



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

ECONOMIC REGULATION OF AIRPORTS

MR P LINDWALL, Commissioner
DR S KING, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT HOTEL REALM, CANBERRA
ON MONDAY, 25 MARCH 2019 AT 9:30 AM

INDEX

	<u>Page</u>
DR HARRY BUSH CB	158–174
REGIONAL AIRPORT USERS' ACTION GROUP GEOFF BREUST	174–191
CANBERRA AIRPORT STEPHEN BYRON STEPHEN CARSON	191–207

COMMISSIONER LINDWALL: Hello, everyone, we may as well get started because there's a bit of introductory stuff that I have to tell you about, including getting evacuated or something like that. So hopefully that won't happen. It happened in one of the hearings that I've had once
5 when we had to be evacuated which was a bit unfortunate.

Good morning and welcome to the public hearings for the Productivity Commission, the inquiry into the regulation of airports. I'm Paul Lindwall, the presiding Commissioner and Stephen King here is my
10 fellow commissioner on the inquiry.

We'd like to acknowledge the traditional custodians of the land, the Ngunnawal people. The inquiry started with a reference from the Australian Government in June 2018. The purpose of the inquiry is to
15 investigate whether the economic regulation of airport services promotes the efficient operation of airports and related industries. We released an issues paper in July 2018 and have talked to a range of organisations and individuals with an interest in the economic regulation of airports. This has included representatives from the Australian state and territory
20 governments, airports, airlines, industry representation, representative bodies, academics, researchers and individuals, pretty much everyone in other words, with an interest in the issues throughout the inquiry.

We have held focussed public hearings on competition in the market for jet fuel in Sydney and Melbourne in late November 2018. Following the
25 release of the draft report in February 2019, the Commission called for further submissions and is undertaking consultations along with those public or these public hearings. We have received 88 submissions prior to the release of this draft report and 13 since the release of the draft report,
30 noting that the closing date is today, but we still expect to receive further submissions and if people have knowledge of the PC and know that we're flexible in the receipt of submissions right up until last day actually, but after we give the report to the government it's very hard to take notice, too much notice of a submission I find anyway.

35 We are grateful to all the individuals and organisations that have taken the time to prepare submissions and to appear at these hearings. This is the first public hearing for the inquiry. Following today, hearings will also be held in Sydney and Melbourne. We will then be working towards
40 completing the final report having considered all of the evidence presented at these hearings and in submissions, as well as other informal discussions. The final report will be submitted to the Australian Government in June. Participants and those who have registered their interest in the inquiry will be advised of the final report's release by

government which may be up to 25 parliamentary sitting days after completion.

5 The purpose of these hearings is to provide an opportunity for interested parties to provide comments and feedback on the draft report and facilitate public scrutiny of the commission's work. We like to conduct all hearings in a reasonably informal manner, but I remind the participants that a full transcript is being taken. For this reason, comments from the floor cannot be taken, but at the end of the day's proceedings I'll provide an opportunity
10 for anyone who wishes to do so to make a presentation.

Participants are not required to take an oath but are required under the Productivity Commission Act to be truthful in their remarks. They are welcome to comment on the issues raised in other submissions or by other
15 participants at the hearings. The transcript will be made available to participants and on our website following the hearings and they are also, well, for any media representatives attending today, some general rules apply. Please see one of our staff at the back there. We've got Catie and Natalie there who can give you a handout which explains the rules.
20

To comply with the requirements of the Commonwealth Occupational Health & Safety Legislation, we are advised that in the unlikely event of an emergency requiring the evacuation of the building please listen for instructions over the emergency warning system. There are two types of
25 tones which may be used, the alert tone followed by the evacuation tone. In the case of evacuation tone, please evacuate directly and quickly to the assembly area through the emergency exit as directed by the emergency wardens which are basically down the stairs and out that way. The National Press car park is the assembly point.
30

If you believe you're unable to walk down the stairs, it's important that you advise the wardens who will make alternative arrangements for you. You are invited to make some brief opening or some opening remarks and keeping them brief and asked not to discuss the matters in greater detail. I
35 would now like to welcome Dr Harry Bush, an independent regulatory and former board member for Economic Regulation, United Kingdom Civil Aviation Authority. Welcome. Do you mind if I call you Harry?

40 **DR BUSH:** No, do, please.

COMMISSIONER LINDWALL: We're Stephen and Paul.

DR BUSH: Please. Hi.

COMMISSIONER LINDWALL: We like to be fairly informal. So could you, just for the transcript, could you identify your name and position and representation here.

5 **DR BUSH:** Yes, so Harry Bush. I was a regulator, the economic regulator at the UK CAA for something like eight years. Prior to that I was at the UK Treasury. Since leaving the CAA in about 2010 I've been on the board of our air traffic control provider in the UK as a non-executive director and that's a regulated entity. I am also on the board
10 of a major teaching hospital, which is again a regulated entity and I've been an independent adviser on regulation and related matters to companies, governments and other bodies.

15 **COMMISSIONER LINDWALL:** Okay. Harry, thank you very much for your comments and submission, but do you want to make any introductory comments?

20 **DR BUSH:** Yes, I thought I'd just make a few. Well, thank you very much for taking the time to see me.

COMMISSIONER LINDWALL: Pleasure.

25 **DR BUSH:** I have to say, a lot of my friends in the UK are envious that I've managed to get as far as it is physically possible away from the Brexit chaos that has descended the United Kingdom.

COMMISSIONER LINDWALL: Yes.

30 **DR BUSH:** As I've mentioned, my background really is a regulatory practitioner rather than a regulatory theorist, and I've been over the years, (because it's been very relevant to what we've been doing in the UK) following at least at a high level some of the things that have been going on in Australia. Prior to the last commission review I had a chance to talk to some of the commissioners before that was all launched.

35 I think the paper I put in is pretty self-evident, pretty self-explanatory, but I thought it useful to set out just two pieces of context (and the question is how much of this you draw out as relevant to Australia) that have informed the way I've thought about these issues. One of these is what I
40 would call the shift in the balance of power between airports and airlines over the last, say, 20 years. This is very striking in Europe as a whole because you've got the growth, at the expense of legacy airlines, of point to point business models. You have very mobile entities able to fly between any two points on the Continent, which can change their plans at
45 relatively short notice and can choose which points. They don't have to

serve anywhere, unlike a lot of legacy airlines in Europe which while not confined to their hub, mainly serve their hubs. The point to point airlines are very, very flexible.

5 And they have placed airports very much in competition with one another, but their countervailing power, if you delve below, comes not just from their ability to do that, but from some basic facts of their businesses and their scale- the fact that they have mobile assets versus the fixed and sunk assets of airports; the sheer scale of some of the major point to point
10 carriers, I think Ryanair and easyJet particularly, but not just them, and the fact that this is a growing segment of the market, the point to point, which makes it very difficult for an airport to grow its business without bringing them in, which gives them a certain amount of power.

15 Because they're negotiating all the time with airports, they're able to bring a professionalism to their negotiating approach, they're dealing with scores of airports on an annual basis; and of course they have a public voice and the influence that brings. So their countervailing part comes from that and a number of other features.

20 And I would say that in Europe, and to a lesser extent the UK, regulation hasn't kept up - airport regulation hasn't necessarily kept up with these developments; better in the UK but even there responses have been belated. My view was that Stansted Airport, the third London airport,
25 should have been deregulated when it was first proposed in around 2008/9. Eventually it came around 2015. Europe's been much slower. Partly it's been struggling with the concept of how to undertake market power tests. Partly, I think, it has been struggling with how to treat the voices it hears as evidence or not evidence, complaints versus evidence
30 you might say.

There's also sort of tradition in Europe, I think, of treating regulation as almost as equidistance between the two parties, so if you reach somewhere in the middle, that sounds like a good place to be. The resulting problem:
35 "Are you really conforming to the underlying economics?". There is a failure, I think, to grapple with some of the conceptual issues which feature in the Commission's report; the concept of scarcity versus the exercise of market power, the fact that airlines can discipline airports by making changes at the margin (you don't have to shift all your business
40 from an airport to exercise a very considerable amount of influence). One plane taken out, you know, with all the passengers and the associated retail revenues and the fact that costs remain behind from the airport's point of view is a very powerful trigger.

I also think we are only now getting to grips with the fact that the ultimate aim of airport regulation should be the passenger. Elsewhere than in the UK you're talking about, balancing commercial interests; one party against another. Interestingly in the UK, up to about 2012 that was where we were because the Airports Act 1986 said that we had a duty towards both airlines and passengers or airlines and their end users. It became much clearer in 2012 that the duty was to the passengers so you should see through the airline, and I think we've better in the UK at doing that.

So that's one set of things and I think the second - I'll be very brief - is the growing generalisation, if you like, of capacity pressures in the system. So we've had, in the UK Heathrow and Gatwick extremely full and that's been true for years for a number of policy reasons. Heathrow's very much an outlier in terms of the scarcity of capacity and the impact that that has had, but Europe is moving in the same direction, as indicated by various publications, Heathrow shows the extent to which if you don't get investment in time (and the reason we haven't done it there is because of government decision making), there is very significant detriment to passengers.

People who are dealing with airport regulation have got to realise that relatively small changes at the margin to airport charges can be swamped by much bigger decisions that are or aren't made on making sure that capacity is available, so that scarcity does not develop in the way it has in the UK. So I say that one of the consequences of this is that regulators should focus, not on building before time or anything like that, but actually making sure that capacity does come onstream as soon as policymakers allow it to.

So that needs to be recognised as a priority, and I think regulatory frameworks need to be supportive of timely investments. They need to look beyond the immediate commercial interests of the commercial parties involved because quite often airlines will be adversely affected by putting on capacity; they will of course obtain some capacity to run extra business but they will have extra competition from other airlines and they will also have a decline in scarcity rents that have built up. And so the real focus from regulators must be on the passenger and societal interests in ensuring that you've got an efficient, functioning airport sector.

COMMISSIONER LINDWALL: Thank you very much, Harry. I might ask a few questions and then get Stephen to ask some too. But along your lines about how the relationship between airports and airlines has changed over a number of years, how would you think Australia should be viewed given that we are quite different geographically with large population centres well apart from each other?

DR BUSH: Yes. So you won't have the same degree of airport competition and I think that's reflected in the findings of the Commission. In the UK we've got two regulated airports with market power, one at - not classically regulated in terms of a classic cost based system, and you've got four despite a smaller economy. So I think that airport competition is not there in Australia to the same extent as in the UK. There may well be, at the margin, the ability of overseas airlines to decide between different airports as to where they put their capacity because they don't necessarily have to serve particular locations in Australia. They are internationally focused, and can make a that decision on how much product that they're offering in Australia. So at the margin I think there's competition there.

But some of the broader points I was making about countervailing power I think do apply - the scale of airlines, the degree of professionalism they can bring from negotiating multiple times with airports. I think those points do apply and of course, who knows, as time goes on you may well find there are more competitive pressures build up. But it's a very different geographical space and I'm not saying that, except to the margin, some of these factors apply, and they would also apply very differently.

COMMISSIONER LINDWALL: No, fair enough, yes. Now, I think you've noted in here comments about our building block methodology that's been used in negotiations between airports and airlines and also that we use individualised contracts, air services agreements, and you've said that it's a bit surprising to use building block methodology. Who do you think drives the use of that or does the mere existence of using a building block methodology comprise some level of countervailing power, do you think?

DR BUSH: I think the reason I was surprised was because you've had the system for 20 years or so, getting on, and the potential for individual airline contracting has been there that amount of time. Now, clearly the origins of it were in a more regulated system where you would have had the building block methodology. I was contrasting a little bit with where Gatwick is trying to get to.

So Gatwick has been given what you might call "some precautionary regulatory arrangements" and then it is able underneath those to negotiate individual contracts with airlines which it has been doing pretty successfully. It doesn't any longer publish a regulated asset base figure. So its trying to divorce itself from that old building block methodology, and actually has made quite a lot of progress in actually talking to the airlines about price and service. Airlines are able to make the comparisons with what they get elsewhere. They are able to say, "Does that represent good

value?" and at the margin they say, "Well, if it doesn't maybe I can take my flight somewhere else?"

5 But I was a bit surprised that the building block approach still existed to the extent it appears to here, and I just wonder whether it doesn't set up tensions between airports and airlines in an unhelpful way because at every point it means that airlines are trying to second guess the cost of the airport including the sort of completely zero sum game of the WACC which always gets a lot of focus whereas if airlines were focusing much
10 more on the service they were getting, and I thought there was some stuff in the BARA submission which I thought was quite interesting in that area, and were trying to move things towards that and where there would be a lot of discussion about, "Is the service right?" This is what's happened at Gatwick - "Is the service right?", "Is the on time performance right?",
15 "What can be done to improve it?", rather than, you know, "Could you knock ten per cent off this because we think you could get the terminal built much cheaper or this bit of the terminal cheaper?" and get your WACC down and all of that, which I think just leads into the sort of old-fashioned regulatory dispute despite not having the old-fashioned
20 regulatory framework. This just strikes me as odd.

COMMISSIONER LINDWALL: That's very good. In your comments you've also said about the constructive engagement used in the UK and you alluded to it there where that perhaps the Commission or some other
25 body might think about a different way to provide guidance to negotiations between airports and airlines. On the other hand you've also said that there are problems with regulators trying to put conditions in which often become embedded in the expectations of both the airline and the airport so where do you draw a line between a boilerplate provision, if
30 you like, becoming effectively a de facto regulation?

DR BUSH: Yes. So what I think I was trying to do in those points was say what I think is essential "not" to do – that is to become too prescriptive, particularly where you're dealing with, as you are here, with
35 individual contracts between individual airlines and individual airports. They will be taking place at different times, there will be different circumstances. What's important for one airline won't necessarily be important for another so there's a whole range of things that would need to be taken into account.

40 Whereas when you're dealing with a more traditional regulatory arrangement, where you've got CapEx and OpEx and all the building block stuff, having properly clarified information requirements, timetables, procedures, can be extremely helpful to build trust. I just
45 wondered, and this was more a question really, is whether it would be

possible at least to provide an umbrella for the parties themselves to get together to try and see whether there was common understandings that they could come to at least as a starting point for discussions.

5 For instance just trying to move from focusing so much on building block
type methodologies - is there some way in which they could shift more
towards service and a service level agreement type of methodology which
it seems to me would be helpful. I thought the thing about having these
boilerplate clauses, standard clauses, where there were common features
10 that struck me as time-saving, I think what one was trying to say is maybe
there are frictions here which contribute to some of the ill feeling that
always comes out in these sorts of processes that could be reduced.

15 **COMMISSIONER LINDWALL:** All right.

COMMISSIONER KING: Can I just follow up on that?

COMMISSIONER LINDWALL: Yes, yes.

20 **COMMISSIONER KING:** When reading the sort of proposal that AAA
and BARA put forward - - -

DR BUSH: Sorry, that?

25 **COMMISSIONER KING:** I come from a competition economics
background so I guess my immediate thought is it would be a fantastic
collusive device so is there a risk of collusion? Certainly you move to
standard boilerplate clauses but at the same time they can become
standard clauses that all the airlines have in their contracts and it could
30 reduce airline competition.

DR BUSH: Well, it depends which they are doesn't it. If they are
standard things around how airports operate, I guess these agreements
have lots and lots of different elements in them but I'm not talking about,
35 you know, for instance standardising things around SLAs, those should be
individual and that's where the discussion should be. It's just there may be
some elements which involve them all going away to their lawyers, they
all turn up, they all end up broadly in the same place but in the process
they've wasted a lot of money, time and effort. The question would be in
40 my mind is whether by having that all sorted you actually can get to a
better place on the stuff that really does affect competition between
airlines and the service that airports provide. That's where I was going.
There's a risk but I don't think it's a great risk if it's defined properly.

5 **COMMISSIONER LINDWALL:** Some of the participants to this inquiry have suggested that we need a negotiate-arbitrate framework which would involve a compulsory arbitration process. That would presumably be still based upon (indistinct) a building block methodology because I can't see how it would work otherwise but would you say that there would be - well, if you understand the proposal, how would you explain its benefits and costs if you like?

10 **DR BUSH:** So I include some comments on this in my paper. I mean, at one level it seems perfectly intuitive. Here are two parties, why not have an arbitration if they disagree. The problem that you run into, and which we run into whenever we try to liberalise arrangements within a regulated framework, is that it's difficult to get the regulator out of the room - and by "regulator" in this context I mean "arbitrator" as well, if that's the
15 ultimate authority. Because the parties will be looking towards what the arbitrator will do, that becomes almost more important.

20 So you find this in negotiations, whether it's within constructive engagement or where Gatwick was allowed to go off and conduct individualised negotiations with airlines, until the regulator very firmly got out and wasn't hanging about and instead says, you know, here is the framework, I'm out of it and I'm no "going to come and arbitrate between you, the issues are for you to deal with commercially. You've got the safeguard arrangement but underneath that you get on with it. Until that
25 was absolutely clear it was very difficult to get these negotiations going properly and I think that's inevitable because if you've got somebody out there who's going to make the ultimate decision parties are concerned with what are they going to say if it goes to them and that conditions then the sort of discussions they have.

30 And so I think that's the real risk with embedding arbitration as a clear and constant feature of these arrangements. Of course if you'd found, you know, that market power was being exercised the balance of argument might shift but I think where you haven't found that and what you're trying
35 to do is encourage these commercial arrangements between airports and airlines as a good way of getting decent outcomes, then I think there is a real possibility of negotiate-arbitrate undermining the thrust and dynamic of that.

40 **COMMISSIONER KING:** Sorry, could I just follow up on what you were saying there. Because you said earlier in your comments about the importance of, you know, looking through to the consumer and one of the questions I have about any arbitration proposal between an airline and an airport or airlines and airports, is that who represents a consumer? How
45 does a consumer fit into there? And I was wondering your views on that.

DR BUSH: This is why it starts to take on the attributes of regulation because I think for exactly that reason you'd have to start saying, "Well, what is the job of the arbitrator here?" and the job of the arbitrator to some extent would be to take into account passengers, and as your report indicates it would also have to take account of the interests of other airlines not just the ones that have initiated the arbitration. It would have to take account of maybe different timeframes because what might be right for that an airline now may not be right for all airlines at a later stage and consideration needs to be given now to that later stage.

So by the time you finish it's actually quite difficult in an interconnected system like an airport to actually confine the particular dispute and the particular problem, we're now actually broadening it out to include a whole set of other parties and considerations. I think that's one really difficult point here.

COMMISSIONER LINDWALL: If you were to look at negotiate-arbitrate and what it would likely lead to in terms of investment, would you be able to say that it's - would it lead to less or more investment and if so could you be definitive about that do you think?

DR BUSH: No, I don't. I would find it quite difficult to be definitive about whether it would lead to more or less. I can see that where there are going to be big disputes, they are likely to be around the point where airports are introducing new facilities and those are going to be putting charges up and therefore to the extent that, you know, you provide a route whereby that can almost as a matter of routine be challenged, I think that might tend to delay and make it more difficult to invest but I'm not sure I'd be utterly definitive and I don't know what the scale of the impact would be.

COMMISSIONER LINDWALL: But to the extent that it did reduce investment, would that be relevant to your comments earlier about congestion and leading to - - -

DR BUSH: Yes. I don't know precisely where you stand in relation to congestion across the Australian airports, but you know, it's clear, I think, both in the UK, and Europe, and quite a lot of other countries, I mean India is another example, where there's a need for huge amounts capacity as it's growing so quickly, even the airports that were recently built, and now need to be expanded, very dramatically, that you have got to have systems and processes and approaches here, which enable decision on investment to be taken relatively speedily where they can be, because there are public constraints. But where those are overcome, or can be set

aside, then I think the economic regulation should enable those decisions to be taken speedily, because even a couple of years delay, when you've got real capacity constraints, represents a big loss. Those years are now.

5 **COMMISSIONER LINDWALL:** So, if that evidence, you cited from frontier economics at Heathrow, led to the congestion, if I'm not mistaken, led to - well, rents, I suppose, to airlines, is that how you'd - - -

10 **DR BUSH:** Well, yes. So, I mean, as part of the airports commission works - so, let me go back a stage. There had always been a vague discussion about the existence of scarcity rents in the London system, because, of course, there are very high slot values demonstrated by slot trading at Heathrow, and some extent at Gatwick.

15 **COMMISSIONER LINDWALL:** Yes.

20 **DR BUSH:** And the result is you have very high slot values, which actually represents scarcity rent, because you wouldn't have them without such scarcity. So, that there is a clear relationship there. So rents were there, often denied, interestingly, at the same time as the money changed hands. But, what the airports commission framework provided (this was the investigation of where the third runway - or second runway in Gatwick's case - should be) was work which sought to quantify what those were, because actually, getting rid of those rents, or reducing them was
25 actually part of the cost benefit appraisal, so you need to have some degree of quantification. I haven't got precise figures to mind, but they are very large, and of course, as the scarcity increases, over the period until the new runway, comes on they are getting larger, and at an increasing rate. So, you know there are very few places quite in that category, but
30 you can see certain airports in Europe starting to get there.

COMMISSIONER KING: Okay.

35 **COMMISSIONER LINDWALL:** Can I just ask - yes.

COMMISSIONER KING: To follow up, you mentioned the importance - - -

40 **DR BUSH:** Actually, you know, when we talk about scarcity rents, it sounds, you know, rather theoretical, but let me be clear. That's a cost borne by passengers, and then a - in a building block, methodology type of approach, such as in the classic regulation at Heathrow, or where charges are set informally on that basis, those rents go to airlines.

COMMISSIONER KING: So, in your introductory comments, you also mentioned the importance of capacity investment. And one way you discussed in your short report to us is we've got pre-financing by the airlines.

5

DR BUSH: Yes.

COMMISSIONER KING: I guess, two things: from someone who's an outsider to airports, pre-financing looks slightly odd. I'm used to things like take or pay contracts in areas such as energy, but pre-financing does strike me as being a slightly unusual way of financing. So, I'd like your view on that. And secondly, what alternatives have you seen overseas, for example, in Europe?

DR BUSH: So, actually, I think it's the other way round. I think not having pre-financing is odd. Where you have a building block methodology, which takes the costs that you are incurring in the airport today, and comes up with a price, part of those costs today will be the work you are doing to open a new terminal, or whatever it may be. So, those are costs which are being incurred today, to produce the new facilities tomorrow. So, it seems to me odd to exclude them.

Now, if you've got a different sort of economic regulation, where it's looser in some way or other, or where you have a price path, which takes account of the fact of scarcity and the need to invest for the future, some sort of long-run, incremental cost type of path, you wouldn't need pre-financing - the whole subject wouldn't arise. The subject only arises because you have these very tight, cost-based systems. And at that point, airports are not throwing off, inevitably, the cash to help them finance new investment. And I think the other angle, particularly for larger items, is that if you don't watch out, the way in which the building block type of methodology works is that you end up with low prices now, and magnifying the pricing increase when it comes on later.

Which is not how a market would work. The market would allow at least some of the scarcity rents to go to the airport. I mean if regulators weren't interfering. Let's assume that there isn't classic market power, but there's, you know, scarcity. The airport would, to greater or lesser extent, take some of that rent, and at that point we wouldn't be talking about pre-financing, because they'd be throwing off the cash from the scarcity rents, that would enable them to finance new investment.

It's because you hold the prices to - so closely to cost, that this problem arises. So when airlines say, "Oh, but this doesn't happen elsewhere, because you only ever, when you're in a normal market, you only ever pay

45

when a facility opens, or a new product comes on stream". But the whole point of a normal market is price isn't held that closely to cost in every single year.

5 **COMMISSIONER KING:** The airlines, I suspect, would respond by saying that the pre-financing puts an odd risk on that, so airlines today who may not be using the new runway, let's say, when it comes on stream in five years' time, are actually paying for it, rather than the parties who use it. Any comments on that?

10

DR BUSH: Yes. They have a point, as a factual point, that will be right. But actually, you know, the point about an airport is it's got some facilities that have been there for 50 years, some that have been there for 30, some for 20, some for 10, and then there are others that will be there in the
15 future. And actually, just to isolate that one particular investment is odd. Those airlines who are there today, may not have been there yesterday, so they are benefiting from investments that have been made in the past.

 And so, just segmenting this particular investment seems to me
20 conceptually wrong. I think that needs to be looked across the whole airport. There are inevitably some rough and ready approximations across the life of the airport, and this is one of them. You're not asking them to bear the whole cost, you're asking them to bear some of the cost in pre-financing, and what you're asking them to do is bear the cost, where if it's
25 a very big change in capacity, they are getting - already getting the benefit from scarcity - any scarcity rents that are generated. It also produces much better price paths and signals. I mean, this is the other thing.

 So, if you take the Heathrow example, again, which is classic, and at the
30 extreme. But before T5, terminal 5 came on (that was a - essentially, a replacement piece of investment; it wasn't actually expanding very much, the overall capacity). Before T5 came on, you know, the natural forces of depreciation running through, were pushing prices all the way down, so that by the time you come to the new terminal, you've got a big problem in
35 terms of price increase.

 So pre-financing, enables you to smooth that somewhat, as well, and start sending signals to airlines that costs are going to be rising, providing also more credible regulatory price paths, because it's very difficult to
40 introduce very big increases. And it is far better to smooth them over time, both for the airport, but also I think for airlines making decisions about, really, where they want to base themselves.

COMMISSIONER LINDWALL: Just on the - just the last one on this. Other examples that you've seen. I mean, is pre-financing used, for example, for more regulated airports in Europe, or how do they - - -

5 **DR BUSH:** They are - it varies. Some use it, some don't, and I suspect it's salience is going to grow as the capacity issue grows. So, you know, it comes down to national regulation, some - some are using it.

10 **COMMISSIONER LINDWALL:** So, scarcity rents, which of course could be split between airlines and airports, although the evidence is we mostly go to airlines - - -

DR BUSH: They go to airlines where you set the price according to cost rather than, as it were, market forces.

15 **COMMISSIONER LINDWALL:** But to the extent that scarcity rents also went to airports, they don't have an incentive to delay investment to keep some of that rent?

20 **DR BUSH:** There are a lot of pressures on airports to expand. I mean, they've got several income streams. They've got their retail, their car parking, their other income streams, which are actually pushing them towards expanding an airport.

25 **COMMISSIONER KING:** Yes.

DR BUSH: So I think they've got some very powerful forces offsetting your concern. Plus if you sit there and your airport is very full and passengers' experience is deteriorating, you have got a lot of public and political pressure to grow it and to deal with those problems. Certainly that's been the experience in the UK, where airports generally stay below the public horizon, except where things get really bad. And when they get really bad, you're in the press.

35 Of course, at that point it's very difficult to do anything quickly because you are years behind the game. So I think a sensible airport which is interested in what you might call its licence to operate within a community or within a society will need to balance the issue you're talking about here, against the need to ensure that passengers and others aren't overly inconvenienced.

40

COMMISSIONER KING: Can I push back a little bit against that.

DR BUSH: Yes.

45

5 **COMMISSIONER KING:** By saying that while the airport may have some incentives, it's going to be balancing up the scarcity rents versus the political pressure. Wouldn't a more firmly regulated regime result in more investment? Because then the regulator can require the investment to come on stream earlier. Given that there is more regulation in Europe, is that the case or is it the opposite or what line?

10 **DR BUSH:** Well, I mean, I sort of contrast if you like the regulated sector in the UK and the unregulated. Most of the airports have never been regulated in a classic sense, they're smaller. We never really have complaints or difficulties about those airports having insufficient capacity – they build little bits here and there, they build capacity as they need it.

15 Manchester now deregulated has just been building a large amount of new capacity both to replace some of its existing old capacity but also to expand. So those unregulated airports don't seem to have a problem. The problems we've had have been in the regulated sector. Now, I'm not saying that those problems were due to regulation, but regulation didn't necessarily overcome the problems, and the airports were pressing for new investment.
20 They couldn't get there, partly because of public policy issues.

The regulatory frameworks themselves can involve delay. You tend to have five-yearly investigations of cost and price. So your investment programs tend to have to be lined up in order to meet those deadlines. They will then
25 require a lot of detailed invigilation and examination by the regulator across several years. So you're adding, in addition to the sort of discussions you would have had with your airlines, you're adding a lot of process and some delay into the pot.

30 **COMMISSIONER LINDWALL:** I'm conscious of time, so I wonder if – unless you've got some other questions on those themes - - -

COMMISSIONER KING: No, no.

35 **COMMISSIONER LINDWALL:** - - - we could touch on some jet fuel and noise issues.

40 **DR BUSH:** I think you're not going to find me very helpful on those, but anyway.

45 **COMMISSIONER LINDWALL:** I mean, you were at the National Air Traffic Control Services, as you said, and you have different approaches to handling of aircraft noise in, say, Heathrow, because obviously Sydney Airport's a critical area here in our inquiry.

DR BUSH: So the noise issue is a big issue around the third runway at Heathrow; it's requiring a great deal of public consultation. But in addition to that we are having to – and I come to this through my place on the board of our air traffic control system – change the air space in the UK because it is running out of capacity. So capacity issues don't just apply on the ground (one of the things people forget when they build new infrastructure) but even without building new infrastructure the airways themselves can become very constraining.

That is involving us in – the airports are often in the lead for the lower level of airspace where the noise problem arises. But we are becoming more proactive in trying to join with the airports in explaining to people what's going on. In general, this modernisation should lead overall to less noise, but often to a shift in noise. And this is one of the big problems you run into, that you may be shifting noise around as you modernise airspace, or you may be concentrating noise, because modern equipment enables you to fly much more directly, and therefore something that was diffused by accident becomes concentrated by design.

So that's where you run into difficulty. All I can say is we have had problems in introducing these changes and some delays have been imposed because of problems with consultation. So I think what we have found is we have to have a very, very well set down consultation process. Because if you don't have that, you find at the end you're in court and the whole thing goes back to the start.

So one of the things that's come out of the recent experiences is some new CAA processes which mean that a lot more work is done up front in terms of explaining to the people affected, and I think that is the key thing, is to get everything out on the table right up front and ensure that everybody's aware, you've consulted fully, everyone's aware of the impact of the various choices that can be made and what the consequences are, and that you then lead on to a full process and the decision-making that's based on that.

I think it sounds obvious, but actually we didn't do it properly to start with. So it just shows you it can go wrong.

COMMISSIONER LINDWALL: On jet fuel, I don't know if there's anything to say. I mean, in Australia of course at our major airports we have joint ventures which are usually fuel providers providing the infrastructure and servicing the uploading of Jet A-1 to the planes. Is there anything you can comment there about the competition, say, in the UK?

DR BUSH: I don't think so. I don't think this subject's emerged while I was in situ.

COMMISSIONER LINDWALL: No, that's all right.

5

DR BUSH: It doesn't seem to, and just in recent regulatory documents and proceedings I don't – I haven't come across it.

COMMISSIONER LINDWALL: No, that's okay. There are other questions I could ask, but we're running out of time. Did you have anything?

10

COMMISSIONER KING: No, I didn't.

COMMISSIONER LINDWALL: Any final points, Harry, that you - - -

15

DR BUSH: No, thank you very much.

COMMISSIONER LINDWALL: Thank you very much for coming and seeing us.

20

DR BUSH: Thank you.

COMMISSIONER LINDWALL: Well, I think we're now hearing from Geoff Breust from the Regional Airports Users' Action Group. Geoff, hello.

25

MR BREUST: Good morning.

COMMISSIONER LINDWALL: Morning. So, Geoff, if you wouldn't mind just saying your name and organisation and then if you'd like to give some introductory comments, that would be perfect.

30

MR BREUST: Yes, that would be great, thanks. Thanks very much.

35

COMMISSIONER KING: We're obviously taking as much time to stretch as we possibly can.

MR BREUST: Do you want a 10 minute break?

40

COMMISSIONER KING: No, a break comes after you, so it's all right. We're following a schedule here, so it's all right. We know from past experience that a few days of these hearings you tend to find you sit a bit too much.

45

MR BREUST: Well, thank you very much for giving us the opportunity to come along and talk to you.

COMMISSIONER LINDWALL: Pleasure.

5

MR BREUST: My name is Geoff Breust, I'm convenor of the Regional Airports Users' Action Group, which is a very fancy name for a Facebook page basically. I'm the convenor of that, and I think we've got about 400 members, but basically that page is just simply to allow people to post comments and discuss some of the issues.

10

My personal background – and I actually submit in the context also as an individual as well. My background is very much regional aviation, I was general manager and CEO of Kendell Airlines back years ago, and you remember the days when Kendell used to fly in and out of Canberra to Sydney.

15

COMMISSIONER LINDWALL: Yes, I used them several times.

20

MR BREUST: And then more recently I was managing director and CEO of Regional Express and I retired from there a few years ago. I'm currently just a general aviation pilot and aircraft owner and so forth, but I still retain a very strong interest particularly in regional aviation, and on that basis could see a number of the issues and was really pleased that this time the Commission was given a reference to look at the regional airports as well, because the whole thing is really tied together, and it gave us an opportunity to make some comments to you.

25

Just in terms of opening, and I'll just run through it, but we did provide at the end of last week a further submission to the Commission.

30

COMMISSIONER KING: Thank you, yes.

MR BREUST: But I think I'll just very briefly just run through. I've always had a very positive view of the Productivity Commission, because I always believe that you look at things rationally and look at it from an economic point of view. But I must admit, I was a little disappointed with this draft report, I thought it was a little too academic. I was really hoping that there would have been some more robust investigation and sort of forensic look at some of the real issues, and particularly the areas of disputes between the airlines and the airports.

35

40

I think when you get into that you really start to understand really where the market power lies. I'm really not in a position to be able to comment about the Kendell and Rex days because I'm not involved with those

45

organisations now, but I did have during those periods some fairly significant negotiations, particularly with Sydney airport, but also with Canberra, Melbourne and Adelaide and so on.

5 Those arrangements were difficult, they took up a lot of the time with the
airline, and we believe very much that, from where we stood, that the level
of power definitely remained with the airport. So I was a little disappointed,
particularly in the main finding, that on balance the Commission was
10 satisfied that the airports have not systematically exercised their market
power in commercial negotiations with airlines to the detriment of the
community.

The reason in saying that I don't really believe that's a great finding is that
I look at things fairly simply and I just don't believe it passes the pub test,
15 and I don't believe it passes the pub test because – for a number of reasons,
there are six in particular that we put in. That airport profitability is high
and continues to grow year on year and it's well above the inflation rates.
It's certainly better than many other industries.

20 The dividend returns to airport shareholders are increasing at very high
rates; I think their shareholders should be particularly happy. The average
revenue per passenger is increasing, but at the same time total passengers
over the year are increasing and increasing at quite high rates. The airports'
return on aeronautical assets, particularly for the major airports, continue to
25 be around 10 per cent or above. I note that Sydney airport's ROA was in
the order of 14 per cent for some years.

Now, that's very, very high, given the long-term nature of the assets that
are involved there. I think as a general rule in business if you're looking at
30 long-term assets, a rate of return of around 5 percent or even a little less is
probably more closer to the mark. So we raise that as an issue.

There's obviously been conflict between the airports and the airlines and
there's been some very notable exercises in relation to that. I also come
35 back to the continued comment by the ACCC that the light-handed
approach is not enough to constrain the market power. So on that basis, I
was disappointed that it was same, old same old in the sense that we
continue on the same way, and I thought we would end up with something
a little different.

40 But having said that, really very, very pleased that regional airports got the
coverage that it did in the report and the consideration. Whilst I was a little
disappointed that you didn't recommend a national airport infrastructure
fund, which we'd put in our submission, we understand that there might be
45 some limitations in relation to that from your terms of reference.

5 But the issue that a lot of the regional airports have is just simply funding the infrastructure. They all rely very, very heavily on Government grants, and a lot of the Government grants are very hit and miss. Success can depend on a whole range of issues, that I'm sure you're aware, but politically in particular.

10 Having said that, I was really pleased with recommendation 10.6 because we believe that it heads in the right direction, particularly the inclusion of considerations on a regional level rather than just simply the local government area. Because even at local government level, there is a lot of political interference and we thought taking into account the sort of broader regional level issues was a good approach.

15 The independent evaluation at the end of or as part of the funding process, we also believe is extremely important and a good part of that recommendation. Most airport infrastructure projects funded by grants are just built and then there's no evaluation after the event. There have been quite a few infrastructure projects which have turned into semi-white elephants.

20 Your recommendation 10.7, which draws on the Western Australian approach to arrangements in that state, I think again is very, very good and we'd certainly support it. The only issue we believe that you would have is getting the Governments and all the parties to support it all, and I think that's going to be a chore. But I think the approach is heading in the right direction.

25 I'm involved – or I have been over the years involved in a number of airport advisory committees, and in particular I'm on the current one that's established for the Wagga airport, which is where I come from. That's been going for almost two years now, it is a difficult process, particularly getting to the actual level of costs that are involved with the airport. I note in the draft report that there is a table there of the various regional airports in particular and their costs and revenues and their underlying profits.

30 I take a lot of that with a grain of salt, because I know that in many cases a lot of the cost numbers are just simply aggregated and then somebody makes a decision to allocate, so there's no true costs involved. I'm actually trying to go through that process with our friends at Wagga at the moment and I must admit I'm getting a bit of push back, but I continue to go down that track.

35 The other area of the report that we're a little disappointed about – not so much disappointed but concerned the issue was not highlighted and that is

5 the cost of security, Security costs and related issues are a major problem for regional airports. In particular at the moment new and increased security requirements are being imposed on many of the regional airports, – effectively taking the size of the aircraft to which the improved security requirements down.

10 So previously QantasLink, for argument's sake, operate a Dash 8 300 series, which is a 50-seater. They've moved generally to the 70-seater version but they have a number of 50-seaters. Rex in particular operate the 34 seat SAAB 340. Rex is not subject to the security requirements and they will not be under the new arrangements, but the 50 seat Dash 8 will be. And that's going to impose a lot of issues at competitive airports. I know that the QantasLink people are pushing for overall screening, so in other words both Rex and QantasLink would have to be screened.

15 I think there are some practical issues in that, but again, it's a cost impost on an operator that really doesn't have to comply. So when you move things on the margin like that, those sorts of implications come into effect.

20 But I think the biggest gripe that we would have at this point with the new security requirements is that whilst the Federal Government has indicated that they will pick up the capital cost of the equipment, there are major issues with getting that equipment and the new process into current terminal facilities. The Federal Government is now saying that funding will not be available for any building works for this purpose..

25 Now, even in Wagga's case, to actually establish those new security requirements will involve quite a substantial change to the terminal and that's going to be very, very costly. So effectively they're pushing that back onto either local government or through local government onto the airlines and the passengers.

30 So we think that there is a need for the Government to reconsider that, particularly in the funding area and take some of that burden away, because regional air services are difficult and there's not a lot of margin in it all and it would be very easy for, as a result of some of this, it would be very easy for some of the regional airlines to just walk away.

35 **COMMISSIONER LINDWALL:** Shall I start on some of the regional issues and maybe you can cover some of the – now, as you know, a lot of these airports, both the ones that take RPT traffic and the ones that don't, and the ones that could or whatever, they vary in their traffic quite a bit. So many of them do not make money, they are often council owned that have been given by the Federal Airports Corporation many years ago under that regional scheme.

40

45

So the costs that they have are not fully recovered through landing fees, for example; do you think that's a reasonable thing that council's cross-subsidise their asset in that sense?

5

MR BREUST: I think a lot of the councils, and I think you can split regional airports into two groups; you've got ones that have got RPT services and then you've got a whole bunch of others that don't. The ones that receive RPT services again are, to a very large extent, considered vital to the local economy and the local community and I think a lot of councils believe that on that basis there needs to be a contribution from the local ratepayer.

15 But on the other hand there is this view that the airports should run on a commercial basis and I don't really think that that is possible. I think , in terms of airport passenger throughput, I think you're going to have to look at airports that have somewhere around 200,000 passengers a year before they could more than cover their operational costs. I'm not saying they'd cover all of their, particularly their infrastructure costs, but certainly cover their operational costs.

20 One of the issues with RPT services at an airport is that it substantially increases the airport's costs because you've got more requirements to meet, you've got to have more staff, you've got to do all these other things, whereas at a local airport which doesn't have an RPT service, the cost level is much lower. I think if you went to all of the non-RPT communities that have got airports, they would say that that airport is an absolute vital asset for them because it provides access for, you know, medical services, for emergencies, for all of those sorts of community things and on that basis I think the local community is fairly happy with meeting some of the costs. However, it still comes back to the costs of their infrastructure and they all have to go cap in hand to governments, either State or Federal, to get money to either upgrade or to build.

35 **COMMISSIONER LINDWALL:** All right. Now, in terms of the security I heard that some of the airports, of course the issue maybe it is Wagga too, it's about the load bearing on the floors of the terminal that requires - - -

40 **MR BREUST:** I think there's some of that but it's also the space. I think - and I don't know the security process because there's a whole lot of confidentiality about it, but from what I understand from the local people in Wagga, that the actual square meterage area for the whole process increases quite dramatically and on that basis, because Wagga has been

pretty good at maintaining the facility the right sort of size for its operations, it's going to have to do extensions.

5 **COMMISSIONER LINDWALL:** So you don't think it's unreasonable for the airport to charge on an operating cost basis for the extra security if - - -

MR BREUST: I think that's okay but it's the infrastructure - - -

10 **COMMISSIONER LINDWALL:** It's more the infrastructure and the actual building and that type of thing, yes.

MR BREUST: Absolutely, absolutely.

15 **COMMISSIONER LINDWALL:** Now some airports, and I can't think of one offhand, have decided they'll screen Rex planes and the 34 seaters and the 50 seaters, at the same level. What do you think of that?

20 **MR BREUST:** I think that's a bit discriminatory but again it has to be practical and I'm sure the airlines have got a view on this, but I have heard Qantas group say that they believe in situations where there's themselves and another operator and the screening is required, their view is that all of the outbound passengers should be screened. Now, Rex may well have a different view to that, I can't speak for them but - - -

25 **COMMISSIONER LINDWALL:** Well, it does in its submission, yes. Now, the thing about your investment fund, could you talk about the role of the Australian Government versus the State Government for infrastructure provision at airports at regional centres?

30 **MR BREUST:** Yes, it's one of those areas that I really don't understand too well because it just depends on what sort of programs the various levels of government are putting in place. From my understanding, the Australian Government, the Federal Government, is more about regional development-type activities and employment and those sorts of things, and if you can work your submission relating to an airport improvement based around some of that, maybe you'll get a tick.

40 The State is a little different. I think they look a bit more on the infrastructure side of things because I know in a couple of - well, even in Wagga's case, the approving authority or the management authority for the particular grants for the airport go through the Department of Infrastructure in New South Wales and they look at it on a different basis.

5 So as an example, I'm aware that an airport received money to do some terminal upgrades as well as some taxiway upgrades - this was before the new security requirements were announced to come in. The terminal upgrade would not suit the new security requirements but their taxiway work that they had some money approved, was not enough to complete that work. They've been fighting now with Infrastructure New South Wales for two years to try and get a transfer of the funds and it's not happening because Infrastructure New South Wales think the terminal is the thing that should be done because they can see it, while a taxiway is not so visible and media presentable.

COMMISSIONER LINDWALL: So - sorry.

15 **MR BREUST:** No, no.

COMMISSIONER LINDWALL: I was going to say the national transport or airports infrastructure fund that you propose, what's been spoken about, would you see a benefit if both the Australian Government and the relevant State Government be involved in it together?

20 **MR BREUST:** I would see it as a partnership.

COMMISSIONER LINDWALL: Yes.

25 **MR BREUST:** Very much as a partnership. And in our initial submission we also suggested, or recommended, there that there be some funding allocated from the major airports as well. They probably won't like that too much but I just thought that on the basis though that they're very much part of the system and they do very well out of non-aeronautical activities, that maybe a small amount of the revenue that they receive from that could go into that fund and overall improve the system.

COMMISSIONER KING: They benefit from the network after all.

35 **MR BREUST:** Yes.

40 **COMMISSIONER KING:** Actually let me start with the second one but there's just a bit more on security that I wanted to cover up on. I mean, it's often said with the regional airports that, "Oh well they're gold-plated", it's claimed sometimes by the airlines that they're gold-plated. I went through Wagga recently. I must confess I don't think Wagga looks very gold-plated but it may apply to some other regional airports. But to what degree do you believe that's correct? So there's political decision made to fund infrastructure that's just more than is needed for those regional airports. Let me stop there and I've got some follow-on bits.

MR BREUST: Yes, look it varies and I think you have to look on a case by case basis and I again come back to Wagga. Wagga's got different characteristics because it's an RAAF base as well as an airline airport.
5 The actual main runway facility was originally put in place for the Air Force and has been maintained on that basis. Whereas the terminal facilities and various other facilities there are very much related back to not only the airline operations but general aviation as well. But I think if you go then and look perhaps at Dubbo, Dubbo went through a major
10 terminal expansion a few years ago and it was an overkill and I think Rex, in their submission pointed out a number of airport terminals particularly where they believed it was too much.

Now, a nice airport terminal facility is necessary but it needs to be of the
15 right size and it needs to be practical and I just look at the Dubbo one and say, and I've got direct experience with Dubbo, the Dubbo one to me was an overkill, it was not designed well, it's a huge building, it's very costly to heat and cool, it splits arrivals and departures so much it's not funny, and yes it's just not efficient. The council at the time would not take input, you
20 know, and I'm sure the airlines were saying that at the time - these are the issues with it - but their views were not taken onboard. So they're the sorts of things that have happened and that's why I believe that as part of the funding process, a regional approach to it with input from other - not only the users but the regional community as well, that take a level of the
25 discretion of the local Government away, I think you'll end up with better outcomes.

COMMISSIONER KING: Yes. So, I mean thinking of both the recommended fund approach that you suggested in your original
30 submission and also our draft recommendation 10.6, I mean, do you see it as being as formal as a cost benefit - economic cost benefit analysis of a regional level so trying to, you know, how formal would that process be to try and work out, "Well, is this really value for money?"

MR BREUST: At least some level of cost benefit analysis because I'm not sure anything is done at the moment. Even with Airport Master Plans, you know, - in most cases a local council will bring in a consultant and the consultant will look at it in the context of all the other airport master
40 plan consultancies they have done, bring out their template and away they go.

COMMISSIONER KING: Yes.

MR BREUST: And nearly all of the master plans that I've seen of late, the projections on into the future, even the projections they did, sort of 10 years ago for now, are just wildly over the top.

5 **COMMISSIONER KING:** Yes.

MR BREUST: So in that context if you look at the master plan, and say, well, this is what we need, of course, you're going to get infrastructure which is too great.

10 **COMMISSIONER KING:** So widely over the top in terms of passenger number projections or?

MR BREUST: Yes.

15 **COMMISSIONER KING:** Yes.

MR BREUST: Passenger number and aircraft size.

20 **COMMISSIONER KING:** Yes, okay.

MR BREUST: I think if you look at the master plan for Wagga, I think the future involves 737s and a new terminal and runway and the whole works.

25 **COMMISSIONER KING:** Yes.

COMMISSIONER LINDWALL: A lot of regional airports think they're going to international services, too.

30 **COMMISSIONER KING:** Yes.

MR BREUST: Yes, yes.

35 **COMMISSIONER KING:** They just need to be in a more marginal seat.

COMMISSIONER LINDWALL: Yes.

40 **COMMISSIONER KING:** When you do – with the regional airports in particular we've seen some we called it argy-bargy, I guess, in the – in our report. We've seen some interesting discussions and reactions by – for example, REX on King Island, in Mildura, and so on. More broadly, how much countervailing power or generally just power because of – divert to the airlines have at the regional airports in particular and to what degree

does that really mean that there's an effective cap on the degree for owner's local councils to pass through any excessive costs.

5 **MR BREUST:** It's a fairly difficult area. I think just looking at it from a regional airlines point of view and obviously you can talk to them as well, but my experience has been that you've really only got two ways of exercising countervailing power. That is to go through the media and the political process and stir it up locally and lobby hard at the political level. The other bit of power that you've got is walking away. Or reducing
10 services. And that's basically it.

The political and media process is not a good one. It just stirs up a lot of noise and a lot of activity. And I'd think, at the end of the day, it doesn't do anybody any good. That's why coming back to having effective
15 advisory committees and good relationships being developed can lead to a lot of that noise just simply going away, because everybody ends up on the same page and I think that that's a very necessary part of what the future should be.

20 **COMMISSIONER KING:** Yes. Can I come back briefly to the major airports, because I'm really interested in your experience at Kendall. Did Kendall have any countervailing power with the major airports? So, let me (indistinct) again, I'll do a follow up afterwards.

25 **MR BREUST:** Yes. Not very much at all, really. If you go back into the history of it, post the Ansett close – sorry, pre-the Ansett collapse at the major airports, Kendall operated out of the Ansett-owned terminals. So our negotiations were with our partner in effect. So that was pretty straightforward. Following the collapse of Ansett of course, those
30 terminals reverted back to the airport owner and so forth and I guess – and at that stage, of course, Kendall had gone. When I came into REX which was about a year or so later after they got up, Sydney Airport was our big issue. And there's a very significant case where REX and Sydney Airport had a – quite a major stoush over access to gate facilities – and I was
35 heavily involved in that. And I can speak on the basis of my experience in relation to that and I'm certainly not speaking on REX's behalf.

The only real opportunity we had there was to go political and to go to the media. And we did try to negotiate and it was very much: this is what
40 you're getting. If you don't like it, go away. And we started a campaign based on the fact that Sydney Airport were pushing REX out to Bankstown Airport. Of course, that probably wasn't necessarily the case but it was the means by which we had to take it to get the right sort of support. And at the end of the day, REX ended up getting its proper gate
45 facilities and lounge, I mean, a VIP lounge for which we paid quite dearly

in terms of the monetary side of it. But at the end of the day it was a political decision made at high level..

5 We believed at that stage, that was the only means by which we could have some sort of countervailing power in relation to Sydney's approach

COMMISSIONER KING: Any similar issues that the other airports you mentioned Melbourne and Adelaide for example - - -

10 **MR BREUST:** Well, not to the same degree, but it required a lot of time and effort to go through the process because – and I – in some respects, I think that's starting to change at some of those other airports, but at the time it was – you'll get what you get, basically. And then when we kept pushing back and working hard on it, eventually we ended up getting what
15 we needed. I think in Adelaide's case, I think we had to run our passengers through the old international baggage area or something like that. You know, it was pretty terrible stuff. But eventually, after a long time, it came through. But it's a difficult process. It takes a lot of time and effort and, yeah, it just uses up so many resources.

20 **COMMISSIONER KING:** Resources.

MR BREUST: and I think REX has made the comment, you know, that in a couple of cases where they're not prepared to put any further
25 resources into the negotiations, they say – we'll just walk away.

COMMISSIONER KING: When you're talking about that it took a long time, just for our benefit, you're talking months? Years?

30 **MR BREUST:** Yeah, months. In Sydney's case, it was a good six months or more.

COMMISSIONER KING: All right. Thank you very much for that, by the way, because it's sort of taking you a bit away from your submissions.
35 Can I come back to just the security issues for a second? I guess – I'm sorry about jumping a bit between topics, but to come back to the earlier discussions you had on security at the regional airports, I guess at the end of the day, there's three parties who can pay for – for capital, the operating costs. It's going to be the passengers or the rate payers or the broader tax
40 payers.

Your view or at least your submission says that the government level, so the broader tax payer level, they should be funding the installation - - -

45 **MR BREUST:** Certainly the infrastructure.

5 **COMMISSIONER KING:** Yes. Why – given that presumably the benefits of the better security actually fall to the passengers using the airport or to the local community because not having an incident at your local airport’s presumably a (indistinct) thing.

MR BREUST: I think it’s – I think it’s even wider than that.

10 **COMMISSIONER KING:** Okay.

MR BREUST: You know, I think the airport security and other security issues now relating to terrorism and all the rest of it, is a national issue. And I think that in terms of that infrastructure, to me it’s almost just like funding the AFP or the army or the defence forces in that sense. It is a
15 much wider issue. So – and I think what’s happened is that because it’s been aviation and it’s been fairly specialised and it’s easy to look at and it’s easy, relatively easy to put things in place to be seen to be doing something. That’s how it’s being channelled.

20 But I think it’s gone beyond that. I think it’s a much wider issue. I think certainly operationally, the passengers should effectively pay for the provision of that day to day security. But the infrastructure, there’s a lot of money involved in that and it’s up front type expenditure and I think that should be funded more broadly.

25 **COMMISSIONER KING:** No, thank you. That’s a good perspective on it. Sorry, there was one other thing. Sorry. Paul, if you’ve got something? Because there was one other thing and I’ve now completely lost it.

30 **COMMISSIONER LINDWALL:** Well, I’ll go back on that – well, while you’re thinking about that I’ll go back to the infrastructure fund. Now, at the moment, you’ve been saying a lot of it’s been a bit ad hoc with Federal Government and the State Government – allocate money by
35 having a fund with a defined amount of money, good processes for costs benefit analysis and directing the money to the size of the infrastructure that’s appropriate for that particular area. Could you conceive in fact, that it might actually be cost effective for the tax payer, then? You might actually get a lower cost?

40 **MR BREUST:** I actually believe it would be, because it - it takes the guesswork out of it, and I think a lot of it is, you know, that the decisions are almost, dare I say, made on whim, rather than good assessment and analysis. So I think - it sounds a bit socialist, I guess, but by the same
45 token, it's - to me, it's good allocation of resources, an good use of funds’.

And I think the funds would then go to where they're needed, and done in the right sort of way, particularly if there is a proper assessment process after the event. So, in other words, it's reviewed in, sort of, 12 months' time, or 2 years' time, or 5 years' time, that it's actually - - -

5

COMMISSIONER LINDWALL: Would the funds be a predetermined amount that's announced and then done - and monitored, I guess - - -

MR BREUST: Yes.

10

COMMISSIONER LINDWALL: And would it be managed by something like the future fund, is that how you see it?

MR BREUST: It could be. It could be. But again, I think, at the end of the day, it would probably go back to either the local government area, or - or something like that, to actually do the job. But I think there needs to be a management of that funding on top of that to make sure that it's actually been done properly.

COMMISSIONER LINDWALL: Sorry, have you decided what you?

COMMISSIONER KING: Yes, I have remembered what I - and apologies again, because it's to jump back to security.

MR BREUST: No, that's all right.

COMMISSIONER KING: So, in your submission, you mention, you know, that maybe QANTAS group is pushing regional airports to adopt screening for all RPT, and unnecessary costs on its competitors. Do you view that that leaves some of the airlines, maybe, involved in a bit of game playing with security at regional airports?

MR BREUST: I don't know, you'd have to ask them. I really can't comment on that. But - but, I think, you know, if I was an airline that didn't require screening, I - and you know, that's a substantial increase in costs, to me, I would be pushing back.

COMMISSIONER KING: Yes.

MR BREUST: And therefore I'd be trying to do everything I could to - to not have to be the subject of it. But at the end of the day, you need to have a practical outcome. And I would say that if, at a regional airport in particular, if you had the process of advisory committees, and a good relationship build along the way, I think you can overcome the issues. Because at the end of the day, we've got to approach things fairly

45

rationality, and I think if you've got people in a room, with that sort of an approach in mind - we've all gone to Wagga with that in mind and we're actually starting to kick some goals, as an example.

5 I think the big issue Wagga has to face now, is this security requirement because there needs to be a lot of work done on the terminal to facilitate the new requirements.

10 On top of that, actually drilling down, so that we know exactly what the costs are for the airport, because at the moment we really don't know. We can't get into the detail. There's a few areas where we can, like direct staffing costs, but other costs that are pushed onto the airport from the council – such as last year's budget had \$50,000 allocated to the airport in costs for IT.

15 Now, that just doesn't make sense. All of the plant and equipment used on the airport is managed under a total pool for the council, and we're saying, well, "How much did you spend on fuel for the airport last year?" "Oh, it's all part of the big pool." And we're saying, well, you know, if
20 you're going to allocate \$100,000 for plant and equipment for the airport, we need to know what those costs are. And at the moment, they can't tell us.

25 **COMMISSIONER KING:** Okay. Do you see - I mean, there sort of seems to be a natural coalition that I would expect to have formed between, say, Wagga, perhaps the local council, REX, sort of, pushing back a bit on this idea that you should have upgraded security for - for the planes that **REX use**. I mean, are you seeing that, do you - or is it just for relations, you know, that sort of - - -

30 **MR BREUST:** I don't know what's going on behind the scenes, in terms of all of that.

35 **COMMISSIONER KING:** Okay.

MR BREUST: And I'm really not in a position to comment, and I really - - -

40 **COMMISSIONER KING:** Okay, that's fine.

MR BREUST: I don't think I'd really like to.

COMMISSIONER KING: Yes.

MR BREUST: Because that's a matter for them. And in terms of REX, you know, I'm a has-been. I was there a few years ago.

5 **COMMISSIONER KING:** That's all right. That's all right. I think that's all I have, actually.

COMMISSIONER LINDWALL: Okay. Well, there's a couple of issues we should touch upon. One's the Sydney regional access, of course.

10 **MR BREUST:** Yes.

COMMISSIONER LINDWALL: What can you say about that, and does it work, and would you improve it in any way?

15 **MR BREUST:** I think what you're suggesting in terms of the change is appropriate, but I think, you know, again, I'm just speaking as myself. Obviously QantasLink and REX and others will have views in relation to that, particularly in terms of the change that you're suggesting. Definitely the access requirements for regional services are necessary, otherwise the
20 the regions will miss out, and if it's just left to operate purely on economic rationality, folks, the regions won't have service. It's as simple as that. And you can't blame the airport, in that sense, because they've got a physical asset they need to maximise utilisation.

25 **COMMISSIONER LINDWALL:** (Indistinct) capacity - - -

MR BREUST: (Indistinct) get the best out of it as, you know, A380s every day, you know, every flight. But, to accommodate the smaller aircraft, you need to have some sort of an arrangement. So, unfortunately,
30 that's the way it is.

COMMISSIONER LINDWALL: And the way the creation of the Western Sydney airport, how do you see that effecting - - -

35 **MR BREUST:** I think that's going to have a huge impact in Sydney. I can see regionally that Wagga, for argument sake, will end up with services to both - both KSA and to Western Sydney, and I half suspect both the airlines will do them, and I think that's going to open up Sydney tremendously, and I think that's going to benefit, you know, Canberra, and
40 Brisbane and Melbourne and all the rest of them as well, because it enables services to be generated into western Sydney, which is a huge catchment area.

45 **COMMISSIONER LINDWALL:** Could I finally ask then about jet fuel, or even, in your case with GA, outgas, in regional airports. Is there

anything you could comment about both the provision of it, the pricing of it, the quantity that's available et cetera?

5 **MR BREUST:** We all - from the general aviation side of things, we all just say, well, "We have to pay what they want, otherwise we won't get it." And it's \$2.33 a litre at Wagga at the moment, and you can get some discounts, but it's fairly difficult. But you can pay as much in the more remote areas - I think I paid, last September in Birdsville, about \$3.20, \$3.50 a litre. But again, understandable, it's a long way from nowhere.
10 (Indistinct).

COMMISSIONER LINDWALL: I heard in the forest (indistinct) it's about \$4 a litre.

15 **MR BREUST:** It could well be, yes. Yes. But most of the more remote Queensland and New South Wales places it's up in that \$2.50 plus. Wagga's a little better - Wagga's not so bad, because there are two operators there, and also they've got the REX Pilot Academy, which increases the throughput quite considerably. So, we sort of - - -

20 **COMMISSIONER LINDWALL:** Yes. So, who are the two operators you've got (indistinct).

25 **MR BREUST:** We've got World Fuel and BP.

COMMISSIONER LINDWALL: Okay, so having two operators does provide a little bit of competition?

30 **MR BREUST:** It does, absolutely.

COMMISSIONER LINDWALL: All right, I think - - -

35 **MR BREUST:** In fact, they've just changed World Fuel has now taken the contract for the Pilot Academy off BP, so, BP might become a little cheaper again, I don't know.

COMMISSIONER LINDWALL: Okay, well thank you very much (indistinct).

40 **MR BREUST:** Thank you. My pleasure, thank you.

COMMISSIONER LINDWALL: What type of plane do you fly?

45 **MR BREUST:** Beechcraft Bonanza. (Indistinct).

COMMISSIONER LINDWALL: (Indistinct). All right, well let's take a break for morning tea, and resume with Canberra Airport at quarter past 11.

5

SHORT ADJOURNMENT

[10.58am]

RESUMED

[11.18 am]

10

COMMISSIONER LINDWALL: Well I'd like everyone, could we welcome Stephen Byron and Stephen Carson. Now gentlemen, if you could address – say your names and jobs, and then perhaps a brief introductory statement, that would be perfect.

15

MR BYRON: Sure. Stephen Byron, I'm the managing director of Canberra Airport.

20

MR CARSON: And Stephen Carson. I'm the chief financial officer of Canberra airport.

COMMISSIONER LINDWALL: Welcome.

25

MR BYRON: Thank you. And as you say, we will make a brief introductory statement, and happy to sort of return to a number of issues as you choose and take you through. But I did by way of introduction want to acknowledge the interim report and the rigor that has gone into that and the work that's been done.

30

One issue that we did want to pick up by way of introductory comment was in relation to Canberra Airport's market power. And in part, it might just be a little bit of slight weighting of the words and that, but I do think it's worth teasing out somewhat. In the draft report, I think you single out Canberra Airport as being closer to the threshold for market power and regulation than others. And that could imply we're super close, or not very close or what have you, and that's probably one of our reasons for bringing it up.

35

40

But for us in part, we turn back to your 2012 report, where it was acknowledged that Adelaide and "to a lesser extent", Darwin and Canberra had moderate market power, so I suppose that pitches where it is and puts us relative to Adelaide. The conclusion made by the PC in this draft report was significantly drawn upon the high proportion of business versus leisure traffic at Canberra Airport, and that's probably what we

45

wanted to flush out. Our view is that there's been no significant change in market power or dynamics since the 2012 report, where we were lesser than Adelaide.

5 There are the same mitigants in place, although in reality, given the growth of Adelaide being substantially more than Canberra, we are a smaller airport proportionally to them. Probably the differences are that now there are more formally two airlines domestically: there's no independent, low cost carrier, and we think that has and is playing itself out in the Australian domestic market, but particularly in Canberra in terms of the capacity control that those two airlines exert on Canberra airport. That control of the market by them, not us, is greater.

15 And secondly, to examine this issue of modal competition and to put that in the context for discussion of the proportion of business versus leisure traffic. The airlines who control the market don't service Canberra Airport, really with a low cost carrier. We have a tiny taste of Tiger and we're grateful for it to Melbourne and a couple of services a week to Brisbane, but we don't have Jetstar. And by comparison, a place like Tasmania, which has the same number of domestic tourists, 2.7 million domestic tourists per annum, they have over 230 weekly services versus our 11. And similarly, Adelaide, which has I think 50,000 more domestic tourists than us, 2.8 million versus our 2.75, they have – I think it's 150 – 135 weekly LCC services.

25 The point about that is (a) it shows who's got the market power in controlling the market, but secondly, it shows that if we had those services, we would have probably 1.5 to 1.8 million more leisure traffic, and therefore you'd be able to make a different assessment of Canberra Airport. So the fact that something that we have no control over, the share of business v leisure is counting against us, is something we'd like you to have a little look at.

35 The other aspect of it is particularly the modal shift when we look at the Canberra/Sydney market, and that's always been a case where we've had significant competition with three aspects: the road, the bus service, but then also Sydney Airport as an alternate airport to us for international services and access to LCC services like Gold Coast and Hobart. So it's been our competition, but the mode of road (indistinct) on Canberra/Sydney is the now competition.

40 Again the evidence where you don't have a low cost carrier on that route, is that passenger numbers have come down. They've come down from 2010 where they were 1.1 million passengers, to now in 2018, 950,000

passengers. There used to be 35 per cent of our passengers on that route, and now it's 29 per cent.

5 So that's very significant. And it's something we don't have any control
of, that shift to particularly the Murrays bus, – the hourly services that go
from 4 am to 7 pm. And again, the context we say in terms of your
assessment of market power for airports is not only to acknowledge the
competition we face and the modal shift where we've substantially lost the
battle; secondly, that it's not in our control, it's in the airlines' control, not
10 ours; and thirdly, that if you took into account about 1 million, maybe 1.5
million passengers that are on the Canberra/Sydney route on the route via
private car or a bus, they're leisure travellers. And if you added them into
the assessment of our market - we think you should include them in the
assessment of our market size and competition – you'd see that the market
15 is such-Canberra is a market with the leisure traffic; it's just they're not
flying, for forces outside our control.

Lastly on that point about market power, whilst I've said we don't set the
airfares it's the airlines who fly here, we instead, our charges are flat.
20 They are fixed, and they are not distinguished between leisure and
business, in fact we essentially have no pricing control over the structure
of our charges. But if we were to be a profit maximiser seeking to
capitalise on this high business share that we end up with, we would have
yield-based pricing that would differentiate between the types of
25 passengers, the routes on which they fly, and indeed the charges that the
airlines charge. We don't have the power to do any of those things, and
our charges are the same for leisure and business, the same for every
flight, and so on, so forth. So that's probably the opening discussion point
that we wanted to put forward and - - -

30 **COMMISSIONER LINDWALL:** Thank you very much.

COMMISSIONER KING: Can I just do one clarification?

35 **COMMISSIONER LINDWALL:** Yes, yes.

COMMISSIONER KING: Just on that last bit. Sorry, Stephen. Just
to clarify that bit on price discrimination, so you said something along the
lines of, you aren't able to set differential charges. The pricing is beyond
40 – outside your control. Do you mind just expanding on that more, the
restrictions are on Canberra Airport's ability if they wanted to set different
prices? Is it a legislative constraint, or - - -

45 **MR BYRON:** Yes. I mean do you want to respond to it?

5 **MR CARSON:** Yes, I think the key point to make there is that we have long term pricing agreements with the Qantas Group and with the Virgin Group. And so within that horizon, the prices are largely fixed for and set for the two mainline carriers, but also the two low cost subsidiaries of those airlines.

10 **MR BYRON:** And the thing is, the structure of those prices is determined by them. So if we had an idea and canvassed it in different ways of changing the nature of the relationship, so maybe it wasn't a per pax charge. We've at different times talked about for the landing component going back to an MTOW based charge. That's dismissed out of hand summarily, and you know, it's not one thing that we as an airport get to discuss very much. It's not possible for us to embark on a discussion with the airlines to say maybe our airport charge should be different for Perth than say, for Sydney.

20 Maybe it should be a proportion of the airfare in line with if you're charging business passengers more, then the airport charge could be different. That's not within our control to really have those discussions, and - - -

COMMISSIONER KING: Sorry, I just want to - - -

25 **COMMISSIONER LINDWALL:** Yes.

30 **COMMISSIONER KING:** So have you had those discussions or raised these potential issues with the airlines in the past, and if so, what has been – you know, when you say it's not really within your control, you can raise them with the airlines.

35 **MR BYRON:** I mean, at different times we've had a long, four or five hour discussion over a whole range of issues in the last six months with some airlines, and we spent a couple of minutes on the idea of a differential charging mechanism to change the relationship between the airport and the airline. Part of that would require them to share their data on their fares and revenues, and it was not something that was attractive to them. They certainly feel that they get the lowest charges from an airport such as ourselves by having it fixed in this way.

40 They also strongly want them to be passenger-based charges so that they can pass them onto the passenger outside the – you know, as a ticket tax and lump it in with taxes, not – you can never understand that, but they have tried to move a lot of the costs of an airport, including their own costs, in the airport/airline relationship to be the airport's responsibility, and secondly, to be expressed as a per passenger charge.

5 **MR CARSON:** The other thing that I would add too is that when we've reached a long term pricing agreement with the airlines, we've taken – the airport has taken the volume risk, so we sort of, with the airline, have agreed a price path, and we're projecting a certain growth which would result in a certain revenue stream to the airport. And if that passenger growth doesn't arise, which it hasn't in our case, then you know, as an overall – the overall commercial outcome is worse for us under that approach.

10 But once the prices are set, it continues to be the airlines – or the airlines have the capability to determine the product, the frequency, the airfares, et cetera, and they've got a fixed price so they can take that into account when they're setting their fares and determining the yields that they're going to generate from the market.

COMMISSIONER KING: Sorry, just one last thing on price discrimination.

20 **MR BYRON:** Yes.

COMMISSIONER KING: Just again, this is more clarification really. Has Canberra Airport ever raised differential time of day pricing, so higher charges if you're landing at a desirable – you know, let's say 8, 8.30, I want to get to a 9 o'clock meeting. Have they been thought of, raised, what's occurred?

30 **MR BYRON:** Not really, and I can't see an easy way for us to make the argument, and it's certainly not something – we haven't had in discussions with them, you know, maybe over 20 years of doing this job, I've thought about it once or twice, sometimes in relation to a question like that. But it's not something that's yet necessary given the pressure – the availability of infrastructure, and particularly on the runway side there's no – you need to manage it in that way.

35 **COMMISSIONER KING:** Okay.

COMMISSIONER LINDWALL: Now you use a building block methodology to negotiate with the airport, airlines. Why?

40 **MR BYRON:** I mean, certainly that's a methodology that the airlines are accepting of and supportive of. So that's been the basis for all of the negotiations bar one that I'll come to. And I think that's a function of the evolution of coming out of the price cap mechanism and the negotiations

that were done in those first few years, and then you know, where do you go to from there?

5 It's something that the airlines have been very comfortable with, something they feel delivers them the lowest result, and certainly for us, particularly on the airfield side, we have always over that first 15 to 18 years had a price that has been lower than the building block methodology, so a lot of the negotiation has been, you know, how does one get to a pathway to get up to price, as it were.

10 In terms of, whilst that's been the framework around all of our negotiation, and particularly the more regular airport services agreement pricing, when we did the terminal agreement with Qantas, it was not structured in such a way. It was, in fact, a much more commercial deal, and it was in 2005, 15 December 2005, that we signed a commercial agreement that set the charge for the new terminal at \$5.50 per passenger, and that wasn't set off a building block methodology. It was an agreed commercial price.

20 Probably in the background we had a bit of a sense, both of us, that it was fair, given the infrastructure we would build, and it had a set of expectations and service level requirements to be delivered. That was formalised in a development deed at November 2007, and we were able to then build a terminal, but we could have built something a lot less. We could have built something, perhaps, like what Gold Coast is now, and if 25 we'd have done that the charge would have been the same.

30 So the fact that we built something better did not cost Qantas or Virgin anything more. That was a position that we took. So certainly it's been a bit ironic along this process to see some aspects of the airlines running a gold plating argument.

COMMISSIONER LINDWALL: Yes, I was going to ask you that question, that they have been saying that it's been gold plated, Canberra Airport, and that therefore is, by both implication plus statement, has led 35 to higher prices for customers at Canberra Airport, but you don't agree with that.

MR BYRON: Well, it's about as factually incorrect as you can get. There is no relationship between the quality of what we have there and the charge that was set and they know that. It was set by commercial 40 agreement, not set on what we built, number one. Number two, you know, at its opening, the Qantas CEO significantly praised the facility and welcomed it, and I remember then another walk-round with him two months later where he said we should get the Emirates CEO here to look

at the quality, enormously welcoming, and every Qantas executive has been pleased about that.

5 At the time of the start of this PC discussion, and possible elements of gold plating being alleged generally, I wrote to the airlines, both of them, to ask if they had any concerns about the pricing arrangements we had which were pursuant to written, contractual agreements and the issue of gold plating. Got no response. On the day Qantas media ran it against us last year in August, we were in a five hour meeting with Qantas and we
10 had specifically written to them ahead of the meeting asking them to articulate any issues of gold plating. There was no concern. The issue was not raised. So you're getting this divorce in this gaming world of the hearings, of the rhetoric, from the commercial reality.

15 **COMMISSIONER LINDWALL:** So what about the other claim that Qantas put in its submission that Canberra Airport charges are 200 per cent more than Adelaide Airport which they say is a similar type of airport?

20 **MR BYRON:** Well, we're not aware of it, but I mean, they're not 200 per cent above, but they're above. You know, there's a volume-based issue here, and for example, Air Services Australia, air traffic control tower and fire services are approximately double of Adelaide because of the - sorry, double at Canberra versus Adelaide because they have more
25 volume for the same level of infrastructure.

I haven't seen the details of the claim, but again, you know, if you go through and work through whether Qantas are happy with our charges or not happy, what we've worked through is that every element of every
30 charge they've entered into willingly, particularly, for example, the terminal charge. They gave up a terminal lease and that infrastructure. They gave up an engineering lease and they did it because they wanted the terminal we were going to build and they wanted the commerce on that. It was entirely willing.

35 Every price that Qantas has paid they've accepted. When you look at the air field services charge pricing, they make the final offer to us of what they're willing to pay. When you then have written contracts and some price increases that they don't agree with in the pricing contract they will
40 not pay that charge down to the level of 4 to 8 cents. They'll refuse to pay it. So if there's a little bit of skirmish it's at the edges. It's in the cents, and it's not a function of saying Canberra Airport's charges are massively higher than another airport. They're the charges that we've worked through together commercially to deliver the infrastructure we have.

45

COMMISSIONER LINDWALL: A former hearing participant earlier today, Harry Bush, said that he was surprised, and he comes from the United Kingdom, that Australia, which has what he thinks is a fairly sound regulatory framework, doesn't - hasn't moved away from the building block methodology, more to the commercial type of approach that you mentioned. To what do you attribute that and is there a scope for more of a traditional commercial negotiation rather than a building block methodology to be used.

MR CARSON: Yes, I mean, it will come down to the negotiation, I guess, and the appetite, I guess. There is a conditioning in the market that the airlines are familiar with a building block approach, and, you know, there's elements to review and discuss. The four monitored airports are almost monitored against that. Their prices against them on volumes and theoretical returns versus the, you know, a building block concept. So I think in general it's embedded into our industry a little bit. But at the end of the day, the agreements that we have reached have moved away from, even though you've started a discussion using potentially a building block approach, that gets moved away from in the end when agreement is reached.

MR BYRON: The other comment I'd make is I think, I think if it stays into the final report, your comments about the parity pricing clauses, or the terms no less favourable clauses that airlines have insisted on airports, I think if they are removed there is more scope for commercial negotiation and deals in a broader bundle kind of way to the advantage of all participants. I think the rigour with which those clauses have been applied on smaller airports have locked in the structures of the way you deal and negotiate, and I think they're very anti-competitive. Our board took a decision before the 2012 inquiry that we wouldn't accept signing agreements with them any more, and we would always start every negotiation with that point, and then at the very end it would be insisted that it be put in.

So we don't have a lot of market power on the non-price terms such as that or bank guarantees and the like, but I think the removal of that and that being clear in the pricing principles, and it should apply from when the report or when it gets enacted. It shouldn't wait until those things just expire over the next decade.

COMMISSIONER LINDWALL: Do you think that, Stephen, that the pricing principles are sufficient for that? We did recommend that would be included in there in the local pricing principles, but they're optional, they're not mandatory, so could it still be even if we - even if the

government - if we put that in our final report and the government had accepted it, would it be that you might fear that they still exist?

5 **MR BYRON:** I think it would probably be enough. It's not guaranteed, but I think it would allow us to stand our ground and not - and try to argue for the point that it not be in a final concluded agreement because it's contrary to the pricing principles. It's not certain, but, you know, today we got no chance- - -

10 **COMMISSIONER LINDWALL:** Given what you've said about the absence, the general absence of low cost carriers at Canberra, what do you attribute that to, given the potential demand, as you say, with tourists, et cetera, coming to Canberra?

15 **MR BYRON:** I mean, it's difficult, but you know, the airlines are, quite rightly, allowed to choose to profit maximise and , you know, let's also be clear that it's very important for the airlines in this country, domestically and internationally, to be profitable businesses. You know, what's a fair return is always up for grabs, but that's not completely part of this inquiry.

20 **COMMISSIONER LINDWALL:** Yes.

MR BYRON: But the airlines have decided that they maximise their profit by servicing only a segment of this market, and if you don't provide the cheaper product, you don't cannibalise your yield, we're hopeful that through direct engagement and articulation of the size of that market that we might be able to attract Jetstar and we'd like to see that and we'd like to see Tiger ramp up their services here as well to service the growing tourism market.

25 **COMMISSIONER LINDWALL:** But to be clear, in your current contract you are unable to offer a lower price to Jetstar which might potentially attract them to come to Canberra which at the moment is too expensive perhaps.

30 **MR BYRON:** There are carve-outs for the introduction of services and particularly the introduction of new routes, but they only last for 12 to 24 months. But, you know, on the other hand, I mean, Tiger Airlines has shown that low cost carriers can and do operate very profitably, and the ability to access this market is not – and service the leisure market isn't a function of the airport charges at Canberra Airport. That's a misnomer.

35 **COMMISSIONER LINDWALL:** I assume, but can you clarify, Canberra Airport has entered into discussions with Jetstar or approached them in the past about operating services out of Canberra?

MR BYRON: Yes.

5 **COMMISSIONER LINDWALL:** Yes. You said the airlines and the airlines' approach. Just to clarify, your comment could be let's guess that when you're approaching Jetstar but it's really the decisions about Jetstar are based on what's good for Qantas and Jetstar together rather than Jetstar as an independent company, so is that what you meant or is that a misinterpretation of what you said when you were talking about the airlines?

10 **MR BYRON:** I don't know that's what I meant or what I said, but it's absolutely correct, and I don't – I'm just checking myself to see is it commercially fair to say that, but, you know, Qantas in all of their announcements, publicly say that they have a dual brand strategy domestically and that gives them a very strong powerful market position and it allows them to maximise profits across markets. So they are quite
15 publicly clear that the decisions about, you know, how much Jetstar and how much Qantas in a particular market, even if it's 0/100 per cent or 100/0, those decisions are made by the Qantas Group as a whole in the interests of maximising its Group profitability.

20 **COMMISSIONER LINDWALL:** Okay, so Jetstar's not operating out of Canberra. Your view is one of the reasons behind that is that the Qantas group does not believe it will maximise profits for that group.

MR CARSON: That's right.

COMMISSIONER LINDWALL: Yes. Is it a similar situation with Virgin and Tiger?

25 **MR BYRON:** So yes, and I think that's why you have 11 services a week from Tiger, not, you know 45 or 55, and why you don't have 70 or 80 services from Jetstar. But, you know - and I don't know that we'll get to there, but we can get to a better place. You know, maybe if I'm a bit more clear, in 2016 we ran a process with Jetstar and Tiger and we said that
30 we're working in partnership with the state government and the state tourism authorities to get a low cost carrier and we will put out an offer to you that will have the commercial terms to attract the commencement of low cost services into Canberra, and we did that and we said it would be available only to one of you on a first come, first served basis, and within
35 twenty – we said you must respond within 28 days, but in any case it's first come, first served.

Jetstar responded to accept the commercial terms and the charges that we'd offered together with the support commercial framework and marketing support from ourselves and the government, and they just had a

couple of queries to work through. But in parallel, Tiger had also accepted and they moved more quickly to accept and publicly announce those services.

5 So Jetstar – we got very close to getting Jetstar. In the end we got Tiger, and who knows what will happen down the track. I think ultimately there is a big leisure market and it's big enough for both of them, and my feeling is that the Qantas Group is missing out on some profitability by not yet having Jetstar. But that's up to us to deliver and work collaboratively with them.

10 **COMMISSIONER KING:** Sorry, Paul, just one last one before passing back to you.

COMMISSIONER LINDWALL: That's all right.

15 **COMMISSIONER KING:** In your introductory comments and just then you mentioned the size of the leisure market and in your earlier submission you talked about Canberra Airport, private vehicle being the main competition on the Sydney/Canberra route. Do you have data behind that that you'd be able to provide to the commission?

20 **MR BYRON:** Yes, we can go back to some of that data, but, you know, on the road there's about 5,000,000 passengers. On the bus, there's now over a million passengers, so there's more on the bus than in the air, so we can do a bit more work on that.

COMMISSIONER KING: Just understanding what the data is and also the source of the data is useful from our perspective.

MR BYRON: Yes, yes. Apart from the infrastructure.

25 **COMMISSIONER KING:** Can I ask the other data question, which is can you make publicly available your I guess rack rate charges for aeronautical services?

MR BYRON: Yes, we can do that. Why don't we do that through – with you.

30 **COMMISSIONER KING:** How much – Sydney airport has had a number of cancellations – sorry, not Sydney airport. A lot of cancellations of flights between Sydney and Canberra have occurred, and I think you mentioned this in your submission, and delays due to basic –
35 also the way Sydney airport has got its constraints in operations – operational constraints to Sydney. Does that bear on the market for people driving as well, I presume, that people would drive rather than use a plane because they're worried about reliability of the service to Sydney?

MR BYRON: Yes, I mean, most certainly that plays into it because you do have the modal choice and when – you know, these things are about reliability. When you see the level of airfares on Canberra/Sydney, you know, the reality is that it is business people substantially using it, so they
5 are time-poor and reliability and time precision is critically important to them.

We certainly had a situation where the cancellation rates blew out above 8 per cent and as a number of different senior airline executives of different airlines made it clear to me, is that if you're above 2 per cent, you're losing
10 confidence of the market and you're going backward and you've got a, you know, trust and confidence issue that needs to be addressed. Canberra airport – sorry, Canberra/Sydney has had a rate of cancellation above the national average for too long, and so in April of last year we put a
15 challenge to both airlines that we would reward them with a \$100,000 reward to the best airline so long as its result was as good as or better than the national average.

You know, all we are asking for on Canberra/Sydney is a result that is on average as good as the national average. We're not asking for special
20 treatment. And it hadn't happened – it hadn't occurred for how long? About seven years before then. There hadn't been a month where Canberra/Sydney was better than the national average. Well, in April, on Canberra/Sydney, both airlines were better than the national average and over the next five months there were three months where both airlines
25 were better and four months where at least one airline was better than the national average.

So it was an outstanding success and shows what can be done. And I think it's critically important to the consumer and the traveller on that route.

COMMISSIONER LINDWALL: Did you pay the reward?

30 **MR BYRON:** They didn't want us to.

COMMISSIONER LINDWALL: No?

MR BYRON: So it's interesting in the context of debates about airline charges where, as I said, airlines will not pay you to the tune of 4 or 8
35 cents for 18 or 24 months or longer. When it came to that, what was equivalent of a dollar per passenger or \$100,000 per month, neither of the airlines wanted to be rewarded with that.

COMMISSIONER LINDWALL: You've now got two international services, Singapore and Qatar, and I understand you haven't used

negotiations with them through BARA. How have you found the negotiations with the international carriers, and where do you see that heading for Canberra?

5 **MR CARSON:** I think in relation to the internationals, those negotiations have been good and collaborative, and probably more time has been spent negotiating and discussing the operations and the operational aspects rather than the commercial aspects.

10 **COMMISSIONER LINDWALL:** Now, you know that some participants are the ACCC, A4NZ and some airlines have argued for a negotiate-arbitrate approach for airport and eight ASAs and they have – obviously if you're to follow our model it would be something for all those airports with market power and we've already said that you didn't have in our draft report, but hypothetically what do you see – negotiate-arbitrate having an implication for Canberra if Canberra did have market power and was exercising it?

15 **MR BYRON:** So we'll just get all the assumptions clear.

COMMISSIONER LINDWALL: Yes.

20 **MR BYRON:** So if we had market power, if we were exercising it in an improper way, and if we weren't then the airlines would pass on the savings - - -

25 **COMMISSIONER LINDWALL:** Well, actually the second part is not relevant because the argument is that you have market power therefore they have negotiate-arbitrate, you don't have to be exercising it. That's what the ACCC have said, A4ANZ has not said that. So what implications would that have?

30 **MR BYRON:** So we will return to the point later about whether they'd pass on the savings because ultimately they'd pitch this as an argument to the benefits of consumers. My view is that every engagement on a commercial matter would be seen through the prism of how you position yourself and get ready for the negotiate-arbitrate, so you'd know you were never negotiating and I'm sure we would fall into that line of behaviour necessarily as well. So you'd never get anything done. You'd be always postulating and setting yourselves up for that.

40 My view is that the airlines with the biggest market volume would use it to control capacity and try and prohibit investment, and so ultimately that would be pretty detrimental to competition, to airfares and to the consumer.

COMMISSIONER LINDWALL: So you're basically saying that it could lead to higher fares, rather than lower fares?

5 **MR BYRON:** Yes, and lesser investment too. I mean, you know, I think this negotiate-arbitrate locks in gaming behaviour. And I think we've seen very significant gaming behaviour in the lead up to this inquiry and through the inquiry. You know, I've articulated the fact that, you know, the airlines have made public arguments on particular aspects about Canberra Airport in the same hours we've been in the meeting room where that's not been an issue of contention to be even raised or discussed.

15 So you get this divorced behaviour. You get behaviours for two years coming onto this inquiry. In my mind, a desire to prove that agreements can't be made or that airlines will not stand by already existing written agreements that are binding. And then I think you see when you see the writing on the wall of detailed credible economic analysis and an acknowledgement even by the political media classes that this is – the arguments are not being properly made by the other side, without integrity and without the reality of the savings being passed on to the consumers, I think the political classes are not seeing the appetite for the change.

20 So I think you are seeing the strategic change play itself out very quickly with the airlines in terms of the willingness to enter into deals and to move away from their more recent behaviour.

25 So if that happens every five years or seven years when we have these inquiries, goodness me, what happens if every commercial negotiation can go to a negotiate-arbitrate. The gaming behaviour's locked in as a permanent state of being.

30 **COMMISSIONER LINDWALL:** Did you have anything you want to talk about in negotiate-arbitrate or gaming?

35 **COMMISSIONER KING:** Not so much on that, but come back to international just very briefly. I am just aware of the time, yes. Just on the international services, BARA has in its submission since draft, notes – I am paraphrasing them, but the issue is service quality, service measures, rather than so much price per se, at least at the airports that have market power.

40 In your negotiations, how have you dealt with that? Has that been the major part of a negotiation? Where have the negotiations to international airlines really focused?

45 **MR BYRON:** I mean, it is interesting in documentation terms, it hasn't focused on that. In realty terms there's been a lot of focus on that, and you

5 know, our desire to make them as operationally successful as possible. Clearly we're in competition with Sydney Airport internationally when we were having the service Sydney, Canberra, Wellington we were very much in competition with Wellington, Auckland, Singapore or Wellington, Melbourne or Sydney, Singapore.

10 So there's a lot of focus operationally and collegially on the product and so we've got a high class transit – you know, it is a transit lounge but it is a high class product for all passengers. So that's true. In the commercial negotiations, I don't know that we've got heaps in those agreements. I know in the domestic airline agreements we have significant service level standards particularly in the terminal agreement around all of the elements of the service that have, as I said, service level standards and penalties for not meeting them. So it is all in the documentation.

15 **MR CARSON:** We haven't actually negotiated with BARA or discussed with BARA - - -

20 **COMMISSIONER KING:** No, I understand it wasn't with BARA but yes, I was just wondering because this had been put to us and I was just interested in a practical example because you are not negotiating with BARA.

25 **MR CARSON:** Well, we think and we also stand behind the quality of our product and the service that we provide and the international experience is pretty seamless for travellers, for departing and arriving passengers. It's a very efficient process from check-in through both levels of screening and with Border agencies. So you can be from the aircraft to your car in ten minutes getting off an international flight in Canberra.

30 **COMMISSIONER LINDWALL:** I don't think you can do that anywhere else in Australia.

35 **COMMISSIONER KING:** I can tell you, you can't at Melbourne.

COMMISSIONER LINDWALL: Did you have any - - -

40 **COMMISSIONER KING:** No, that's – resolving disputes with your customers, how are they normally handed both when there's a contract in place versus when one had expired and there was a bit of argy-bargy for want of a better term, like publically in the newspapers and on the television and so on, about you know, Qantas has made a bit of a song about that. So what would you say?

MR BYRON: Yes, I mean, our agreements, the airfield services agreement and the terminal services agreement have dispute resolution clauses. They've occasionally been used, enacted through the notice provisions and of course, there is the ability under those contracts to go to
5 the more formal dispute resolution thing called the courtroom. You know, they're written contracts in place.

The reality is, we are bound by way of our connection forever together, and they are our major customers. Our business depends on them and, you
10 know, I reflect back on the fact that we've done some of the most fantastic things in the domestic aviation industry with Virgin and with Qantas, and we've delivered them and we've been great partners, and I think particularly with Qantas, I think for 18 of the last 20 years, we've probably been the pin-up model airport that they pointed to, and you know, we fell into a way of
15 not being in agreement in the last more recent time and I think that's matured now and we're back onto an even footing.

It's interesting that the dispute resolution clauses didn't particularly provide the framework to resolve the commercial disputes. It took the goodwill of
20 the parties to meet at the highest level and to commit to the relationship before then the detail was worked through, and you know, I think sometimes we're a very small airport that doesn't get a lot of time at the high levels in the airline businesses for understandable reasons, and so sometimes some things can manifest themselves and get further out of the
25 best kilter.

COMMISSIONER LINDWALL: So disproportionately, you basically - - -

MR BYRON : Yes. And anyway, we're in good shape now with our airline customers and looking forward to, as we said, the challenge of growing their business, leisure and business in the town.

COMMISSIONER LINDWALL: Do you think that your contracts and your arrangements and your positioning with your customers is such that
35 you can capture innovations and technology which mutually benefit both sides?

MR BYRON: Yes, I do. I think so. I mean, we're cutting edge in terms
40 of the deployment of facial recognition technology for staff security control as a two-factor authorisation process. You know, when you arrive at Canberra airport you go down from the upper level to the baggage level and you go through from the sterile of the secure area into the non-sterile, and there's no security guards there. That's made an enormous saving because
45 of the deployment of world first technology through a Sydney-based

Australian company and Qantas and other airports now deploy that detection, pass-back detection technology.

5 When we were building the airport we realised as the security issues were moving forward and there was debate about the screening of vehicles, so we decided to put a tunnel from our loading dock through into the airside for all vehicles that need to go, so that we could use the common security screening point for staff and goods going into the terminal because investment of capital substantial as it was, very substantial, was net cost saving versus the labour cost of additional security points just for vehicles.

10 So you know, I think our contracts enable and encourage that and they require us, particularly in security, to deliver security efficiently and cost effectively for the passengers and the airline.

15 **COMMISSIONER LINDWALL:** Okay. Thank you very much for appearing today. Stephen and Stephen, thank you.

20 **MR BYRON:** Thank you.

COMMISSIONER LINDWALL: Now, we do always offer an opportunity for anyone to come up and have a say, either to agree or rebut or anything else for that matter. Does anyone want to take that opportunity today? No. In which case, I will adjourn the proceedings until tomorrow in Sydney. Thank you all for being here. A short day today.

25 **MATTER ADJOURNED AT 1.01 pm**
UNTIL TUESDAY, 26 MARCH 2019