of service provided within domestic terminals owned and/or operated by airlines. The role of quality service monitoring is to complement other aspects of the oversight program, in particular the price cap.

As stated in the information memorandum and the final Pricing Policy Paper the ACCC will take the results of quality of service monitoring into account in its consideration of pricing proposals. However the ACCC state that “in its administration of prices oversight arrangements it will not take a direct or mechanical approach in assessing the relationship between quality of service monitoring and pricing proposals. Such an approach would not be possible or appropriate. The approach proposed by the ACCC is to consider the medium and longer term trends in service quality at an airport and will carefully assess the underlying causes of changes in quality of service.”

Quality of service monitoring relates directly to two of the objectives specified in the Pricing Policy Paper issued by the then named Department of Transport and Regional Development (DoTARD), namely:

- To promote the efficient and economic development and operation of airports; and
- To facilitate the comparison of airport performance in a transparent manner.

To date AAL has not been significantly impacted by the requirements for quality of service monitoring and reporting as these requirements are effective from 1 July 2000 for Phase II airports. The predetermined performance indicators although comprehensive will be an additional burden to the airport operator, as the information must be provided to the ACCC within one month after the end of the appropriate financial year.

3.3.3 Impact on investment decisions

The current regulatory regime has not impacted on investment decisions at Townsville airport to date.

Notwithstanding this, AAL’s experience to date in dealing with the major airlines on matters relating to necessary new infrastructure matters is that the process is slow and cumbersome. Airlines have proven to be difficult and in some cases have not been amenable to better options proposed by the airport.

An example of this at Townsville relates to constraints that are experienced on the apron. This could be easily alleviated by the airlines introducing the practice of nose-in, push-back instead of the current practice of free-wheeling movement. The nose-in push back method requires the use of less apron space for the aircraft and would free up a valuable finite asset to accommodate additional aircraft operations. AAL recognises that the nose-in push back method would impose greater direct costs on the airlines than the option of increasing the capacity of the apron through the construction of additional pavement area. Preliminary costings for the option to increase apron capacity through the provision of additional apron area are approximately \$1 million. AAL proposed that this cost be recovered from all RPT airlines using the RPT apron. The airlines have indicated in verbal discussions that the costs for them to operate nose-in push-back compared to free wheeling imposes an additional annual charge to them of approximately \$500,000. The elements of this cost estimate have not been disclosed.

The major airlines recognise that the apron is constrained and that this could be alleviated through the introduction of nose-in push-back procedure. However they argue that over time they have already paid for the apron at the airport, and that as the increase in aircraft operating from the airport has been in the regional market, that there is no obligation for them to contribute to the costs to provide the additional apron. This argument was not accepted as valid by the ACCC in its assessment of Canberra airport's successful application to increase their apron area and hence apron capacity.

All regular public transport airports, irrespective of their position within the marketplace require core infrastructure including runways, taxiways and aprons, terminal buildings, passenger processing facilities, roads, carparks, etc. Airports are capital intensive entities, which require large lumpy periodic amounts of capital to be injected into the infrastructure for expansion purposes and to ensure that the airport is continually maintained for all those utilising the airport. Airports are unique infrastructure assets with diverse revenue streams. However ultimately the revenue sources of many airports rely on the same customers as the airlines, namely the passenger.

3.3.4 Compliance Costs and Procedural Issues

The compliance costs for prices regulation at Townsville airport have been a significant encumbrance on existing staffing levels. The requirement to lodge audited annual Regulatory accounts within 90 days after the end of the financial year whilst at the same time preparing Statutory accounts to satisfy shareholders and loan agreements is a heavy burden on a small airport. As one of the main focuses of the Regulatory reports is for the determination of price cap compliance, the extent of information required to prepared the reports is extremely detailed and based on allocations determined by the airport.

Compliance costs equate to \$35,000 per annum which is reflective of the hours required to prepare the Regulatory accounts, allocate all applicable items between aeronautical and non-aeronautical activities and submit applications to the ACCC for revising existing charges. AAL believes that these costs will increase significantly when preparing a detailed application for necessary new investment to the ACCC.

The General Aviation Infrastructure Tariff (GAIT) has proven to be a difficult area for Phase II airports when it comes to determining compliance with the price cap due to its nature as a daily based network charge.

Under FAC GAIT charges were applied to non-regular passenger transport aircraft weighing less than 10,000 Kg via a range of alternate discount systems. The maximum charge applied was \$5.34 per tonne/day for itinerant/casual users of the airport, which included landing and parking. A system of discount charges were also offered for regular users by way of a monthly, six-monthly or yearly fee on a per tonne basis. By purchasing a yearly sticker, for example GA operators could land and park at any participating airport as many times as needed in that year paying \$702 per tonne. This equated to a 64% discount from the casual per tonne/day charge. As a consequence of privatisation this reciprocal arrangement of GA operators to land at several airports has been lost. However as AAL owns both Townsville and Mount Isa airports operators

can continue to land at both airports and not incur any additional fees under the GAIT label structure.

Due to the lack of detailed information available on the number of units and revenue associated with each level of GA charges under the FAC regime, it was difficult for the ACCC to derive the appropriate starting point (base year price) for GA charges. The ACCC after consultation with the relevant airport operators devised a 50/50 revenue split between itinerant charges (\$5.34) and the range of GAIT discounts resulting in a starting point of \$4.05 per tonne/day.

3.3.5 Impact on Existing and New airlines

Equal access to the decision making process relating to investment decisions and the rate of return on the investment would be viewed favourably by the existing airlines. In some cases, like the abovementioned apron capacity matter at Townsville airport the process has the potential to delay the operations of a new entrant airline. From a new airline's perspective, AAL believes that the regime would be viewed favourably.

3.4 Future Prices Regulation

The objectives for setting prices for services generally and airport services specifically should be to:

- Provide protection for the interests of all parties;
- Ensure prices commence from the correct base to ensure efficient operations of the airport; and
- Provide appropriate incentives for efficient investment.

These are best achieved through the periodic review of actual outcomes compared to the required outcomes.

3.4.1 Airport Specific Regulation

AAL believes that regulation should be specifically tailored to the airports sector rather than reliance on more general regulation such as the TPA. Regulation specifically tailored to the airports sector would:

- Provide certainty in approach and hence consistency in application of the regulation for all parties;
- Ensures that the body administering compliance are experts in the field; and
- Less costly and quicker resolution of issues.

In adopting airport-specific pricing regulation AAL supports the following approach:

- A broad CPI based price cap set for some airport services prices with scope for pricing reviews for new investment or other special circumstances and no other prices surveillance or monitoring.

The following aeronautical services should be covered by price regulation:

- Runways; Taxiways and Aprons; and
- Airfield Lighting and Viz Aids;

Passenger Processing Facilities, such as aerobridges and other services, which are not the subject of a lease or licence agreement with the airport operator, should also be subject to price regulation. The provision of these facilities should be recovered by way of a passenger processing charge.

AAL believes that the provision of all other services should be the subject of commercial negotiations between the airport operator and the other relevant parties. Charges for services such as rent for retail premises should not be regulated, as commercially negotiated lease agreements will protect the interests of both parties in the arrangement.

3.4.2 Lessons Learnt from Current Regulation

The main lesson that can be drawn from the application of the current legislation is that ambiguities exist between the intent of the legislation as expressed by the government and interpretation of the legislation by the ACCC and other parties. It is apparent that the legislation has been interpreted more liberally than intended.

One ongoing concern with the current administration of the legislation relates particularly to the understanding of relative elasticity of demand and pricing for airports.

In addition consistency in the provision of expertise within the Airports Section of the ACCC to manage applications from airports for approval of necessary new investment applications is paramount. Enhanced and stable expertise is necessary to ensure confidence for all parties in the validity of the final decision.

3.4.3 Appropriate Legislative Framework

The most appropriate legislative framework for implementing the preferred approach to price regulation is the Airports Act 1996. AAL believes that ACCC is the appropriate body to administer the regulation due to the knowledge base that has been accumulated over the past three to four years.

Central to any legislation are transparency and procedural certainty. AAL does not support appeal mechanisms as they only add to unnecessary timing and costs of the process.

The most appropriate regulatory option which has been previously proposed reflects a broad CPI based price cap set for some airport services prices with the scope for pricing reviews for new investment or other special circumstances and no other prices surveillance or monitoring. AAL believes that this will promote the best outcome for all parties.

To reiterate, the content of the legislation must be clear, and not open to interpretation. It should be a process that is transparent in its application and provide the required outcomes of keeping compliance costs, regulatory delays and regulatory creep to a minimum.

3.4.4 Promotion of Commercially Negotiated Outcomes

In promoting commercially negotiated outcomes in airport operations the regulation needs to clearly state the process to be undertaken by the parties prior to taking an application to the administering body. AAL has reservations with the practical application of the concept as only one party in the process is regulated.

AAL believes that the option proposed structure above would best promote efficient operation of the airports. The option proposed allows for the airport operator to implement strategies that increases productivity and benefits from these productivity gains whilst also providing appropriate incentives for efficient investment in necessary new infrastructure.

Benchmarking however would not assist in promoting the efficient operation of the airports and establishing appropriate prices for airport services. AAL does not believe that it is possible to determine an appropriate benchmark due to wide disparity in demand for, and quality of, services amongst airports.

In order to encourage efficient levels of investment in airport facilities, the price regulation should provide the ability for pricing reviews for necessary new investment and take into account the airport's expectations for both increases in aircraft movements and related expenses.

3.4.5 Price Increases post CPI-X era

Price levels should be adjusted in the first instance to ensure that they commence from the correct base. One way of achieving this is to model the airports forecast increases in traffic, and related forecast aeronautical expenses for a set period of say five years and then setting the prices at a level that ensures that the charge per unit is commensurate with the expenditure per unit. By modelling over a set period into the future, this will ensure that consideration is given in the price setting for any forecast major maintenance expenditure and productivity improvements. An example of this would be

for rejuvenation or overlay treatment of the airfield pavements, which is a periodic lumpy expenditure.

With the correct base for prices being set, prices should then be increased at CPI each year with no other monitoring required. To ensure that airport operators are complying with the CPI increase, the airport operator would be required to provide ACCC with audited statements on aeronautical statistics and charges only. The current requirement to provide full statutory accounts outlining both income and expenditure for the total business is costly and unnecessary considering that compliance is only of the price cap.

AAL does not believe that the starting point for prices from the current regulatory regime is an appropriate starting point for any future price regulation. As stated previously in Table 5, costs per unit at Townsville airport was actually \$5.90 (exclusive of interest) as at 30 June 2000, whereas the current charge per unit is \$5.85 (excluding GST). In accordance with the Section 3.5 of the Guidelines issued by the ACCC with respect to Regulatory Information Requirements (Version 2 September 1998) certain items are not required to be disaggregated into either aeronautical or non-aeronautical areas of activity. For items contained in the profit and loss statement, disaggregation of interest cost, tax expense or dividend distribution is not necessary. This may ultimately result in a material understatement of the true costs of providing any particular service. Interest expense is a significant component of AAL's total operating costs equating to approximately 19% of total costs for the year ending 30 June 2000.

3.4.6 Quality Service Monitoring

Quality monitoring is an essential component of ensuring that airport operators are operating the airports at an efficient level whilst at the same time ensuring that efficient investment decisions are made in a timely fashion. The body that administers the pricing regulation should also administer the regulation of the service quality.

3.4.7 Sunset Review Arrangements

Sunset/review arrangements are critical to the assessment of the success or otherwise of regulation. Reviews allow appropriate amendments to be made to business operations to ensure that efficient decisions are being made.

COMMERCIAL IN CONFIDENCE

APPENDIX A - Capital Invested by AAL - 11 June 1998 to 28 February 2001

COMMERCIAL IN CONFIDENCE

APPENDIX A - Capital Invested by AAL from 11 June 1998 to 28 February

COMMERCIAL IN CONFIDENCE

APPENDIX B - Proposed Capital Expenditure from 2001 to 2005

COMMERCIAL IN CONFIDENCE

APPENDIX B - Proposed Capital Expenditure from 2001 to 2005

APPENDIX C - Airport Charges at Queensland Airports as at 1 February 2001

AIRPORT	AIRPORT CHARGES (INCL OF GST)		CONDITIONS	AIRCRAFT TYPE/MTOW/APAX CAPACITY				
				B737 63,476 116	Bae146 44,225 92	DASH 8 19,500 36	METRO 5,670 19	CESSNA 3,288 8
TOWNSVILLE								
General Landing Fee	\$6.44	per 1,000 Kg MTOW per Landing	Aircraft > 10,000 Kg	\$408.79	\$284.81	\$125.58	\$0.00	\$0.00
GA Landing Fee	\$6.44	per 1,000 Kg MTOW per Landing	Aircraft < 10,000 Kg	\$0.00	\$0.00	\$0.00	\$36.51	\$21.17
GA Parking Fee	\$0.00	per 1,000 Kg MTOW per Day	Aircraft < 10,000 Kg	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
			TOTAL	\$408.79	\$284.81	\$125.58	\$36.51	\$21.17
BUNDABERG								
General Landing Fee	\$7.70	per 1,000 Kg MTOW per Landing	No Conditions	\$488.77	\$340.53	\$150.15	\$43.66	\$25.32
Parking Charges	\$0.00	per 1,000 Kg MTOW per Landing	No Conditions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Passenger Levy	\$4.40	per Arriving & Departing Passenger	No Conditions	\$714.56	\$566.72	\$221.76	\$0.00	\$0.00
* Those operators occupying leased areas at the Airport do not pay any landing fees								
			TOTAL	\$1,203.33	\$907.25	\$371.91	\$43.66	\$25.32
MAROOCHYDORE								
General Landing Fee	\$6.55	per 1,000 Kg MTOW per Landing	Aircraft > 10,000 Kg	\$415.77	\$289.67	\$127.73	\$0.00	\$0.00
GA Daily Landing Fee	\$6.55	per 1,000 Kg MTOW per Day	Aircraft < 10,000 Kg	\$0.00	\$0.00	\$0.00	\$37.14	\$21.54
Parking Charges	\$0.00	per 1,000 Kg MTOW per Landing	No Conditions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Passenger Levy	\$11.00	per Arriving & Departing Passenger	No Conditions	\$1,786.40	\$1,416.80	\$554.40	\$0.00	\$0.00
* Those operators occupying leased areas and pay daily landing fees receive no discount								
* Those operators occupying leased areas and pay annual upfront fees receive a 20% discount								
			TOTAL	\$2,202.17	\$1,706.47	\$682.13	\$37.14	\$21.54
ROCKHAMPTON								
General Landing Fee	\$4.40	per 1,000 Kg MTOW per Landing	Avtur Aircraft	\$279.29	\$194.59	\$85.80	\$24.95	\$0.00
General Landing Fee	\$5.50	per 1,000 Kg MTOW per Landing	Avgas Aircraft	\$0.00	\$0.00	\$0.00	\$0.00	\$18.08
Parking Charges	\$0.00	per 1,000 Kg MTOW per Landing	No Conditions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Passenger Levy	\$5.50	per Arriving & Departing Passenger	No Conditions	\$893.20	\$708.40	\$277.20	\$0.00	\$0.00
			TOTAL	\$1,172.49	\$902.99	\$363.00	\$24.95	\$18.08

Assumptions:

1. Load factors for ROT is equivalent to 70%
2. Passenger Levy is only applied to adult passengers
3. Aircraft parked in excess of 3 hours

APPENDIX C - Airport Charges at Queensland Airports as at 1 February 2001

AIRPORT	AIRPORT CHARGES (INCL OF GST)		CONDITIONS	AIRCRAFT TYPE/MTOW/APAX CAPACITY				
				B737 63,476 116	Bae146 44,225 92	DASH 8 19,500 36	METRO 5,670 19	CESSNA 3,288 8
MACKAY								
General Landing Fee	\$8.50	per 1,000 Kg MTOW per Landing	Aircraft > 4,000 Kg	\$539.55	\$375.91	\$165.75	\$48.20	\$0.00
GA Landing Fee	\$2.41	per 1,000 Kg MTOW per Landing	Aircraft < 4,000 Kg	\$0.00	\$0.00	\$0.00	\$0.00	\$7.92
Parking Charges – On Airport	\$34.69	per seat per annum (max \$341.37)	GA Aircraft only	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Parking Charges - Off Airport	\$4.59	per Day or Part Thereof (minimum)	GA Aircraft only	\$0.00	\$0.00	\$0.00	\$32.01	\$4.59
Passenger Levy	\$8.50	per Arriving & Departing Passenger	No Conditions	\$1,380.40	\$1,094.80	\$428.40	\$0.00	\$0.00
* Parking charges for off Airport Operators are payable after three continuous hours			TOTAL	\$1,919.95	\$1,470.71	\$594.15	\$80.21	\$12.51
CAIRNS								
General Landing Fee	\$3.84	per 1,000 Kg MTOW per Landing	No Conditions	\$243.75	\$169.82	\$74.88	\$21.77	\$12.63
Parking Charges – On Airport	\$0.07	per Day to maximum of \$264.76 pa	No Conditions	\$0.00	\$0.00	\$2.59	\$1.37	\$0.58
Parking Charges - Off Airport	\$2.66	per Day or Part Thereof (minimum)	No Conditions	\$37.12	\$37.12	\$0.00	\$0.00	\$0.00
Passenger Levy	\$3.84	per Arriving & Departing Passenger	No Conditions	\$623.62	\$494.59	\$193.54	\$0.00	\$0.00
* Parking charges for off Airport Operators are payable after three continuous hours			TOTAL	\$904.48	\$701.54	\$271.01	\$23.14	\$13.20

Assumptions:

1. Load factors for ROT is equivalent to 70%
4. Passenger Levy is only applied to adult passengers
5. Aircraft parked in excess of 3 hours

APPENDIX D - Classification of Aeronautical and Non Aeronautical Services

Service	Potential to Abuse Market Power
Aeronautical Activities	
<i>Airside</i>	
Aircraft Movements	Minimal as required under Lease Agreement with Federal government to provide access to all operators
Aircraft Parking	Minimal as required under Lease Agreement with Federal government to provide access to all operators
Runways, Taxiways & Aprons	Minimal as required under Lease Agreement with Federal government to provide access to all operators
Airside Roads and Grounds	Minimal as required under Lease Agreement with Federal government to provide access to all operators
Airfield Lighting and Viz. Aids	Minimal as required under regulations to comply with minimum safety standards and number of providers available.
Environmental Hazard Control Services	Minimal as required under regulations to comply and number of providers available.
<i>Terminal</i>	
Public Conveniences & Amenities	Minimal as driven by number of services
Aerobridges	Minimal as driven by number of services
Departure, Holding and Arrival Lounges	Minimal as driven by number of services
Passenger Check In Counters	Minimal as driven by number of services
Airline Support Areas	Minimal as driven by number of services
Baggage Facilities	Minimal as driven by number of services
Public Areas	Minimal as driven by number of services
<i>Landside</i>	
Terminal Access Roads and Lighting	Minimal as driven by number of services
Terminal Facilities and Parking	Minimal as driven by number of services
Aeronautical Commercial	
Hangars	Minimal as driven by Townsville market
Flying Schools	Minimal as driven by Townsville market
Charter Operators	Minimal as driven by Townsville market
Aero Clubs	Minimal as driven by Townsville market
Airline Catering Facilities	Minimal as driven by Townsville market
Car Rental Counters	Minimal as driven by Townsville market

APPENDIX D - Classification of Aeronautical and Non Aeronautical Services

Service	Potential to Abuse Market Power
Aeronautical Related Activities	
Refuelling Services	Minimal as driven by number of services
Aircraft Maintenance Sites and Buildings	Minimal as driven by Townsville market
Freight and Cargo Facilities	Minimal as driven by Townsville market
Ground Support Equipment Sites	Minimal as driven by Townsville market
Carparking (Public and Staff Carparks)	Minimal as driven by number of services
Powerhouse and Emergency Power	Minimal as driven by number of services

Service	Potential to Abuse Market Power
Non Aeronautical Services	
Car Rental Support Facilities	Minimal as not an essential aeronautical service and therefore ability for substitution of location off airport
Leased Offices within the Terminal	Minimal as not an essential aeronautical service and therefore ability for substitution of location off airport
Retail Concessions	Minimal as not an essential aeronautical service and therefore ability for substitution of location off airport
Club Lounges	Minimal as not an essential aeronautical service
Non Public Facilities	Minimal as not an essential aeronautical service and therefore ability for substitution of location off airport
Golf Driving Range	Minimal as not an essential aeronautical service and therefore ability for substitution of location off airport
Vacant Commercial Land	Minimal as not an essential aeronautical service and therefore ability for substitution of location off airport

Notes

1. Townsville market refers to the whole region as a market force driving and in turn supporting the economic development of the airport. The Airport is not a stand-alone entity and is extremely reliant on the support of the region to either sustain its position or grow further as the region develops.

APPENDIX D - Classification of Aeronautical and Non Aeronautical Services

Notes Continued...

2. The number of services refers to the actual number of participants within the local airport environment including aircraft operators, airlines (domestic, regional, charter and general aviation), support industries and relevant infrastructure. Townsville airport would not be a commercially viable entity if it was not supported by the market and thus it is the destination not the airport which is the driving factor.
3. It is a condition of AAL's lease with the federal government that we provide access to all airline operators for aeronautical services.
4. Pressure from the local community to provide appropriate level of infrastructure at appropriate price that supports sustainable growth and development of the region.

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