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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON PRICE REGULATION OF AIRPORT SERVICES

PROF R.H. SNAPE, Deputy Chairman
DR N. BYRON, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON THURSDAY, 18 OCTOBER 2001, AT 9.50 AM
Continued from 17/10/01

PROF SNAPE: Welcome to the second day of public hearings on the Productivity Commission's draft report on prices regulation of airports. I don't think there's any need to introduce ourselves again, but I'm Richard Snape. On my right is Neil Byron. Staff members are present who would be pleased to give advice on procedure should it be required. As you know, the Commission is to report on whether there is a need for prices regulation of airports and, if so, the appropriate form of any prices regulation, taking into account a number of principles that are set out in the terms of reference. The final report is due to be submitted to the government by 21 December.

Our public hearings provide an opportunity for interested parties to make oral presentations in relation to the draft report. Generally this is in the form of speaking to written submissions, these being available on the Commission's web site as well as in hard copy. Due to the sad events over the last month or so, we appreciate it has been difficult for many parties to make full submissions, and we thank participants for the efforts that they have made. In the cases where we only have notes at this stage, we look forward to receiving full versions as soon as possible so that they may be given adequate attention in writing the final report.

As you know, transcripts of the hearings are sent to the relevant participants to check for accuracy of reporting and are normally available on the Commission's web site within a few days of a hearing. At the end of the scheduled hearings for today I shall invite any persons then present to make unscheduled presentations should they wish to do so. Now I invite our first participants for today, which is Gold Coast Airport, Coolangatta, and I thank them very much for their written submission, which no doubt, as I said, with the events of recent times it's been difficult for them to get to, get pen to paper. I thank you for it and for getting it in so that we were able to consider it ahead of the hearing. I ask you to introduce yourselves both separately for the transcript and then one of you to speak to the submission.

MR CHANT: Thank you, professor. Denis Chant, managing director, Gold Coast Airport Ltd.

MR GOLDSMITH: Robert Goldsmith, general manager, business development, Gold Coast Airport Ltd.

MR CHANT: Thank you, professor. I'd like to approach it through just briefly going through the points that are summarised there at the front of the submission. There's about seven or eight dot points there which should encapsulate what we have to say. Taking the first dot point, there is a correction there. I understand we're actually the third lowest. Somehow Adelaide has slipped in underneath us, even though they have a lower X factor. There must be some recovery or costs or something there, but we are actually the third lowest behind Perth and Adelaide.

That has I suppose presented us with some challenges since we've had the airport, and in one of the attachments there which formed the basis of an earlier submission to the ACCC when we were looking at moving this year from landed tonne based charges to a passenger based charge, we've had the problem of not just a fairly aggressive X factor but also with the slow reduction in landed tonnes due to the use of more efficient aircraft and higher load factors on the Gold Coast over the last few years. It's really I think been a product of the airlines' push for profitability that on a fairly low yield route they've been pushing more to improve their load factors and their profitability, which we understand entirely. So the combination of the X factor and reducing tonnages while the passenger figures were remaining relatively static led us to feel that the charges based on passengers was a more appropriate way of setting charges.

Just looking at last financial year, our aero revenue fell by something like 10 per cent, and that was being exacerbated this year particularly when Qantas moved from 767 and 737 fleet to the Boeing 717 fleet, which potentially for the same number of seats was cutting the landed tonnage by something like 30 per cent. So that was quite a big incentive for us to enter negotiations with the ACCC and the airlines about six months ago to change to a passenger based charge. Basically that's encapsulated in the second point there.

I think if we look over the last three years or the first three years of privatisation for the airport, we've actually reduced our loss situation from a loss of 2.7 million to about 1.2 million last financial year - that's over a three-year period - but most of that has been achieved through reduction in costs. We've actually reduced our cost base from about 6.95 to about 5.6 million, so virtually all of the improvement in profitability has come about through reduction in costs. We've basically got to the stage, we feel, where we can't responsibly reduce costs any further, and in fact we are worried about covering some of the longer term and higher maintenance costs, particularly in the movement areas, things such as overlays and maintenance of runway repairs. So again that was the sort of thing that was driving us to go to a passenger charge. We did have agreement in writing in principle from both Qantas and Ansett and an understanding from the ACCC that we would proceed to a passenger charge. It was the intention that that would come into place on 1 October, but events in September precluded that.

The Ansett collapse has put in jeopardy potentially 40 per cent of our revenue. That had our financiers on the door within hours, not days, after those events, so we had to do some fairly quick calculation. I suppose the big problem we have is the lack of any degree of certainty in the short and the longer term but more importantly in the short term. So we then made approaches to the airlines and the ACCC to significantly increase that passenger charge from what was going to be $2.17 based on the regulated regime to $5.90 as a short-term measure to satisfy basically just finance and covenants that we had with our bank, and that is articulated or summarised in the draft submission in appendix 2, I think - 1 or 2 - that was the basis of our submission to the ACCC. That was also forwarded to the airlines. Again, the ACCC was reasonably understanding of our position .

The problem we faced under the regulated regime was that if the charges did go up we were then creating a contingent liability and there was a real dilemma of how that adjustment would ever be made in the future. That was the subject of a discussion between ourselves and the ACCC, and again we did get a reasonable hearing from them.

PROF SNAPE: And a solution?

MR CHANT: We didn't really get a solution, but their suggestion was that probably we're looking at a period beyond where we would have probably been regulated anyway, assuming that in two years' time we would be not further regulated. So we were sort of I suppose playing around the edges but we didn't have a definitive solution. At the same time we raised the issue with the government and articulated our dilemma to them, and I suppose the remedy in our particular case was the decision made by the government on 5 October, which effectively gave us the flexibility then to implement that short-term solution without the that shadow of that contingent liability hanging over our head. That would appear to have given our financiers some degree of certainty.

It hasn't been an uncontroversial decision and not one that we made lightly. I mean, we are very much open to competition from Brisbane and, apart from the fact that a lot of passengers want to come to the Gold Coast, the airlines are well established in Brisbane and it's not a hard thing for them to just move their whole operation up there. So we're very mindful of that and we did engage in discussion with them as early as possible. I won't say they were happy. I think there was a degree of understanding of why we're doing it, but they certainly didn't express any joy at that level of charges.

I suppose in the longer term now, that the price cap and price monitoring has been removed. So long as we can get over this short-term problem - and I think the problem again is the uncertainty. We really don't know where Ansett is going. We can't get any joy out of the receiver. In fact, we can't even get a return phone call. We're not - in terms of any announcement that has been made public - on the screen for reintroduction of services. They did pay the rental this month but we don't know whether they're going to pay it next month. So again, it's that level of uncertainty.

As soon as we can get something definitive, we can really show it a way ahead, and certainly we've given undertakings with the airlines as soon as we do have some degree of certainty, we would continue to liaise with them in terms of establishing parameters on which charges could be set. In fact, we've sought discussions with the airlines already to try and define those parameters, and one of the problems we have in this case is the airlines don't really have any sort of defined parameters under which - they want us to provide a lot of figures, but they don't tell us how those figures are going to be judged, and I think now we have the opportunity, as do businesses who have very similar interests, of actually sitting down and working through this issue without the spectre of some prescriptive regulation over the top of us. So I think in the long-term, it allows us to come up with a mutually agreeable commercial solution to the setting of charges.

Just reinforcing our view, taking the next dot point there, that the competition from Brisbane - also the price-sensitive nature of our market. I mean, really, we are servicing what is the lower end of the market in terms of airfares. I think looking at it in perspective, our increase is around about 3.40, 3.50 a passenger, plus GST. So in itself, it's not a huge impost. I mean, it does further - - -

PROF SNAPE: That's in and out, both ways?

MR CHANT: That's both ways, yes.

PROF SNAPE: So you double it.

MR CHANT: Yes. But when you add that on top - I mean, if you look now, it's ironic that our airport charges are so low but our Commonwealth charges are amongst the highest in the country, if not in some cases the highest, in terms of air services and Australian protective services. So we're already at a competitive disadvantage price-wise because of those very high charges, and the charges we're proposing now probably put us roughly on a par with what the Commonwealth is charging for those two services. I suppose what we've found in discussions with some of the no-frills airlines, that, I suppose, are dedicated to that end of the market, is that they're really becoming concerned about the whole magnitude of imposts that are being put on passenger tickets, and if you look at those charges which - I mean, there's the Ansett levy, there's the airlines' insurance levy, there's the fuel levy, if that's still being charged. For the internationals, the departure tax is increased by $8. So, I mean, our charge - extra $3 or 3.50 or whatever it is, put in that context, is not a great increase.

But we're having genuine concerns that, you know, you really are putting a lot of impost on say, from New Zealand, what is a $NZ400 return ticket. You know, if you start to add on charges that are in tens of - not single percentages of the original ticket, you know, at the end of the day, it must start to affect that market. So I think overall, we're concerned and the tourism industry is concerned that there is this huge increase in charges. We regard that and the competition with Brisbane as a discipline that we have on capping our charges, and I think it has been reasonably well articulated in the findings of the report and even in the ACCC submissions, that there is a real competitive situation there. So I think in the submission we did to the ACCC that's in there, you will see that the criteria we used had nothing to do with returns on assets or even achieving profitability. It was purely established to meet our financing requirements, basically cover our interest costs. So there's no profit taking there within the charges we propose.

The other thing, to sort of put it into some context - I mean, we did get some flak, you know, from a range of people, including the Queensland premier and Virgin in particular, and it was interesting that, you know, a Queensland government run airport at Mackay and one that Virgin was courting as being one that they would look at growing services, with the implication that they wouldn't be growing services and would be reviewing what they were doing at the Gold Coast. I think their charge, Mackay's charge, is about $8.50 each way for passengers, and $8.50 landing charge. So I can't, unless there's some extremely deep discounting, I can't reconcile the criticisms from those two quarters that came out in unison, I might add. Again, it's pretty hard to put these cases without upsetting some very important stakeholders, but we felt that that was a little unfair and given the consultation that it had with Virgin and the fact that the Queensland government didn't bother to talk to us before they made those criticisms - I mean, we also made - I think that did smell of politicking in that, if you read the premier's press release, because I think he was really having a go at Minister Hockey.

PROF SNAPE: And us.

MR CHANT: And the Productivity - so I suppose we've got to live with that. I suppose just in closing, the Ansett collapse also illustrated a couple of other issues that were alluded to in the Commission's findings, and that was this issue of substitution of destinations and modal substitution. On the Gold Coast, while we lost a lot of air capacity and the planes were absolutely full, the accommodation houses reported that their bookings weren't down. If anything, they may have been a little bit stronger for that short school period which coincided with the collapse. The feedback they (Gold Coast Tourism Bureau) were getting from the operators was that many of the people who had booked packages made the decision to drive, and they were driving from as far as Adelaide, Melbourne, to the Gold Coast, which is not such an onerous drive. So the drive market really saved them. There was anecdotal evidence that some of the - there was new bookings from some of the shorter-haul markets that were frustrated in trying to get out to longer-haul destinations.

Looking at some of the surveys that have been done - and there has been myriads of surveys done by various tourism and government organisations in the last few weeks - it would seem that Cairns did suffer much more substantially, say, than Gold Coast - that's correct. So, you know, the destinational substitution was coming in there and I think there's some interesting examples of the dynamics that might be worth pursuant a little more, you know, if you need to justify that position you've had there. So that's really meant to be an overview of where we are at this moment.

PROF SNAPE: Thanks very much, Mr Chant. I guess Uni Super is a large investor in Coolangatta as well as Adelaide?

MR CHANT: Yes, they have 49 per cent.

PROF SNAPE: Yes, so I suspect that - well, I think perhaps for the benefit of the transcript, given my background, some people may think that I have a conflict of interest here, but in fact, for the transcript, I am no longer and have not been for some time in Uni Super so there is not. So I can now stay in the room, I think. A brutal view could be, from an airline - and I'm not suggesting that they're saying this - but a brutal view could be, "Well, okay, the owners have got very large debts which they have to meet," as you indicated in the very helpful submission and transcripts and attachments which you have there, and it could be said, "Well, you paid too much for the airport and, you know, an airport will continue there. If your company isn't running it any more, then it will probably continue. The debts will disappear," that is, that you'll go bust, "and so why should they pay more for a misjudgment in the purchase price?"

MR CHANT: Yes, and I think that question would have exercised the government's mind in looking at ourselves and a number of other airports that triggered them to make that decision several weeks ago. I suppose we have to look at several aspects of that. One is we look at the shareholders. We have Uni Super, we have Hastings Funds Management who are managing a number of other funds that include super funds as well as union super funds, we have not-for-profit organisations such as the University of Melbourne and RACQ, so we have, I suppose, an interesting group of shareholders and the immediate result of the company collapsing is there's something like a $60 million investment by those type of organisations in jeopardy.

When you look at the - I suppose, even in the political context as well as the confidence in the sector, the airport sector, if a business falls over it's basically $3.50 which is a very small percentage of some of the other imposts that have been put on and one of which is to save entitlements for people who have been put out of work. So I mean there is a political and a confidence-in-the-sector aspect which is the sort of more macro sense. I think looking at the reality of the situation, I mean what's important to us in terms of operating the airport successfully, is that our airline partners are profitable and we understand that they have been struggling for profitability at our airport for some considerable time.

But it's certainly our understanding that from six months ago when we started our negotiations with the airlines, and that was Qantas and Ansett primarily, and Ansett speaking on behalf of Ansett and the Air New Zealand group which included Freedom, was that when we levy the passenger service charge, that would be then passed on to the passengers. It's certainly our understanding that that would be the same philosophy that would be adopted if we have a $5.90-charge. So in fact if anybody is subsidising this, it would be the passenger. Now, the one thing I think that gives us some certainty is that the passengers actually want to fly into the Gold Coast and that's been - I mean, in some press cuttings there the local newspaper went down to the airport and said, "Well, this is what we're going to do," and they said, "Well, look, if it keeps this airport going, we're only too happy to pay that small amount."

I think if we again look at the position of profitability of the airline, I mean take Qantas - and I don't want to get into a bunfight with Qantas because they're an extremely important part of our business and I like to think we have good relations with them - I would think that out of all of this, their profitability should improve. If they carry 30 per cent more passengers through our airport this year, given the nature of our traffic, its not time sensitive. We don't have peaks so they can actually spread the load. So without having to do anything to their terminal facilities and also presumably without changing staffing much, Qantas can accommodate at least another 30 per cent no problem, and I think that's the order of probably what the additional traffic they'll be carrying this year.

Qantas also currently share the concession revenue with Ansett. Once if Ansett - the worst-case scenario is that Ansett leaves their lease and doesn't operate there again, so in terms of the non-aero revenue that they can generate will be considerable. So I think one would hope that Qantas can make more money out of the situation there within - by (1) increasing the load factors, and they're very hight at the moment. I think we're in the very high 90s. I'm not sure how long we can sustain that, and certainly our understanding is the passenger at the end of the day who will be paying the levy liked the convenience of being able to fly there.

PROF SNAPE: In making the calculations that you have here of getting to that - what was it - 5 point - - -

MR CHANT: 9.

PROF SNAPE: Dollars, isn't it?

MR CHANT: Yes.

PROF SNAPE: $5.9, yes. What assumption did you make in there about the responsiveness of the number of passengers? Did you just assume a constant number of passengers and say this extra $5 or $6 each way won't affect the number of passengers?

MR CHANT: What we tried to do was to - what we found is our passenger numbers are generally reflected by the capacity that's available. We are generally supply constrained because of this issue of yield and basically the way we worked it was looking more at what capacity we thought would be available, then we put a load factor to that. So that's the way that we came up with the numbers and we did build some growth into, you know, over and above. We assumed that Qantas took up some of the Ansett capacity, which I might add hasn't actually been done to date. I think we had - the week after Ansett collapsed we had something around 64 per cent of the pre-Ansett capacity where - it varies; I think last week was 67 per cent, the week before was 62 per cent. So we had been fairly stable but Qantas have indicated that there will be some increase from 28 October.

PROF SNAPE: But you're not assuming that the price increase itself will affect the amount of traffic that you have, the number of passengers you have.

MR GOLDSMITH: No, because in the context of the way that air fares have developed with all of the other additions to the overall consumer cost, we believe that the airport charge or the increase in the airport charge is a very small proportion of the average fares in that marketplace now because - again, there are press reports. We don't know what the average fare levels are but there are press reports and illustrations that the Gold Coast fares from Sydney and Melbourne have increased quite considerably compared with the heavier competition days when Ansett was flying, so in that context we're not - we don't feel we're in a position to judge what sort of suppression of the market our small element of the overall price would actually have; I mean particularly when we're not even sure about how quickly Qantas themselves are going to be bumping up their own capacity into the market.

PROF SNAPE: See, you can probably see what I'm getting to here, in that the airlines tend to say and the airlines representatives tend to say, "Well, the airports are a monopoly so you can just bung up their prices and people will continue to fly," and so then they'd say, "Well, okay, you've gone up to $6 here. Next year, you may put it at 20." So if you don't think it's going to affect the number of your passengers, why stop at $6?

MR CHANT: Well, I think I'd like to make the point that, you know, we do have real competition at our airport, and I think that it was with extreme reluctance that we went to where we have. I mean, Virgin have already said they're reviewing their operations into the Gold Coast now. If we look at - I mean, I think what drives our future and the way we operate is more airline profitability than passenger demand. The passenger demand is always there, whether they come through Gold Coast or whether they come through Brisbane. You know, it's just the convenience of coming through the Gold Coast that wins out. I mean, there would be many hundreds of thousands, if not some millions a year of passengers that come through Brisbane that go to the Gold Coast already. So it's really the profitability of the airlines that drive it, not the demand of the passenger and, I mean, that's - - -

PROF SNAPE: I can understand that an airport would not wish to drive an airline out of business, but surely a $20 charge would not drive Qantas out of business.

MR CHANT: I mean, we have to - I mean, it is our intention to sit down with the airlines and work through this and come up with a set of criteria which is agreeable to all parties, or at least as close a compromise as we could get, and I don't ever see that a $20 charge would be a level that they would agree to. I mean, we're in the marketplace as well. We just can't go out - - -

PROF SNAPE: What would they do if they didn't agree?

MR CHANT: Well, I don't know. I really don't know. The option is for them to - well, I mean, as I say, Virgin is hanging on a thread at the moment.

PROF SNAPE: But there are differences between airlines, and you may have some scope for charging different airlines different landing fees.

MR CHANT: We tend to adopt a philosophy with landing charges and those basic aeronautical charges that what we charge one airline, we charge the other airline, and that's a conscious decision. We want to work as closely with our existing carriers as we do with trying to, you know. The best option for us is for them to put in more capacity rather than - - -

PROF SNAPE: But there are various way so of charging different airlines different prices, so one is to give incentives, another is not to press too hard for collection, and I suspect you didn't press too hard for collection in the last few months, in the last few months of their existence.

MR CHANT: I don't think we favoured anybody. We were still pursuing Ansett as we would anybody else.

MR GOLDSMITH: I don't think we actually participated though in a (indistinct) anyway at that particular point in time, so we certainly didn't go easy on Ansett.

MR CHANT: I'd like to think the airlines sort of understand a little bit of what the price sensitivity of the market is, and I just did a quick sweep of the Web page yesterday, of Qantas Web page, and if we take somebody wanting a week - from Melbourne to Gold Coast for a week early in December, you know, to get a fare direct Melbourne-Gold Coast is, say, $387. Direct Melbourne to Brisbane for those same days and roughly the same times is $288. So, I mean, the airlines I think already see that there is value in that direct link because, you know, for the passenger doesn't have to meet the costs of transfers. So, I mean, I know what you're saying is that, you know, in this new brave world, what's to stop us from doing as Mackay does and charge $8.50? Whilst I think it's - I mean, what the government takes away, the government can put back, and if we can be shown to be, you know, raping and pillaging the airlines, I'm sure there would be pressure from the industry which they're very closely aligned to, that is, the tourism industry, to do something about these so-called monopolistic practices. So I think we have a lot of disciplines there that mean we have to be on our mettle.

DR BYRON: Coming back to the original CPI minus X calculations, do you know if they had some underlying assumptions about growth in passenger numbers, and if so, whether the actual passenger numbers, which you say have been fairly static over the last couple of years - is that much less than the predicted price?

MR CHANT: Yes. Yes, very much so and, I mean, unfortunately we haven't been able to find how the basis of that X calculation - and we have had discussions with several government departments and were contemplated doing a freedom of information type request to try and get the information out. But I can only assume that, you know, basically looking that all of the assumptions that have been prepared for traffic growth at Coolangatta, which was very much a projection of what happened in the early 90s, when there was very substantial growth. All of the projections continued that growth. About the time of the sale of the airport, that trend changed significantly, mainly, as I said, because of supplier constraints. I think there is - you know, the terminal capacity is there to handle far more than the two million passengers we're handling now, as I've outlined with the Qantas issue. Qantas can probably handle 50 per cent more passengers through their terminal, so one could have said quite easily, the airport could have handled another 50 or 60 per cent.

So, yes, there was certainly much more aggressive projections in terms of passenger growth, which was really a continuation of what was there before. I don't think - the thing that people didn't understand and saw, it to be wise in hindsight, is the airlines changing their view from winning market share to the much more understandable premise of trying to improve their profitability. So they've been driving up the yields too, particularly through increased load factors. I mean, it's interesting that the airlines also, just prior to the privatisation, committed to something like $30 million worth of improvements to the terminal, and basically within six months of the sale of the airport, they wanted to get out of that and for the past two and a half years they've been trying to renege on that obligation. So one would think that maybe they also got it wrong. So there's a number of us probably, you know, government, investors and airlines, who are probably all overly optimistic some three or four years ago.

DR BYRON: You mentioned the Air Services Australia charges and the APS charges. Is there any chance of any movement on those in the foreseeable future?

MR CHANT: Yes, and because of the quantum of those charges, that probably worries us even more than our own charges, because while theirs is mainly generated on through put - you know, a 36 per cent reduction in capacity - it must put additional impost on them. I mean, Air Services tell us that they're already in a loss-making situation at Gold Coast, so one wonders what's going through their minds at the moment.

DR BYRON: I meant what were the prospects of those charges coming down, but you're telling me they're likely to go up because they work on a cost recovery basis?

MR CHANT: Well, they basically seem to, you know - I suppose the only thing that prevents further increases is we keep the pressure on them. We keep pre-empting that they're going to put them up so we have to keep putting the pressure on them. I mean, they still can't explain to us how they establish those charges, because I honestly don't think they know themselves. But, yes, our real fear is that those charges could go up if they're going to, you know, adhere to their philosophy of site-specific charging.

DR BYRON: Related to that, I was looking on page 4 of the submission where you list the increased international departure tax, airline fuel levies, airline insurance levies and the Ansett levy, and I was trying to jot down, you know, dollars beside each of those and then see how your aero or passenger facilitation charges, whatever, the $5.90 which is up by an increase of $3.60, how that ranks compared to, you know, the $10 Ansett levy, the $8 increase in international departure tax you mentioned and all the others. I'm just trying to get some sort of order of magnitude perspective on all these add-ons.

MR CHANT: Yes. I mean, the most informed document I've got in terms of, say, some of those other charges like the insurance levy, there's an article there from the Fin Review, so you know how robust that is. I mean, they're saying on a fare from Inverell to Sydney, $27.10 to cover the insurance levy. Now, I would have thought that's much higher than I envisaged it and they're saying on Melbourne-Sydney for a full business fare, $300-fare, there's an insurance levy of $7.26. So I thought it was more like $2.50 or something like that but I'm not sure how that has been established so it would seem it is a significant cost and there was a - - -

PROF SNAPE: And full business fare of $300 Melbourne to Sydney is - - -

MR CHANT: Seems a bit low to me as well.

DR BYRON: Where can I get one of them?

MR CHANT: Yes. So as I say, that's - I mean, it must be reasonably easy to establish but we've done nothing to try and establish that, it's just - - -

DR BYRON: Yes.

MR CHANT: And the fuel levy, I understand, if that's still on, was $9 plus 90 cents GST I think, $9.90 was the - - -

DR BYRON: I guess it's easy for everybody who proposes or bungs on one these additional charges to say, "Well, it's only a small percentage, it's only 5 per cent." But by the time you put it on half a dozen of these and they're all only 5 per cent, it really starts to add up.

MR CHANT: Yes. Well, the other problem we've got is with the increase in security costs. APS charges are, as I said, amongst the highest in Australia at our airport and if you were putting in - and they're talking about now increasing their presence by something like - well, it will require 100 per cent increase in their presence at our airport because of the fact that we haven't been operating 24 hours before. So if you're looking at that charge and dividing it up by fewer passengers, you know, all of these imposts go up and that goes back to what we're saying, that as being heavily exposed to the tourism sector we're more worried about this, the total magnitude of all these charges that are being levied on tickets.

PROF SNAPE: Who runs the fire services?

MR CHANT: Airservices.

PROF SNAPE: Could that be done more cheaply?

MR CHANT: Yes.

PROF SNAPE: To the required standard?

MR CHANT: Yes, that happens to be both air traffic control and rescue and firefighting. We think we could integrate that within our operation far more cost-effectively than what is done at the moment and certainly there are economies in scale in terms of better utilisation of staff, stripping out a lot of administrative costs. Yes, that would certainly be an avenue for at least capping if not reducing the cost of those services.

PROF SNAPE: Dick Smith a little while ago made much of those type of charges, as you recall.

MR CHANT: Yes, well, I think we've probably been sort of beating the drum on that for some considerable time. I mean, it's ironic now that we're sitting here saying we put our charges up to the same level as them after we've been beating them around the head but we think we have considerably more assets there than what they do.

DR BYRON: Just coming back to the opening comments and you referred to the premier's press release and so on, the perception that I think I and most members of the public would have had, that this announcement of the 170 per cent price increase was a great shock that just totally came out of the blue. What you seem to spell out in here was that there was a fairly lengthy period of discussions and leading up to this in that many parties including some or all of the airlines involved had good indications of what was coming.

MR CHANT: Yes, there were lengthy discussions about going to a passenger charge. Because of the time frame, it's a bit hard, I suppose, to say it was lengthy discussions with the airlines but certainly a couple of weeks before the government made their decision the airlines were aware because, as I said, we'd given them a copy of that submission that we'd given to the ACCC. We'd had meetings with airlines prior - you know, certainly well prior to that decision being made. So yes, in some ways I was a little bit surprised at the ferocity of some of the comments. I mean, some of the comments - certainly in Virgin's case some of the comments they made in their press releases are just plain wrong.

DR BYRON: You don't know - I don't suppose there's any way that we can find out whether or not there's a particular incentive package for Mackay, for example, given that the figures that are down here, their list prices are substantially more than your increased prices.

MR CHANT: Well, I assume if Virgin have made that comment that it's a more friendly regime at Mackay, that somehow they've got their charges beneath ours.

PROF SNAPE: Okay. Well, I think we have gone through what we wished to ask. It's been a very helpful submission and we thank you very much for it, again for the effort of getting it in in time for the hearing but also for the amount of detail that you've given us there and the financial circumstances that you find yourself in. We thank you very much for that.

MR CHANT: Thank you.

PROF SNAPE: We will be now having Brisbane Airport. Good. We now go to Brisbane and welcome Mr Rothwell, who will identify himself on the tape and then speak - while we haven't yet got a written submission we have some notes. Thank you for that. We would look forward, I think, to a full submission fairly soon if we can. Mr Rothwell.

MR ROTHWELL: It's Tim Rothwell, the chief financial officer of Brisbane Airport Corporation. I'd like to start by saying this is not an economic paper of the quality of some of the other submissions but a few comments from a simple accountant trying to run an airport in very difficult times. I sympathise very much with Denis's concerns at Coolangatta and I think we have some very difficult problems in the industry.

PROF SNAPE: You need to keep the voice up just a bit if you would.

MR ROTHWELL: Sure. First of all I would say that Brisbane Airport Corporation welcomes the draft report of the Productivity Commission into price regulation of airport services, the general thrust of which is that airports and airlines should get together and reach fair commercial agreements for use by airlines of facilities at airports. It's not surprising that airlines strongly oppose the Commission's report. The aviation industry is one of the most overprotected, regulated and unnecessarily complex and confusing industries in the world. Airports and airlines around the world were historically owned by governments.

Over recent years some enlightened countries have seen the benefits of moving both airlines and airports into private ownership. Australia, at the forefront of airport privatisation, has achieved much, but there are a number of issues to overcome if the process is ultimately to be judged a success. Airport and airline businesses operating in a competitive environment will undoubtedly be the way in which Australian tourism, travel and industry generally will see the greatest gains over time. Nations around the world - and Australia is no exception - have for years protected their national carriers on the grounds that it is good for the country. Many countries are starting to see the folly of this approach. What has happened in recent times in the domestic aviation industry illustrates the issue well.

Despite falling airport prices under the CPI minus X price cap, domestic air fares grew rapidly. Without competition the domestic airlines were able to manage their businesses as a duopoly, seemingly immune from the regulators' eyes. Whilst Qantas took the opportunity to improve its efficiency, Ansett stumbled along, seemingly incapable of making the obvious hard decisions needed to protect its future. When Impulse and Virgin Blue and low air fares came along, Qantas reacted aggressively to protect its business, while Ansett, then owned by Air New Zealand, went from bad to worse. Whilst the demise of Ansett is sad, especially for the good and hardworking employees, a number of whom are personal friends, it was not competition which killed Ansett; it just encouraged them to make their decision a little earlier.

Continued overregulation of the industry in the future will result in more inefficient businesses, incapable of dealing with competition when it inevitably arrives, as we all learn to cope in an increasingly global economy. Just as an example, the unbelievably complex web of intrigue known as international air service agreements have a devastating effect on international activity. I pose the question: would the Australian economy be better off protecting its national carrier or encouraging more and more flights to Australia from any country or airline wishing to come? Do we as Australians care if another country does not provide reciprocal rights to Australia's airlines? Australia would benefit from the incredible growth in tourism that would follow, and Qantas, which has already demonstrated its abilities to adapt to a changing and challenging domestic market, would still be there as a major player on the international stage but as a truly competitive international organisation. The recent paper of the Productivity Commission on price effects of regulation in several industries suggests international air fares are 3 to 22 per cent higher just as a result of those air services agreements.

I do not intend to stray too much into solving all of Australia's aviation problems, but it is important to illustrate the damage caused by protecting and subsidising inefficient businesses. Interested parties would do well to read the recent aviation paper of the EU transport and competition Commissioner issued after the 11 September acts of terrorism strongly opposing subsidies, particularly by governments, on airline activities.

To get back to airport prices. The Australian taxpayer and airports have for years been subsidising airlines. Airport prices often bear no relationship to the assets utilised by airlines. In Brisbane's case, regulated aeronautical assets of $561 million generate an annual return of less than 1 per cent before interest - I repeat that: less than 1 per cent before interest. Airport prices at Sydney are around 30 per cent above Brisbane's domestically and three times Brisbane's international prices. One would expect large airports to offer considerable scope for economies of scale and resultant lower charges.

Airports were sold by the government on a dual till basis, in other words, an aeronautical business and a non-aeronautical business. Substantial premiums were paid to government for non-aeronautical businesses such as retail, carparking and property businesses. The aeronautical business was privatised on the basis that there would be a five-year period of price regulation as a move towards commercial airport pricing from 2002. Airports expected that they would over time be able to make a fair commercial return on aeronautical assets and that government would use its general powers to prevent unfair monopoly profits. Brisbane has no problem with that approach.

Airlines argue that they bring the passengers and should therefore share in the revenue of non-aeronautical businesses on airport. In the case of the Gold Coast, it is the significant investment in hotels, golf courses, resorts, theme parks and the like that bring the planes. Do the airlines offer to give a share of their revenue to investors in the tourism industry? I think not. The argument is a nonsense. In any event, if airlines want an argument, it is with a government which sold the airports on a very clear dual till basis and pockets the proceeds. The argument is not with the airports. BAC prides itself on working in partnership with its customers, suppliers and stakeholders. Agreements with the Queensland government, Brisbane City Council, Nuance, Spotless, Virgin Blue and our many customers, consultants and suppliers are designed carefully as win-win agreements. Unfortunately, some airlines think that they or the government own the airports and conduct win-lose business negotiations accordingly. BAC strongly agree with the PC's view that airports and airlines should reach a commercial agreement, and BAC will shortly be making a proposal to airlines using Brisbane with associated pricing for our aeronautical services. We're about to send this document and discuss it with airlines in the next few days.

Based on the methodology adopted in ACCC's decisions on Sydney Airport pricing and new investment at privatised airports, substantial price increases are clearly justified. BAC though is not unrealistic and will be seeking a fair pricing regime in the current difficult political and economic times. Whether the airlines attempt to understand the financial issues facing airports and genuinely negotiate a fair commercial agreement or simply resort to lobbying government and running media campaigns about evil monopolists earning 1 per cent before interest on their assets will be a test of whether the industry is maturing.

In closing, we welcome the PC's draft report on what is a complex overregulated industry and look forward to the final report and its favourable review by the government of the day. I'd be pleased to take any questions.

PROF SNAPE: Thank you very much, Mr Rothwell. Part of your comments there are referring to bilateral air agreements et cetera. You might recall the earlier inquiry that we undertook on international air services where we addressed some of those questions and the problem of escaping from that framework when, of course, whether there are more flights that you can take or not depends upon the policy in the other country as well as the policy in your own country. But that was all in that report.

You've given us a very good statement of your position here. I suppose that, as we were saying to the Gold Coast Airport, the airlines could say, "You paid too much for it. Okay, you're getting less than 1 per cent before interest but that's on the valuation of the assets as they were, including the equity, so it's time to write down the valuation of it and work out your profitability," on what they might regard as a more realistic basis.

MR ROTHWELL: You could say that - I'm sure the airlines would - but I don't think that's a fair assessment of the situation. If you read the various documents surrounding privatisation, particularly the Department of Transport's statements on policy intent at the time, it is absolutely clear that the intention was for a five-year price cap to allow for a move towards commercial negotiations. It's our contention that commercial negotiations have to be on the basis of assets utilised or market value, and in the absence of a market because of the nature of the airport investment in some cases, assets utilised is probably the best means of assessing the value. Indeed, ACCC itself has used that methodology in determining prices at Sydney

Airport.

So we're not arguing about what we paid for the airport. That's irrelevant. We're arguing about the value of assets utilised by airlines at Brisbane Airport, and basically at the current level of charges, if someone was to build a new Brisbane Airport tomorrow to replace it, they could not possibly go into business on the charges there. We're not arguing about the five-year period of the price cap, although we very much, because of the fairly disastrous impact on our results of recent events on top of the Asian crisis, did lobby government for some sort of relief and were pleased to get it. We're not arguing that we didn't take the commercial risk in relation to the first five years and the price cap. What we are arguing is that after the end of five years there was a very clear government intention that there should be commercial agreements between airports and airlines.

We are proposing to the airlines a commercial agreement which is consistent with the methodology used by the ACCC in setting Sydney charges and we would hope and expect to see the airlines' support for what is a reasonable commercial agreement.

PROF SNAPE: I suppose critical in that ACCC calculation and indeed on all the calculations of rates of return on assets in airports is the valuation of the land, and the methodology adopted by the ACCC with respect to the valuation of land is not one which is accepted by all commentators.

MR ROTHWELL: The valuation of land is relevant but I might say in the approach we have adopted we have not - it's not a particular big number. In total assets of $561 million, we have only allocated something like $35 million to the land and that's based on local surrounding light industrial land values, not based on Brisbane's CBD prices, so it's a very modest and cheap opportunity cost assessment of land value which is consistent with most regulatory decisions. So even if you took the land out and charged it at zero, we're still way, way below any sort of sensible level of return.

PROF SNAPE: Yes - as some people have suggested of course for Sydney, that it should have been valued at zero. But in that case it is not a major factor in your calculation.

MR ROTHWELL: No.

DR BYRON: The recent announcement from Minister Hockey, minister for financial services, regulation 5 October about the 6.7 per cent one-off price increase that would be allowed for Brisbane, I've got a series of questions about that. Are you planning to implement that or are you using the fact that such an increase has already been approved in advance by the minister as a basis for talking to your airline customers? Do you think that that is sufficient increase? Do you know how the 6.7 per cent was derived, what it covers?

MR ROTHWELL: Right.

DR BYRON: Sorry, there's a whole raft of related questions like that.

MR ROTHWELL: We had already approached the airlines seeking a 25 per cent increase in charges for the remaining period of the price cap. The 6.7 per cent is about a quarter or thereabouts of what we were hoping to achieve and what we felt we needed in the present uncertain environment.

PROF SNAPE: That's 6.7, however, of the starting price. That pushes it up a bit, doesn't it?

MR ROTHWELL: Fractionally but not very much; fractionally.

PROF SNAPE: Okay.

MR ROTHWELL: I think the answer is we welcome the government's recognition of the plight that airports are going through at the moment and the fact that they are fixed infrastructure businesses that cannot respond to markets overnight. I can understand the airlines' concerns about rising prices at airports but they're a different type of business to airlines. It is impossible for us to do anything. Ansett overnight withdrew 28 per cent of our domestic revenue and 5 per cent of our international revenue. We simply sit there captive to the decisions of airlines, which is their prerogative. Airlines can make decisions over time to lease less aircraft, do other things. The majority of our costs are the investment in the airport and we're powerless to do anything about those sort of issues in the short term. So a CPI minus X regime that fixes you too hard forever is extremely dangerous. In relation to how the 6.7 per cent was set, I have no idea at all.

DR BYRON: Do you think it would be useful to know what's included in that or how it was calculated?

MR ROTHWELL: Not really, I'd rather move forward and get on with prices beyond 2002 to be honest. Just to go back on your comment - sorry about the setting of the X factors in the first place - when you asked Gold Coast earlier that question, the answer is that they were set assuming a certain level of growth and also bearing in mind capital expenditure but, like Denis, we repeatedly tried to get information out of the government and they refused to provide that. Having said that though, there were - I don't know about phase 2 airports but for phase 1 airports there was a capital guarantee that airports had to give to government under the airport leases and those capital expenditure guarantees were linked to a series of forecasts. So in other words, you had to guarantee certain capital expenditure but if a forecast turned out to be more or less, that could vary those guarantees. So one would imagine that those forecasts were the ones the government would have used in assessing X factors.

DR BYRON: Well, on the subject of investment, have the recent events with Ansett and overseas and general downturn and so on altered your board's perception of the riskiness of continuing investment? Has the rate of return as expected for new investment increased or changed in any way and are you still investing along the same sort of trajectory as originally envisaged?

MR ROTHWELL: Well, like Denis, we were talking to our lenders and shareholders - in fact we did a fairly comprehensive report on the implications of a possible Ansett collapse a few days before they collapsed and we were having extensive research with both Moodys and Standard and Poors, our credit rating agencies, and in fact late today I have a meeting to follow up with S and P on that same subject. The answer is, yes, Brisbane like all airports I think is coming under reasonable pressure from its lenders, from its shareholders, from ratings agencies to try and keep them updated on what may be the possible financial implications of all that's going on.

In terms of perhaps the impact on Brisbane, which might help a little bit, Brisbane is budgeting to make a net loss next year anyway of around $12 million and we'll see that net loss increase. Cash generated from operations after interest but before capital expenditure we still think will stay fairly strong from the company's point of view, so the company doesn't have any cash flow issues. We've already taken decisions for a number of capital projects with consequent interest savings. We've made reductions in operating expenditure and we've taken steps to increase non-regulated revenue in a responsible way where we can without further damaging the industry.

For our analysis we assume that after a period of disruption, both international and domestic traffic levels from January 2002 would be about 10 per cent below previous forecasts. In the shorter term we're assuming that - well, overnight we'd lost 28 per cent of domestic capacity. Even with Ansett Mark II just starting to fly, we've really seen perhaps a 5 per cent growth back of that at most. We're assuming that we'll lose something like 50 per cent of Ansett's passengers over the next three months, 25 per cent over the next six months. So we're assuming that Virgin Blue and Ansett Mark II and Qantas between them will bring on some extra capacity between now and Christmas but that it will be into the new year before we start to see some stabilisation, and we think that will be about 10 per cent below current levels.

Internationally is guesswork. The first quarter has been very good for Brisbane - as at the end of September was ahead of budget and about 9 per cent up on last year - but as each day goes by in October, the passenger levels are dropping and it's very clear that - that's what you'd expect. The events occurred on 11 September, so really most international tickets were already paid for by then or certainly booked. So we're starting to see now the advance bookings drop off. Denis is probably closer to this, but I guess we expect to see a drop of about 20 per cent for the remainder of the year on previous numbers. I think those sort of numbers are consistent with some of the tourism bodies and hotels on the Gold Coast and so on.

Clearly, the domestic numbers are very much dependent on the competitive reaction of Qantas, Virgin Blue and others and in particular the extent to which and how quickly those or new airlines add capacity or increase prices to improve profitability, and it will be a balance of the two, I think. Prices will go up but there will still be an increased capacity but not back to anything like the levels prior to September.

DR BYRON: Would you agree that much of the contention between airlines and airports has been about distribution of risk between two very different types of business, one which has, if you like, highly mobile assets and one with highly immobile assets?

MR ROTHWELL: Yes, I think there is a very strange relationship in the industry. It's not the industry I've been in for many years. I've been involved for about seven years, but it's extraordinary, the antagonism between airports and airlines, and I think it needs a lot of work to do to sort those things out. Denis talked earlier about incentives, and that's a very difficult issue. For example, we've had Ansett Mark II trying to get us to give them free landing charges through Brisbane. Much as we desperately want Ansett Mark II to succeed, can we as an airport give incentives to Ansett to compete with Virgin and Qantas on the same routes? It's very hard as a business to go down that line. With Qantas as our major supplier, if I was them I'd be wanting bulk discounts because they offered more, so once you get down that track of discounts in that area we think it's very dangerous. So Brisbane has historically not and continues not to provide discounts to any airline, including Virgin Blue, in relation to landing charges.

On terminal charges and on marketing costs we've been a bit more flexible and in our office rents, where we've tried to help new entrants, new routes, new airlines whatever, but we've played a very consistent line in relation to landing charges and will continue to do so.

Perhaps a couple of other things, could I add, that occurred to me during Denis's discussions. Customs charges in Brisbane: the government collects each year around $50 million through Brisbane Airport for customs charges; that is, for running the customs service. We get around $35 million for investing in $561 million worth of assets and it's ludicrous, absolutely ludicrous. So if people are concerned about the passenger charge going onto tickets, a very good starting point is to review the level of customs charges that are currently being levied. They cannot possibly bear a relationship to the costs, and if they do it's a frightening thought how the costs are at the level they are.

In relation to fire services, I very recently had a tour of the fire service at Brisbane. I was quite fascinated to see that their fire engines cost about $900,000, so I'm sure there is some scope for looking at the costs of running a fire service.

PROF SNAPE: Thank you. The leases that Ansett has on its terminals, what is the status of those now and what do you envisage happening with those leases?

MR ROTHWELL: I think like all airports - I might be wrong - the administrators have paid rent up to and including 31 October. What happens beyond that I don't know, but I'd be surprised if Ansett fails prior to an election, so one would imagine it will pay rent for November as well. Beyond that I'm really very unsure. Certainly

Ansett cannot afford to pay the rent it does in Brisbane to run the few flights that it's currently running. So the only reason for paying those payments is to protect their leasehold interests in the terminals and in the maintenance and freight buildings and so on. Like Denis, we haven't had the courtesy of a discussion with the Ansett administrator apart from one brief chat from a local Arthur Andersen person in Brisbane who phoned to say hello. We've written several letters and tried to communicate, but we're only the third-largest airport in Australia so I don't think we're important enough to talk to.

PROF SNAPE: Is the lease a saleable asset for the administrators?

MR ROTHWELL: Not in Brisbane's case because we're different to a number of airports. Brisbane Airport was being built as the FAC was being established, and in the case of Brisbane, Brisbane own the terminal building totally and Ansett simply owned the improvements within that building, most of which are either 12 years old or Ansett-specific, and so the value of their improvements is in our view negligible. Having said that, the ability to operate through a terminal is of considerable value to Ansett, but I don't think it's necessary for them to have the same lease they currently have with Brisbane to be able to run a successful airline. Indeed, our preference all the way through has been to see the whole domestic terminal be a common user terminal to provide greater efficiencies of all the airlines using Brisbane.

PROF SNAPE: Unlike most others, you do have a common user terminal within the terminal building at this stage.

MR ROTHWELL: Filling rapidly.

PROF SNAPE: Yes, and so you could envisage the Ansett terminal space becoming a common user terminal? You wouldn't have to buy it back from - - -

MR ROTHWELL: We'd be delighted if the administrator or Ansett Mark II keeps paying the lease, but we'll be very surprised if they do.

PROF SNAPE: When they ceased doing that, it would revert to you?

MR ROTHWELL: Yes, it would.

PROF SNAPE: If price regulation were to be removed, for example, to move say to a monitoring system like our preferred recommendation, would you continue with the taxi charge and the fuel throughput levy?

MR ROTHWELL: At this stage we intend to continue with the taxi levy and the fuel throughput charge. For the record, the fuel throughput charge arises through a contract entered into between FAC and the oil companies a few days before the signature was put on the final price to buy the airport, and it's inconceivable to think that the government or the Office of Asset Sales did not clearly intend bidders to implement the fuel levy and indeed were very keen I think to use it to influence the sale price. So commercially we believe that the levy is justified for those reasons, and also the Department of Transport papers on ground facilities fees clearly have stated all the way through that their view is that those were outside the price cap, and indeed I think their submission to the Productivity Commission supports that position.

PROF SNAPE: Nevertheless, that occurred in the context of there being price caps.

MR ROTHWELL: Sure.

PROF SNAPE: So I'm sort of saying, okay, now if the price caps were no longer there would you continue to levy the separate charges or just roll it all into a single charge?

MR ROTHWELL: I think from our point of view it's not really an academic argument in that we're trying to run a business and have sufficient funds to run that business, so we're probably indifferent as to whether it's fuel throughput fee, a taxi fee, landing charges, terminal charges, passenger based charges, landed tonne based charges. We're happy to negotiate sensible agreements with the airlines. So as far as we're concerned all issues are on the table for negotiation. If we can reach a fair commercial agreement, we're probably indifferent to the form in which we receive payment for our services, providing that payment is relatively efficient. For example, we currently have common user international check-in counters for which we charge on an hourly basis. We do that because it means they are used very efficiently. If the airlines just paid a fixed sum each year, we'd probably need another few check-in counters. So with certain charges the way in which it's charged is very important, but in others we're indifferent.

DR BYRON: You mentioned in your comments who gets what share of the non-aeronautical business of the airport. We were asking Melbourne Airport yesterday about the big increase in commercial activity in the Qantas terminal in Melbourne, and presumably the revenue from that retail goes to Qantas rather than - - -

MR ROTHWELL: Correct.

DR BYRON: Now, what you said just a few minutes ago with the nature of your lease with Ansett in Brisbane makes me wonder if your situation is different from Melbourne.

MR ROTHWELL: No, it's exactly the same in that they lease the shell of a building with certain fixtures in there and they then fit out that building, and that includes the right to sublease to retail tenants and so on within that building, so it's the same commercial position. If Ansett improve their retailing and generate more money, it's Ansett's money not the airport's.

DR BYRON: So in that sense the airline is already collecting some of the non-aero income from its passengers.

MR ROTHWELL: In the case of domestic terminal, it collects all of it; relationships with car rental companies, relationships with retailers, cafes, any office space they may have sublet, any other arrangements they may have, advertising, all those revenues flow to Ansett or Qantas.

PROF SNAPE: The price of the lease doesn't vary with those non-aero connections - - -

MR ROTHWELL: No, the price of the lease tends to vary with CPI and part of it with passengers but in the main it doesn't vary with - it certainly doesn't vary with retailing.

PROF SNAPE: But that was on domestic you were talking about.

MR ROTHWELL: Correct.

PROF SNAPE: Yes.

DR BYRON: So the greater retail turnover they do, most of the proceeds stays with the airline.

MR ROTHWELL: Well, all the proceeds, yes.

PROF SNAPE: Just a point, you did refer in here to a recent aviation paper of the EU transport and competition Commissioner issued after 11 September strongly opposing subsidies on airline activities. I was reading in the Financial Times, one of last week's, that they seem to be weakening a bit in that resolve following the Sabina Swissair - - -

MR ROTHWELL: Issues.

PROF SNAPE: - - - experience, yes.

MR ROTHWELL: It's a very difficult issue because it goes counter to the whole EU policy of trying to break down subsidies and farm subsidies and other things within the EU. I think the general philosophy is to break down all trade barriers and encourage competition. So the Commission, I'm sure, is committed to competition but whether or not pressures have been put on it, I don't know. But certainly from my understanding of a brief reading of the summary of that report, then they are very much in favour of airlines not being subsidised through even these difficult times.

PROF SNAPE: Yes. As you said, however, airlines are often regarded as something different from other enterprises - and airports too, I might say.

DR BYRON: With the Ansett collapse, do you think that's likely to lead Brisbane Airport into having more formal comprehensive service agreements, contractual sort of relationships with the airlines than you've had in the past?

MR ROTHWELL: The document we're preparing for the airlines doesn't just cover charges, it also covers some sort of service commitment from Brisbane to try and strive to achieve a certain performance standard through the airport, so we're very much in favour. I don't think it will make a lot of difference to the way we do business in that we are committed to providing the best service to airlines anyway. We monitor very carefully performance of checked bag screening facilities, of time of check-in counter use, average queue times, all these things are monitored through the airport but we're happy to give the airlines and probably think it's appropriate to try and commit to those things.

What we won't do is provide guarantees for levels of service unless we receive some compensation for it. No business will seek to take risks it doesn't currently take unless it's compensated accordingly. It's a difficult concept because if you offer to make, say, guarantees in relation to availability of baggage reclaim units at the terminal, if an airline is late or early and messes up those arrangements, who is at fault? The airline then compensates the airport who in turn compensates the other airline. I think you get into very difficult situations once you start moving to guaranteed service levels.

PROF SNAPE: But that can be a two-way thing, can't it? I mean, if you're entering into a guarantee service, you will - I would have thought - seek some guarantees about times of arrival.

MR ROTHWELL: Which is why the discussions break down.

PROF SNAPE: Yes, subject to weather of course.

MR ROTHWELL: Or whatever, but that's where the discussions inevitably break down. The airlines tend to want guarantees one way but are not prepared to look at guarantees in the other direction and airlines have historically wanted penalties in one direction but not in the other. Now, I might say in more recent discussion with Qantas, their views have softened and they're happy to see some form of service level undertakings or whatever. I don't know whether that view is consistent throughout all airlines or not.

PROF SNAPE: Well, we did hear a suggestion of that yesterday. Can you elaborate on that point a bit more?

MR ROTHWELL: On what, sorry?

PROF SNAPE: On that point of a softening of attitude in recent times from airlines in relation to such agreements - - -

MR ROTHWELL: Well, I think initially we were approached by, I think BARA and Qantas particularly in relation to service level agreements and there was a lot of pressure, and I think there was pressure actually on the airport prior to privatisation by at least Qantas to sign service level agreements. Some airports, I think, did sign something; Brisbane did not. More recently we were approached about that same thing. Inevitably you reach the point in discussions where, "Well, if you want us to guarantee this, what are you going to guarantee," and I think when you get into those discussions the obvious logical conclusion is to try and put in place some sort of service standards which we're happy to publish or whatever.

To some extent we already do through the ACCC framework of quality of service monitoring which ensures that airports stay up to a high standard. We've got no problems with some sort of monitoring reporting of these sort of things. I mean, we'd love to see it for the domestic terminals . I mean, if Ansett - well, not Ansett now but if Qantas are prepared to - if they think this is important for the travelling public, we'd love to see service level standards in the domestic terminal in terms of queuing time and check-in counters and baggage reclaim and so on. So I think if it's important for the airport, it's important for the whole airport.

DR BYRON: I don't think I've got anything else.

PROF SNAPE: Yes, I think we've covered the issues that you have there and we would look forward, if possible, for a full submission and, where relevant, a discussion of the analysis or recommendations in the draft report.

MR ROTHWELL: Okay.

PROF SNAPE: But we thank you very much, Mr Rothwell, for being with us.

MR ROTHWELL: Thank you.

PROF SNAPE: Thank you. Now, we've got a bit of a break. As you will have seen from the schedule, we're going to have a very long session straddling lunch, what is usually the lunchtime from midday through to 2 o'clock and so we've scheduled a bit of a break which is - we've got a little bit more time than we anticipated so that people can have a little bit of sustenance at this time and then some more after 2 o'clock. So we will now adjourn. We will have the Board of Airline Representatives of Australia which was scheduled for midday - if we're able to start a few minutes before, then perhaps we will but we'll say roughly midday for the start. Adjourn until then. Thank you very much.

PROF SNAPE: We welcome the Board of Airline Representatives Australia Incorporated and we thank them for the two submissions that we actually have, one a short one which was actually a letter addressed to the Chairman of the Commission with a copy to Treasury, and the other one is a lengthy submission and we thank you for being able to get that in to us in time for us to digest it. We do realise that it has been very difficult in the airline business in recent times to get pen to paper and to concentrate on this inquiry rather than to keep the business going. So thank you very much for being able to do that and giving us something to chew on there. Let's begin, and if the three representatives would each introduce themselves separately for the benefit of the transcript, thank you.

MR BENNETT: Warren Bennett, executive director, Board of Airline Representatives of Australia.

MR WOODBRIDGE: Graeme Woodbridge, consultant, assisting BARA.

MS HARRIS: Anthea Harris, a consultant assisting BARA.

PROF SNAPE: Thank you. Mr Bennett, are you going to speak to the submissions or are you a triumvirate or what?

MR BENNETT: Yes, we would like to follow the process that we adopted in the first round of public hearings. I'll make a brief opening statement and then pass over to Graham and Anthea to address specific aspects of the economic questions associated with the draft report.

PROF SNAPE: Thank you.

MR BENNETT: It's fair to say that you probably understand from our two submissions that the BARA has some concern about the recommendations and the analysis that underpins the recommendations in this report. Before I go on to that, perhaps I should emphasise the fact that as we indicated in our first submission on the very first page, BARA represents international airlines. We have about, at last count, 44 members. We represent airlines in their interests as international carriers. We do not represent in any way, shape or form the activities of domestic or regional carriers in Australia.

Having said that, our submissions right from the very beginning have concentrated on the effects that price regulation of airport services might have on international operations of airlines.

PROF SNAPE: Sorry, could you just clarify. Of the 41 members of BARA, is there only one Australian member?

MR BENNETT: Yes. Our principal concern I guess with the draft report as it has been presented is that the Commission has provided very little detail on how option B, its price monitoring recommendation, might operate and as you would expect, in these sorts of situations the devil is really in the detail of regulatory regimes and it's only once the detail is specified that industry can sensibly react and identify the likely outcomes of that possible regime yet in the draft report we're not given any sort of indication as to what the criteria might be against which airport and airline behaviour can be judged over the intervening period, the five-year period that the Productivity Commission suggested might be appropriate for a price monitoring approach to apply.

Whilst there's nothing in the draft in terms of the criteria, we were also very concerned that what actually is there seems to us to be somewhat inconsistent. The implications of price monitoring, the recommendation that seems to be favoured by the Productivity Commission, are really unknown but so far as BARA is concerned, we believe that if implemented it's likely to result in significant increases in airport charges and hence airline ticket prices and it will result in additional costs as parties adapt to yet another regulatory regime operating in Australia.

We really believe that it's a major failing of the draft report that the Commission hasn't examined the broader economy-wide implications of its recommendations. There appears to us to be a distinct lack of empirical analysis and evidence that has been provided by the Commission in the draft report. There is no analysis of the effects of the recommendations on aeronautical charges, air fares and wider employment prospects. It appears obvious to us that adopting a radical change in airport regulation during a period of significant turmoil in international aviation is a very, very risky proposal. The consequences at this point in time just can't be predicted.

We suggest, based on the analysis that we have done, that the changes that are being proposed by the Productivity Commission are likely to lead to significant increases in airline costs and that is at a time when IATA has recently estimated that airline losses collectively - international airline losses collectively for 2001 - are likely to be in excess of $US7 billion. That's a huge hit that the airlines are taking at the present time. BARA has the view that it's far more prudent to improve on the current regulatory system as it operates in Australia at the present time and we believe there are good reasons for adopting this approach.

Firstly, there is no hard evidence that the current system is delivering poor economic outcomes. There is only conjecture that that in fact is the case. Secondly, there are significant investments in developing and understanding of the current regime. Those that have been undertaken will be lost if a new regulatory regime is put in place. So we have a situation where we believe it will be far more prudent under existing circumstances to have possibly the sort of secondary recommendation that the Productivity Commission included in its draft report as being the principal one that is going forward as more appropriate.

The present situation does involve a great deal of uncertainty. You heard Coolangatta Airport complaining this morning about the high degree of uncertainty that they face. They're not alone in that problem. Airlines similarly face a very severe lack of information on how their market might develop in the future. Just as a final comment, it might be worth noting exactly what the international airlines are facing at the moment. Just in recent times the limited number of announcements that have come forward from international airlines really give food for thought. It has already been reported that Japan Airlines will reduce its capacity on transpacific routes by 24 per cent in the foreseeable future. All Nippon Airways has cut weekly flights to the USA from 67 to 50. United Airlines flew 31 per cent fewer revenue passenger miles in September this year compared with the previous year and its load factor has dropped to 61 per cent.

Traffic on United Airlines Pacific routes fell 33 per cent in September alone. British Airways passenger numbers fell 22 per cent overall in September. Malaysian Airlines has withdrawn from 12 of its routes, including Darwin and Cairns and Qantas has cancelled two daily flights to the USA and has advised that it will reduce other services. At the same time United Airlines is similarly looking very seriously at the number of flights that it conducts from Australia to the USA at the present time and could possibly in the near future announce significant reductions in their frequency of services as well. So international airlines at the present time are facing the dual problem of declining load factors and if the airports in Australia have their way, increases in aeronautical charges at the end of what are very long haul routes to Australia. It's worth reflecting on those issues that the international airlines are facing. Now I might hand over to Graeme to make some comments on the economic analysis contained in the draft report.

MR WOODBRIDGE: A lot of the comments on the economic analysis and some of the draft recommendations of the Commission's report are in the submission so I will just try and summarise what I think are the major ones. I suppose at the outset it seems like a number of the recommendations of the Commission are based on an economic framework of airport pricing and how airport pricing behaviour might change under different regulatory regimes and even in the absence of regulation. I suppose I've got concerns about whether that economic frame will be sufficiently comprehensive to capture all the effects of different regulatory regimes and removing regulation in its entirety.

Airport pricing is a difficult issue to analyse because as the Commission has recognised, there are a number of different economic factors that complicate the issue. There's economies of scale in the provision of airport services. There's common costs across different services. There's complementaries and demand across the different products provided by an airport and it seems to us that the Commission has - although it's difficult - analysed each of those individually and come up with prescriptions of the effects of each of those on pricing behaviour, as I said, in isolation of the others. We think that isn't sufficiently comprehensive to understand the implications of monopoly pricing of airport services and the consequences of the Commission's recommendations.

I suppose there's a number of examples of that. There is talk throughout the report about subsidies between aeronautical and non-aeronautical services where it seems like the analysis of cross-subsidies ignores the fact there are independencies of demand between those two services. You get a different result depending on whether you take that into account or not. Another is the efficiency cost of monopoly pricing. In the report that seems to be limited to efficiency costs on the aeronautical side of the business.

However, the literature shows that if you've got interdependencies in demand and common costs between the two, the efficiency costs are not limited to just those on the aeronautical side of the business, and there are many other examples of that. It seems to us that in order to fully understand the implications of the Commission's recommendations, one has to actually specify a comprehensive economic framework that takes into account not only those factors but the interreactions between them, and you do get, as we claim, different results.

The other thing is the Commission seems to overlook some important efficiency implications of its recommendations. One is the fact that you've got airports at each end of the route which are independent monopolies, and I guess that gives you a problem in the economic literature called double marginalisation, that is, the monopoly loss associated with monopolies at each end of a production chain is far greater than if they were both owned by the same entity. In fact, the work by King and Maddock in their book tends to suggest that could be double or even more the efficiency loss, but that doesn't seem to be picked up in the report. I guess what is of real concern is regulations about trade-offs. You're trading off potential for one efficiency loss against another. There's no perfect answer. In order to get a feel for what trade-offs one is making, we feel one needs to sort of quantify what the efficiency losses are, what are the implications on prices.

We feel that to bring all this together it would be helpful if the Commission sort of specified its economic model in a bit more detail and tried to quantify the effects a little bit. This is something that happens quite a bit in the debates about regulation. We can point to examples. I think Julian Ryde at the University of Auckland has done a lot of work in mobile telephony that tries to model what the implications of regulation of mobile termination rates were. That's a difficult problem, and the insight that his model provides is, given that there are so many things going on if you regulate one part of a business, you really need to actually specify the model and try to quantify it. I suppose that's what we think is a way forward for the Commission, to really improve the debate here a little bit and provide some confidence in the recommendations, would be to try and actually model what the implications of their recommendations are and try to quantify it a bit. So that's I guess where we think it would be a useful way forward.

The other advantage of modelling it is you will tease out all the efficiency consequences and pricing consequences of the recommendations of monopoly pricing and, as we said before, we think the Commission has missed some in its analysis to date.

On another issue, I suppose we have concerns about the Commission's comments about sovereign risk, and this is brought up in the discussion of single till and dual till. I suppose we have concerns about the policy precedent the Commission's recommendations or draft recommendations might have. We're really not privy to what was in the leases for the airports, but in our view if I'm bidding for an asset my expectations would be based upon what's in the legal documents. We think it's going to be a question of precedent. If the Commission recommends that the policy be changed ex post on what may have or may not have been expected by bidders during a process - if it was really expected, it would be in the lease, I would have thought.

The analogy I think of, if I'm going to go to an auction to buy a house and I go to an open inspection a week before and the agents says to me, "By the way, the owner is going to throw in all those nice antiques in the corner if you buy it," if I get there on the day and start bidding for an asset, the house, and those antiques are not in the contract of sale, I probably wouldn't structure my bid on the assumption that I'd get them. I'd be signing a different contract.

I suppose where we think the policy issue here is is about designing the sale process. Ex post adjusting policy based on expectations that were not in the lease seems to us to be poor policy. You can imagine the implications of this. I think most privatised entities are going to start scrounging through any policy document they can find so they can go to a regulator and say, "We expected this." It just puts the regulator in an unenviable position . It seems to us, as I said, that the policy issue is getting the sale process right rather than ex post adjustments.

On another issue we talk about some of the conclusions in the draft report about market power. Although it is thought that the comments on market power of airports seemed quite reasonable, there is an interesting experiment that's going on at the moment, and that is what's happening with Canberra and Gold Coast airports. I think in the report - and my personal opinion was this sounded right - Gold Coast are probably constrained in their pricing behaviour by the fact they're very close to Brisbane Airport. So you ask the question, is Gold Coast really constrained by Brisbane Airport in its pricing behaviour? It seems like Gold Coast Airport are going to increase their charges by 150 per cent, where Brisbane isn't, so you ask the question, really does Gold Coast Airport think they're constrained in their pricing behaviour by the substitute of Brisbane Airport? That doesn't seem quite right. If I can increase my charges 150 per cent relative to my competitors, if I think that a profitable undertaking, then it seems that I don't feel that I'm constrained by the other party.

This is a test that's through the antitrust literature. It's called the Mason perspective. You look at the entity and ask the question, by their action what do they believe to be their pricing constraints? From that action it doesn't quite seem to us that even Gold Coast Airport is constrained by its competitors.

DR BYRON: Do you think you'd get a slightly different answer to that if you expressed it in absolute dollar terms rather than as a percentage?

MR WOODBRIDGE: No. If I double the price, you go into a shop and you see it's twice the price of down the street, where would you go?

DR BYRON: No, but you haven't answered my question. You're still talking about relativities. You said an increase of $3, or $3.60 or $3.70 or whatever it is.

MR BENNETT: I think you'll find that, to the best of our knowledge anyway, the charges at Brisbane and Coolangatta Airport, aeronautical charges, weren't all that much different anyway, so although you're talking relatives - - -

PROF SNAPE: The point I think is - I don't think that point of principle can be enunciated separately from what the charges are initially. Obviously the point that you are making would be absurd if the initial price was 1 cent in landing charges.

MR BENNETT: Yes, but as we understand it the landing charges initially at Brisbane and Coolangatta airports - it's a shame they're not here to - - -

PROF SNAPE: The point was being made as a point of general principle and elaborated as a principle, and you were referring to the US literature on it, and I don't think that that literature was independent of what the initial price was.

MR BENNETT: If you move away from a point of principle and get back to points of practicality, as I said, we believe that the level of aeronautical charges at Brisbane Airport and Coolangatta Airport were very similar at the starting point. So a doubling, more than doubling, in Coolangatta Airport's aeronautical charges represents, if Brisbane was to do it, more than doubling of Brisbane's charges as well.

MR WOODBRIDGE: I guess what I was trying to think about it is what's the cross-elasticity of demand between Gold Coast and Brisbane, and I was thinking if I get 100 per cent increase in one charge, what's the reaction to demand in terms of shifting the demand from one to the other? I agree the absolute size also is a relevant issue. But, look, it's an interesting experiment that's sitting there. Canberra Airport I guess is the same. It's worth thinking about.

I suppose the other thing is, we have some concerns about the draft recommendations about the market power in particular airport services. Where we were coming from is we think the test for market power is to ask the hypothetical: what would be the demand response of purchasers of a service shifting to other substitutes or what would be the supply response of other suppliers if a particular party increased the price of its service? We don't think that the way the Commission has approached it in the draft report, particularly in relation to check-in counters and airport lounges, quite captures those principles. I guess the relevant question we think is to consider Melbourne Airport and ask the question: what would be the supply response in the provision of off site check-in counters as a result of a non-transitory increase in the price of check-in counters at Melbourne Airport?

That's the question that we think is the relevant one. Whether there are check-in counters at train stations around the world probably doesn't quite answer that question. In other words, they're a point of congregation of passengers going into an airport and they're often for convenience. We're trying to think of the other hypothetical question. We're not too sure that the Commission has quite answered that in its conclusions. Similarly, with airport lounges - we're not exactly sure what the Commission have in mind but it seems like just because the expenditure is discretionary, it believes that airports don't have any power in setting charges for airport lounges. I think the relevant question is: is there any demand substitute for airport lounges, rather than whether the expenditure is discretionary or not, and we encourage the Commission to think of it in those terms.

I suppose just quickly, we think that the Commission really hasn't undertaken a rigorous analysis of its comparison of option A and option B. We think an economic framework would assist that, as we sort of said. The other difficulty is just because there's sort of a lack of detail in the price monitoring, exactly how it's going to work, it's hard to sort of get a feel for what the likely implications of it are going to be. In particular, as Warren said, in regulation people have said the difference between good and bad regulation is in the detail. Regulations can have a lot of unintended consequences which the Commission has picked up. Price caps sound great but when you sort of kick the rock over there's a lot of worms underneath it and I suppose it's hard to know exactly what the implications of price monitoring will be until we sort of kick the rock over and have a look but you'd need the detail to do it.

I suppose also it's not clear that the current regime isn't working very well in terms of some of the economic outcomes. There's no evidence that we see anyway - that efficient investment is being deterred by the regime. There's no concrete examples of it. So you're moving to a new regime where it's not clear that the outcomes of the current regime are so optimal. Given significant adjustment costs to moving to a new regime, new precedents have to be established, a lot of adjustment in expectations and behaviour, it's not clear that option B is superior to option A but I will leave it there.

Just as a last point, I suppose, because regulation is difficult and because option B would require a lot of bedding down, we encourage the Commission to sort of think about its issue about its criteria and I think we might have suggested some in the submission and possibly put them out to further comment before finalising them. Because the airports and the airlines probably have to live with it, it's hard at first glance to know what the implications of those criteria might be so we work the thing out for comment before finalising.

PROF SNAPE: Thank you. Thanks very much for that and I would also thank you for your comments on monitoring where, despite the fact that you think we should have put forward the views first so that you could comment on them or the aspects of it, you nevertheless have given us some indication of some criteria and we thank you very much for doing that. We did of course draw attention at the previous hearings to the draft reports which had appeared just a few days before that in relation to the access provisions and telecomm and also PSA and there was some discussion in there on monitoring as an option and we did invite comment. We also explained what the attention was, to try and get away from a binary system of no regulation or full regulation to find whether there was a halfway house in there, and so we did give some indication right back there of our thinking about it.

Anyway, we thank you for the comments that you've got there. I think perhaps you haven't quite taken up the point of it being a transition option or the possibility of it being a transition option. I think your preference is really to stay with the regulatory option, full stop and, well, so be it, that's your job. You have made some comments on modelling, and indeed you've given us a model yourself which I would like to explore a little bit and at least you've given us the results of the model which has appeared not only in the two submissions which you have before us but has also been widely reported in the press and has been used by a number of people in the press in media statements and criticisms of our report, and I would like to tease out your model somewhat since it only appears in one paragraph in explanation. That appears on page 10 of your main submission which was where you suggest that 4000 jobs or more would be lost in the tourism industry if our recommendations were implemented.

In the interests of transparency we would be very interested to see the full working out of that model which gave those results. We would ask you to specify some of the assumptions. Have you, for example, assumed a 97 per cent price increase for all of the phase 1 and phrase 2 airports? Have you assumed that would in fact be distributed across all fares? You do refer to average air fares and you refer to elasticities but we know very well that averages - and you acknowledge, I think, elsewhere - are pretty well irrelevant in this industry where there is in fact so much yield management of fares and that you cannot just have an average fare. You need to know which fares are being increased and the elasticities of those particular categories of passengers. We would be interested in the assumption about the total employment in tourism and so in this we would ask you in fact to supply a model. After all, this figure has appeared very prominently in the press, in your submissions, and we can't see the basis for it. So would you like to fill us in please.

MR WOODBRIDGE: I suppose it says there that it provides a starting point for - it does say that we assumed a 97 per cent increase in all charges and we said that's a starting point to think about it.

PROF SNAPE: Including Sydney? That's already there so that's not a consequence of the Commission's recommendations. As far as international travel, Sydney is by far the most important for international travel. Have you assumed the increase in the fare for Sydney as a consequence of the Commission's recommendations?

MR WOODBRIDGE: We're talking about the dual till pricing of Sydney, yes.

PROF SNAPE: You say - but that has already been implemented. That's not something out of our draft report or our recommendations. That's something that's already done.

MR BENNETT: The purpose of the exercise was to see what might happen in terms of the economic parameters if the Sydney outcome was transferred to all other airports.

PROF SNAPE: That's not what is being said here and it's not what has been said in the press.

MR BENNETT: It was an attempt by BARA to at least get the direction going towards a quantitative analysis. We don't believe that it's BARA's responsibility to actually provide and deliver a full-blown economic model of what the Commission might be proposing in terms of its recommendations. It's BARA's firm belief that in fact it was the responsibility of the Commission to develop that model and provide some sort of analysis of what the broader economic consequences of its recommendations might be. This is just our simple attempt to try and show that in fact there are possibly quite adverse consequences that could emerge from the recommendations that the Commission is putting forward but we don't believe it's BARA's responsibility to provide the modelling exercise for the Commission.

PROF SNAPE: I think that I've been indicating some of the difficulties of in fact trying to calculate this. For example, in order to calculate something like this one needs to know the yield management policy of airlines and if there's one thing that we're not going to be told it's the yield management policies of airlines and how the fares would in fact - any increase in charges would be allocated, so we know immediately that such a calculation could not properly be carried out by the Commission because some of the essential ingredients to it are in fact in the possession of the airlines and not the Commission and you're the representative of the airlines.

MR WOODBRIDGE: Couldn't you do a sensitivity analysis around that?

PROF SNAPE: Again, off the top of your head, you know that when the possibilities are there it would give you such a wide range of estimates that they'd be useless.

MS HARRIS: I think the impression that the draft report gives, however, is that there will be no impact on the numbers of people visiting Australia or the volumes of air travel at all. Airlines simply don't believe that to be the case. If that were the case, you wouldn't find airlines all over the world disputing every time there's an increase in airport charges. That wouldn't happen. Why would they bother?

PROF SNAPE: Okay, well, we can look at our wordings to see whether we've created the impression that there would be no effect. I don't think we have, but we can look at the wordings. But we do get a little bit concerned, I guess, when a figure like this gets such publicity in order to in fact, in essence, attack our report.

MR WOODBRIDGE: The purpose of it was to try and start a debate about what the economy-wide effects might be.

PROF SNAPE: Okay, well, the debate is now continuing. I doubt if it will get us much publicity in the press, however.

DR BYRON: I just wanted to come back to one of the comments you made in your opening comments about sovereign risks and due diligence and the need for transparency. I thought what you were making was a very good point, and that was what we were alluding to with the comments in the draft report about the sale of Sydney; that precisely for the reasons you gave, which would be very clear before Sydney was sold, exactly what was in, what was out, what was the regulatory regime to follow and all the rest of it. Now, for reasons totally unrelated to our and your very logical argument, the sale has been put off, but I think we would be in complete agreement in saying that it would be in everybody's interests to have complete transparency in the next major airport privatisation over exactly what's in and what's out and why, if there's a CPI minus X regime what it entails, what's subject to monitoring or notification and all those sorts of details. So if we gave the impression that we weren't interested in that sort of clarity and transparency, it was certainly unintentional.

MR WOODBRIDGE: No, that was clear from the report. I think the comment was - the debate about the single till - dual till issue and it's a trade-off, and it agreed with that, then in the end there's a comment to say that on the basis of sovereign risk that underlies - I think this is what it's saying - the support the Commission has given to dual till, there's a concern of sovereign risk associated with - I think the comment discussed, given how much airports say they have paid for the assets, we prefer a dual till approach. It's underlying that that the policy concerns relate.

DR BYRON: I guess we don't have to rely on our interpretations of what may or may not be made in the representations to the bidders, because the Minister for Transport and Deputy Prime Minister has made it very explicit what his understanding was at the time. So it's not our interpretation of what may or may not have been said three or four years ago. I mean there's a lot of quite official, on-the-record statements that don't require us to go into second-guessing the nuancing what may or may not have been in those representations.

MR BENNETT: The issue, though, of course, is that in fact the only document that we had for the greater part of the operation of the existing regulatory regime was a document called a pricing policy released by the Department of Transport and Regional Services in 1996, I think, from memory. All that's said in relation to dual till - single till was that the government would not mandate the operation of a single till. We always maintained in our dealings with privatised airports after that point that, simply because the government said it didn't mandate the use of a single till, it didn't necessarily mean that it mandated the use of a dual till.

As I said, for the greater part of the operation of the regulatory regime and for the greater part of the time that airports and airlines were in discussions with the ACCC about the operation of that regulatory regime, that was the underlying theme upon which the decisions were based, and indeed in the case of Sydney Airport you'll find that the ACCC's draft report in fact didn't mandate a dual till; it came out with a price increase recommendation that provided for some recognition of the interdependencies between aeronautical and non-aeronautical services. It appeared from the ACCC's analysis that they saw that as being the efficient outcome for aeronautical pricing so far as Sydney Airport was concerned.

So there was some element of a single till approach, albeit a very, very limited single till approach, with quite significant restrictions on the other non-aeronautical services that were taken into account in developing the price outcome that they would approve. It was only after the draft report came out that in fact we got the Deputy Prime Minister's statement and we got the direction from the government, so it was very, very late in the piece that in fact the government decided to come clean and say exactly what it meant. That again goes to the heart of the comments we were making about the single till - dual till approach. We were concerned that the Commission's linking the adoption of a dual till approach in the determination of aeronautical charges was related back to the issue of sovereign risk, and we wholly support your proposal that every last nut and bolt and every last nitty-gritty bit of the basis upon which Sydney Airport is sold should be made perfectly clear to both the bidders and the users of the airport.

MR WOODBRIDGE: I suppose the issue is that if it's not in the contract or the lease, then what would have been in the mind of the bidder? The problem as I see it is that if you create a precedent that things said outside the formal process should get taken into account in policy in the future, I think you're going to have all sorts of privatised entities scratching through Hansard and any other document they can find and saying, "Well, that was our expectation." It just appears a congruence between stuff said outside the process and what was in the contract. In other words, the example about buying a house is, "I surely will bid on what's in the contract." The policy precedent that one is going to create for a regulator, every time the ACCC now makes a decision someone is going to come up and say, "Well, that was my expectation when I bought it," and they'll probably find some evidence, some statement in Hansard. There's a potential for that precedent to cause problems.

DR BYRON: This morning we were told by Brisbane Airport about the fuel throughput levy and the contract being signed by the FAC two or three days before the actual sale went through. Now, I don't know whether that's in the contract or not, but presumably if there was a contract signed for a fuel throughput levy and the bidders knew that, it made that reasonably or unreasonably - I mean, I don't see any black and white answer on this. I think it's one for the lawyers to debate for a long time.

MR BENNETT: That's not a particularly good example for Brisbane to use though, because as far as we're aware they do in fact have the fuel throughput levy applying at both Brisbane and Perth airports, the only two that actually made an application for a fuel throughput levy to apply. It is in fact operating at those two airports. It's made doubly difficult in this debate because we don't know what the views and expectations of the unsuccessful bidders were. All we're getting is the story of what was in the minds of the successful bidders. It could be that the other consortia who were involved in bids for airports may have had a completely different understanding. Perhaps that's why they lost.

DR BYRON: But my point was that we're not relying only on what the bidders or successful bidders told us. There is also evidence from the vendors of their understanding of what was in the agreement.

MR BENNETT: Which came very, very late in the piece.

PROF SNAPE: I was wondering if I could pick up on the dual till - single till and all of that just a little bit more. We're both saying that neither the dual till nor the single till is in a sense ideal. Both have problems, and we've said that, as you have pointed out, and you don't disagree with it. But in the short submission that you've got, you draw attention to "BARA's reasons for proposing rate of return regulation are clearly detailed in its submissions." So you're emphasising there that really what you're wanting is rate of return regulation. I assume that that is correct because that is what is stated in the short submission that you've got.

MR WOODBRIDGE: That's what was in the previous submission, yes. So, yes, the rate of return - - -

PROF SNAPE: What you want is rate of return regulation on page 17 of the longer submission - you're saying that the pricing approaches that should involve airports retaining a proportion of some of the excess profits for non-aeronautical services thereby lying somewhere between single till and dual till but not creaming it all off. That proportion then, I assume, on what you've got here, would in fact be determined by rate of return regulation. I mean, that's the way to make these two submissions consistent, I guess.

MR BENNETT: Not necessarily. It could be that the approach adopted by the ACCC in coming down with its draft decision on the Sydney Airport aeronautical pricing proposal could be one way of going about it. It doesn't necessarily have to be made of the two.

PROF SNAPE: But here you've endorsed in the short submission, the letter, you've reiterated your proposal for rate of return regulation. That's what you want.

MR BENNETT: We included rate of return regulation as an option in our initial submission to the Commission. What we refer to in our shorter submission subsequent to that is the fact that you have ascribed to us particular views that we don't necessarily believe were appropriate to take from what was said in the original submission. In our subsequent submission we have referred to the option of moving to some sort of compromise between the single till and the dual till. That is another option that can be considered. It can be developed either via a rate of return approach or it can be developed via the sort of approach that the ACCC adopted where it looked at what it felt was the most interdependent services, if you like, between aeronautical and non-aeronautical services and provided for some allocation of the excess profits of those services to the consideration of the revenues that should be achieved by the aeronautical charges. So there are two options that could be adopted.

PROF SNAPE: Rate of return regulation seems to be pretty well unpopular around the world for very well-known reasons and is not being advocated I think in any regulatory framework around the world. Indeed, one of the criticisms of CPI minus

X is that it can converge to rate of return regulation over time and is therefore, if you like, condemned on that basis because of the problems that are with rate of return regulation.

MS HARRIS: I entirely agree that they're certainly not as different as they might look on the surface and in their application they can be very similar so that's, I suppose, why in recommending rate of return regulation we're not thinking this is a huge departure from where we are now, that's so much worse from price gap regulation because in reality there's not much difference between them in practice.

PROF SNAPE: I thought that generally the argument was the inverse of that somewhat; those who are applying CPI minus X should try to ensure that it doesn't become rate of return regulation because there's such a temptation for it to become that, and so that in principle if one can sustain it, it's a preferable one. The question is how to sustain it as being CPI minus X.

MS HARRIS: Which we haven't seen anybody doing; which we haven't seen anyone successfully doing.

PROF SNAPE: There's perhaps lessons there. Then if we go to saying, "Okay, what proportion should be established," I suppose one can say then: is this necessary to be regulated or can it be done by agreement? We see at the moment we've heard from a number of airports who are in financial trouble and I think that that will be acknowledged, that they are in financial trouble. Certainly we've got details of that from the Gold Coast Airport submission which they've made public, which you can see there, which you're probably aware of, and that they have been having discussions. Indeed in that submission they're pointing out that they had to increase their charges or in fact they would have been in default of their obligations under their borrowings and that they are having discussions with airlines - admittedly in this case it would be mainly domestic airlines of course - but that these negotiations are continuing and they're negotiations which one would imagine would be along the lines of being able to sustain that airport as an ongoing operation. That's presumably going to be somewhere between single till and dual till and that's going to be done by negotiations. So does one need regulation? Why can't one go to this sort of objective in negotiations rather than regulation?

MR BENNETT: If the outcome of those discussions between airlines and the airport operator was much closer to a single till than a dual till then perhaps the airport will in fact go out of business. We noticed this morning Brisbane talking about - in relation to airline operations - protections of inefficient businesses in its discussions about international air services agreements. We have a situation here where we need to look at the proposals that are coming out of the airports following the announcement by Minister Hockey, and ask ourselves seriously are these efficient outcomes? It's quite possibly that maybe they're not. We've seen two go broke in Australia in the last 12 months. Why are airports different? You made the comment earlier that perhaps Brisbane and Coolangatta airports paid too much for it. Perhaps in fact they need to take a hit and write down the value of their assets so that in fact the level of returns they're achieving on their aeronautical assets are boosted considerably from the 1 per cent that Brisbane seems to claim that it's earning at the moment but there's no indication on the part of airport operators that they're willing to take that hit.

That happens in airlines all the time. Air New Zealand has just written off $1.3 billion because it made a bad investment decision in taking over Ansett. If Coolangatta Airport made a bad investment decision in buying the airport, if Canberra Airport operators made a bad investment decision in buying the airport, then they, if they were operating in a real market, would take a hit. They would write it down. They would either go out of business or they would take the hit and work from the much lower asset base into the future. The same sorts of conditions that airlines face don't appear to be on the agenda for any of the airports. They're not willing to face the constraints of the market.

PROF SNAPE: So the efficient solution presumably is to be operating the airports at, if you like, the most efficient level, yes, and if it means the current owners going bust then so be it.

MR BENNETT: That happens in airlines.

PROF SNAPE: Yes, but again, does one need - where does that bring in the regulator?

MR WOODBRIDGE: I don't know if it does. I think it's just a question of how the airports perceive themselves. It's evidence of market power, I would have thought, or it's potential evidence of market power, that's all.

MR BENNETT: The discussion that ensued between yourself and Coolangatta Airport this morning seemed to me to indicate that in fact they felt that they could increase their charges by 150 to 200 per cent and the people would still come. They didn't seem to think that people would stop going to Coolangatta Airport and rather go to Brisbane Airport in order to get to the Cold Coast, that they could increase their charges by the $3.70 or whatever it was and people would still come. They made reference to Mackay Airport and $8.50. They seemed to think that they could increase their charges by $8.50 per passenger and people would still come.

PROF SNAPE: But not $20 as you recall from the discussion?

MR BENNETT: I'm not sure that they actually said no to $20. They never actually said, "No, we can't increase them by $20 because people won't come." I just think they didn't answer that question.

PROF SNAPE: I did, I think, hear some discussion that there would be repercussions and that they would - but perhaps we can go back and look over the transcript. I was, as you recall, trying to evince from them some response on what they thought the elasticity was and I think that we did get some responsiveness once we tried $20.

DR BYRON: I was just wondering if we could pick up the double marginalisation that you mentioned before and maybe you could elaborate on that a bit more.

MR WOODBRIDGE: Yes, it's basically the following, that if I have two monopolists in an integrated production chain; for example, if it's a vertically integrated product, I have a monopolist here, a monopolist here and they act independently in their pricing. So the first monopolist prices an input to the second monopolist. The result from the literature is they both sort of act in an independent fashion and what you get in terms of the deadweight loss from the monopoly is greater than if it was just one single monopolist. In fact, as I said, in King and Maddock's book they give an example of this and go through the algebra and say, "Well, look, in this hypothetical example the deadweight loss was two and a half times what it would be if it was one single monopolist," and that's what one has at an airport. You're taking off here, you're landing here, there are different owners. To the extent they have market power they price independently of one another.

DR BYRON: But they're not vertically related in that one is buying input from the other as in your King and Maddock's example, are they?

MR WOODBRIDGE: No, they're just two separate input providers into an air travel service and as a result of that, if you just looked at sort of the single monopoly literature you're going to underestimate the efficiency loss. You've got to take them both into account that they're actually pricing independently. So you get a mark-up on a monopoly at the other end and hence the deadweight loss is bigger than if they were owned by the same - - -

DR BYRON: So does that suggest the logical consequence that the airlines would actually be better off if all the airports in Australia were owned by a single monopolist rather than having different monopolists at each end?

MR WOODBRIDGE: Yes, that's the implication of it.

DR BYRON: Back to the FAC.

MR WOODBRIDGE: I'm not saying that but basically - look, there's other issues involved in whether they should be owned by different people or not but the basic point is that it seems that - just reading the draft report - the Commission seemed to pick up this point and sort of looked at it in the traditional monopoly way when thinking about the deadweight losses from the efficiency and how far prices would increase as well. Basically you'll get a higher price than a single monopoly case as well. So it just hasn't picked up the point; that's all I'm trying to say.

PROF SNAPE: That's if they are in fact both monopolies.

MR WOODBRIDGE: That's right, you don't muck about - - -

PROF SNAPE: But of course this is very conditioned by any competition which they follow, that each of the airports has from other airports or with each other.

MR WOODBRIDGE: Yes, right.

PROF SNAPE: So insofar as they're charging fairly homogeneous landing charges for all takers except for special deals, you would in fact have to take account of not just the traffic between the two, the pair of cities that you're talking about, but you'd have to be taking account of traffic from other areas as well, and so to the extent that traffic was diverted by this monopolistic price on one which you were just operating on the pair that you're thinking of, that would in fact lessen the extent to which that double marginalisation would be able to occur. I find it rather surprising that it could be suggested that a single airport owner privatised, a single airport owner of all the airports might be preferable to the current arrangement.

MR WOODBRIDGE: We weren't trying to suggest that. We're just trying to say that the current situation is you do have different owners so if one is asking the question, "What are the economic implications of different pricing and regulatory options," then you'd have to take into account that you've separate monopolies at both ends. That was the point.

PROF SNAPE: Yes, I understand the point there. You're using the word "monopoly". We tended to use the phrase, I think "monopoly power" as the terms of reference did, which have slightly different connotations, I think.

MR BENNETT: You would have to recall of course that in the context of international air operations, the other end of the chain is offshore.

PROF SNAPE: I understand that it's offshore which gives you a separate owner over there. Some of them have interlocking ownerships with the Australian ones of course but - - -

DR BYRON: At the moment.

PROF SNAPE: At the moment, yes.

MR BENNETT: I think the only direct flights from Schiphol will be Heathrow to Australia though.

PROF SNAPE: At any rate it makes a judgment as to how important is this in practice and I take the point that it is in principle something that we, I think, took the view that it probably wasn't that strong a point in practice.

MR WOODBRIDGE: I think to answer that question one really needs to do a bit of modelling. One can do hypothetical demand curves and one can do hypothetical input proportions and this can be backed out. That's the way - the suggestion where going forward is to try and at least put some boundaries on what the numbers are here. You're not going to work it out exactly, there is no way, but at the moment it's one trade-off against another and it's very hard and this is just a difficulty of the problem that one faces but it's very hard to work out the size of the trade-offs here.

PROF SNAPE: Could I go to the page before that, which is page 5 of the long submission, which is another point in which we are at fault. It's what we have hearings on draft reports for. But it's the paragraph beginning, "Our further failing to extend the analysis," and going to the second sentence:

> If there are departures from marginal cost pricing in non-aeronautical services as a result of economies of scope or economies of scale, for instance, the efficiency loss from monopoly pricing of aeronautical services consists of two parts.

And you then go into those two parts. The rest of the paragraph of course is conditional upon that "if" that is there.

MR WOODBRIDGE: Yes.

PROF SNAPE: Could you give us examples of where the non-aeronautical services are, you think that there are significant - because in all of this I think we have to go for significant.

MR WOODBRIDGE: Yes, I agree with that.

PROF SNAPE: Where there are significant departures from what would be efficient pricing in non-aeronautical services.

MS HARRIS: In terms of - well, on marginal costs, quite a few have been non-aeronautical services, have the high fixed cost, very low marginal cost structure anyway so just, you know, to recover their costs on any kind of stand-alone basis.

PROF SNAPE: Yes, but we need to consider structural as well as marginal optimum where their economies have scaled, so we don't want everything priced at marginal cost because that doesn't do too much for you in the future.

MS HARRIS: No, of course.

PROF SNAPE: Where their economies have scaled, so that's why I in fact changed the word that I just gave to "efficient pricing" rather than "marginal cost pricing".

MR WOODBRIDGE: I think the point here is that the relevant issue is the marginal cost pricing in terms of working out the deadweight loss from any use of monopoly power in aeronautical services. You do get a - by definition, if you are trying to recover your costs in an environment where there is economy scale or economy scope, there are departures from marginal cost pricing, that's right, absolutely. But the issue here is the - and by definition, you will get deadweight losses associated with that but that's just part and parcel of the business - the issue here is if you allow for monopoly pricing in the aeronautical services you will exacerbate those allocated efficiency losses in the non-aeronautical side of the business. All we're trying to say here is if one wants to try and work out the efficiency losses from the use of market power in aeronautical, you've got to take both parts into account. That's what I was trying to say.

PROF SNAPE: Can you give us examples of where this could occur in the non-aeronautical services?

MR BENNETT: We'd point you towards the instance of lounges again. The analysis that we did of airport lounges shows that the rental charges that the airports were making in those areas were very significantly above either what the local market was bearing in areas around the airports and very significantly different to what might be the outcome for rents if you adopted the building-block approach to the areas that were being - - -

PROF SNAPE: I think we would prefer "opportunity costs" to building blocks. If one is looking at marginal efficiency and marginal costs, I think we want opportunity costs, not building blocks.

MR BENNETT: Well, the opportunity costs would be the market in the surrounding areas and in the case of Sydney certainly and also in the case of Brisbane when we undertook a review of rents at Brisbane Airport several years ago, the rents that were being proposed by the airport operator and the rents that are currently being charged by the airport operator are very significantly above the commercial rents that are applicable in surrounding areas. They're related very, very directly to prime retail space in CBDs which has nothing to do with the commercial rents associated with areas around the airports in those two cases.

PROF SNAPE: Now, are we talking about a location on the airport? We're not talking about something around the airport. The relevant opportunity cost of the lounge is in fact what that lounge space could be used for on the airport. That is the marginal opportunity cost.

MS HARRIS: There is some potential over time for an unregulated airport to artificially constrain terminal capacity to keep up those opportunity costs to make terminal capacity scarce.

PROF SNAPE: Have we got any evidence of that?

MS HARRIS: I think most of the terminal capacity that we see today has already been - besides Sydney Airport, there has not been vast amounts of increases in terminal capacity - - -

MR BENNETT: No, there hasn't been, apart from Sydney.

MS HARRIS: Since privatisation, anyway.

MR BENNETT: In the case of Sydney, the great majority of the new terminal space was allocated to retail rather than other - - -

PROF SNAPE: I think so far we really haven't go an example that would satisfy that "if".

MR WOODBRIDGE: I suppose one issue is just circulation space. Within a terminal that circulation space serves the non-aeronautical side of the business and the aeronautical side of the business. It's access to shops and it's access to gates. That's a fair proportion of the terminals. The marginal cost of providing retail is the additional cost once you've got the aeronautical and the circulation space in place but if airports priced in a way to recover just marginal costs on those aeronautical parts of the business and did it on the aeronautical side of the business as well they wouldn't recover the costs of the circulation space. That's the example I have in mind. So by necessity they price probably both of them above their marginal cost and that's the type of thing that one has in mind here.

PROF SNAPE: It doesn't seem to me very powerful to affect any of our assumptions. Again, it might be a footnote.

MR WOODBRIDGE: I think you'll find that Sydney Airport in their proposal said a lot of the costs associated with the terminal were common to both sides of the business. So they're probably pricing both access to retail and non-aeronautical side of the business and aeronautical side of the business above marginal costs within the terminal to recover those common costs. So it's an empirical question to work out what proportion of the costs of the terminal are aeronautical and non-aeronautical or common to both. The only evidence we have is Sydney Airport's proposal and they classified most of the costs in the terminal as common to both. They couldn't directly attribute those costs to either one. So empirically, on the basis of that evidence, it's suggested it could be important. It's an empirical matter.

DR BYRON: Just one very simple quick point of clarification. In your opening comments you were talking about BARA representing the international airlines. I take it then that you're mainly interested in the major international gateways - - -

MR BENNETT: That's correct.

DR BYRON: **- - -** rather than the domestic and intrastate traffic. I'm leading to Mr Hockey's announcement of 5 October and the potential implications and follow-on from that. The phase 2 airports are not really a major concern to most of your members. Would that be right - Launceston, Canberra - - -

MR BENNETT: Certainly there are limited international operations to the likes of Adelaide and Darwin airports.

DR BYRON: But the main game is basically Brisbane, Sydney, Melbourne, Perth.

MR BENNETT: That's correct, yes.

DR BYRON: Have you got any insights into what the reaction would be if Brisbane, Melbourne and Perth were to exercise the one-off price increase that

Minister Hockey in effect invited or permitted them to make.

MR BENNETT: In terms of the 6.2 to 7.2 range, no. The reaction that we got from airlines was in response to the initial proposal for Brisbane Airport for a 25 per cent increase in prices and a number of our members who operate to Brisbane Airport said that that sort of level of increase in prices would under the current circumstances result in their reducing services to Brisbane Airport quite markedly. It had a very significant effect on the returns for the likes of Singapore Airlines, for instance.

DR BYRON: Brisbane told us this morning, and I think you were present then, that their charges were still substantially below Sydney. Was it 25 per cent below or something like that? I was again wondering whether the airline reaction is in terms of the percentage increase or the quantum of increase?

MR BENNETT: It relates to the quantum of the increase. It's the dollars that count. It's a different market into Brisbane than it is into Sydney. The margins are different in the operations between those two cities and therefore the quantum will have a much more significant impact in Brisbane because of that.

DR BYRON: I think you also heard me asking Coolangatta this morning about these various other add-on levies for fuel, insurance, Ansett employees et cetera. Does your membership have a reaction to all sorts of things as well?

MR BENNETT: Yes, they did. It was very strident - opposed to it. Whilst they represent a charge on the ticket and therefore a direct flowthrough to the passenger in the final analysis, the imposts of the additional administrative arrangements associated with the collection and distribution of those levies place very severe burdens on the extremely limited resources that airlines have in Australia to manage their operations so yes, they reacted very angrily to those additional imposts.

DR BYRON: And presumably everything that affects the bottom price of the ticket line in the ticket will actually affect the customer demand?

MR BENNETT: Exactly, yes.

DR BYRON: Throughput. Was what - sorry?

MR BENNETT: I was just going to say, you questioned about the insurance levy and the $7 something that was on the ticket when Coolangatta was discussing that particular side of it. That's easily explained. The new insurance levy is around about the order of $3.50 per sector. So going in and coming out of an airport means you've got two sectors. Therefore $3.50 times two is around about the $7. I'm not sure exactly what the amount is but it's thereabouts.

DR BYRON: What you said about the reaction of your members to the proposed 25 per cent increase for Brisbane, did that imply that Brisbane wouldn't be able to increase by 25 per cent?

MR BENNETT: No, I think that given the correspondence we had from Brisbane, they fully intended to apply a 25 per cent increase and suffer whatever consequences there might be.

DR BYRON: So a 25 per cent increase in their judgment would in fact have been below the profit maximising increase?

MR BENNETT: I'm not sure. We can't read Brisbane's mind.

DR BYRON: If they are reading the market correctly.

MR BENNETT: If they were reading the market correctly, perhaps that is what was in their mind but we can't comment on that. You'd have to ask Brisbane Airport.

DR BYRON: But you got significant reaction to that and airlines saying they might go elsewhere if that occurred.

MR BENNETT: Yes, that's correct.

DR BYRON: That is quite relevant to the degree to which they could exercise - to the extent to which they have monopoly power.

MR BENNETT: It may impose some constraints on them but you would have to look at the relative split between domestic and international operations at Brisbane Airport and their judgment about how it might impact on future demand. It could be that if they impose a 25 per cent increase and international airlines went elsewhere then they may have to look at doing something to reduce their charges to encourage them back again but generally that doesn't happen in airport operations around the world. We saw it in Hong Kong. That is really a one-off.

PROF SNAPE: Under the rules of ICAO, I think, you can't discriminate amongst international airlines but you could have a differential between domestic and international services.

MR BENNETT: You could, yes.

PROF SNAPE: Could we turn to the price discrimination section, which begins on page 7. This does get fairly complicated so I'm fully anticipating this discussion to end up in some confusion. Nevertheless, let's have a go. There's the paragraph there on page 7 which begins "First". It says:

> The more efficiently airlines can price discriminate, the more an unconstrained airport will increase airport charges and the greater will be the increase in air fares. To see this for the purposes of demonstration, that airlines can perfectly price discriminate at the margin. As a result, at the margin, an increase in airport charges can be passed on to consumers -

now, that puzzles me -

> with no effect on the consumption of air travel or the consumption of airport services.

That puzzles me slightly. I'd have thought if it was perfectly price discriminating then it would be at the expense of intramarginal profits.

MR WOODBRIDGE: If you can perfectly price discriminate, I would have thought - not that I can, but what would happen if there's an increase in cost, I will load that cost onto those consumers whose decision to travel won't be affected by that increase in price. That's what I had in mind.

PROF SNAPE: In that case you're not perfectly price discriminating. If you're perfectly price discriminating, you're pricing every consumer at the point at which if the price went up they would cease to travel.

MS HARRIS: I think it must imply that they weren't perfectly price discriminating before but they can, and so they move their prices up to those less price-sensitive consumers and in the end result they are perfectly price discriminating.

PROF SNAPE: Yes, okay. So they're not perfectly price discriminating, because if they were perfectly price discriminating every consumer would be on the margin and you could not pass it on to consumers.

MR WOODBRIDGE: Right. Yes, that's right.

PROF SNAPE: So that sentence is wrong. Is that right?

MR WOODBRIDGE: It's trying to actually respond to the Commission in the draft report - and I may have got this wrong - where it seemed to be saying that the more efficiently airlines can price discriminate, the smaller will be the efficiency cost of any increase in airport charges.

PROF SNAPE: Yes, that's right.

MR WOODBRIDGE: That implies that they weren't pricing off the demand curve to start with, like you just said, so we took it from that that they weren't pricing off the demand curve, so I'm trying to make it, I guess coming from that perspective, where I thought the Commission was coming from, but I'm not too sure if they were or not.

PROF SNAPE: As I said, I thought it would get a bit difficult, but as it reads I think that that's not correct.

MR WOODBRIDGE: No.

PROF SNAPE: But it may be that we have to look at the way we expressed it too. I'll accept that.

MR WOODBRIDGE: So just to get it clear, what we're trying to say here - it's poorly worded - airlines could pass on an imposted cost without affecting the demand for air travel. That was the scenario we were trying to point to.

PROF SNAPE: I'm sorry, say that again.

MR WOODBRIDGE: If there's an increase in airport charges, then airlines can pass that on to consumers without affecting the demand for air travel. That's what we're trying to say. That's the example we're trying to put there.

PROF SNAPE: Okay.

MS HARRIS: Can I go back just a second where you said that you did imply that airlines mustn't be perfectly price discriminating now, but to the extent that they can price discriminate then any increase in airport charges will be passed on with limited impact on demand. That sort of implies that somehow airlines must be able to get better at price discrimination after prices go up for that effect to hold. If they're already doing as good a job as they possibly can, then something has got to give if airport prices go up.

PROF SNAPE: Yes, you're right. I think that the point is around this phrase "perfectly price discriminate", and I think we need to make a distinction between price discrimination and perfect price discrimination. If there is not perfect price discrimination, then there's scope for not passing it on?

MS HARRIS: Not passing the cost increase on?

PROF SNAPE: Yes. There may be. Okay, we'll look back at our wording on that. I just wanted to clear that sentence up, which I think is not correct as it stands, but we'll go and check how we have expressed it too. If I can perhaps come back to page 10 again but not the same paragraph this time. But I'd like to pick up the heading on page 10, which is, "has not established the current regulatory regime, has failed to produce acceptable outcomes." That's not the onus that our terms of reference have, and if one reads the terms of reference which are at the front of the draft report, that's not what it says our position has to be. I think in a number of parts in BARA's submission it might be a bit of the attitude, "If it ain't broke, don't fix it," but that's not what the terms of reference say. The terms of reference say, if I can find the relevant section, "Identify the rationale for any future prices regulation." Yes, it's in 6 under Background:

> Examine whether new regulatory arrangements targeted at those charges for airport services or products where the airport operator has been identified as having most potential to abuse market power are needed -

are needed -

> to ensure that the exercise of such power may be appropriately counteracted -

and elsewhere I think the word "necessary" occurs in there as well. So it's not as if we say, "Okay, the terms of reference don't quite give the thrust that is in that heading and I think implicit in other parts of the submission."

MS HARRIS: I think it's fair to say that the Commission has found that something is needed, even if it's just monitoring to keep an eye on things. Given that something is required, that obviously brings into account what that something ought to be, and radically moving to something untested and completely different, the cost benefits of that need to be taken into account, especially compared to a situation where we've had a fair few years now of dealing with one particular regime. People have at least got comfortable, or if not necessarily comfortable, at least they're a bit clearer on what the rules are these days. Throwing that experience away and moving into uncharted waters certainly has implications that need to be taken into account.

PROF SNAPE: Yes, the terms of reference also and the whole thrust of the regulations that have occurred through the privatisation has been to move to commercial relationships, and I must say that we have been rather struck by the rather bad relationships between the airlines and the airports, and been rather concerned as to why they can't get on and have commercial relationships. Now, we have heard some evidence in the last two days, which you'd have heard, that things are improving. That is, as we understand it, the direction of the government's policy that we're trying to fit into, to push, to provide facility, to moving to commercial relationships if they are possible and efficient.

MR BENNETT: It's worth noting, of course, that in that regard to the type of relationships that exist between airlines and airports - isn't unique to Australia. It's not just Australia where the relationships between airlines and airports can be somewhat testy. That is a common phenomenon around the world. So it's not as though it's something that is uniquely inherent in the Australian psyche or the way people go about doing business in Australia. We - - -

MR SNAPE: And we understand that. But then the history of the ownership and the regulations around the world is fairly similar too and so one perhaps can be looking to a common history also that might be generating that. We had a sentence in here that you've possibly noticed which I quoted yesterday but I quote again. That - and this is to do with promoting commercial agreements - was:

> That such guidance may be helpful for commercial entities in a commercial environment may perhaps be surprising, but it reflects natural monopoly characteristics, the pervasive effects of regulation, the historical ownership of airports and airlines and the easy politicisation of these issues in the industry.

Well, I think that, you know, that explains why we were trying to encourage a movement in it and try to facilitate it and I think that that explains some of our recommendations, in particular the transitional arrangement that we preferred under option B to try and move out of this past history into commercial relationships. Do you find that unacceptable?

MR BENNETT: I think we would have to refer you to the situation in New Zealand where this sort of approach has been tried, and indeed it's been tried at a time in the aviation cycle when there was a growth in traffic and in a number of instances some reasonably healthy returns that were being accrued to airlines, and yet the approach in New Zealand has failed miserably. The airlines were actually in court with airport operators over there because the processes have broken down. If you extrapolate that to Australia at the present time with the current economic regime likely to effect international aviation services over the next 18 months to two years at least, then you really are caught in a very risky process.

PROF SNAPE: With respect to New Zealand, one can never translate one thing exactly to another country, of course. There was a fatal flaw or a fatal condition in there in terms of getting on together, and that was the consultation, which I think is what has taken them to court. It does emphasise the importance of getting it right and getting the wording right so you don't have flaws like that, but also perhaps the Australian industry would learn from the New Zealand experience and try to make sure that that situation, which is probably not satisfactory to any party, would not occur. After all, this is - - -

MR BENNETT: I guess if that's the fond hope, then we go to the videotape and have a look at what's going on in Coolangatta and Darwin at the moment. Because BARA isn't heavily involved in either of those airports we take an interest around the margin, but the reports we're getting back are that both Coolangatta and Darwin are proposing to more than double their aeronautical charges and they're saying to the airlines, "That's it. This is what we want to do but we're not going to tell you how we got there." They haven't provided any financial models. There's been no consultation. There have been no discussions between the airport operators and the airlines operating to those ports that would indicate the basis upon which they're seeking to increase their charges by that rather large amount, so it's not a particularly positive approach or positive start to what might be seen as being a commercial relationship between airline operators and airlines.

PROF SNAPE: As we understand it, there was extensive consultation at least at Coolangatta with respect to moving to a passenger from a weight charge and those negotiations were proceeding quite satisfactorily. Is that how the airlines saw it?

MR BENNETT: I'm not sure what the outcomes were going to be from those discussions, but certainly we were aware that discussions were taking place. But if you get back to the quantum of the increase and the percentage of the increase, then there has been no information provided at all, as we understand it, from either airport operator as to what might underlie the requests for those sorts of increases.

PROF SNAPE: I think that in the attachments to today's submission from

Coolangatta you'll find it fairly well documented.

MR BENNETT: We haven't been privileged with a copy of those yet.

DR BYRON: And if you read the transcript from Darwin yesterday you'll find their explanation there, I think. It's all on the record now.

MS HARRIS: I'm not sure if this was the intention in the draft report, but it certainly gives the impression that commercial negotiations are somehow a panacea to the problem of monopoly power in the first place. If that were the panacea, then we needn't bother regulating any monopolies at all. Just because you smile and don't go slagging off at one another in the papers and come to some agreement doesn't necessarily mean that that agreement necessarily reflects an efficient outcome. It's what's not agreed and what demand never eventuates because of prices that are higher than they need to be that counts.

PROF SNAPE: Yes, quite so, but it may be that the way to go is to see how the commercial relationships are developing or could develop, and if they're not satisfactory one reintroduces the regulation, and that was in fact the thrust of our option B, to try and get the commercial relationships working and seeing what happens, and if they can't be undertaken or if they're not in fact satisfactory, then regulation be reintroduced.

MR BENNETT: It's a high cost option, that. Under the existing regime the relationships between airlines and airport operators were maturing. The discussions that were being undertaken with airport operators in relation to necessary new investment and investment that was required to ensure the efficient operations of the airports in the future were continuing. The level of charges that airports were able to put in place with respect to those necessary new investments were in fact based on a dual till. They were able to make the investments in the secure knowledge that the aeronautical charges that they received were sufficient to meet the commercial costs of those new investments. We are under the existing regime developing a much more positive approach to the consultations and the relationships that exist between airlines and airport operators, and the notion of throwing all that away, all of that experience and all of those benefits away, in the pursuit of something entirely different is a very serious cause for concern for the airlines.

PROF SNAPE: I had a bit of trouble following that, I must say. This I think depends on how extensive the monitoring has to be. As we in fact have sketched it - and I agree that we didn't go into details because we asked for comments and we asked for people to make suggestions, but as we sketched it - it was not to be highly intrusive, and it was to be set at the beginning what would be required in terms of information, and explicitly we said not added to as time goes on, so there wouldn't be monitoring creep, if you want to call it that, over the five years. So it would have been clearly specified at the beginning. That's one of the things that we did make quite explicit in our description of our sketch of the monitoring option.

You do talk about the various forms of things that you've had to gather for the

SACL case, for example. You also, I assume, have to gather a lot of information for CPI minus X reviews. It didn't seem to me in your description around pages 20 to 22 that the cost on you would be greater with monitoring, particularly if in fact it was to be a fairly basic sort of monitoring. We would have envisaged this to be a lower cost option to you, not a higher cost option, than is involved at the moment with CPI minus X reviews et cetera et cetera.

MR BENNETT: I think you're wrong there, with respect. You heard from Brisbane this morning that they're proposing to send us out a document that will propose a pricing regime going forward for the next five years following the removal of the current regime and ominously they referred to the document containing the sort of approach that was adopted by SACL in its pricing proposal to the ACCC, and it appears now that we are going to have to go through admittedly what may not be quite such an extensive exercise as we had to with SACL because of the relative sizes of the airports but it appears that now we may have to go through exactly the same sort of exercise with Brisbane Airport in looking at the assets that it's claiming are aeronautical assets, checking that the assets are there, that the cost of the assets are reasonable, that they're allocated appropriately.

Under the existing regime we don't have to do that. All we do is look at the efficient provision of new investment at each airport. That's now a very streamlined process. We have guidelines or understandings - not necessarily guidelines, formal guidelines, but understandings in place with each of the airports that we deal with, that they provide us with a certain level of detail of the information that is associated with those necessary new investments. We have put in place project control groups between the airport operators and the airlines that review the ongoing progress of the implementation of those investment projects and monitor the costs associated with it, and the system works reasonably well now. We have agreements in place with airport operators similarly that there will be a much more streamlined approval and monitoring process in place for minor investments.

So we have now developed over a period of four years a very much more streamlined approach to the necessary new investment arrangements under CPI minus X. It's been developed to such an extent that in fact with the last necessary new investment proposals coming from Brisbane Airport, the ACCC deemed it unnecessary to go to a draft report because there was extensive agreement between the airport and the airlines on the matter of what should proceed and what the value of those investments were. So the ACCC simply went to a final report and everyone was happy so - - -

PROF SNAPE: Now, the Brisbane proposal is a commercial proposal. It's not a regulatory proposal and it's up to you whether you say - you as the airlines to say, "Look, we don't want to go into all that detail. Let's have a commercial agreement which is somewhat less than that." This isn't imposed.

MR BENNETT: No, one of the more ominous points that Tim Rothwell made this morning was the issue related to starting-point prices in respect of the movement forward for the next five years. If we're looking at reopening starting-point prices at

Brisbane Airport, then it's going to be exactly the same sort of process as we went through at Sydney Airport.

PROF SNAPE: Well, again, I suppose one can only wonder as to how the rest of the world gets on without regulators.

MR BENNETT: The rest of the word has regulators.

PROF SNAPE: Well, some of the rest of the world has regulators - - -

DR BYRON: In some instances, yes, that's right.

PROF SNAPE: Some of the rest of the world doesn't have regulators. Most of the rest of the world doesn't have regulators and most of the rest of the world wants to get the regulators off their backs.

MS HARRIS: Most of the rest of the world has competition.

PROF SNAPE: You, on page 19, say that the bar is concerned that airlines are being set an impossible task to prove efficiency losses caused by monopoly pricing. Well, if one is concerned about efficiency losses and one wants to regulate it, then someone is going to have to be trained to assess efficiency costs, efficiency losses. You're not seriously suggesting that the regulator or anyone outside the airline industry would be better at assessing this than airlines, are you?

MS HARRIS: I think what we're concerned is that if airlines provide evidence to this review in five years' time that we would have, you know, flown this many extra flights into this particular port had it not been for the size of the aero charges, how - - -

PROF SNAPE: But no-one else can determine that. You're surely the only people who could be able to make a judgment on that.

MS HARRIS: Yes, I agree.

PROF SNAPE: The regulator could not.

MS HARRIS: I agree, but why would they be - they could also lie and the person conducting the review would know that they could also lie and how on earth would the person conducting the review know whether the airlines, who indeed are the only people who can tell you how many extra flights would have been flown, whether they're lying or not.

PROF SNAPE: But I mean the counterfactual on this is regulation and one wants to know about the efficiency costs - the efficiency so one can regulate efficienctly. One needs to know the answer - to make it perfect - the answer to these questions. I mean, it's not to say - you are the best people to make that judgment and indeed no-one else can make as good a judgment as the airlines on it. To say, "Leave it to the regulator," must be less - it means that there must be a less informed decision than you could make or a less informed judgment than you could make.

MR WOODBRIDGE: I'm sure airlines could make an estimate but I suppose the point of the comment in the submission is to say, "Look, at a review one would expect to have verifiable measures of the use - costs of any use of market power," and it's difficult. As the Commission has found in this inquiry, it's difficult to work out whether there is an efficiency loss and the size of it, and that's why unfortunately in a lot of these debates it ends up coming back to a comparison of revenues or costs or something like that or something that actually someone can actually grab hold of and verify. So I think the comment was in the sense that if things like profitability really isn't going to be an important determinant of whether there has been the use of monopoly power, it's trying to work out what could be used, it's trying to ask that question.

PROF SNAPE: Well, I think that it may be that no-one can estimate the efficiency losses caused by monopoly pricing but if anyone can give the evidence, I would have thought that the airlines were the best placed to do it. But you're saying they're set an impossible task. I'd have said perhaps that it's a more impossible task for anyone else.

MR BENNETT: Any sort of statement we would make to a regulator in the future, we can't prove. We can't prove what hasn't happened, and I go back to my earlier comment. In the case of the last NNI discussions with Brisbane Airport, there was a commercial agreement, presumably in the Commission's terms, that was reached between the airlines and the airport operator as to what necessary new investment should be undertaken in the next two to three years and again we went to the ACCC largely in agreement on that and the ACCC didn't have to go to a draft stage, it went to a final stage because there was a commercial outcome that was reached between the airlines and the airport under the existing regime.

PROF SNAPE: That shows that in fact commercial outcomes can occur.

MS HARRIS: We're not saying that they can't, just that those outcomes won't necessarily be the efficient outcome.

DR BYRON: What we are after is to get to efficient prices, not necessarily consensus prices.

MR BENNETT: That's true, yes.

PROF SNAPE: Yes, I see.

DR BYRON: But trying to get to efficient prices with minimum transactions and regulatory costs to all parties, not just to minimise the costs for the airlines or for the airports or for the regulator.

MR BENNETT: We go back to Coolangatta's increase, \$2.17 to \$5.90 per pax. Is that an efficient price? We don't know and there is no way we can prove one way or the other whether or not it is an efficient price.

PROF SNAPE: Do you think the regulator can?

MR BENNETT: Under the existing system there was a process moving forward for agreeing price increases associated with necessary new investment.

PROF SNAPE: I mean, it's an imperfect world all around is what it is and we're trying to find the least imperfect of those worlds, I think.

MR WOODBRIDGE: You'll never get the efficient price and you'll never know whether you've got it in the first instance.

PROF SNAPE: Precisely.

MR WOODBRIDGE: It's a game of trying to work out what regime would get as close as you can and - - -

PROF SNAPE: I think we're agreed on that.

MR WOODBRIDGE: Yes, good.

PROF SNAPE: Yes, I realise that the time has gone on. I think Qantas said that they weren't going to occupy the full hour but we've yet to see that, I suppose. Well, perhaps we should finish there. Thank you very much, as I say, for your very helpful submission and getting such a detailed submission in in the current circumstances in time for us to digest it. The length of the discussion has of course been related to the fact that we did have time to read it and digest it. We thank you for that very much. Also if you've got anything subsequently that you want to submit there, then please feel free to do so and sooner rather than later of course because 21 December doesn't get any further away. So thank you very much.

MR BENNETT: Thank you for the opportunity to appear.

PROF SNAPE: Thank you.

PROF SNAPE: Let's resume and welcome Qantas and two representatives from Qantas. Hello, we've got four representatives from Qantas, have we?

MR WOODBRIDGE: Since we helped the BARA submission, we'll just sort of sit here and assist in clarifying - - -

PROF SNAPE: So if all four representatives from Qantas could please introduce themselves and their positions for the tape, thank you.

MR OLDMEADOW: Ian Oldmeadow. I'm a consultant to Qantas.

MS KING: Jemille King, Qantas legal department.

MR WOODBRIDGE: Graeme Woodbridge, consultant.

MS HARRIS: Anthea Harris, consultant.

PROF SNAPE: Thank you very much. Ian, are you leading off?

MR OLDMEADOW: Thank you, yes, I will. I guess it's fair to say that we were pretty disappointed, Professor, with the report and I think BARA's submission, the written submission, covered the concerns that we had about the report and the weaknesses in the report. We're facing a highly uncertain environment. The shareholders, the operators of airlines around the world are taking a hammering. The estimate, as Warren Bennett said this morning, was of losses of $US7 billion plus this year for carriers worldwide and they expect job losses in the industry, direct job losses, of over 200,000 worldwide and the figure currently is sitting at somewhere above 160,000. A number of airlines around the world have sought to cut back services. They have sought to seek assistance from their governments and a number of airlines, such as Swissair, are in the hands of their bankers.

The prognosis is a very difficult one and uncertain one for the airline industry into the future. Not only have we had the anticipated losses for the industry as a whole pre 11 September but the terrible events of 11 September have exacerbated that, an increase estimate to 7 billion. We are in a very uncertain situation. The Australian market has had intense competition with deregulation. We've had the Impulse and Virgin entrants. Impulse is now providing services for Qantas but certainly was not in a profitable state. Ansett quite clearly is attempting to emerge in a different form under the administrator and again, this is a very uncertain environment; a more uncertain environment than we have seen for many, many years. In an uncertain environment it is very difficult to see where, if demand is slowing, shareholders are taking a knock and the airline industry, it's very hard to see a situation where the regulatory framework is being changed in a way that clearly advantages the shareholders of airports.

The acceptance of price monitoring, which for the phase 2 airports, is already having a major impact of aeronautical charges. The proposals - and we've only got three to date. It's fairly recent news that Minister Hockey changed the rules of the game. I think the day before the election - - -

PROF SNAPE: The day before the calling of the election.

MR OLDMEADOW: Calling of the election, I'm sorry, prior to going into caretaker mode, ranging from 110 per cent to 171 per cent. Those increases create a fear for us that the same thing will happen if the report goes forward in its same form and this happens at Melbourne, Sydney, Brisbane and Perth. We have no reason to believe that if you're a monopolist, in a situation where you demand drops or you need some extra revenue to cover concerns about the banks and not making a rate of return that you thought you might have got when you bid that you won't whack up charges. There is no pressure for that not to happen and what we're seeing at the moment is exactly that.

If we take Coolangatta, and it's true that there were discussions about the conversion to a PFC. There were a number of discussions and my advice is that one of the airlines, not Qantas and not Ansett, were supportive of it but one wasn't. Then you had the events of early September with Ansett and now we have a proposal in front of us for a 171 per cent increase. It's interesting that in justifying that increase they talk about their bank problems; they talk about the lost revenue; they don't take account of the additional services that we put on. They don't commit to a review into the future to adjust it for volume increase which may increase in the future and interestingly they also including terminal revenue lost and carparking. So here we are, we've gone full circle.

We've had the airports arguing strenuously for dual till and here we are, we get price monitoring and bang, straight in, we've lost some money out of our carparks. We've lost some money out of our terminal and whatever else they've lost money in. You had better stump-up airlines, and airport and airline consumers and I think it's pretty incredible to think it may only be a small quantum amount but I can't believe that the increases being sought in this unregulated approach are going to do any good for the jobs of people in the tourism industry on the Gold Coast at the moment. Look at Singapore. What did Singapore do? The crisis hits, they decrease the price at the airport on charges. What happens here? We must protect the shareholders in Coolangatta Airport at all costs so what we do is we introduce price monitoring to guarantee the return. I'm sure that unsuccessful bidders, the unsuccessful bidders would have liked to have known that there was an ability to charge whatever you like in the future after the five years or before the five years ends in order to be able to produce a return for those shareholders into the future.

I guess the difficulty for us is, what do we do? We're sitting in Coolangatta, which is supposed to be - not able to exert market power, monopoly power. On the basis of the views of the report, should we not fly there? Is that what that means? Does that mean that because Brisbane is sitting nearby and they can't exert market power, it's the view of the Commission that we should stop flying there to create some leverage. So we are not sure what to do at this point. We have some discussions established next week with Coolangatta Airport, but if you take the logic of your submission, which is that we could exert some leverage back onto the airport, should we now say we won't fly there? We haven't said that, and we're not particularly intending to, but should we say that, because that's the leverage you're talking about, or should we just pay up, or should we go down another route of the access regime?

There's a lot of discussion about commercial agreements, and it would be very interesting for the people who wrote the report to spend a lot of time, some time negotiating with people who have market power where you need the service and you have to have the service to operate an efficient operation, providing the customer service that's required for your customer. In that environment it is very difficult to deal with someone who says, "Here is the lounge," which is not - its next best alternative is not retail, because it's sitting up on the roof of the terminal; not many people want to climb up on the roof to go and do their shopping in the terminal, major terminal in Australia - and say to you, "Here's a price. You either accept that, or you don't get it." Now, that's not what we would call pricing against the opportunity costs, because the opportunity cost is not using that facility, the one that I'm talking about. The next best alternative may be retail, but it's fairly poor quality retail, because people have to climb up and walk to it. It's not in the thoroughfares where the high value retail is.

We would submit that certainly we are attempting to reach commercial agreements with the airports, and I think it's fair to say that relationships with the airports have improved over the continuum of the regulated period, and I think that is to be expected with any form of regulation that is introduced, that there will be a period of shaking down, finding out what the rules are and that commercial relationships do improve. I just reiterate that we are in a highly uncertain environment in the short to medium term. We think it is bizarre that in that environment where everyone else is having to adjust their prices to fill their hotels, having to adjust their employment numbers, that the only group who have the power under a new, the option B the Productivity Commission is pushing, allows you to double your charges, and who to protect? To protect the existing shareholders. Thank you.

PROF SNAPE: Good, thanks very much. Well, I don't think that we have any doubts about the seriousness of the situation facing airlines around the world, and also of course that does affect airports as well too, as we've heard, and we do notice there was a chart in the press this morning which suggested that Qantas was the only profitable airline in the world actually. It was in The Age this morning from Bloomsburg, which is interesting, shall we say, but nevertheless doesn't change our view about the serious situation that airlines are in throughout the world.

MR OLDMEADOW: I hope you're not suggesting, Professor, we should be penalised for being one of the successful airlines in the world at this point.

PROF SNAPE: Of course not. I'm very surprised that you'd think that, rather it's a matter of commendation. You did say, "What could you do with Coolangatta," but you put it in all or nothing terms, and I don't know what you want to do, but just to comment on the picture that you drew, I mean, it would not be "not fly to

Coolangatta". Perhaps one option would be not to fly as much to Coolangatta, or else not to increase the capacity to Coolangatta as much as to another airport, or not as much as would otherwise have been done. I mean, I think the way you painted it was not the way to view it.

MR OLDMEADOW: Well, with due respect, if we reduce our schedule to Coolangatta, then they'll charge us more because the volume has gone down, because that's the prime driver of the increase. I mean, we had over 50 per cent of the market. They're jacking it up by 171 per cent, so there are a whole lot of other costs they're bringing in. But if we reduce the traffic further, they'll just come back and jack it up further, because there's no constraint. What's the constraint? There's no constraint on them doing whatever they like.

PROF SNAPE: Well, we did try some figures on them this morning, and they did indicate that there was some constraints on going to certain levels, yes.

MR OLDMEADOW: Well, does that mean that we should drop our capacity back by 30 or 40 per cent until they get to the point of increasing it by 20 per cent. I mean, it's a funny game to play when you're running a schedule, and I'm not sure about the public interest effects, and I'm not sure about the impact that that - I cannot believe, with the tourism industry of Coolangatta bleeding, well, having difficulty at the moment, that it is in anyone's interest for us to restrict capacity as you're suggesting on that route, professor.

PROF SNAPE: I was not suggesting that you should do that. I was saying that your options are not all or nothing options.

MR OLDMEADOW: I accept that.

PROF SNAPE: That's what I was trying to draw attention to. I think also that monitoring is not there to guarantee returns - it's an expression you used - that they would be surprised that it was there to guarantee returns. As we understand it, Coolangatta are adopting a strategy which may or may not be successful. The Commission certainly is not suggesting that it is a right action or a wrong action. It may or may not be successful, and that is the monitoring is in no sense designed to guarantee a return but simply would increase behavioural options.

MR OLDMEADOW: What, to increase prices?

PROF SNAPE: Behavioural options in general which would - we know option B would be reviewed after five years time.

MR OLDMEADOW: What, we have five years of chaos in - we're talking about five years of chaos, and in five years time we sit down and go through this process again after the damage is done in an industry which is in more turmoil than it has been for many, many decades. So what we do is we say, "Righto, let's introduce five years of potential chaos in that environment."

PROF SNAPE: Well, perhaps I'd just remind you that the draft report came out and was written before recent developments.

MR OLDMEADOW: Well, I think we would like you to take into account recent developments, professor.

PROF SNAPE: You'd be surprised if we didn't.

DR BYRON: Yesterday and this morning I asked Adelaide, Canberra and Coolangatta, I think, why any airline would agree to pay higher charges in order to prevent the owners of an existing airport from taking a bath. It happens all the time. You know, the current owners take a huge hit and a capital loss, somebody else buys the asset at a much lower price, and then operates it. The airport is still there, it will still be running, you'll still have access to it, why should an airline have any particular constraints? Now, I think the three or four airports that I put that question to have all attempted to give some reasons why in terms of regulatory licensing, CASA approvals or whatever, that, you know - perhaps they're clutching at straws, I don't know - but some reasons why it's not actually in an airline like Qantas's best interest to see the current owners of the airport go broke, wait for a few months until somebody comes in and buys it. Do you have any reaction to that?

MR OLDMEADOW: I guess our view is that we don't like to see anyone go broke, but we live in a market environment where we as an organisation are not able to exercise the - we have competitors who go broke, and that is the test of the market. We expected that the regulatory regime would in some way attempt to reflect the way that markets behave and price monitoring in the current environment does the reverse. So the issue for us is - I don't think it is likely - I think the issue is the airport is unlikely to move because they're not a movable asset. It will be there and the important issue for us is that it continues to operate and it operates in a way as closely to the market as possible.

If that has implications for the shareholders then that is a consequence for those shareholders and we're very sorry for them but on the other side of the coin, airlines have shareholders and we are in a ferociously competitive environment and we're not sure why one group of shareholders is given an equity status which seems to be given with price monitoring above any other shareholder, almost any other shareholder I can think of. In your report you ran a fairly what I thought was thin argument, if I can say with due respect, about the equity issues and the losses, that is, the consumer loss that if they jack up prices at the airports then we will pass it on and there's some loss there but of course there's a gain because the profits of the airports will go to the shareholders who are in superannuation funds.

I didn't think that was a very valid argument but that was addressed in our report. But it's interesting now that price monitoring elevates the status of these shareholders with super money in airports that they are impervious to the rigours of the market.

PROF SNAPE: I can't quite follow that. Why is it elevating them to a preferred status above anyone else?

MR OLDMEADOW: If they are able to exercise market power and increase prices by 170 per cent to guarantee a return at a particular airport under price monitoring, you're guaranteeing the shareholders of that organisation. If you're a shareholder in another organisation, say a hotel, and I'm coming back to your question, doctor. If you're a shareholder in a hotel on the Gold Coast and your demand goes down you drop your prices and then you have to revalue your asset and if you can't cover that you sell it. Now, that's the market. So price monitoring allows the airports to operate in the opposite direction. They can just jack up their prices to the point where they get a return. They don't have to worry about the rigours of the market. I'm trying to answer the doctor's question.

DR BYRON: Yes, what is confusing me and it might be Prof Snape's confusion also, is that you're equating price monitoring as a guarantee of some assured value return on funds invested, whether that's - - -

MR OLDMEADOW: Could you explain to me where price monitoring stops it? I mean, over the next five years I see nothing that can stop Coolangatta doing what they're doing except us utilising the access regime or diverting our traffic. I don't see the same with Canberra, the same with Darwin. I don't see any way - I mean, they are effectively able to jack the price up. One organisation said, "We will not give you the model because we don't have to under price monitoring. We don't have to show you why."

PROF SNAPE: I think I'm having a little bit of a problem. Your comparison has been with the pub owner and Coolangatta or wherever. That pub owner has not been subject to price regulation, has not been subject to CPI minus X regulation. He is not constrained in the past to what prices he could charge. Coolangatta Airport and the other airports have been. They have been constrained in the prices that they can charge and that constraint was set on projected - as far as we understand it - number of passengers because they claimed the more passengers the lower the charge because of the economies of scale of operating an airport of that size. So we're coming off a constrained price that was set in the context of a certain amount of expected traffic.

That traffic has - projections have been pricked by the collapse of Ansett. You've taken off the constraint and surprise, they've decided to increase their price. Presumably another way would have been for the regulator to say, "Our projections have been undermined for that X and so we will set a new price but we will in fact have a smaller X than in the past." Essentially that's what they have done except it has been a once for all jump for Melbourne, Brisbane and Perth of setting a new constraint. Now, simply to say that the price has increased in these circumstances and compare it with an unconstrained pub owner doesn't seem to me to be a very helpful comparison.

MR OLDMEADOW: I think it is because there is a fairly competitive market on the Gold Coast for hotel rooms and I think that's why it's relatively cheap compared with other places in Australia. It is a fairly competitive market so there has been competition and we've just pulled - a large slab of market has gone. So I think it would be hard to argue, if you talked to the hotel owners in that part of the world, that they would regard themselves as making supernormal profits in recent times.

The other issue that's very interesting is that they have loaded up the carparking and terminal loss - the loss of terminal revenue at Ansett. That's revenue that - so they have essentially gone full circle on - - -

PROF SNAPE: I understand your point there but that may or may not be a successful strategy. I mean, there have been plenty of business strategies in the past trying to react to decreased demand which have been unsuccessful.

MR OLDMEADOW: But what happens, one would hope that traffic volumes recover to Coolangatta. We have no guarantee that the revenue - that the price will come back down. We have no guarantee in Canberra, have no guarantee in Darwin. I mean, why would a monopoly not keep the prices up there? 110 to 117 per cent is a hell of a lot more than the increases that the government saw fit to pass through at the same time for the currently regulated airports. I mean, we're talking about multiples of 20 to 50 - not 50, sorry, 20 to 30.

PROF SNAPE: Yes, there were a lot of other increases at the same time - charges at the same time of course and all of them larger in dollar terms than the one you're talking about.

MR OLDMEADOW: I think the problem we're trying to get to is there is no constraint going forward. There is no constraint that the airports - and if you were running those airports, if you were the shareholder, you were on the board, what you would be doing is trying to make sure you made a rate of return, and why not make a better rate of return? Why not make a greater rate of return and then sell the asset to someone else? That's what I'd do. I mean, I don't know who else would. It seems to me logical. If you haven't got any price constraint - there's nothing in price monitoring that gives us any assurance that that won't happen - that is what will happen.

PROF SNAPE: If you were running an airport you'd certainly be trying to make profits, but would you not be trying to establish long-term relationships with the airlines which were of mutual benefit because you are in fact in a relationship which is mutually beneficial in some dimensions? You would certainly not wish to try and bankrupt any airline, because they depend upon the airlines. Isn't that what you would be looking for rather than a short-term profit maximisation? These are very long-living assets with very long-term investments. Wouldn't you be looking to long-term relationships?

MR OLDMEADOW: Sure, but I don't think that long-term profit maximisation is inconsistent with having reasonable relationships. It's the issue of who's got the power to stop paying. If the customer isn't happy in terms of the amount they're paying, if you have that market power that some of these airports do have, you'll trade off, I would have thought, profit maximisation long term rather than having a nice cosy relationship. I think that is likely to be the outcome, unfortunately.

DR BYRON: But to come back to the sort of hypothetical with Coolangatta, need it be of any concern to Qantas if the airport becomes insolvent or if the owners become insolvent? Is that something that you would prefer to avoid?

MR OLDMEADOW: We would not want to be in a position of seeing anyone go under, whether it's an airport, a travel agent, a tour operator, a hotel. We would not want to see that. In this current environment of great uncertainty; with a number of organisations having already gone belly up in our industry and associated industries and, I suspect, more to come, we would not want to see that happen as a matter of principle - all of them. It wouldn't matter if it was an airport or a hotel.   You wouldn't want to see it go broke.

DR BYRON: Okay, good, because the airport is very close. What are their options apart from attempting to negotiate an increase in landing charges?

MR OLDMEADOW: They haven't attempted to negotiate it yet. They have sent us a proposal that this is it and we have asked for a meeting. There has not been negotiation as of yet.

DR BYRON: Let's assume a meeting occurs and negotiation begins. Is that the obvious way to go?

MR OLDMEADOW: We will be having a meeting with them next week.

DR BYRON: But given that traffic volumes are down, they could say, "Okay, let's offer to cut our landing charges by 10 per cent, 20 per cent" - pick a number - "and hope like hell that volumes pick up so that we can keep the bailiffs from the door for a few more days." That may also be a fairly high risk strategy, because if the volumes don't pick up they're absolutely dead meat. I suspect that they'll be interesting negotiations.

MR OLDMEADOW: Yes, but they're the same negotiations you would have if you were a major supplier to another organisation in that situation. There's nothing special about the airport - and I think that's the point I'm making - unless you have a view about shareholders of airports, which I thought was implicit in the Productivity Commission report - - -

PROF SNAPE: Not at all.

DR BYRON: Not at all.

MR OLDMEADOW: - - - about that sort of argument that their welfare exceeded the loss in welfare or the distributional losses for - - -

PROF SNAPE: I'm not quite sure how you drew that conclusion. The only thing was that in distribution we saw that in terms of income distribution there is probably not a great deal of difference between the owners of airports and travellers, that it was not that the airports were being owned by the filthy rich and all the travellers were the worthy poor, for example, or vice versa, nor was there a great difference, a huge difference, between Australian and international and that they were well represented on both sides of it. Sure, we could go a bit further than that in terms of measurement, but it was not as if it was all one-way and it was Australia versus the rest of the world or vice versa. That was the only point that we made in relation to ownership.

DR BYRON: We were actually trying to say that no one group of shareholders was any more meritorious than any other group, and certainly not to say that those who happened to have shares in airports would be guaranteed whatever they felt was their target rate of return.

MR OLDMEADOW: Unfortunately the system you're proposing, your preferred option does that, and I think it's probably an unavoidable consequence but I think that's my view of what it does. That's the submission that we're making.

DR BYRON: The things that we got from Coolangatta this morning suggests that, even with their - shock horror - 171 per cent increase at $3.60, they're likely to continue to have losses for at least the next three years, which is not quite the same as saying that they're guaranteed their target, weighted average cost of capital or any other target rate of return.

MR OLDMEADOW: I guess the issue is what risk do you take when you buy something. I'm not here to debate that, and we're sympathetic and we'll be sympathetic in the discussions. We're not sure of what Canberra's 107 per cent increase is due to. We know that carparks are a part of it. We know that their loss of Ansett terminal rent is part of it, which is pretty interesting given the views on single till, but there's no review mechanism. I mean, did Coolangatta say to you - I missed it; I apologise for that - "We will guarantee that each six months we'll review it and if the volumes come up we'll drop it back"?

PROF SNAPE: No, they said that this was a proposal for a stop-gap.

MR OLDMEADOW: The point is, though, professor, if I were in their position I'd say the same thing but where does that leave us in six months' time, 12 months' time, because price monitoring doesn't do anything for us?

PROF SNAPE: I think it leaves you in the discussions that you're going to have next week.

MR OLDMEADOW: And Canberra the same thing, Darwin the same thing. Who's next?

DR BYRON: Probably all of them you'll have discussions with, I would imagine.

MR OLDMEADOW: Going down the access road, is that where we should go if we fail in those discussions, or should we just cut back capacity, as you've suggested?

PROF SNAPE: I would have thought that that's something you have up your sleeve. You're suggesting you've got no negotiating power. I think you've got a lot of negotiating power. You've just indicated one piece of negotiating power that you have.

MR OLDMEADOW: What's that?

PROF SNAPE: That was in fact to threaten the access route.

MR OLDMEADOW: So that's our piece of negotiating power?

PROF SNAPE: No, that is one piece of negotiating power. I must say that you're probably fully aware that the theme that we've had from many other participants in the conference is how Qantas currently can determine their whole business because of the share of the business which Qantas has at the airport. That's the theme, as you would expect, which many of the airports have been putting forward. They are completely under the control of Qantas. You may or may not agree with them, and I'm not advocating that as a position. I'm simply stating that as what they have been saying.

MR OLDMEADOW: Maybe you're being gamed, professor. It's very rare for someone who's at your mercy to come along and say, "We're going to charge you twice as much." I find that an absurd argument. If people are at Qantas's mercy, then it's very strange to come along and double-charge - - -

PROF SNAPE: Even the worst poker player can make opening bids.

MR OLDMEADOW: Well, I don't think from the discussions we've had with some of these airports that they regard them as opening bids, nor do they see any negotiation in it, and to set up an adversarial situation and mechanism as has been set up now seems to be against the intent of your earlier points about trying to get the airports and the airlines working together.

PROF SNAPE: I think we get your point on that. Are there other points that we should - - -

MR OLDMEADOW: No, I have no other points.

PROF SNAPE: Okay. Neil, unless you have - - -

DR BYRON: No.

PROF SNAPE: I'm sorry, I didn't ask you. Thank you very much. We are now scheduled to have a break until 2.45 so we will resume then and we thank Qantas very much for their participation today and we look forward to - can we look forward to a submission?

MR OLDMEADOW: We will rely on the BARA submission.

PROF SNAPE: So there will be no further submission from Qantas?

MS KING: Can we get back to you early next week?

PROF SNAPE: We would like you to do that but if you are giving us a written submission could we have it rather earlier - - -

MS KING: We hadn't planned on it, professor.

PROF SNAPE: - - - with respect to the final report than we did with respect to the draft report where we got it very close to our closing date. In fact, it was over our closing date and so we tried valiantly to incorporate Qantas into it. You think we misrepresented you in some parts of it, I gather, but that no doubt was due to the short time that we had to us to read it. Anyway, we look forward to that if it's coming and thank you very much for your participation and I adjourn until 2.45.

(Luncheon adjournment)

PROF SNAPE: We come to our final participant in this set of hearings in fact, unless there are any volunteers in the audience. We welcome Westralia Airports Group and as usual we would ask the two representatives to identify themselves for the transcript please.

MR MUIR: I am Graham Muir, the chief executive officer of Westralia Airports Corporation.

MR TICEHURST: And Wayne Ticehurst, chief financial officer of Westralia Airports Corporation.

PROF SNAPE: Good, thanks very much. We have some notes from you which I have misplaced for the moment but which I have here. Who is going to speak to them?

MR MUIR: Well, Prof Snape, I'll start off and then Wayne will talk later about how we see the arrangements going forward. Thank you very much for allowing us to speak on this hearing. Being the last cab off the rank I guess has some advantages and I guess - the other thing is that Wayne and I are probably the two longest-serving Australian airport executives that are still left in the system so hopefully we've got something to offer the Commission in its review.

PROF SNAPE: It's all your fault - - -

MR MUIR: Yes. But clearly we've seen the transition of Australia's airports from government to private ownership and we think that we are well placed to talk about some of the issues that the Commission has asked for comment on. There is no doubt that the major airports in Australia are now a lot better managed than what they were some five years ago; in particular, the airports are now far more responsive to the needs of the communities that they serve. This is, I think, very much the case in all of the destinations. It wasn't the case under the FAC which was considered to be a centralised organisation and not necessarily understanding of the needs of areas such as Western Australia.

It is also apparent that the regulatory arrangements under which we've operated the airports in the last four years or so haven't met the outcomes which the Commonwealth envisaged when it set the airports under private ownership back in 1997. Our submission to the first phase of the inquiry and other submissions of course have quite appropriately dealt with these failures, and in our view the Productivity Commission's draft report recognises these deficiencies and offers a way forward which will continue to ensure that Australia's airports lead the world in terms of providing the sort of environment in which the air transport industry can flourish. Specifically, we certainly agree with the Commission's draft recommendation that there should be no direct control over airport prices given that there are many commercial incentives which would deter any potential for abuse of market power which we may possess and that the threat of regulatory intervention is always potentially available in the event that it's found that we have in some way misused this position.

So in this submission we'll address the matters on which the Commission has sought further comment, particularly market power of airports and airlines, passenger based charging, default price cap options, commercial agreements and the issue of what constitutes good behaviour. But really the issue of market power I think is the matter that has focused much of the attention of the Commission. It's pretty hard to argue that we, as the owners of the only airport for several thousand kilometres that can accommodate a Boeing 747, don't have the potential for market power. We really believe that - the fact is that there are many constraints that we need to take into account which would deter us from ever considering abusing this market power, and I'd just like to sort of talk through some of those rationales.

As a company, a privately owned company, we have an objective to maximise our shareholder value. In our view, this simply can't be achieved by increasing our unit prices for aeronautical services. The fact is that at present less than 30 per cent of our income comes from the regulated aeronautical services. The rest comes from a range of activities including retailing, carparking and, in Perth Airport's case, real estate management and development. As you indicated in your report, the draft report, Westralia Airports Corporation has the highest ratio of all of the airports in terms of the profit per passenger from our non-aeronautical businesses. These are set out in section 7 of the report. But of course all airports make considerably more profit from the non-aeronautical services and in our case the profit level is some four to five times higher than what we managed to achieve in terms of EBITDA on a per passenger basis. So clearly we've got a major incentive to grow the business. Every unit of aeronautical growth delivers several times that in terms of the profit we can achieve from other activities such as retailing and of course carparking and other activities. We have the incentive to create the right environment for this sort of growth as well.

I'd just like to talk a little bit about one of the issues that we've faced at Perth Airport in respect of undertaking a redevelopment of Perth's international terminal. Those of you that are familiar with the Perth international terminal will know that it's a building designed in the 70s which is not very passenger-friendly. It involves a number of level changes, directional changes, and indeed you walk down a reasonably long flight of steps to get to the aerobridge before you board the aircraft. As the CEO of the airport I get continuous criticism of this from people such as premiers of the state and leaders in the tourism industry, and even local airline managers are quite critical of the fact that this is the way that passengers must be processed. For instance, airlines need to push wheelchairs around the place to get people up and down these levels and it's a very inefficient system.

We've identified a redevelopment option which would enable the departing passengers to proceed out on a single level pretty much as you would do at an airport such as Melbourne. At the same time it gives us an opportunity to significantly improve our retail performance. So in other words, we have a mind to our commercial profitability at the same time as our interest in improving the way in which passengers experience the terminal in Perth. We've been working with the airlines for probably the best part of two years on this redevelopment option. It involves capital expenditure in the order of $16 million, which is relatively modest, and we have assessed that about $4 million of that expenditure is related to removing these level changes from the passenger flow.

The fact that it's $4 million means that we would need to recover something in the order of 20 cents a passenger in order to get the cost recovered under the current necessary new aeronautical investment arrangements. Regrettably, whilst our airline customers agree that the solution is desirable, they've yet been quite firm in refusing to make a contribution towards the cost. We've considered whether the profits we can make from improved retail could allow us to proceed with the redevelopment, and possibly before the events of 11 September that may have been possible but now it doesn't seem that the redevelopment that we had proposed could occur without the airlines agreeing to make a 20 cent per passenger contribution. Unfortunately we're now forced to look at other options which will allow us to achieve the commercial potential but unfortunately we may not be able to address the problems that passengers experience.

This is most unfortunate because certainly in the eyes of state government we need to do something to fix up Perth's international terminal. When you leave Perth you arrive at either Changi or Kuala Lumpur or Hong Kong; you know, the world's best airports.

PROF SNAPE: Or Jakarta.

MR MUIR: We have few flights to Jakarta but even Jakarta of course is a relatively modern airport and arguably works better than ours in terms of the international terminal. So we're faced with that situation and we do wish to make the government work with us, it's very important - and I'll cover that in a moment in terms of the importance of government relationships and why that is an incentive for us to be seen as supporting the growth of aviation. We certainly work with government to encourage new airlines. I've recently come back from Dubai with the premier meeting with Emirates who have announced that they will operate services to Perth from late next year, and we're continually in discussions with airlines such as Virgin Blue and more recently Ansett II.

The tourism industry in Perth desperately needs growth in capacity and they see us as a major player in delivering that growth. The fact is that if we were seen to be a high-cost airport, that would be contrary to that objective and when we meet with airlines, particularly new carriers such as Emirates, I can assure you that their interest in our charging is extreme and we are under a lot of pressure to ensure that our prices are competitive and comparable with what they would pay elsewhere in the world. But there is also the issue that airlines have considerable balancing countervailing power and they're very much in the position to withdraw services in the event that the airline believes that our costs are too high.

We've recently received a number of threats from international carriers on the basis that if we were to consider increasing our charges, they would consider withdrawing their services, and no doubt many others have mentioned the reference in the Financial Review last week regarding BARA where they quoted that airlines are sensitive enough to price increases to take their services elsewhere. So when we look at our pricing, we have an eye to growth, attracting new carriers, and of course ensuring that existing carriers in fact don't take their services elsewhere, and of course when you make four to five times the profit contribution per passenger from growth than you do from the aeronautical revenue, it's pretty clear that we take these threats very seriously.

There's also the issue about competition in the aviation industry and the fact that that could limit the countervailing power of airlines. The events of September of course have seen Qantas's position in the domestic market becoming even more dominant, and therefore the potential for that to be even less than it was. Just talking about the situation with the demise of Ansett, it's clearly had an immediate impact on our passenger numbers and the revenue, not only from the landing charges, but also from property and activities such as carparking. They've all declined significantly. But we're not alone, of course. The tourism industry in Western Australia has been decimated by the demise of Ansett and are desperately looking for a way forward. In the aftermath of Ansett's closure, the fact is that in Perth cheap fares were simply not available, and whilst Qantas did I think an excellent job in increasing capacity to try to meet the needs of travellers to and from Western Australia, and also within Western Australia, really the fares that the tourist depend on were simply not available, and in fact at one stage the cheapest fare between Perth and Sydney was Garuda via Denpasar, or Singapore Airlines via Singapore, and of course tourists aren't prepared to do that. So not only did our business suffer dramatically, but so did of course everyone in the tourist industry.

I just wanted to talk at the end of this, in regard to market power, about our relationship with government, and all airport companies depend on relationships with government at all levels for successful performance. In our case, as I alluded to earlier, we derive more revenue from our property activities than from airport charges, and with 2105 hectares of land only 10 kilometres from the central business district of Perth, the potential for realising the value of that land is enormous. The fact is, that without the support of the state government, we can't achieve that. They can put numerous obstacles in our path if they don't believe that our development is consistent with their objectives, and if we were regarded as an airport which prohibited or prevented the growth of aviation into the state, our relationship with government would be very, very difficult. Western Australia of course depends on aviation more than any other state. So in regard to our ability to get property developments away, we do need to have the support of the state government, and it hasn't always been forthcoming.

Similarly in regard to the issue of aircraft noise, the last thing that an airport needs is talk of curfews and restrictions on operations. It's very important that the state government, and local government for that matter, appreciates the work that airports do to grow the aviation business because of its importance on the economy, and it would be quite counterproductive for us to be seen as operating a charging regime which discouraged growth. These relationships with government are incredibly important, and as I said at the outset, it's one area where the new airport companies have succeeded, compared to the situation which applied previously. In terms of political power, it's very clear that airlines possess enormous political power because of the dependency of states such as Western Australia on aviation, and their access to politicians et cetera of course is considerably more than that of small airport companies.

The final issue in regard to market power that I would mention is that in regard to our ability to raise charges. It's one matter to raise the charges, but it's another matter to collect the payment, and in the past we've seen situations where airline companies have simply refused to pay charges with which they disagree, and airport companies are faced with the rather daunting prospect or taking billion dollar companies to court. Airport companies typically are small companies with limited resources, so even were we to increase charges to a level which airlines found to be unacceptable, there's no guarantee that we could legally pursue them in the courts. So in concluding, it's clear that in regard to market power there are clear constraints against any potential abuse of it by airports, and to the extent that it does exist, it's well and truly balanced by the countervailing market power which the airlines enjoy.

Just turning to a couple of other matters which the Commission has sought comment on, firstly the passenger based charging principle, very quickly this is something which we support, and in fact in July 2000 we introduced passenger based charging for users of our international terminal. The philosophy there is quite simple, that it's passenger volume not tonnage that drives terminal costs and future investments, and of course we're prepared to share the risks of higher or lower load factors with the airlines, and I think airlines are generally supportive of this principle. We would also agree that airport prices could be disclosed on airline tickets, although if that were to be done, then obviously there are a lot of other charges which are associated with an airline ticket, not just airport charges.

Then finally, in regard to the default price cap option, we do support the Commission's view that this system would be impracticable. The level of service requirement is difficult to specify and may differ between users. It's also very hard to measure, and it does depend at an airport on the level of service provided by third parties. For instance, the manning of check-in desks or customs desks, or even in respect of the performance of baggage systems, for instance, airline staff can overload the baggage system to the extent that it breaks et cetera, so you can set performance targets in some of these service areas, but it's very difficult to measure the performance and to attribute responsibility. Then of course you have the potential for unscheduled arrivals and departures, or particularly airline arrivals in peak times, which create enormous congestion in parts of the airport terminal, so we don't think a default price cap option is a sensible way forward.

I'd now ask Wayne Ticehurst to talk in regard to how we would see commercial agreements between airlines and airports being developed and implemented.

MR TICEHURST: Okay, thanks Graham. Thank you again for the opportunity of speaking today. In keeping with the Productivity Commission's recommendations in the draft report, WAC is committed to working with airport stakeholders to develop a prices of the services accord, and that would cover the provision of services where market power has been identified as being high at Perth International Airport. Why are we prepared to commit to that? We commit to that because we see benefits for both the airport and our stakeholders in developing those commercial agreements for the delivery of airport and airline services, and those benefits we see are numerous, but they include the provision of greater certainty of price, service and quality. We see them promoting and enhancing relationships with stakeholders, and we see them definitely being a step away from the inherent well-documented difficulties that we've all experienced to date with a regulated approach and a regulator generally.

We agree with the Commission that commercially negotiated agreements should be voluntarily agreed and without automatic recourse to the regulator. We'll seek to develop the accord as far as possible on a generic basis, rather than as a series of individual agreements. However, we recognise that the tailoring of the accord may be necessary in certain circumstances. We would see the following things to be included in the accord - and we've tried to set out as much as possible detail in this regard but obviously the accord will be a document that will be developed over some time. We certainly see the definition of services to be covered in the accord to be paramount, and in that regard the services that have been identified in table 6.1 of the Productivity Commission's draft report where market power is being identified as high may well be an appropriate starting point.

We would see the term of the accord being possibly a five-year period. It may need to be flexible for certain circumstances but as a starting point again we would see possibly five years being appropriate. We would see that the accord would necessarily define the process for determination, publication and notification of prices for those designated services. It would include provisions for price increases to cover new investment, including a framework for determining increases. So, for example, we would see that some of the traditional issues that have been a source of tension between the parties, the weighted average costs of capital, useful life estimates for the assets, traffic forecasts, operating expenditure and indeed the beneficiaries of the investment would be as far as practical spelt out in the accord.

The provision for variation of charges would need to be part of the accord and obviously that would be - all of these things are negotiated between the parties. We would see the accord also specifying the conditions of use for the airport. So that would cover things like the payment terms, insurance arrangements, indemnities and so on. The accord would very definitely include consultation procedures and protocols. We would see it also including a bilateral exchange of information between the parties and that's really important. It's not just a one-way document. We need information from the airlines in terms of passengers and other things.

We would commit to transparency as far as practical through the publication of performance indicators and we would also commit to financial reporting through the accord. We would see the accord providing quality of service and we would consider that the current quality of service monitoring arrangements would be an appropriate starting point. We would also be prepared to consider in the accord an undertaking on service standards. I think this is something that the airlines are particularly interested in, subject to the comments that Graham made before. Those undertakings would need to be within our control. We would not see them to be necessarily undertakings that would be punitive in nature but certainly we would be prepared to negotiate with the airlines. Where there are failures in certain service standards we would be prepared to commit to remedying those and possibly some sort of compensation.

Very definitely the accord would need to reflect or to encompass dispute resolution procedures and that would be a third party. We don't see that third party being the regulator but it could well be somebody that is of sufficient stature in the community to be able to hear any disputes that fall out of it. We propose that the accord would be lodged with the minister for transport for ratification. Once ratified the services covered by the accord should be exempt from further access determination. We would see that the ministerial ratification should be binding and enforceable on all users.

Our preference is that the framework for the accord - for the ministerial ratification of the accord is through an amendment of the existing section 192 of the Airports Act rather than through enactment of specific legislation. I guess our thoughts are somewhat preliminary on this but we see primarily - we've come to that conclusion primarily on the basis that there could be some practical benefits of amending existing legislation, although we note of course that section 192 has a use-by date of June 2002 at the moment but we see that it might be practically more efficient to amend that rather than to draft new legislation.

Amongst other things - and as I said, our thoughts are still evolving on this but we would see amended section 192 providing for the enforceability of airport charges levied pursuant to the approved accord. That's a really important point as Graham has said earlier. At the moment we have no legal powers as such for the enforceability of our airport charges and we think this would be a really significant and important part of the ministerial ratification or the framework that supports that. The amendment would specify the matters which the minister would need to take into account in approving the accord and we would certainly recommend that it specified a mandatory time frame for ministerial approval of the accord.

In terms of good behaviour, if I can move on to that, the Commission recognises that the preferred option of continuing reform involving commercially negotiated outcomes in a five-year review places the emphasis on airports to demonstrate a willingness to operate without exercising market power and airlines to not undermine the process. The Commission has suggested that certain elements of good behaviour be defined in that process. We would regard the following initiatives that we are prepared to commit to undertake consistently over the regulatory period would demonstrate good behaviour. Certainly we think that compliance with the information and monitoring and reporting requirements would be mandatory.

We would commit to a minimum of two airline consultative meetings per year. Minutes of those meetings could be provided to a third party as, if you like, ratification that that process is being carried out efficiently. We would continue to a process of annual quality of service monitoring. We believe that the good behaviour would also involve demonstrated evidence of our efforts to develop commercial agreements with our stakeholders. Certainly we would be looking to notify price changes to the regulator. We would see a minimum of 60 days' notification of price changes to stakeholders. We would commit to the provision of reasonable transparency of information in support of charge increases and that would include such things as sharing volume forecasts, our weighted average cost of capital operating expenditure estimates and useful life estimates as I've said before. We think it would be appropriate for the development of airport performance indicators and we would certainly see aeronautical charges related to costs or where there are provisions for independent review there would be provision for that to take place.

That's our overview, I guess, of the way forward. If I can just make a closing statement, we appreciate the opportunity of presenting our case further today. I think there's a number of messages we've made in our earlier submission and which we would like to just restate today. We accept that WAC does possess market power in certain services but we believe very genuinely and sincerely that there are significant constraints on that exercise of power. We think that airline countervailing power is also significant and has increased. We believe the current regulatory arrangements have failed to address government policy directives. I won't go into the details of that today because I think they have been already well documented. We support the Productivity Commission for light-handed regulation involving price monitoring with no direct price control and a period of review after five years. We are genuinely committed to working with all of our stakeholders in developing commercially negotiated outcomes and as a final statement, we certainly trust that the information we've presented today has been helpful and provides some blueprint for the way forward. Thank you.

PROF SNAPE: Thank you very much for that. That was very interesting and indeed helpful as you said and the features proposed for commercial agreements, are they done on your own or have you been working those up in consultation with other airports?

MR TICEHURST: It's fair to say that we've been watching with interest and certainly have had a close review of the submissions that have been put by other airports in that regard but the nucleus of the idea of a price for an airport use agreement, airport service agreement, call it what you will, has actually been with us for a considerable period of time. In fact, we were one of the first airports to conduct a consultative meeting with the airlines after privatisation. We got off the mark very quickly with that and we actually foreshadowed this type of agreement back in 1997. Unfortunately there was a couple of goes at it but it wasn't successful but certainly the evolution of a number of - a fair bit of thinking already by Perth Airport and we've also looked at other airports' submissions.

PROF SNAPE: Have you got any indication of the receptiveness of the airlines?

MR TICEHURST: Well, obviously the situation has changed significantly since when we first put it to them. I think my judgment - and Graham may chime in here but certainly I think airlines would want to see some sort of quality commitment on the part of the airports and we think that is not unreasonable, providing that it doesn't carry with it unreasonable compensation and it's within our control. So we would accept that if we're unable to provide a level of service due to our fault then there ought to be some sort of redress on the part of the airlines. I guess that has been an area that we have not really been too specific on in the past but it's now our view that we need to reflect that in an agreement as a measure of getting their support.

MR MUIR: I have got nothing more to add to that really. Clearly the airports and airlines have been focused very much on working through the vagaries of CPI minus X and if necessary new aeronautical investment and I guess we've all awaited this forum as a means to thrash out the best way forward. So we intend to pursue this though directly with airlines from now on, regardless of what transpires with the recommendations of the Commission and government decision.

DR BYRON: Are you aware of similar issues by any of the other airports?

MR MUIR: From what we've discussed and also read in the sort of submissions that they've made to the inquiry, yes.

PROF SNAPE: I wonder if you would like to elaborate a bit more on the use of countervailing power by airlines.

MR MUIR: I think I covered it in my initial talk.

PROF SNAPE: Just if you could elaborate a bit more with specific examples, for example.

MR MUIR: I think certainly in regard to the ability of airlines to withdraw services is the classic example and we've got recent interaction with airlines where these measures have been threatened and even as we sit today, new airlines such as Virgin Blue or Ansett II have to make choices as to where they operate their limited fleet and so a destination at an airport which is considered to be more costly, for instance, may lose out to another. So there is competition for the limited capacity which is available, particularly for new carriers. I think also we shouldn't underestimate the importance of the political power that airlines have, at particularly a state and federal level and the importance and reliance that airport companies have on relationships with government and so therefore we need to convince government that we are behaving appropriately and supporting the growth of the state economy, for instance.

PROF SNAPE: You heard the previous discussion with Qantas?

MR MUIR: Unfortunately we arrived towards the end of it.

PROF SNAPE: Even towards the end you probably got the flavour of it.

MR MUIR: Yes.

PROF SNAPE: Do you have any comment on what you heard?

MR MUIR: I was very concerned about the way in which airlines were comparing airports to hotels and I thought you covered that fairly well because clearly airports haven't been enjoying profits from the provision of airport services, therefore if you're not making profits you're not carrying the potential risk of making losses. We've continually made losses in terms of providing aeronautical services to airlines under the current regime and of course unlike hotels, we're pretty much a fixed cost operation. The grass around the runways will grow just as fast, regardless of how many aircraft are landing on the runway and we will need to cut it and we will need to maintain the infrastructure to pretty much the same extent that we would in regards to the volume whereas of course a hotel can reduce staff, it can close down floors. It can do a number of things to reduce its costs.

So airport companies are unusual in the fact that they incur a fixed level of cost, regardless of volume. So I thought that was an interesting issue for airlines to raise. I would have to say that it is disappointing that we seem to be not acting as partners should be acting and I think this is a product of the CPI minus X regime and particularly the fact that it was not adequately explained at the outset. Definitions of new investment and that sort of thing took over a year to come forward and as a result airport companies have made certain assumptions, made business plans based on those assumptions and airlines have a vastly different view of it and so we found ourselves in continuous confrontation and I think that's most unfortunate. It's our objective through the pricing accord to ensure that whilst, you know, we will always have debate, that at the end of the day we will both have an objective to reach a commercial outcome and that surely is the most sensible way forward.

PROF SNAPE: You don't think that that initial problem is all now bedded down and so that's history?

MR MUIR: Certainly not. I gave an example earlier regarding our efforts to improve the way in which our international terminal operates and the current system simply fails to deliver that sort of outcome.

DR BYRON: I was going to come back to a point that I've raised with a few of the other airports and also Qantas about the nature of the distribution of risk between the two very different types of enterprise which are inevitably in a close relationship of some kind which is either antagonistic or mutually beneficial but it seems that whether there's something inherently different in a business where the assets are extremely mobile, such as aircraft, and an airport where your assets are fixed and I'm gaining the impression that a lot of the disputation in the past, although it appeared to be about prices and every other thing, was also about, you know, who enjoyed how much of the upside potential and the downside risk and the airline claims that if aviation globally is suffering then airports should share some of the airlines' pain; I guess if you've got a domestic airline that's doing very well domestically, whether you need to share some of that pain too.

MR MUIR: There's no doubt that the events of the last five or six weeks have imposed enormous pain on companies such as Westralia Airports Corporation. The effect on our revenues will be considerable. Even with the small pricing adjustment which the government has approved we will still experience a major loss of profit before interest tax depreciation and amortisations and of course that will exacerbate the overall operating loss that we will incur. So we're certainly sharing the pain of the current situation.

PROF SNAPE: The lease that Ansett has on its domestic terminal, what state is that in as far as you're concerned?

MR MUIR: Ansett have a similar lease in Perth to the ones that exist in places like Melbourne and Sydney and it has roughly 17 years left to run. To date Ansett has managed to make its payments on the terminal and of course we would like that to continue. Realistically though, the level of business that Ansett is now conducting through the building means that it's unlikely that they could sustain the sort of rents which are currently required and inevitably we will need to sit down and negotiate a way forward. The lease does provide for the airport company to buy back the improvements under certain circumstances, and the administrator of Ansett has indicated to us that that is a matter that they would like to pursue. Of course the issue then will be what is the value of the improvements? Now, we have a view which is significantly different to that of the administrator but it does present a number of opportunities for us in respect of whether we should control the terminal infrastructure and that is something which we're having a look into at the present time.

PROF SNAPE: Yes, I was interested to hear you say that your preference is that they continue with the lease of at least some part of it. You would prefer that to using it as a common user terminal.

MR MUIR: What I meant there, Prof Snape, was that the arrangement in terms of payments at the moment we find satisfactory and acceptable. We certainly don't look forward to a situation where those payments are not coming forward.

PROF SNAPE: No.

MR MUIR: But we will look at whatever options are available to us in the situation.

PROF SNAPE: But let us suppose that in a few months' time you have the option of say leasing half of it to an airline, or maintaining it all as a common user terminal, which - - -

MR MUIR: Well, it seems to make more sense to us that the terminal would operate as a common user terminal. For one thing that allows us to facilitate access of new entrants. In the case of Virgin Blue, whilst we can accommodate them through the existing international terminal, which is some distance from the domestic terminal, Virgin Blue have made it very clear that they would prefer to be alongside their competitor, Qantas, and under the current lease, of course that's not really achievable unless they can reach a commercial agreement with their other competitor, Ansett. So if we were to take control of the building and operate it as a common user terminal, then obviously we can facilitate growth and the entrance of new airlines.

PROF SNAPE: Yes, I suppose I'm a little bit surprised that you didn't show more enthusiasm a moment ago for the common user option, because I thought that these long-term leases were a bit of a millstone for the airports.

MR MUIR: Well, they have positives and negatives. I guess I was looking at it in the context of the potential revenue that we could earn from passenger charges in the immediate future. Obviously it would nowhere near approach the sort of revenues which we currently receive from Ansett, and that was the point I was making, that in the longer term, obviously we would prefer to have control of it, but it will cause quite a loss of revenue for us in the short term.

PROF SNAPE: Has anyone been permitted to engage in - any foreign airline been permitted to engage in cabotage out of Perth in this situation?

MR MUIR: Well, the only airline that could do that is Air Mauritius, which operates a single service per week through to Melbourne, and I think they operated one flight where they carried domestic passengers. But as of last year, Qantas ceased operating services through Perth to South Africa, and those services are no longer available, so that decision basically withdrew, I think it's something in the order of - it was nine 747 services per week which were going through Perth to Sydney, and now there are none, so cabotage is not really an issue for Perth.

PROF SNAPE: So are Garuda or Singapore, they're not interested in flying Perth and on, Malaysian?

MR MUIR: We have spoken to them. They would of course therefore need to operate an additional leg. At the moment they terminate in Perth and go back, so it would be up to them to operate a forward service. My view is that you need to be very careful in regard to cabotage in that it enables foreign airlines to cherry-pick the market with a very low marginal cost, particularly if they're already operating a sector for international operations, and it seems to me that it could be detrimental to the viability of dedicated domestic carriers if in a situation where there was a significant opportunity for cabotage, for that to occur. But as I said, it is not an issue for Perth, realistically.

PROF SNAPE: Yes, okay.

DR BYRON: Minister Hockey on 5 October announced the special one-off price increase that would be allowed. Was it 7.2 per cent for Perth?

MR MUIR: Yes.

DR BYRON: Are you planning to implement that?

MR MUIR: Yes, we're making application to the ACCC in the next day or so for approval of the increase, and we would seek to implement that as soon as possible. We do that because taking into account the demise of Ansett alone, we will experience a 30 per cent reduction in tonnage through the airport, not to mention, of course, the flow-on effects into other revenues that we derive, and the 7.2 per cent increase allows a small recovery of some of those costs of providing the infrastructure, and we think that's not unreasonable.

DR BYRON: Will it compensate for the reduction in volume from Ansett?

MR MUIR: No.

DR BYRON: Or the international travel?

MR MUIR: No, it would only cover a small proportion of that, sort of in the order of less than 20 per cent. That's why I said earlier that we certainly experience considerable pain as a result of the demise of Ansett and the events of September 11.

MR TICEHURST: Can I just qualify I think it's actually less than 10 per cent of the total potential revenue loss that this increase would get us back to.

MR MUIR: Yes, I was being conservative.

DR BYRON: Do you know what the 7.2 per cent covers? I mean, is it supposed to partially compensate for any bad debts that you may have had or anything like that?

MR MUIR: No, that's not evident from the documentation we've seen. It merely reflects the fact that there has been an extraordinary drop in airport volumes, and provides a small pricing adjustment as a partial compensation for that. As I said earlier, unlike other businesses that can reduce costs, we don't have that ability. If 30 per cent of our business disappears, we can't reduce the length of the runway by 30 per cent. You know, you're really stuck with the fixed costs. So I think it's sensible, and of course given that over the last four to five years airlines have enjoyed something in the order of a 24 per cent real reduction in charges, we think in the current extraordinary circumstances that there should be a partial adjustment to that.

PROF SNAPE: I suppose the way that the physical airport can reduce costs is for the current owners to go bust and it to be re-floated, if you like, at a much lower debt than it has at the moment, a lower value, in other words, a write-down of the capital value.

MR MUIR: Well, it's difficult to see how that would benefit the users of airport infrastructure, particularly in the short to medium term, and the disruption that could be caused would be yet another nail in the coffin of those industries that depend on efficient air transport.

PROF SNAPE: Would there be much disruption? I mean, presumably someone would ensure that the airport was going to be operating pretty quickly.

MR MUIR: Well, it's not a scenario that we've contemplated.

PROF SNAPE: It's not in your business plan.

MR MUIR: No.

PROF SNAPE: Okay, but that, you know, that is I guess what some of the airlines think, that maybe you paid too much for it, and to - - -

MR MUIR: That's not the view of our shareholders, and certainly prior to September we were performing in terms of the return on the investment pretty much in line with what had been expected during the bid process. So I don't think that could be said, and in fact I would argue quite strongly that the Australian government implemented a very successful sales program for its airports, and delivered to the taxpayer appropriate value and that contrasts with a number of airport privatisations around the world where clearly the taxpayer was short-changed. Our job as airport owners and operators and developers is certainly challenging but our shareholders took a long-term view and are certainly very satisfied with the asset and the way it's been performing, even though we've experienced quite extraordinary difficulties over the last four to five years with in particular the Asian economic melt-down which occurred simultaneously with the take-up of the airport lease.

We've managed to survive through that, as well as things such as the social instability in Indonesia, which was very important in respect of Perth, not to mention Y2K and other things. So we believe that it wasn't the case of paying too much, and as you can see from the sorts of pricing issues that are now arising, Australia is still among one of the lowest places in the world in terms of the cost that airports wish to charge airlines. So I think that reflects the fact that we don't have expectations of needing massive increases in our charges in order to make the business profitable

MR TICEHURST: Can I just add to that, that I think if you look at the premium that was paid for the airport above the carrying value, a great proportion of that was attributable to projected growth in non-aeronautical assets and in consideration of the huge landbank that we have. I guess it goes back to emphasise the point we had before that in order to develop that landbank we need the cooperation of the state and various others but certainly, you know, that's where the value potential of the airport was seen and that's why the premium was paid.

PROF SNAPE: Do you envisage that that 7.2 increase, which for you is the whole amount of it, would in itself affect the demand for the airport?

MR MUIR: We believe that the increase should be applied to domestic airlines, given that predominantly the situation we face is a result of changes in domestic aviation and clearly Qantas at the present time is enjoying substantial profits through very high load factors and yields, certainly into Perth. So we believe that in that circumstance the increase should apply to the domestic carriers.

MR TICEHURST: Can I add also that our proposed increase is in context; is still an extremely small component of the fares. You're talking of something less than a dollar per passenger. It's closer to 50 or 60 cents per passenger.

PROF SNAPE: If our preferred recommendation, our preferred option were adopted, you would see that you could quite easily increase the charges well beyond that.

MR MUIR: So in regard to a cost based methodology for determining - - -

PROF SNAPE: No, not cost based but if you were in effect simply monitoring prices then you would have much greater flexibility - you could have greater flexibility in the pricing and you wouldn't have the constraint of a CPI minus X and so if you think that the 7.2 per cent increase is in fact not going to affect the level of demand for the airport, you know, once you get over the current hiccups of course; so it isn't going to affect the demand, then why not go to 20 per cent?

MR MUIR: I think the way we see the accord being constructed, the criteria by which the airport charges would be set would be agreed and the concept of the building block approach seems to us to be a sensible way to do it. That would of course see an increase in the charges compared to where they are today but we would be prepared to see a phasing in of that over several years but clearly the prices that airlines are currently paying for airport charges is not sustainable and you can see how airports have experienced the recent events. It's clearly not a sustainable pricing structure.

PROF SNAPE: So you would in your accord or whatever one calls it, have a building block approach to pricing in it?

MR MUIR: Yes, that would be one of our preferred ways of doing it.

PROF SNAPE: What proportion of the valuation of your assets is the valuation of your land?

MR TICEHURST: At the moment we're carrying our assets pretty much as a historic cost so that you're looking at a total land value of about 100 million. Aeronautical land is around about 20 per cent of that.

PROF SNAPE: Aeronautical and of your total assets?

MR TICEHURST: Total assets would be approximately between 5 and 10 per cent.

PROF SNAPE: So in some cases, you see, what I'm getting at is that the valuation of the land in there is a very critical element if one is using a building block approach for airports, or for assets such as airports. One would say that I'm not quite sure there are other assets like airports and so as compared with say telecomms where you don't have perhaps the same arbitrariness in a building block approach, when land looms as a very significant factor in the valuation of assets and then it becomes very much a matter of dispute as to how one should value land and very critical in calculating what the charges should be, and it's I think well illustrated by the SACL example but also the exercise has been going on in New Zealand where they have been given - you know, calculating to two decimal points, with the valuation of land able to swing the whole thing around by not a few decimal points but a few integers and so it may not turn out to be that simple.

MR TICEHURST: Professor, we accept that there are great complexities in the valuation of land in particular, certainly, and we've been watching the situation in New Zealand and particularly with Sydney decision with a great deal of interest. We would see this as part of the negotiating process. I mean, it's clearly our position that we would start off with an ODRC method for valuing land. We have an idea of the optimal area for the airport so we've already done some work on that. We've already done a fair amount of research and work into what a valuation would be. It's really a question of getting down to the issue with the stakeholders and clearly we would hope that there's going to be some middle ground there.

PROF SNAPE: The stakeholders being the airlines only?

MR TICEHURST: Airlines principally.

PROF SNAPE: You've been negotiating passenger based charges and we have heard that different airlines take differing views on that, depending on whether they're operating on high capacity or low capacity. How are you progressing on that.

MR MUIR: We've implemented it in July 2000 for international airlines using the international terminal and from my discussions with particularly the local airline managers, they're very satisfied with it. They think it makes sense that if their loadings are lower they pay lower charges and if they're high-low factors then they're perhaps in a better position to pay a higher fee for use of the terminal. Of course, passenger volume is the best measure of the extent to which they use the facility so we haven't really received any disagreement with that approach.

MR TICEHURST: It's important to note that when we did that it was done as a package, a rebalancing package, so in fact implemented a passenger based charge and we actually reduced their basic landing charge so that in terms of - it tended to be reasonably cost neutral, obviously depending on the load factors but it was reasonably cost neutral to most of them. In fact, some have experienced price reductions, overall price reductions as a result of this rebalancing.

DR BYRON: It also incorporates that element of sharing the risk of higher or lower load (indistinct) doesn't it?

MR TICEHURST: Yes.

PROF SNAPE: So you also have a weight landing charge as well as a passenger - - -

MR TICEHURST: Yes.

PROF SNAPE: So it hasn't replaced the weight charge?

MR TICEHURST: No, not entirely.

PROF SNAPE: A landing charge and a terminal charge.

MR TICEHURST: Yes.

PROF SNAPE: I don't think I can think of anything else at the moment. I think we've reached the end of our questions. Is there anything else you would like to say?

MR MUIR: No. Thank you very much for allowing us to talk to you even at the end of the inquiry. It has obviously been a very comprehensive examination of the issues.

PROF SNAPE: Thank you very much and we hope that you may be able to give us a written submission. Of course we got what you read on the transcript and we have it there but if you feel able to get it and perhaps elaborate it more if you're able to, sooner of course is better than later as far as we're concerned but we do appreciate what you've done today and it has been very helpful what you've run through. So thank you to Westralia Airports.

PROF SNAPE: I now say what I foreshadowed at the beginning of the proceedings. Is there anyone present, other than the Commission staff, I hasten to add, who would wish to make a statement at this - yes. You had better come around to the microphone. Name etcetera again, thanks.

MR GOLDSMITH: Robert Goldsmith, representing Gold Coast Airport. Just in the light of the fact that Gold Coast Airport has been one of the more controversial subjects discussed today, I just thought I would take the opportunity to set the record straight with regard to a couple of the statements made by the representatives of both BARA and Qantas who I can really only assume have not been fully briefed regarding Gold Coast issues, probably because we're usually a pretty low priority in the scheme of things with bigger issues happening at bigger ports. It was suggested that Gold Coast, Darwin and Canberra airports had conducted no consultation with regard to the proposed increase in charges and also that no financial models had been produced and I just wanted to set the record straight that this strictly wasn't the case in terms of Gold Coast Airport's conduct.

We've been in almost constant dialogue with Qantas and Ansett's airport charges managers since May with regard to the move to the passenger related charge. We also had a number of meetings with both Virgin Blue and the ACCC with regard to the same subject throughout the period from May 2001 onwards but following the failure of Ansett, these discussions continued with just the same intensity with all of the parties, particularly Qantas and they were advised of our proposed charges increases at the earliest opportunity. A detailed justification of our proposed increases, which was included in appendix 1 of our submission to the Productivity Commission was actually sent to the ACCC on 25 September following an earlier meeting we had with the ACCC on 19 September at which we received a fairly sympathetic hearing, to say the least.

Qantas received the same documentation by email and post sent at the end of the month and the following week we had a personal briefing meeting with Brett Godfrey, chief executive of Virgin Blue. So we feel we've done our utmost to keep our customers in the loop of what was happening, why we were implementing these changes and why we felt they were justified and necessary, even though we knew they wouldn't be popular with our customer base.

The second point was I would also stress that we did provide our financial model as Qantas and BARA put it. Clearly Mr Oldmeadow and Ms King were not aware that we provided that model and it's actually contained again at the end of appendix A in our submission and was actually sent through to them on the dates I just stated. Also Qantas, again, which is factually incorrect, stated that we haven't included any replacement capacity in our charges assumptions going forward. Again, that isn't true. We actually clearly state in our submission that we've actually allowed for 22 per cent of the Ansett capacity to be factored into the calculations and that was at a point in time when absolutely no extra traffic, or extremely little - only irregular flights - were actually being reintroduced into the Gold Coast. So again, it was a risky assumption in our view to build in anything at that point when we were faced with insolvency problems.

Finally, the point has also been made about the interim nature of these prices. I think Denis Chant made clear when we were discussing this earlier today that these were interim measures and they would be reviewed after Christmas. So I would just like to put that on the record because I do actually feel that some of the comments made actually misrepresented perhaps our position and our good faith with trying to keep our customer base informed. Thank you.

PROF SNAPE: Thanks very much, Mr Goldsmith, for that. Are there any other people present who wish to make statements? If no, then I shall thank you very much for your participation and draw this round of hearings to a conclusion. Thank you.

AT 3.50 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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