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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO PRICE REGULATION OF AIRPORT SERVICES

MR G. POTTS, Presiding Commissioner
DR N. BYRON, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON TUESDAY, 24 OCTOBER 2006, AT 9.03 AM

MR POTTS: Good morning, everyone. Welcome to this public hearing in Melbourne on the inquiry into price regulation of airport services. My name is Gary Potts, the presiding commissioner for this inquiry, and joining me is Neil Byron from the commission as well. A draft report was released on 7 September, as you know. In total, we've received over 60 submissions, original submissions, plus follow-up submissions on the draft report. In addition, in the process, we have spoken to many of the stakeholders and we very much appreciate their assistance, both in relation to those meetings and also in the formal submissions themselves.

Since we released the draft report on 7 September, there has been of course an important development, which is the Federal Court decision, and I foreshadow at this point that we will be very interested in discussing that particular issue with participants during the course of these hearings. We shall also be conducting public hearings in Sydney next Monday and following that, we will prepare a final report for the government which is to be submitted by 6 January 2007, although we are hoping to have it completed before the Christmas break.

Proceedings, of course as usual, are as informal as possible to allow productive exchange, but nonetheless there will be a full transcript produced and that will be made available to all participants and interested parties. Although we have a schedule of participants for discussion this morning I will, as is normal I understand, offer an opportunity to any other observers here today who wish to make a statement in relation to this inquiry.

With those introductory comments, I welcome our first participants which is Melbourne Airport, Chris Barlow and also Warren Mundy. If you could first just mention your names and the organisation you represent for the record please, and then perhaps some introductory comments and we'll take the proceedings from there.

MR BARLOW: Thank you. Yes, obviously my name is Chris Barlow. I'm the CEO of Melbourne Airport but I'm also chairman of Launceston Airport. With me today is - - -

DR MUNDY: My name is Dr Warren Mundy. I am Melbourne Airport's regulatory adviser and I suppose it's proper to declare that I also provide advice to a number of other airports in Australia, New Zealand and in Europe.

MR BARLOW: Just a very brief introduction, I think it's probably important for the commission to understand the philosophy of Melbourne Airport as far as our customers are concerned. We have a very simple philosophy that actually goes through our business I think in Australia and the rest of the world and that's, "The customer is king." That's really important. We go out of our way to find out what our customers want and what services we provide.

There's always debates in airports. Our customers are very clearly the airlines and very clearly the travelling public because they come to our airports before they actually get on board a plane, so we have two major customers and our job is to provide services to those customers. But also actually we have a role to play in the community in providing air access, particularly obviously in our case in Victoria and Tasmania, and that's to the community and the government. One of the key things I wanted to say up-front is that we are very, very conscious of the power of the government to re-regulate us at any time and that goes through the whole of our thinking, from the board right down to lower management in our company.

The approach that we take in Melbourne and to a certain extent other airports in Australia I think is working well. The last report that the commission did was enacted by the government in most of the ways - but I'll come on to one of those ways where it didn't happen in a second - and that's improved I think the situation for all the industry, that includes the airline and the travelling public, has actually given our shareholders greater confidence to invest money in the infrastructure. As I said, our job is to deliver infrastructure and services to the airlines to enable them to grow their business because if their business doesn't grow, ours doesn't.

Actually, we're part of that high-risk industry and we've faced some significant risks in the last few years: continual security upgrades and changes, and that is not going to go away; we survived the Ansett collapse; we've also had the new star OzJet start and collapse on us. The 380 delay of two years has not only affected the airlines, it has affected us. As you well know, in Melbourne here, we had to do the 380 works well in advance, about a year in advance, of when we maybe wanted to do them from a business point of view because of the Commonwealth Games. We're not moaning about that; that's our job. We got them done, we got the works done, but we are suffering just as much as the airlines from the delay.

Obviously here in Melbourne we have competition, albeit limited, from our new airport that's opened and doing very well down the road at Avalon, which I think is good. We're not complaining about that at all but it is some competition there, although we do accept it's not huge.

I think what has been delivered to the airlines in the way of charging is simple, it's transparent and, from our point of view, I think it's very important for the airports to have it predictable. We did a deal with the airlines nearly five years ago and we said we would stick to the deal, and we have done and it hasn't cost them a cent more than they expected. By the way, if the airlines, as they often do, start complaining about airline charges, they could easily show us up in public by putting our charges on the invoice. I don't know if you ever look at an invoice that you get from an airline, but it never shows airport charges separated out. So if they wanted to sort of

name and shame us, they could do that and I think it's quite interesting that they don't, so maybe it's a lot of crying wolf on their part.

Going into more detail on our behaviour, I repeat what I said a while ago: we take the threat of re-regulation very, very seriously and I think actually our conduct over the last five years has reflected that. The threat of re-regulation has certainly weighed heavily with us and, if it didn't, what stopped us putting our charges up by 50 per cent rather than 35 per cent in 2002 when the regime was changed? What stopped us was us being responsible, making sure we had a good deal for our customers, and making sure we were transparent and were acting properly and reasonably.

A key point in this debate I think is that the last time we were here the late Prof Snape said that if an airport behaved badly - and I remember these words vividly - the constable should step out of the cupboard, and that actually has had an effect for us. In the last four and a half years, clearly - and the Federal Court decision and the Supreme Court decision we'll come to in a second - some airports in people's opinion have not behaved sensibly and properly. Now, why wasn't the constable coming out of the cupboard? That was a key part of the recommendations you made last time. Why didn't the government step out of the cupboard? In your report so far, you haven't said why. I would ask you to delve into that a little bit more and find out why; a key part of it, why didn't the department, why didn't the government step in and nip it in the bud before we went to this ridiculous length of going through all the courts and slowing the whole thing down; a fundamental part and a fundamental point, as far as we're concerned.

Can I turn to non-price terms and conditions that we agree with our airlines. I think it's important to note that, certainly at Melbourne, we're negotiating with 30-odd airlines, and those airlines are in competition with each other. Our job is to try and even the playing field and provide access and use of that infrastructure to all the airlines, whether they're in competition or not. We need to treat them equitably. Now, sometimes an airline, if it's treated equitably and wants to be treated specially, gets a bit grumpy. I think it's actually important to understand that. We've got to provide the best solution for all our customers, so actually we've got to make some sometimes hard operational decisions to actually provide the best way of working for all the airlines. I don't think the Commonwealth lease the airport to us so that dispute resolution mechanisms would determine the operation outcomes of the airport. We have a responsibility and I think we take that on board fully and properly.

Turning to ground access services at Melbourne, I don't think we have significant market power in relation to ground access. Perhaps we have as far as the forecourt is concerned and the short-stay parking for very, very short stays. But again we're very, very conscious of our responsibility. We look at comparisons with

the CBD and our strategy is to look at, as I said before, what the customer wants and certainly provide the right product at the right price. Just looking at the competition we've got for parking generally, off-airport competition is significant and it is growing. It's competition to us and we freely accept it's there and we'll meet that competition.

One of the key things is about providing extra facilities to the customers. Since 2002 we have expanded our carparking facilities massively. We've actually put in over 70 per cent increases or an extra 6000 spaces. As you fly through Melbourne, I think every time you go, particularly into the long-term carpark, you'll see construction vehicles there, expanding and expanding. Of course we've done the same with the short-term. Now, we've introduced a very, very good, new bus service at our cost, no increase in price for the long-term carpark - really, really important that the market drives our ground access services.

I now come to quality of service monitoring which I'm not going to say an awful lot about except to say that at the moment our friends in Customs are listened to and their comments are in the report. I think that's absolutely crazy. They have statutory access to the airport. We have no market power over them whatsoever. They're a service provider, and I have to say that in the past, both airports and airlines have been deeply unhappy about the service they provided to the passengers, although we have worked very hard at Melbourne in the last few months and they have improved their services dramatically and now I think they're actually very good at Melbourne.

That's not the case - I know - still at other airports. They actually charge the travelling public $38 each for passenger leaving the country. That's far more than we charge for the whole of our airport services. Also, by the way, they expect us to subsidise them with signed leases that we've got at the airport. They refuse to pay the terms of the leases and say, "We won't provide you a service unless you subsidise us by giving us, for instance, free parking and free accommodation in areas." For an organisation like that to have the power to criticise airports in a public forum I think is just crazy. They are not someone that uses our services; completely the opposite. So they shouldn't be allowed to comment on it. If anything, it should be the other way around, the customer should be commenting about them.

If I can talk about improving commercial negotiations. I mean, we want to get the lowest possible costs and predictability for the airlines and our customers, and by the way I notice some of the comments that the airlines have said. We think any savings that we get should be passed through to the airlines. We do. Every five years we reset our charges and the savings that have been made at Melbourne Airport are passed straight through to our airlines.

One of the issues I know other airports have got - to be honest, we didn't have it much last time we negotiated - was the unwillingness of some airlines to make a reasonable counter-offer. All they come up and say is, "No, we don't like that. No, we don't like this," but they don't make a counter-offer. So I think if they don't do that you can't go into dispute resolution, you can't have a failure to negotiate a price. We would, up to seven days ago, looked at very closely what the commissioner said and we would probably have agreed with you and said, "Well, airports don't need a separate dispute resolution clause. We should be treated the same as the rest of the community."

However with the Supreme Court decision that came in last week, I think we do. There is clearly an area where if we can't get an agreement with the airlines, we have to have some sort of resolution and Warren will talk a bit more about that. But what I'd say to the commission at this point is to speed up that process, make it more transparent and stop gaming. You should insist that the other party puts in a counter-offer which at the moment often doesn't happen.

You touched briefly on the ARFF services, the fire service provided by the federal government. Warren is going to have to tie me down here because I'm just livid about this. I cannot believe it. The decision that the government made was absolutely, in my opinion, ludicrous, inconsistent with the airport policy, and what message does it send to us? There's no transparency in the service now where the service has provided the same cost across the whole of the nation. It's not transparent, it doesn't reflect the new costs, which is exactly what we're trying to do in airports. Not only the government I'm disappointed in but also the ACCC. If that's the sort of decision they're taking, God help us if they ever get involved in our business.

Going on to the issue of asset valuations and the contentious issue of asset valuations, we accept there's been a problem. We accept that it needs to be solved, but your arbitrary date which I know you recognise as being arbitrary, of the line in the sand of 30 June 2005, really penalises airports I think like Melbourne that have been - can I call it - the good guys, and rewards others that haven't had that same responsible attitude. For instance, if we actually put it into operation you could say that we'd be losing tens of millions on our value and rewarding other airports probably by hundreds of millions of dollars' added value.

We think there's another way of doing it. Warren might talk about that. But I think a more equitable way needs to be found and I think there are solutions, and Warren may point to some of those. We read with interest your finer points in your first draft which to be honest I think are going to be lost, particularly on the press; certainly will be lost on the airlines. I think you have to realise that we live in the real world and I think we need some more rigid guidance to get a better, even playing

field. So please can we find a way of minimising those differences. So I'll wrap up now and I think just to say the regime in Australia has been one of the best in the world. We've learnt from what has gone out elsewhere in the world, and I think certainly from our shareholders' point of view they were prepared, or were prepared, to keep investing and providing services to our customers.

A few minor areas of improvements; you've looked at those and you've recommended some improvements. I think that's good for passengers, good for airlines and obviously good for airports. We do remain fearful of re-regulation, and I don't think anyone would benefit from that. But we are - and you've asked us to comment on this - extremely concerned about the recent Federal Court decision. If it stands and if we've understood it properly or we need to take some more legal advice on it, it appears to blow apart all the good work that the commission and the government policy and the airports and the airlines that can negotiate with each other have done over the last five or six years. It is a very, very serious issue. If it goes back to the bad old days, shareholders will not have confidence to go ahead and invest. The whole growth of aviation in Australia will slow down, and I think we need to look very, very carefully at how this can be managed. So we are very, very concerned. We think it blows away everything we've done, and Warren will talk in a bit more detail about maybe a way forward on that. Enough for me; over to Dr Warren Mundy.

DR MUNDY: Thanks, Chris. As Chris has indicated, there's a number of issues, particularly in relation to the Federal Court decision, which I'll come to last, but there's just a couple of other issues that we'd like to touch on. The first has been some comments that have been made by various participants in the inquiry in relation to some benchmarking data that we've presented that we had commissioned by TRL. Yes, it only covers international services. Why? Because there is no internationally recognised benchmarking series for domestic aviation services. The data is not there. We haven't seen any alternative analysis brought forward.

Yes, there are issues in the data series because, quite frankly, it's very difficult in the vast sweep of jurisdictions to actually get your hands on the data. Outside Australia and New Zealand, and perhaps the United Kingdom, this data is very sparse. Try and source it in the United States and it almost becomes meaningless. It's the best data available. It's not perfect, but we note there is no other data brought forward to contest that analysis.

What the data basically shows in our view, as we put to the commission, is that Australian airports are priced in probably the third quartile. They appear to be relatively efficient and they appear to be relatively profitable. Some people have said, "Yes, look how profitable they are," and therefore that must constitute an abuse. Even the ACCC in its submission to this inquiry has recognised that persistent

returns above WACC of themselves may not constitute an abuse of market power. But the point I'd also make is that, in the recent profit announcements that we've seen from Virgin, from Qantas and indeed to some extent from Rex, what we also see is some of the most profitable airlines in the world.

I think when you step back from all this what you see is an aviation industry that is growing, that is safe, that is secure, that is relatively efficient, and everyone in it seems to be making reasonable money. So from an industry policy economist's perspective there doesn't seem to be an awful lot wrong. The place isn't falling apart, there is no refusal to supply generally, and some of this is undoubtedly due to the efficacy of the government's policies as generally developed by the commission.

As far as prices are concerned, the commission in its report in 2002 acknowledged that the removal of price caps was going to lead to a step increase in price. Why? Because prices were being set below long-run incremental cost. How do we know they were being set below long-run incremental cost in the price cap? Because the NNI arrangements were there precisely to deal with the fact that the prices were not sufficiently high to sustain investment going forward. Why was that? Because, quite frankly, no-one knew what the capacity requirements and the investment requirements going forward were going to be when the price caps were set. So that prices have gone up is not surprising and should be of no concern.

What we've been trying to do in setting our prices in 2002 and as we've worked towards making an offer for the next five years, hopefully in the next month or two, is to get to a point where our prices reflect generally long-run incremental costs. Airlines have constantly said to us, "We want long-run price certainty, at least in real terms." That's always going to be difficult to achieve absolutely because long-run incremental costs change over time, technology changes, and this notion of what is the increment is highly problematic in an operational sense. But what we have sought to do is find a set of prices which going forward we'll be able to sustain our investment program under.

I think it's fair to say that if that's what you're trying to do - and that's an efficient investment outcome - then you have to understand that over time incremental costs may well be rising. Why is that? Fact 1: the real costs of material and construction labour in Australia at the moment is cyclically high. Look at the condition of the construction market, look at the price of steel, the price of glass and, indeed, the price of concrete. But put away those unit costs questions for the moment and assume they weren't. What we have is a situation where we have developed operational airports which are undertaking incremental investment in operational environments. It is inevitable that the cost of undertaking investment at the margin in those environments will be higher in terms of the unit capacity than if you were able to operate in a greenfields site without having to secure the airport for

safety reasons and have to secure it for security reasons.

Indeed, when we recently revalued our assets and looked particularly at the effect of the revaluation of the runway widening project, if you DORC them - that is, put aside all the operational issues associated with construction - what you find is that the increment that's associated to the DORC value of the runway asset from its widening is less than what we spent. Why is that? Because when you DORC assets, when you look at their greenfields value, you don't have to account for the fact that you have to secure the airport for safety and security reasons. You don't have to deal with the fact that you have to rip out old assets, deal with them and then replace them with new ones. So it may well be the case that over time incremental costs are rising or at least higher than current average costs.

So whilst we agree with the commission's general proposition that traffic growth should place downward pressure on prices, it may well be the case that over time prices will naturally rise as a reflection of just the investment realities that are in place. That said, it may also be the case - and this was certainly the case in Cairns - that airlines actually agreed to a phased-in price increase. In other words, airlines were happy to agree to a step increase in price over time. Why? Because it reduced the initial impact of the price increase. That's fine too.

The other thing, of course, is that - and this is something that's fairly well known in relation to rate of return regulatory environments - if you have this view that prices should fall over time, then what you are doing is in fact driving the price of the service away from its long-run incremental cost, and indeed what's happening is the capacity is tightening. The shadow price of the surplus capacity is falling when in fact it should be logically rising as it becomes more scarce. So I think the take on the question about the pattern of prices needs to be considered in the light of what the level is at any given point in time, but also the real issue is: have the parties agreed to this? If the parties have agreed to this, that's really all we need to say.

Just while on that, Chris touched on the issue of asset values. I've already touched on why DORC might actually drive prices away from incremental investment costs. It seems to us that DORCing assets going forward may actually provide a disincentive for investment because it optimises out legitimate costs that are incurred. That's a real issue, and it could optimise out in the case of our runway widening costs by the order of 10 to 15 per cent of the capital costs which we capitalise. So that's point 1.

So increasing values and DORCs seem to be largely driven by increases in units costs or land valuations, and we agree with the commission; it's pretty clear: we just don't think the argument about revaluations is an argument in efficiency. We don't buy it and, to be honest, that was the view that we put to the ACCC when it

considered Sydney's prices in May 2000. So this has been our position for some time.

We are very concerned, as we put in our second submission to the commission, that the line in the sand will in fact encourage some airports - not all, but some - to undertake effectively de facto revaluations against the prices which they're currently charging. We don't think that's right. There's no justification in efficiency for that, and having thought through it and having been through an exercise ourselves of trying to work what our asset values would be if we had revalued, it occurred to us well, if that only took us a couple of hours to sit down and do what we thought, with a reasonable amount of rigour, how hard can it be to unwind previous revaluations to get back? It might be more difficult but it doesn't seem to me beyond the wit of man, once a reasonable position is set, to reconstruct a set of reasonable asset valuations that are consistent with the general propositions in efficiency that the commission is advancing. At the end of the day, there are only a small number of airports to be involved and each airport only needs to do it and do it once.

There's been a lot said about commercial negotiations and quite frankly, we're quite disappointed with the very broad-brush approach that airlines have taken in describing the conduct of airports. It is a fact and an undisputed fact that every airline that uses Melbourne Airport has a signed agreement. Now, it has been represented that where these agreements have been signed, this is a consequence of essentially take it or leave it behaviour. That's not my experience of these negotiations and maybe what's going on here is that the people who are drafting the submissions to the commission actually haven't been in the room. If it was in fact the case that Melbourne Airport in some sense stood over Qantas in 2002 and said, "Sign this or else," just think about Qantas for a minute; why is it that Qantas seems to have signed agreements, as far as we can ascertain, in Melbourne, in Cairns and in Adelaide, but it hasn't signed agreements in Perth, in Canberra, in Brisbane or in Sydney? Perhaps it has something to do with the conduct of the airports concerned, rather than a blanket approach to the industry as a whole. It comes back to Chris's comment about the constable in the cupboard.

Indeed, if Melbourne Airport had stood over Qantas, then why did Qantas nominate Melbourne Airport for the IATA Eagle Award in 2002, saying, "This is the sort of conduct we want"? It just beggars belief. This is the sort of gaming that we see. This is the sort of gaming that we saw in the NNI processes that the commission rightly advised the government to abolish. So I think any conduct-based regime, which a light-handed regime actually is, has to logically deal with the conduct of individual participants.

Without going through it chapter and verse, we can say similar things about our dealings with other airports. We reached a set of pricing outcomes with airlines

generally in the last couple of weeks of June 2002. Five months later we finalised the non-price terms and conditions of Qantas; hardly an outcome that was on a take it or leave it basis. The matter was ultimately settled by give and take in a discussion between an executive general manager of Qantas and our CEO. This is not take it or leave it conduct.

So there's a real issue in this for us about the efficacy of the policy of dealing with failure to comply. As Chris said, we have approached this on the basis, to use Prof Snape's language, of the constable's in the cupboard. I think it's incumbent upon the commission to inquire of DOTARS what circumstances the constable might have emerged from the cupboard because to date, there is no evidence of that happening. That leaves airlines quite legitimately to question the efficacy of the policy and it may not be a problem with the policy in its design, it may well be a policy in its administration. Now, that's not a matter of the commission's doing, but I think it needs to inquire of the department, "What's been going on here?"

This brings us to the point of dispute resolution. Qantas is right, there is common ground between ourselves, DOTARS, BARA and a range of airline participants that there needs to be a decent dispute resolution mechanism in this industry. Qantas is also right that Part IIIA is probably not the best way to deal with it. It's clear that from the inordinate amount of time that it has taken to resolve the matter with respect to Sydney Airport for entirely legitimate reasons from all the parties that that's just not satisfactory. As we've constantly said to the commission over a protracted period of time, we think we can do better than Part IIIA.

The problem really resides now very clearly in the declaration criteria. Absent the decision of the Federal Court, taking the reasoning of the tribunal, it may have been possible for an airport that was rigorously complying with the requirements of the government's policy to have constructed a case that would not have seen it declared - possibly, not certain, but possibly. That said, it seems to us on reading the decision of the Federal Court that any vertically separated piece of infrastructure of national significance in Australia that can't be duplicated will be declared.

That appears to be Qantas's view and we probably agree that that's a reasonable interpretation of the judgment of the Federal Court. Where we I guess diverge from the Federal Court is we do not believe that that is the intention of policy. In particular, we don't believe that that's the intention of policy as we know it to have been amended as a result of the commission's inquiry into the national access regime and we certainly don't believe it is the intention of the government's airport policy that airports will just be declared for the purposes of Part IIIA, because if that was the government's intention and policy and that was how it understood it, then why did we ever have section 192 of the act which deemed airports declared for a period of time? Why would that have ever been necessary if that was the government's

view?

This argument that is advanced about, "Well, look, this business of declaration isn't a problem and it's not overarching, it's not hideously intrusive because, look, when 192 was in force, there were no arbitrations, so what was the problem?" there were declarations under the Prices Surveillance Act, there was a price cap and there were necessary new investment regimes. That is what was tempering pricing conduct, not section 192. Indeed, in the matter of the declaration that Virgin sought of the domestic express terminal, it was pretty clear that the ACCC knocked them back on the basis they had already dealt with those matters under the Prices Surveillance Act. So it's clear that the binding issue, the regulatory form in relation to section 192, was the PS Act declarations, not 192 itself.

We have always been of the view that compliance with the principles should be a relevant test in declaration. What is now certain is that conduct is not a relevant test in declaration. So the notion of policy, "Do this or else that," is now bunkum as the way the war is, as we read it. What we do doesn't matter. There is a simple deterministic application of the test that needs to be applied.

It may well be the case that the reforms that were enacted only very recently will raise the bar on that test, but when these issues and these reforms were proposed by the commission, the base level of that bar was clearly in the minds of the commission - and I'd suggest in the minds of the government and the parliament - much higher than the Federal Court now tells us it actually is, so any raising of the bar that's occurred as a result of the passage of the amending act is from a much lower base than was anticipated. It is unclear and will remain unclear until there is another judgment on the law as it currently stands today or the parliament clarifies the situation as exactly where the bar is.

Melbourne Airport is looking to invest somewhere in the order of half a billion dollars in assets which this commission would consider to be aeronautical in nature over the next five years. We now sit in a situation of less clarity than frankly we have ever had since the time we purchased the airport. We simply don't know. It's not enough, I think, for us to be left in that position. This is clearly an issue that goes beyond airports. The commission has been asked by the treasurer specifically to consider this question, and it's our view that the commission needs to consider it broadly and not just in the narrow focus, just not in the narrow focus of airports.

It also raises a wider range of policy issues. What does this now mean for the COAG reform agenda that was agreed at COAG in February of this year where there was an assumption that light-handed and monitoring-type frameworks would stand instead of access regulation. That now is in question. What we need now is a policy-led response from the government advised by this commission that deals

widely with this question because it is not the way it was thought to be. Whilst we'll continue to deal reasonably and in good faith, at some point we're going to have to make a decision to enter into agreements that are going to involve the investment of somewhere in the order of half a billion dollars.

We think it is really important, and that this inquiry has taken on a fair greater importance as a result of the decision of last week, and we just urge the commission to think through this and try and solicit from policy-makers more generally, and maybe even from the treasury, what the wider government response to this really is, because that must inform the outcome of this inquiry.

MR POTTS: Thanks very much. We might try and break this up into different areas, if we could, in terms of the way we handle the discussion. We might begin, if we could, with the very first terms of reference we have in the commission, and that is to evaluate how effective price monitoring has been in terms of constraining possible monopoly behaviour by airports, which is of course the rationale for having the regime that we have. You both made some observations on that, some comments on it. Perhaps I could try and tie two together and ask for your comments in relation to them. But you were emphasising the point that Richard Snape made in 02 about the constable in the cupboard. I think that's quite a legitimate point.

I guess what we've had from many participants in their submissions is the difficulty of knowing when something should be triggered, of knowing whether a particular airport or airports generally have gone beyond the bounds of reasonable behaviour, if you like. I guess the comments that you're both making in relation to how you evaluate the financial conduct of airports in the last five years, for instance, and how you juxtapose that with what we're getting from other stakeholders like the airlines who are using other consultants, for instance, to come up with quite different conclusions about the behaviour of airports, raises the question of, is it feasible under these arrangements to know when something should be triggered. You mentioned, I think, Chris, that if you'd implemented a 50 per cent increase rather than a 20 per cent increase, or whatever it was, then you would expect something to happen. But the question is, what would happen if it was 25 per cent rather than 20 per cent. It's always the things at the margin that become more crucial.

So I'd be interested to have your observations on that issue, and in particular whether it's within our capacity, if you like, to be forming judgments on whether the financial conduct of the airports in the last five years or so has been reasonable, without a very forensic analysis of the conduct of individual airports that perhaps is the sort of thing that the ACCC might normally undertake.

DR MUNDY: Well, I mean, I think it's a long bow to draw to believe that a monitoring regime was ever going to, at some point in time, blow a whistle and say

the line has been crossed. The monitoring regime in our mind is just one of a suite of information sets that the government has at its disposal. The fact that people aren't going to the government and complaining about every airport would seem to suggest to me that acceptance is a pretty good test of reasonableness. It's clear from submissions that have been made to the commission that there's a whole pile of non-price conducts which are in play, some of which are acceptable and some of which are not.

The point you make, Gary, is absolutely right, that there is a more forensic approach available with the ACCC. It's what they do. I would have thought that the law at Part VIIA as it is currently structured provides the government with exactly the opportunity to send the ACCC on a more forensic examination if the government believes prima facie there is good reason to do so. That was the sort of framework that we were alluding to in our initial submission to the commission that if everyone is over there and is quite happy with what's going on and getting on with it, then there's probably not a problem. Let's be honest about this: if airlines are unhappy about the conduct of airports, the department knows about it pretty promptly. Airlines are not shrinking violets. DOTARS knows those issues are brought to them.

It seems to me that again this is a policy that is about identification of conduct that may be problematic from which further steps can be taken. The criticism that we have with the government, or what is apparent, and what the airlines are reasonably entitled to say is, "Well, we've seen all this conduct in some cases but it doesn't go anywhere." The government has chosen not to use Part VIIA, the inquiry provisions, and potentially the imposition of prices notification in relation to conduct it finds unacceptable. Now, that's where the grey area is. I think the idea that you end up in a world of picking apart every last nut and bolt of cost, really leaves you in a world which looks a bit like what we say in telecommunications and that's highly undesirable.

So the real issue here is - and it's almost a fundamental issue in the design of a monitoring framework - that there remains an administrative element to it, that there must be an administrative decision taken on the basis of the monitoring information that some further step is required. People say, with some justification, that it doesn't appear that there is another step. The constable is still in the cupboard; the question is, when does he come out. That's the challenge in that. Now, my view is that if an airport was exposed to an inquiry under Part VIIA you'd probably pretty quickly see its conduct turn around if its conduct was unacceptable.

I think it is possible to draft a reference to the ACCC under VIIA that would probably enable it to get non-price terms and conditions. So the question really here is about the government making clear in a general sense when it might start to pull out VIIA and send the ACCC off on the sort of forensic inquiry that you alluded to.

MR POTTS: So I take it from that and your other observations that you regard the conduct of Melbourne Airport as being satisfactory. In fact you said that Qantas had, by implication I guess and accepted that, by nominating Melbourne Airport for an award. I mean, what is the implication of that in terms of the reinterpretation, if you like of, of Part IIIA? Does that mean you think that Qantas would be quite happy to continue with normal commercial negotiations without going down this other route that you seem to be suggesting now would be available to them more easily?

DR MUNDY: Well, it seems to be - I mean, without wanting to put words in Qantas' mouth - from their submission to the commission of late last week that in the event that something isn't done about dispute resolution at a policy level, that they will proceed to have airports declared. There is no indication in Qantas' submission to the commission that that action will be tempered by their view of previous conduct and we have to take them on face value. That's clear and, subject to what effect the amending act might have, their analysis that it's probably pretty close to the money; that declaration would flow.

That may be changed by the amending act, but that is unclear, and obviously the pursuit of that clarification would take four months in the council; two months for the minister; who knows, three, four, five, six months in the tribunal; and then we can get to the Federal Court and discover what the law is. What are investors going to do in that time frame?

MR BARLOW: In the meantime - I think that's the key thing here - I started off by saying at the moment investors have confidence and will invest. With this uncertainty, as Warren said, there's no way our board would be investing in that half a billion dollars of absolutely essential infrastructure. Now, if Qantas actually thought that through and it applied to every airport, they'd be thinking, "Our premium passengers that are flying to LA will be going out there by coaches instead of going through terminals," because that's what it means, certainly in Melbourne. I'm not sure they've thought that through as a company yet. They'll have to speak for themselves. There are different parts of Qantas that have different views of life. All I can repeat is that in the discussions that we had - and Warren alluded to those final decisions that I had with senior people in Qantas - they wanted those new facilities and the money spent, and therefore they trusted us.

MR POTTS: There's a number of issues here, but in terms of dealing with this uncertainty - and I can understand that from an investor's point of view - it's presumably within Melbourne Airport's hands to eliminate that uncertainly, for instance, by going down the undertaking route.

DR MUNDY: We could go down the undertaking route. We've had some

experience with the undertaking route. We found it very intrusive, we found it driving into the sort of operational issues that Chris alluded to earlier. I wasn't involved - it was before my and Chris's time - but I am reliably advised that one of the issues that exercised the mind of the ACCC when considering the undertaking was how were the fire trucks going to get on the airport and where was our undertaking to grant fire trucks rights of access. So the detail of the operational intrusion was quite problematic.

But at the end of the day we could go down the undertaking route. We would probably need to work it through in some detail with the customers, reach an arrangement and then back-fill it, but the policy of the government in which we have invested heavily in the last five years has implied that such a route is not necessary, and it seems that this court decision is undermining what people have generally understood to be the policy. There's a two stage analysis here: "Is the policy right in its general construction subject to some tinkering at the edges?" which we generally support; and, if that policy is the correct policy, then the law needs to be changed in some way to give effect to that policy, rather than the policy being effectively abandoned because the law isn't as, frankly, most people believed it was.

We could go down the undertaking route. The reason why we haven't gone down the undertaking route - and policy, I would have thought, has been constructive - is the undertaking route is very expensive, and it is much easier for us to negotiate in bilateral terms with some confidence that our conduct is sufficient to avoid regulator intervention and get there. It's a much cheaper and more systematic approach and it, frankly, also means that we can conduct our negotiations with our customers in private rather than, if we go down the undertaking route, having to disclose all sorts of information. The commission's consideration of the undertaking process is public, and that mightn't be a circumstances which we, or indeed airlines in all cases, might want to pursue.

So the current framework is actually superior to the undertaking framework in the event that people are acting and behaving reasonably and there is some understanding about what is generally constituting reasonable conduct.

MR BARLOW: I think that is the key point: the operation that we've got now, as I said, with a few exceptions which you've pointed to, really is world's best practice. We've talked about the comparisons with other airports and other aviation industries throughout the world, and I'm sure there's some weakness in that, but overall any of us that fly around the world and come back here into Australia would say that the aviation scene is extremely healthy and works extremely well, and that's across the board. Of course there are some discrepancies, of course there are some arguments, but overall it knocks spots off most places in the world, and we should not destroy that.

To answer your question more directly, there are going to be some grey areas: when does the constable come out, when doesn't he, but when you see it, you know it. There are a number of places where, clearly, he doesn't need to come out of the cupboard, and we've looked at some of those. There are airports throughout the whole of this country that have got signed-up contracts with airlines. A constable doesn't need to come out there. Those that haven't - perhaps he needs to look hard at it. But to go through the process of the courts that we're going through now, ending up with this Federal Court decision, is not good for anyone in the aviation industry.

MR POTTS: Just while we're on this Part IIIA question, I think I can take it from your comments that if the interpretation of the Federal Court decisions stands, - as you said, at the moment there's no policy change - the whole viability or appropriateness of the price monitoring system becomes questionable. Is that an interpretation of what you're saying, that you feel as though you will be forced down either the undertaking route or - - -

DR MUNDY: As I said, you only have to reflect back on the NNI processes to see the sort of game that went on. Frankly, it went on by airports - I did it - it went on by airlines, and it went on by airlines quite often for anticompetitive reasons. Airlines would oppose certain things on the basis that they didn't need them but their competitors did. So that process was highly problematic. We've seen it in the planning processes, the Airports Act. We have seen airlines quite deliberately object to very reasonable developments on competitive grounds. Ansett's conduct in relation to Virgin Blue's entry is classic. They sought to stop that development, not because it interfered with their operation in any meaningful way but because they sought to preclude the competitors. So we've seen this sort of gaming conduct.

If we are in a world where airports are de facto deemed declared - and, subject to the effect of the recent amendments to the act, that does appear to be the case - there doesn't seem to be an awful lot of purpose to the collection of data and the publication of data under Parts VII and VIII of the Airports Act or under the procedures in Part VIIA of the Trade Practices Act. Why? Because parties will be forced to negotiate and disclose information and, if they don't do it, when they end up in arbitration the ACCC will extract it from them. So there is no purpose. There will be no need for information to be collected and published for the government to form a view about behaviour, because the government won't be forming a view about behaviour; the ACCC will be determining outcomes if parties can't agree.

So the whole price monitoring framework will become an unnecessary burden, and if it gets into the sort of drilling down and forensic examination of costs and prices that you're alluding to, Gary, then again it's not useful for that purpose. Its purpose is to inform policy-makes about the need for regulatory intervention. Its

purpose is not to determine, and never has been to determine, the appropriateness of any given set of prices, so it becomes irrelevant and therefore an unnecessary cost, and I'm sure the chairman of the commission would have a strong view about unnecessary regulatory burdens that lead to overblown costs. So that's where we'd end up.

MR BARLOW: Can I just be very clear on the implications of declaration with the ACCC involved in the middle of it, and just take a real example that I spoke about of expanding the international terminal at Melbourne, where we need a number of extra gates for the airlines to operate from - a significant number of extra gates in the next four to five years. That process has been through our board and we're going to do detailed design on it. If the ACCC, for whatever reason, came in the middle of that - and at the moment we're going to start serious construction in about a year's time or just under a year's time. If the ACCC come in the middle of that, there's no way our board would say, "Go construct." They would wait until we have the discussions with all the airlines, reach the decision or not, and if the ACCC had to be brought in, they would go through a process of time, and realistically probably it's about a year or so, the fastest track for that, so a year delay straightaway. If we didn't like what the ACCC said, we wouldn't build it. We'd go back to the drawing board, think of another way around it and go through the process again.

DR MUNDY: It needs to be understood that we've been there before. When we built the domestic express terminal, we had an agreement with Impulse, and then the ACCC came and chiselled the price when we were in construction. It's arguable whether the ACCC felt it could get away with that on the basis that we wouldn't dare abandon the project. Now, the reality is that once bitten, twice shy, and if we're in a situation where we're subject to approximate regulatory price determinations, then it is only sensible to see what those price determinations are before you invest capital. Under the current regime, we have had sufficient confidence in it to proceed as we have. If the regime continues, we will continue to have that confidence. But if we're subject to the application of IIIA, our board will have to reconsider that.

The other thing that's important to realise is that there has not been an arbitration under Part IIIA of the Trade Practices Act. There has not been one. So we have nothing by way of precedent to draw upon. Frankly, if you go and have a look at arbitrations or setting of reference prices under the gas code, dare I say if you go and look at what's been going on in telecommunications, that's not the sort of precedentary sort of environment that's going to fill you with joy and confidence. So it creates a tremendous amount of uncertainty and a level of uncertainty which is well beyond what we currently have.

DR BYRON: Could I just briefly take up the question of the dispute resolution process. In the submission I think you empathise with our concerns about a dispute

resolution process that gives one party an incentive to not negotiate in good faith, and I guess what we've been grappling with and would like your assistance with is how do you design a dispute resolution process that ensures parties do negotiate in good faith rather than one side thinking, "We'll get a better deal if he we go to the arbitrator," and therefore not - - -

MR BARLOW: The one point that I made and repeated is that a counter-offer must be on the table from both sides; the more detailed stuff, I'll ask Warren to do.

DR MUNDY: This isn't probably unique to airports, this has been a longstanding, understood concern about negotiate-arbitrate models. We've seen conduct in other industries, particularly the gas industry, where there's a reference tariff, and therefore if the reference tariff isn't charged, off they go and what ends up is being a reference tariff. It's complicated in this case in an operational sense by the fact that you have multiple users and common use facilities who are competitors with each other and you have to manage the whole lot.

There is no issue in our mind about the problems of vertical integration. There is no reason to believe in our mind that an airport will actively seek to discourage use by users, unless it's capacity constrained and then it might start to undertake some sort of price discrimination of some nature. So going back to the proposals that we originally put to the commission which the commission obviously wasn't particularly enamoured with is this notion that we have this vehicle to look at - and you could concatenate the Part VIIA processes, but almost that there has to be some evidence of abuse of market power before you get into the IIIA environment. Now, I have issues about operational issues, about multiple arbitrations within a IIIA sort of context, primarily if operational-type, non-price terms and conditions become involved because it may well become very difficult and messy about gate allocation and all sorts of things like that. But if you're thinking primarily about the question of price, then I don't think that's so much the issue.

But the real issue in my mind is, and as we've always said, that if an airport's offer is reasonably compliant with the principles, and assuming the principles are reasonable, then why shouldn't an airline accept it? Airlines - and let's face it, ultimately negotiations are generally multilateral in their nature - have a capability to come back with an offer and they have done it. I mean, we know from the BARA claims that the prices that were set in Adelaide were set on the basis of a counter-offer it made. As I indicated before, the prices that were ultimately set in Cairns in relation to international services were off the back of a counter-offer made by the airlines, a reasonable counter-offer that was amenable to acceptance.

So if people are working in that world - and it shouldn't be beyond the wit of senior officers of the Department of Transport and treasury to form a view that if

things are breaking down and falling apart, it should be possible for a decision to be made about whether this needs to go off to VIIA. But what the fundamental question is is about dealing with the conduct that's there and does it breach what the government's policy is, and the problem that we now have with Part IIIA is the conduct is irrelevant.

So as Chris says, if a counter-offer can be made which is consistent with the principles and there is an offer on the table from the airport which is also consistent with the principles, then I think in those circumstances, adults will work it out. If one or two of those is not the case, then either the airline should be told to, "Go away, you're just being vexatious," or someone should say to the airport, "You're really not playing by the rules of the game here and if you really want to have it out, you can go and sort it out at the ACCC." It's that sort of process, so you create the incentive for a counter-offer, but you have to have some overarching view that both positions are reasonable. Whether that means you insert a VIIA-type inquiry in there or not or you just let it go straight to some dispute resolution process I think is debatable. I guess the VIIA inquiry slows things down, but a VIIA inquiry can be conducted in three months.

DR BYRON: Thanks.

MR POTTS: Just following on from that, the concern we had was - and if you look at the literature in relation to this issue about final offer approaches - it's generally used for one-off issues that need to be negotiated and settled, rather than becoming an ongoing framework for setting charges or prices. The concern is, if it's ongoing arrangements, that the respective parties know which arbitrators will, they think, give them a favourable decision. That will be their view, without naming who the other traders might be. So there will be a tendency for the parties concerned, to the extent that it's possible, to be trying to move the negotiations towards an arbitration framework that's going to suit their particular purposes and that given that this is going to be an ongoing process, that will become a very well-informed one, so that the parties know exactly where the outcomes are likely to be in terms of the chosen arbitrators. So I guess the issue in our mind is whether, if you go down that route, in time you will end up with a de facto form of price notification almost, if you like, because the parties will know where the arbitrator will come out, if given the task.

DR MUNDY: Two things first: final offer arbitration won't work, and it won't work precisely for the reason you identified, that it will typically not be a single issue. There will be a suite of them and they will need to be balanced and weighed, and there's a real issue about consistency and deliverability of the offer. So that's the first problem. Final offer arbitration is sometimes called baseball bat arbitration. I think it's fine if you want to determine the price of an apple but probably not much else, particularly where there's a complicated dimension of price and quality - by

"quality" I mean anything that's essentially non-price - but also where there's multiple users. I think what the final offer then becomes - if the final offer from one party is not consistent with the needs of others, you're also using a facility, the whole thing becomes a bit of a mess. So I think the notion of final offer arbitration becomes really problematic.

You're right, but the point is that you have to create significant incentives for agreement or, if you like, significant disincentives for failure to agreement that arbitration is an undesirable process. Now, we come back to the point: we have been able to negotiate very extensive agreements with both major domestic carriers and all the international carriers, and so have other airports. Is arbitration sort of there? Well, it's an expensive business. The real risk is the richness - I very much doubt that the richness that we now see in some of the agreements that emerged and which may emerge in the future will not be constructible under Part IIIA. I just don't think they're the sort of thing an arbitrator can construct because they are agreement rather than arbitration, and therefore they're likely to be more rich.

I mean, you draw on the question of whether people will want to go to a particular arbitrator. One of the reasons why we have suggested that commercial arbitration is more highly desirable is then the parties typically - in a commercial arbitration position - is either the parties can agree or essentially one will be pulled out of the hat by the president of the Institute of Arbitrators in the state concerned; whereas if the arbitrator is the ACCC then the ACCC is the regulator. The ACCC in arbitration has specific obligations under the act which have been about transparency and consistency and ensuring that its precedents are well understood which have recently been put into Part IIIA.

So the ACCC will be bound to act in a very, as you say, deliberate and predictable way because the law requires it to, and if it doesn't, well, we all tread to the tribunal and away we go. So the sort of concern that you have, Gary, and you've just expressed, is much more likely under IIIA than it is under some other commercial arrangements where the parties either agree on an arbitrator or effectively one gets pulled out of the hat. That's why we were building that option into the stuff we originally put to the commission that where there was a dispute, and a legitimate dispute, that either party should be allowed to bring in a commercial arbitrator to resolve it, and if the other party won't agree to that then the obvious consequences flow - either the airport needs to be dealt with under more rigorous regulatory intrusion, or the government needs to say, "Well, if you're not fair dinkum and you're not prepared to submit this to commercial arbitration, get out."

MR BARLOW: So we think the commercial aspects of it does away with, to a certain extent, the point that you were making. Although it's not perfect we do accept that.

DR MUNDY: Because there are a limited field of competent arbitrators but, you know, to solve the problem you're alluding to, that is better than an arbitrator who has statutory guidelines they have to comply with.

MR POTTS: Just to finish this off, just in terms of Melbourne Airport and its dealings with the airline in your dispute resolution provisions and the contracts, which I presume, it is, is there a way that takes you right to the end so that if the parties are still disagreed, you are agreed that a particular arbitrator will be appointed, or is the end point one where the parties have to agree on an arbitrator?

DR MUNDY: No, there's two issues here. There are two issues in arbitration and they're very separate: there's disputes within agreements and then disputes about agreements. In the situation of disputes within agreements, we have provisions - and I'm sure we're not going to get dragged through the courts for disclosing confidential information here, because they're very standard - and the procedure is very simple. It is this: if there is a dispute notified by either party around a range of matters for which there is dispute resolution, which isn't everything but it's the bulk of matters, then if the dispute is notified, the CEOs or their delegates will meet and discuss it formally. If agreement can't be reached then, then the parties will agree on binding dispute resolution. If the parties can't agree on the person to conduct that dispute resolution - it will be done by expert determination - then the parties have agreed - and this is everyone we have an agreement with - that that dispute will be resolved by a person nominated by the president of the Victorian chapter of the Institute of Conciliators and Arbitrators, whatever they're called. So it is binding and the decisions are binding on both parties absent any manifest illegality or any of those sorts of normal carve-outs.

The situation with regard to what happens when agreements expire - well, I think that's actually what the airlines are talking about - is what happens if the parties cannot agree. The problem with saying, "Well, there will be binding arbitration as well," that becomes much more problematic. It's a different logical problem for us. The notion that, "Well, if the parties can't agree" - you see, people have said to us - there's been suggestions, "Well, maybe one way forward is if the parties can't agree then the prices just should remain until the parties can agree another set of prices." That doesn't work. So there is an issue about that. We actually think that's an issue that's best dealt with in a policy framework because you will have situations where there will be heavy to and fro. But, as I said, these negotiations are not easy, they're not trivial, they're complicated, they're robust, they take time. In the negotiations that we've had, particularly with Virgin and with Qantas, there has been give and take on price and non-price terms and conditions. They have not always got what they want and we have not always got what we wanted.

But we've ended up with enough on either side to go away, which leaves everyone in a reasonable position. Why? Because quite frankly if they didn't, they wouldn't have signed and their conduct is such - the conduct of the airlines is such - that when they enter a situation that they are not happy about and they are being stood over, it's pretty apparent. We come back again, the issue here is how do you create an environment that forces people into reasonable behaviour. Now, we believe that the weakness that has perhaps been displayed today has been a reluctance on the part of the people administering the regime to actually come out and deal with behaviour which is, if not in breach of the general principles, then certainly pushing up against the boundary fence.

MR POTTS: Well, Chris and Warren, I think that's all the questions we have. I think a number of the issues we wanted to touch on were picked up in your introductory comments anyway, which were very helpful. So thank you very much. Are there any final comments you'd like to leave us with?

DR MUNDY: No.

MR BARLOW: No, I don't think so, other than to recap a very, very good system now, needs a bit of a tweaking, and let's hope we can keep it as it is now.

MR POTTS: Good. Thank you very much.

DR MUNDY: Thanks, Gary.

MR POTTS: Welcome to the hearings, Geoff. I'm not sure if you were here for the opening statement I made but if you could just mention your name and the organisation you represent for the record, that would be useful, and then perhaps some introductory comments and we can take it from there with a few questions.

MR BREUST: Okay. That's great. Thank you very much, Gary. Good morning everybody. My name is Geoff Breust. I'm managing director of Regional Express which is a regional airline, the largest independent in this country. We operate particularly out of Sydney, Melbourne and Adelaide airports, so we have quite a considerable relationship with three of the seven major privatised airports in this country, as well as quite a number of smaller regional airports.

Our position really is that we believe that there is considerable monopoly power available to the large airports and as a result of that I think we believe that there needs to be an effective level of oversight to ensure that there's no actual misuse of that monopoly power. I guess in a lot of ways it's fairly easy to adopt a sort of economic rationalist approach to these things, but at the end of the day we really need to have a system that covers off particularly what the government and I

guess what the community requires in terms of national interest and policy objectives; I think some sort of balance between what we can use in straight commercial and economic terms, tempered with some oversight associated with meeting those policy and national interest objectives.

In a lot of ways we believe that a straight economic rationalist approach would probably force regional services out of the major airports. In a lot of ways we believe that the adoption of straight, pure pricing arrangements would probably lead to at least a reduction in services, if not the removal of services from some communities. Now, whether that's in the national interest and whether that suits the government's policy objectives, it's probably fair to say that there would be some issues, both politically and socially and economically as a result.

We believe that the main tool to at least achieve a minimum degree of control is simply transparency. Under the price monitoring arrangements that we have currently, obviously we do have a level of transparency, but that only really applies to the aeronautical and aeronautical-related charges associated with major airports. Rex believes really that we should extend the definitions of what's called aeronautical and aeronautical-related charges to include all of those activities that an airliner and air service operator requires to actually provide the service. So in other words, it's not just simply landing charges or the charges associated with passengers moving through a terminal, it also includes the costs associated and even the access associated with gate lounges, facilities for officers, for engineering, for flight crew and so on, even down to the extent of hangar facilities for the provision of services so that you can at least maintain your air operator's certificate and operate your services. All of those activities, we believe, should be included in that monitoring process. In that way you're bringing an effective level of transparency to it all. We just don't believe at this point in time that it goes wider.

One of the issues that we've actually seen along the way, and I think to a degree was raised in the discussions just a moment ago with Melbourne Airport is that we currently have a number of agreements between airlines and airport operators where obviously they're commercially negotiated and are in fact confidential. I guess you could say that we as a small operator don't have a lot of bargaining power when it comes to some of those commercial negotiations, but we've actually found that in many ways we're actually put at a fairly significant disadvantage because of arrangements that have been put in place through commercial negotiation with major operators which have an impact on us. We can't really go into the detail of those because we really don't know what they are. But we've actually been limited in certain activities because the airport has said to us that they can't go down a particular track or adopt or agree to our proposal because they're limited by contractual arrangements that they have with other operators and that's a difficulty that we see. Full transparency in that sense would, in our view anyway, ensure that

there are not too many sweetheart deals out there which effectively put one competitor in a better position than another, and we see that as an issue.

Briefly in terms of dispute resolution, we do believe that the approach of an independent arbiter or an independence in a level of dispute resolution is required. We think that that could be achieved, not simply using the ACCC arrangements or indeed using some outside appointed independent arbiter, but the actual establishment of an ombudsman-type arbiter who has specific knowledge, not so much experience but certainly knowledge in relation to the operation of airports and the operation of airlines, so that we get a degree of expertise rather than relying on - in Melbourne Airport's case - the provision of some independent person that's pulled out of a hat who really doesn't necessarily have the expertise or the capability to come to a particular view.

We believe that as a last resort that sort of ombudsman type or independent arbiter type approach would ensure that you would have to go through the commercial negotiation process, and if resolution can't be achieved but as a measure of last resort, that goes to that authority. In some senses I guess the government could in terms of policy provide some guidelines in relation to that, but I don't necessarily believe that the ACCC arrangements would have the necessary specific expertise or the specific issues involved with airline-airport arrangements to be necessarily appropriate.

In some ways the final offer process of arbitration has some merit, but I think at the end of the day a rational approach by an independent arbiter based on commercial negotiations in an environment where there is transparency. So, in other words, at the moment you have a situation where the airports have really got all of the knowledge. They understand and have the details of all of the negotiations and the commercial arrangements between all of the operators. The individual operators when they go to the table have no knowledge of any of the other arrangements. So in effect you start off from a long way back. If it's a situation where there is that degree of transparency, at least the playing field is relatively level in terms of the commencement of those negotiations.

One final point - and it's a little bit outside the normal scope of the inquiry - is that Rex does deal with a number of major regional airports who in a lot of cases receive competitive services. We've found that those airports in particular adopt processes which are probably even worse than the major airports. The only real sanction that we have in those circumstances is the threat of withdrawal of our services, unlike the smaller airports where there is a great degree of concern about whether the services will remain, so therefore the ability to negotiate and work through proper terms is much more prevalent. Some of the major regional airports have got a lot to learn and a lot to be held accounted for in that area as well. So

they're just some brief remarks to kick things off. You would have received our comments on the report and I'm happy to discuss some of the other issues.

MR POTTS: Thanks very much, Geoff. You've picked up quite a few of the issues that I was interested in raising with you, so I might begin with those if it's all right. On this transparency issue, you seem to be emphasising that in terms of the information that was given to you as an airline at the moment, it wasn't wide enough in terms of its coverage, but what about the question of whether it's deep enough, if you like, because what we're talking about here is the setting of charges and when talking about the charges, we're interested in the financial performance, I suppose, of the provider of the service. Equally I think from the point of view of the provider of the service, they're likely to be interested in the financial performance and implication to the user of the service.

MR BREUST: Yes.

MR POTTS: So I guess I've got two questions there. One is, in terms of this greater transparency which you think is important in terms of getting reasonable outcomes, do you see that as a two-way process, so there are obligations on the airlines to provide information to the airports about the implications of different charge levels on passenger numbers and the like or do you see it as essentially something that should apply to the airports rather than to the airlines as well, and the second question is, is the issue you're raising one of wit, as I mentioned, in terms of how much have you covered, or is it also a matter of the information that you're getting at the moment doesn't go deep enough?

MR BREUST: I think as a public company, there are certain restrictions that apply to us in terms of some of the information that we can make public, but having said that, at the end of the day, to a degree we do believe it's a two-way street. The operation of an airline system involves not only contributions from airlines but it also involves contributions from the airports and indeed other bodies such as Airservices and CASA and so on. We believe that it's in terms of a total system and it should be as transparent as it possibly can. But I think in the main, it comes back to transparency of an infrastructure provider who is in effect a monopoly provider and I think that, from not only our point of view but also from the public point of view, needs to be as transparent as it can be.

In terms of the width, yes, certainly; extending it out to cover the sorts of areas that I mentioned earlier, even down to the lease of land, say, for hangar facilities, the leases and access to offices and storage areas and facilities where we can do online maintenance, where our catering can be put, where our baggage handlers and tarmac services can operate their services from, et cetera, et cetera. I think that coverage needs to be there in terms of width.

In terms of depth, I don't think it needs to be overly onerous. I think it needs to cover certainly the pricing aspects of it and certainly the areas and what's involved in the term and the physical sort of nature of it all. I don't think it needs to go too much further than that.

MR POTTS: Good, okay. This issue of bargaining power which you touched on, and I think you were here for the discussion with Melbourne Airport and the questions that we were asking there, but can I put a similar question to you about if it becomes a permanent-type arrangement, so that there's a framework in place that allows for arbitration if the parties can't agree, even if the arbiter is not the ACCC, do you still see that in practice over time the parties, would come to know - unless there's some revolving of the arbiter, so a different basis is used for arriving at decisions - where that arbiter would come out, and that would essentially condition commercial negotiations, so you might think that they're commercial negotiations but in reality perhaps, they're not fully commercial in the sense that they're being conditioned by whether respective parties know the arbiter will come out?

MR BREUST: I think it actually happens not so much there but perhaps even further, because what we're suggesting is that if there is that level of transparency there, both parties will know really the borders in terms of where the negotiations are going to go. I think in that sense it takes us a long way down the track before even going to arbitration because at the moment, we really don't know where it sits. We don't really have any idea. We can go along to an airport and say, "We would like to lease this particular part of the terminal facility," or, "We would like to build on to this particular part of the terminal facility," and you'd get a price and that's it. In fact we don't really know what somebody else has paid for it, whether it's an airline or indeed in some respects the amount that's been paid by a retail outlet. So at least in terms of that level of transparency, you'd know basically where the borders are and effectively if you negotiate within those borders, you should be able to come to a reasonable outcome.

I would suspect that if it got to the point where you still couldn't reach agreement and you had to bring in the independent arbiter, there must be some particular major issue in it that would require the involvement of somebody like that. So I think we would go a long way before we would get to a point where it was - I think the conditioning would already be there through the transparency process but at the end of the day, the provision of the independent arbiter at least allows a mechanism by which some sort of dispute can be resolved and moved on, without going through the long process of going through ACCC, going to court et cetera.

MR POTTS: In a practical sense, from Rex's point of view, are there a number of entities, whether they be individuals or firms, organisations, who you think would

have the technical, professional capacity to be effective arbitrators in such a system?

MR BREUST: No, none come off the top of my head in terms of that. To my mind, it would have to be probably just a government appointment. I don't see it as a huge bureaucratic exercise. I think it would possibly just be an appointment by perhaps the minister, and that appointment lasting for a set period of time, but the appointee brought from an area with suitable expertise to be able to resolve the dispute.

MR POTTS: I guess my question was even if the minister makes a decision - and he'd be interested in making sure that if such a system prevailed, the decisions would be acceptable to the stakeholders, including the airlines - and I guess my question is, from your perspective, who are the entities out there that you think would have the professional capability to make a sensible decision on charging levels?

MR BREUST: Off the top of my head, I couldn't give you a straight answer on that. I'd need to go away and think about it.

MR POTTS: No, that's all right. I guess my question is implying - you know, are forced back towards the ACCC, for instance, or are there a number of bodies out there, as you see it, who would have the capability of doing this?

MR BREUST: It's such a specialised area that I think you would need to have almost a unique appointment.

MR POTTS: Right. On this issue of countervailing power which you mentioned, and it's a fairly familiar one, I do have to say that going around talking to airports as we've been doing, and some quite large airports, it mightn't come as a surprise to you but in a way, they've been - maybe "complimentary" is not the right word but we've made a point of saying that Rex, for instance, is very effective in negotiating certain aspects with airports. So even though you're a relatively small player compared with the two major airlines, nevertheless there is some feedback that we get that perhaps you outbox your weight class, if you like.

MR BREUST: We like to think we do.

MR POTTS: Yes. So I make that as an observation but I guess if there's any comment that you'd like to make on the record in relation to that it would be useful.

MR BREUST: I think the difficulty really - and, look, it is true we've had a degree of success and we've had some fairly significant disputes with a couple of the airports over the last few years, but I would say that we really have had to resort to approaches and strategies that I don't necessarily believe is necessarily the right

thing. We've had to use a lot of political pressure, we've had to use a lot of media pressure to effectively garner support from our stakeholders to put pressure through the political system back onto the airports to make things happen. Whilst it can be reasonably effective, I don't see that as perhaps the best approach or indeed the long-term approach. I think the regulatory or the oversight system that should be put in place should enable us to go through the processes of negotiation and come to a position using that system without necessarily bringing in outside.

I'm sure the political people that have been involved in our disputes over the last little while would prefer not to see that happen, and we would not necessarily prefer to see it happen either. So we've had to resort to those approaches and strategies simply because really we've started from a position in terms of bargaining power so far behind that we've really had to garner that support through those levels to achieve what we consider to be a reasonable outcome.

MR POTTS: With the smaller regional airports do you find that you have to follow a similar approach, or where perhaps the bargaining power is more even?

MR BREUST: We've actually found the take it or leave it approach in some of the regional airports is more prevalent than at the major airports, especially in those airports where there is competition, and particularly competition between us and the other major carrier. To a very large extent those airports consider themselves to be bullet-proof because they've got that level of competition. Their charges are quite high and they think that there is no risk of them losing a service. The only sanction that we have in those circumstances to get a reasonable outcome is to either make the threat of the withdrawal of our services and the reduction of competition, or indeed walk away, and we have walked away on some occasions.

MR POTTS: Right. That's been effective to an extent, the threat of walking away, rather than actually walking away?

MR BREUST: The threat of walking away has worked in a couple of instances, and for other reasons we walked away out of a particular market. That was more for commercial reasons, but the message was certainly received loud and clear that the approaches of the airport weren't necessarily the right one.

MR POTTS: Just a purely factual question, if you like. In the last two or three years there have been substantial increases in fuel charges, of course, which have impacted significantly on airlines. Are you able to give us any feel for what impact that has had in terms of passenger numbers that are going through Rex? I mean, have you found that the higher charges have discouraged air travel, for instance?

MR BREUST: It's how it has been managed. There's no question that the fuel

increases add a substantial cost pressure on us, but there has been the ability to impose the fuel surcharge. We've done that and we've effectively followed the major airlines in doing it. We're in a situation where, to a fairly large extent, even though we do have quite significant throughputs in terms of volumes, it still makes it fairly difficult for us to negotiate in comparison to the major airports in terms of throughput discounts et cetera.

We also uplift a lot of fuel in regional centres where, of course, the fuel price with cartage and other costs are significantly higher, but we've had the benefit of the fuel surcharge. But what we've actually been able to do - and this is as a result of a lot of the work we've done internally in reducing our own costs and the other costs that we have a degree of control over - is to not impose the full surcharge, particularly on our leading discount fares and our lower end discount fares. In a lot of cases there's very little fuel surcharge effectively on those fares at all. When you buy a ticket, of course, it will have the full amount on it, but it's the price at the end that the customer pays is the relevant one, and what we do is we pull the base fare down and put the standard fuel levy on it, but it still comes out at $99.

We've been very particular at ensuring that we've maintained those leading fares at those lower levels to ensure that we keep generating demand. It has actually worked a little bit for us in the sense that we've been able to maintain a pretty good relationship between our leading fares to the costs of actually driving, because in a lot of ways our biggest competitor is the car. It has actually worked reasonably well, so we've still continued to increase demand levels or maintain demand levels during this period but we're under great cost pressure. The beauty of the fuel surcharge is you can put it on but you can also pull it back off again, but in terms of then moving your base fare, your normal fare, through increases and other infrastructure and regulatory charges, puts a lot more pressure on. Now, people will understand the fuel side of things; they don't understand an increase in fares which come from other infrastructure costs.

MR POTTS: What, roughly, is the size on average of the fuel charge? You mentioned you apply it differentially across tickets but on average - - -

MR BREUST: It's close on 20 per cent of our direct operating costs is fuel.

MR POTTS: Can you put a dollar figure on it in terms of an average ticket price, just roughly?

MR BREUST: Just roughly. Our average fare with the fuel levy is about $120, so it's roughly 20 per cent of that or a bit more than 20 per cent.

MR POTTS: Right. Thinking about this in terms of landing charges, is there any

scope, as you said, to apply landing charges differentially?

MR BREUST: I'm not sure what you mean.

MR POTTS: You're saying with the oil surcharge, for instance, because you're concerned to support the lower end of the market, if you like, you'd add it to the same extent there as you did for higher price tickets, if you like, where the demand is more inelastic, so it's less price responsive. Could you envisage such a system applying in relation to landing charges, for instance?

MR BREUST: Well, to a degree you actually do.

MR POTTS: You do?

MR BREUST: Because what we do in terms of working through our charges for - effectively our airport charges. Generally in most regional centres you just have a single passenger charge, although there are a few places where you get both a landing charge and a passenger charge. At the major airports you get both a landing charge and a passenger throughput through the terminal charge, a passenger facilitation charge. What we generally do is we work out a level that pretty much covers those two charges from the airports and we include that as the extra tax, if you like, on the price of the ticket. So in that sense there is a differential. The cost at Adelaide, for argument's sake, is lower than it is at Melbourne and of course in Sydney. So there is a differential associated with that which goes directly into the fare. I think most airlines do that.

MR POTTS: Right.

DR BYRON: Going back to Gary's first question, at Melbourne Airport is our terms of reference, how effective has the regime been. The sort of follow-up question to that, depending on your answer, is should we be looking at tweaking it and trying to improve the current regime or is it a question of discarding it completely and starting again with a different sort of regime? I'm just wondering if you could be - - -

MR BREUST: I think where we've come from is we believe - we started off saying to you, we came in fairly hard saying that we should notify everything. But having read the other submissions and the difficulties faced by the airports, particularly in going through the process of investing and undertaking new projects, we've actually come back from that because we believe that that is too much of an imposition. So on balance in our comments on the draft report we've actually said that we believe that monitoring, in other words, the current system, to a fairly large extent is okay, but it needs tweaking, and the tweaking that we're talking about is the widening of

the definitions of what's aeronautical and aeronautical-related. Getting that level of transparency there I think will go such a long way to make it a fairer and a more equitable approach.

DR BYRON: And a better dispute resolution process for the exceptional cases.

MR BREUST: I think so, Neil. I think that process of transparency in itself will reduce the level of disputation, but on top of that, if there is a resolution process which involved some sort of independent activity, I think it would meet the bill.

DR BYRON: I wasn't sure quite what you were referring to in your earlier comment about not knowing what sort of deals other parties have negotiated with an airport and therefore what you can get or why you can't get something you've asked for. My understanding is that a number of airports have contracts with the major airlines that guarantee them that they get terms no less favourable than anybody else, and if that's right would it partly explain at least why an airport couldn't offer you some sort of preferential deal on passenger or landing charges if it meant that they would then have to offer it to ever other airline that used them. Is that the sort of thing you're talking about?

MR BREUST: I'm not sure how far the "terms no less favourable" goes, and we can't really come to a judgment on that because you really don't know.

DR BYRON: You don't know what their terms are?

MR BREUST: Exactly. At the end of the day it's "trust me", but again we simply come back to the point that if it's transparent, it's out there, it's in the public domain, then everybody knows, and on that basis you know basically where the boundaries are. At the end of the day I don't believe it's an arrangement whereby everybody gets the same rate or whatever. There has to be a degree of negotiation and commercial reality in that, but if you're within the ballpark at least you understand where it is and you know where the terms lie.

DR BYRON: I was intrigued by your comment that some of the regional airports are more inclined to take a "take it or leave it" stance than the three big ones that you said you deal with.

MR BREUST: We did deal with four, but we're not any more.

DR BYRON: Yes. That suggests to me, though, that there's something about the scale - whether it's scale or something else - that even an airport in a country town in western New South Wales or South Australia does have some serious market power if passengers want to fly to that particular town. Now, the brakes on misuse of that

market power may be less effective than when we're talking about the major capital city airports. There's a lot of debate, as you know, about how effective any of those conditioning things about countervailing power or commercial interest and so on. Carparking revenues are, but it seems from what you're saying that some of the regionals don't have many brakes on them at all in terms of their negotiating a stance.

MR BREUST: I'd make a comment that the only brake that seems to have occurred on those major regionals has been dealing with us, effectively, because we've at least gone in and pushed for efficiency, pushed for cost reduction, and in a lot of ways shown them the benefits of getting the unit costs down so that we can provide lower fares and build the market even further. That sort of process is starting to come through there, but it's a difficult process and it's a mindset change which is fairly difficult to get through.

DR BYRON: Regional airports with relatively low RPT traffic and usage, I imagine, would have higher operating costs simply because there's so much underutilised capacity. Is there any case for suggesting, where you've got two regional airports that aren't very far apart - Tamworth and Gunnedah or something like that - that if one airport was operating at a much higher capacity utilisation, its charges should be lower than the two existing ones? Is there any point in going down that sort of thing?

MR BREUST: I'm sure you can understand that regional people are pretty parochial, and you'd only have to go down to the north coast of Tasmania to understand exactly how parochial they are. You've got a situation there at the moment where you've got Burnie Airport, Devonport Airport and Launceston, and you can almost throw a handkerchief over the three of them.

DR BYRON: Certainly within driving distance.

MR BREUST: Yes. You have a situation there as indeed you have at Lismore and Ballina on the north coast of New South Wales. In Tasmania's case you've got three airports there, you've got Virgin Blue and Jetstar operating jet services not only to Melbourne but also to Sydney, et cetera, from Launceston. You've got QantasLink services into Melbourne, Tullamarine, as well. There's a lot of competition there, a lot of low fares, and people are driving. So there is a level of competition there. The impact of that is that the two airports, Devonport and Burnie, are now very conscious of that level of competition and are working extremely hard to reduce their cost levels and keep the cost going through into the ticket as low as they can to entice people across.

As to the question of whether there are too many airports on the north coast of Tasmania, sorry, I won't go into that argument because we have to live there, but I

think you're quite right: those sorts of pressures do bring a sense of reality in terms of cost reduction and all the rest of it. It's the ones where that competition level is not understood or seen, such as a town like Dubbo, Wagga Wagga, Albury, Tamworth or one of those places, where they believe they don't really have any competition, that really do push hard in terms of a costs-plus approach and a "take it or leave it" approach.

Whilst the cost of an airport is reasonably significant, the cost of actual operation at a lot of the regional airports is not huge. The issue is certainly enough to keep a depreciation level there to maintain the facilities, but the overall cost is not high.

DR BYRON: Thanks. Gary?

MR POTTS: Geoff, regional ring fence, Sydney - we dipped our toe in the water in our report and caused a few waves, I suppose, in regional New South Wales. You've been on the radio quite a few times in relation to this.

MR BREUST: I've reacted to the media calls to me, but the political system has picked it up and ran, so we have to - - -

MR POTTS: Sure. I'll just emphasise we didn't make any recommendations on this, just some observations. Nonetheless, we very much appreciate that you put forward a few options in your supplementary submission about perhaps over time, and I want to emphasise that - we're not talking about anything immediately but over time how the issue might be dealt with - I'd find it useful if you could perhaps go through these three suggestions that you have here on page 8 of your submission. Beginning with the first one, my understanding here of what you're saying is that there should be just a cap for jet aircraft and not for turbo aircraft. But I guess my question is if that is the case, to what extent and practice would that have a real effect in terms of the number of aircraft movements? Given the technical limitations of gaps between aircraft and particularly given they have to be larger between jet aircraft and turboprop aircraft, would this particular suggestion here have any significant impact unless other elements were changed?

MR BREUST: If you take it back to the principles, really the cap of 80 movements an hour and the noise-sharing arrangements and the curfews are all about issues of noise around the airport in Sydney, and in effect the turboprop aircraft doesn't really fall between the noisy standard that applies to the jet aircraft. Admittedly, new generation jet aircraft are becoming much, much quieter and I think in an overall sense perhaps the industry and others should put that back on the table again, although particularly it's a very difficult ask. But the suggestion there is that whilst all of this relates to noise and the turboprop aircraft particularly are not really in the

same category, it may be as a means of increasing the efficiencies of Sydney Airport that you do remove the cap in relation to turboprop aircraft; so in other words, if the cap could be used to 85 or 90, particularly during the peak times to facilitate the operations with turboprop aircraft, but in effect increase the operations with jets as well. So in other words, most of the services in and out of Sydney Airport currently, with regional turboprop aircraft, probably are not going to grow that much in the foreseeable future at those peak times. But by operating the current or maybe a slight increase in turboprop operations, by allowing the increase to flow through to jet aircraft could improve the efficiency and overcome some of the efficiency and productivity problems that Sydney Airport has. That's one idea.

The other one is the operation of even the curfew; it really doesn't apply to turboprop aircraft, we in fact can fly services in there at night, but we're limited to operations on one of the particular runways which is an approach over the sea to the north and of course if you've got a southerly wind, you can't operate. So you can't really, with any confidence at all, build a schedule of services every day when you've got that limitation on. We could operate further services in and out of Sydney Airport if that arrangement was removed.

MR POTTS: Can I just interrupt you just briefly. That's an interesting observation because I think in the draft report we've talked about making more use of the shoulder period, you're right.

MR BREUST: The shoulder periods are really between 6.00 and 7.00 in the morning and then 9.00 and 10.00 - - -

MR POTTS: Sure, but you're also saying, for instance, between 5.00 and 6.00 in the morning, if that's opened to turbo aircraft, you believe that the demand would be present from regional airports presumably to arrive in Sydney at that time to justify services? Is that the implication of what you're saying?

MR BREUST: Not really, because the difficulty from an operator's point of view is that arriving in Sydney between 5.00 and 6.00 is probably too early and you're not going to capture the market with it. But arriving between 5.00 and 6.00 in the morning obviously is perhaps of more benefit to some of the larger operators who have got longer distances to fly.

MR POTTS: I see.

MR BREUST: What I'm saying - and I think what I tried to spell out in the comments - is that the shorter the sector length, the more critical the actual schedule timing because as I was saying, your competitor in a lot of cases is the car. In other words, to meet your demand or to meet the requirements of your customers, you've

got to have a schedule that really suits exactly what they require. But if you're got a longer haul flight, say a flight from Perth to Sydney which is four or five hours, the actual timing of that is not nearly as critical as it is for a 40-minute flight, say, out of Orange in New South Wales into Sydney. It's not nearly as critical timewise in comparison to an international service arriving from LA into Sydney.

MR POTTS: But I thought you were saying that you've got one runway you can use in Sydney if you arrive from the south, but the problem with that is if the wind is in the opposite direction.

MR BREUST: That's a different issue to what I'm talking about now though.

MR POTTS: But I thought you were saying though that you'd be able to schedule services if you had some certainty that you'd be able to land at Sydney Airport and the problem you have at the moment is that if the wind is in the wrong direction, you can't fly the service. So that presumably means that it's outside of the curfew time. Is that right? It's outside of the 6.00 till 11.00 at night.

MR BREUST: No, it's inside the 6.00 to 11.00.

MR POTTS: It's inside the 6.00 to 11.00 at night?

MR BREUST: Yes, it's inside the 6.00 to 11.00. For argument's sake, we do a late-night service from Sydney to Cooma, particularly in the winter to cover the ski season; we could operate services well into the night for that particular market, given - - -

MR POTTS: So you're not allowed to land at Sydney Airport from the north - - -

MR BREUST: That's right, during curfew.

MR POTTS: But before 11 o'clock at night?

MR BREUST: No, we can before 11.00 but we can't after 11.00.

MR POTTS: I don't want to go on too long about this, but I thought you were saying - isn't the implication that if you're able to land both ways on Sydney Airport out of curfew hours that you would be able to run more services?

MR BREUST: No, out of curfew we can land in both directions and we can expand our operations there. What I'm saying is that theoretically at least we could operate more regular services into Sydney Airport actually during curfew if we could land in both directions; so in other words, enable turboprop operations like ours to

operate within the curfew.

MR POTTS: Right, that's what I thought.

MR BREUST: But in terms of operation on the shoulder periods between, say, 6.00 and 7.00 and 9.00 and 10.00 and between 4.00 and 5.00 and 7.00, and 8, 9 o'clock at night, the limitations on a regional operator comes back to the convenience of the schedule and the shorter the sector length, the more critical the time period.

MR POTTS: So how many more services do you think you'd be able to operate in the curfew hours?

MR BREUST: Within the curfew hours?

MR POTTS: Yes, if you could land both ways, just a rough order of magnitude. Is it one or two or 10?

MR BREUST: You could probably run three or four services, but again, it's a matter of going out and building a market to do that. Obviously we've done no work on it because there's no capability on it.

MR POTTS: So you think that would be new demand, if you like, rather than being able to shift it from - - -

MR BREUST: It would be new demand.

DR BYRON: Just to follow up on that, I was wondering to what extent you see your growth in passage of traffic coming through more scheduled services or - well, obviously both, but the increasing gauge of the aircraft moving up from Saabs to 50-seaters or something, where's the balance between increasing the number of flights and increasing the size of the aircraft?

MR BREUST: What we've found really is the frequency and the convenience of the schedule really is the thing that builds the market more so than the aircraft size and of course in some respects, at certain times of the day that's not a good thing for the airports, but at other times of the day, it is. To give an example, we have traditionally operated four return services from Wagga Wagga to Sydney. The aircraft departs out of Wagga in the morning at 6.30 and then it just runs backwards and forwards four times. What we've done is that we've increased the schedule on that by putting another aircraft into that operation and we actually depart Sydney and Wagga effectively at the same time each morning and we've increased the frequency to six returns. But what's that's done is it's improved the service for that particular

route for that market. It's used the same sized aircraft but it's improved the service for it, so we're building the market more, but we're actually helping the airport, we believe - Russell, you might disagree with me here - because we're running some additional services on the shoulder period. We actually depart Sydney at 6.30, 20 to 7 in the morning, which is a shoulder period, and there are slots available.

DR BYRON: Good, thanks.

MR POTTS: Is there anything else on those three suggestions? Have we covered it adequately?

MR BREUST: The other point was to get some efficiencies through air services. One of the things you might say is that there needs to be more separation between a turboprop and a jet. In effect, on approach a turboprop can be faster on the landing and reduce speed a lot closer to the runway threshold than a jet can, but the other area is the wake turbulence from a take-off, and that's a limiting factor. But we believe that there are some efficiencies that air services can achieve by adopting more of the sort of approaches that are adopted elsewhere around the world.

MR POTTS: Geoff, just on Part IIIA and the Federal Court decision, it would be understandable if you perhaps weren't quite as up to date as some other stakeholders.

MR BREUST: No, I'm not as up to date as some.

MR POTTS: But just to give you the opportunity to make any observation you wish in the light of that decision.

MR BREUST: No, I don't feel confident enough to understand it fully.

MR POTTS: Right. Neil, do you have any more questions you'd like to ask?

DR BYRON: No.

MR POTTS: That's probably it. Thanks very much, Geoff. Is there anything you'd like to say just in wrapping up?

MR BREUST: No, I'm fine, thanks very much. I think we covered the issues.

DR BYRON: Thanks very much for the submission and all the input.

MR BREUST: Thanks very much.

MR POTTS: We're having a short break for 10 or 15 minutes.

MR POTTS: Welcome, Ian and Sarah, to these hearings. As I mentioned at the beginning, if you'd just mention your names and the organisation you represent and then make some introductory comments, and we'll follow with questions.

MR KEW: Thank you, Gary. My name is Ian Kew. I'm the CEO of the Airport Development Group, and the Airport Development Group is the ultimate holding company of Darwin International Airport, Alice Springs Airport and Tennant Creek Airport.

MS DEWAR: I'm Sarah Dewar. I'm the commercial projects finance director for the Airport Development Group.

MR KEW: I have a hopefully not-too-long statement which I'd like to read through. It basically expands, where appropriate, on the points that we made in our submission to the Productivity Commission. I'd like to start by thanking the commission for allowing us to be here today. We welcome the Productivity Commission's recommendations in relation to Darwin International Airport. We feel that the Productivity Commission carefully considered our submission, particularly in relation to the unique prevailing market circumstances and how they have changed Darwin over the past five years, and how they may continue to change in the foreseeable future.

Darwin International Airport would like to take the opportunity to briefly reinforce and, where appropriate, provide an update on the key points that we made in our submission. DIA, Darwin International Airport, is the 10th largest airport in Australia, in passenger throughput terms, behind Sydney, Melbourne, Brisbane, Perth, Adelaide, Cairns, Gold Coast, Canberra and Hobart. With approximately 1.2 million domestic and 200,000 international originating and departing passengers, DIA is only slighter larger than Townsville and Avalon Airports, and it is probable that both these airports will overtake Darwin during the next five-year review period. The fast-growing airports of Newcastle and Maroochydore on the Sunshine Coast are growing at 10 per cent annually and will also be equivalent in size in domestic terms to Darwin if they continue to grow at their current pace.

The Qantas Group, including Qantas, QantasLink and Jetstar, provide and, dare I say, fill 85 per cent of the domestic capacity compared to say 60 per cent nationally and 76 per cent of the international capacity, compared to their market share of 31 per cent of the international market in Australia. The only effective domestic competitor is Virgin Blue, and they have found Darwin, together with other long-haul markets, problematic, as evidenced by their withdrawal from the

Darwin-Sydney route in September. They withdrew from the Alice Springs-Sydney route at that time also. That reduction represented a 33 per cent reduction in their capacity at that point. I would like to take the opportunity to correct an interpretation that the PC made in its draft report, where on page 60 it said that Virgin Blue had cancelled most of its services into Darwin. As I stated, Virgin Blue cancelled 33 per cent of its scheduled capacity in September 2005 and, while one-third is significant, it is not most of its capacity.

Similarly, on the international front, Tiger Airways is the main competitor, providing since December 2005 the only competition to Qantas to the all-important Singapore hub. In the very recent application by Qantas for ACCC authorisation, A40107-A40109, to enter into a cooperation agreement with Orange Star - or should I say Jetstar - to coordinate their flying operations and activities in any way, Tony Davis, the CEO of Tiger Airways, stated:

> In the event that such approval is given by the ACCC and appropriate remedy conditions not applied, it is unlikely that Tiger would be able to continue operation in competition with Qantas/Orange Star (read Jetstar) on many routes, including Singapore-Darwin.

Tony Davis and Tiger were unsuccessful in securing any of their proposed remedy solutions. If Tony Davis's prediction comes true, Qantas and Jetstar will have an absolute monopoly on the major Singapore and through-to-Europe kangaroo routes.

In terms of our key point that light-handed regulation has led to a substantial increase in airport infrastructure investment and acknowledgment that this model has delivered good outcomes in comparison to other regulated infrastructure asset classes, GHD in their annual survey of key infrastructure in Australia last year rated the airport infrastructure in the Northern Territory, and in Darwin in particular, as A-minus, will well-maintained facilities that provide sufficient capacity for the forward-looking passenger projections.

As to the key point that we have, after extensive consultation with the airline customers, reached agreement on long-term pax price charges, I would say that Darwin has consulted extensively with its airline customers and, with the exception of Virgin Blue, we've reached agreement with all those airlines. Those airlines include Qantas; Jetstar; Airnorth; SkyWest; BARA, representing Garuda, Royal Brunei and Merpati; and, most recently, Tiger Airways. We put to those airlines a long-term pricing path and an aviation infrastructure investment program that underpinned that pricing path.

Darwin International Airport was the first airport in Australia to move from

weight based MTOW charges to per pax charges for both landing and terminal charges on 1 December 2001. This pricing methodology more equally shares risk with the airlines. Quite simply, we share the bad and good times together. If the aircraft is full, the airline pays more. If the aircraft is empty, the airline pays nothing. Clearly it's in our interests to help the airlines be successful an to increase their traffic, and we're productive in working with airlines that wish to do so. However, if and when things do go wrong, our per pax pricing methodology provides instant relief, as has been the case with airline services over Bali after the first and second Bali bombings, when traffic dissipated overnight and even today has struggled to recover.

There have been instances where we have charged an airline less than $100 per plane to land based on our per pax charges, whereas if they had been paying on MTOW based charging, they would be paying over $1000 for that landing. Unfortunately, to date we have failed to reach formal agreement with Virgin Blue, even though we commenced our long-term pricing discussions with them in October 2004 and we reached agreement with the other airlines almost one year ago.

Virgin Blue - and I'm making the point here because they have responded in their PC submission to comments about Darwin - stated they had been prevented from engaging in constructive commercial negotiations with NT airports because we have consistently refused to provide Virgin Blue with a working copy of the model that they have used to justify our latest round of price increases. In response to that assertion, we have provided Virgin Blue with hard copies of our model output, we've sat with them and taken them through the model and we've undertaken to provide the spreadsheet if and when they confirm to us which airports have provided the model and which authorising officer has approved that. If we see that the majority of airports have provided a working model to them, then we will go along and do the same, but to date they have not come back to us.

They also state there, in reference to our claim in our Productivity Commission submission, where we said that all airlines have readily accepted the transition from MTOW to passenger based charges, Virgin stated that it was not flying to Darwin Airport when the transition took place, with the inference being that they were not a party to or in agreement with that charging method. Virgin announced their intention to fly to Darwin in early November 2001 and that was after they had secured from the Northern Territory government $2 million a year for two years to underpin their services and a share of the federal government's support, which had agreed to spend $7.5 million to underwrite Virgin Blue's flights from Brisbane to Darwin and from Brisbane to Cairns during the following December and January months.

As I said, we commenced our per pax charging on 1 December 2002 and I met with senior Virgin Blue representatives in November 2001 who were finalising their

arrangements to commence the services to Darwin and I outlined our per pax pricing regime at those meetings. They were delighted with the pricing regime that avoided the fixed costs like having to rent check-in counters, ground storage equipment areas, departure areas, when they were only going to have one service per day, particularly during that critical start-up phase, and to quote Rob Sherrard, the Virgin Blue COO at the time:

> The reality is in that start-up phase on any route, there's a lot of red ink and any assistance during that period is vital.

They commenced the Brisbane-Darwin service on 20 December 2001, being the date after 15 December when the Ansett administrator relinquished the Ansett lease at that time. Our per pax charges were promulgated in an MOU with Virgin Blue that was willingly signed and even suggested by Virgin Blue to Hobart Airport to use as a good template agreement for them to consider with their arrangements.

Another key point we made was the Darwin International Airport has made valued investments in airport infrastructure that far exceed the original schedule 11 lease commitments to the federal government. DIA has invested over 23 million in additional aviation infrastructure during the past five years and is committed, with airline support, to invest a further $45 million in aviation infrastructure during the coming five years. The majority of it will be spent in the next three years.

Our investment in recent years has far exceeded that original schedule 11 commitment to DOTARS that was contracted at the time of sale. Darwin faces significant competition from the non-regulated Broome and Cairns International Airports for future international traffic into northern Australia. Cairns and Broome Airports, being non-price regulated airports, are both significant competitors to DIA, Cairns with 3.7 million passengers is three times the size of Darwin and being owned by the Queensland government, has access to both significant low cost capital and via the Queensland Tourism Commission, significant promotional support to attract new airlines to their part of northern Australia. Broome is privately owned and has proven to be very innovative in seeking to attract new airline services to its region and with the assistance of the well-resourced West Australian government, it announced last week at the national conference of the Australian Airports Association that it expects international services to commence in April 2007. Both of these airports directly compete not only for the international traffic into northern Australia but for the domestic leisure traffic. They of course are not price regulated in any way.

In response to the Productivity Commission recommendation 4.2, Qantas states that Darwin's non-transit international passengers is only 14 per cent of our total domestic and international traffic and it is likely that Darwin and Cairns are

complements in consumption with many international and domestic visitors visiting both cities on their holidays.

Yes, our non-transit international pax numbers today are approximately 200,000 but prior to September 11, they were about 300,000, an immediate loss of 100,000, and the NT government and the tourist commission is spending millions of dollars attempting to regain those lost international passengers to Darwin. We compete vigorously with Cairns and we know that time-constrained holiday-makers have to make a choice between going to the Northern Territory or to Queensland and if Qantas's statement is correct, then we would enjoy as many international passengers as Cairns does. We have 200,000, they have 1 million.

Darwin International Airport believes that the current quality of service monitoring by the ACCC is not insightful into the level of customer satisfaction experienced by airlines and our joint passengers. We believe quality of service and customer satisfaction is critical to business success and we've very mindful of the perceptions of both our airline, our border agency stakeholders and the all-important public that use our facilities, whether they're meeters and greeters or whether they're travellers. Those people are not surveyed in the ACCC process.

Just one comment in relation to the Productivity Commission recommendation that the federal government considered to the monitoring airport carparking and other land-side vehicle services. We are not a supporter of that recommendation. Our carparking business segment competes with taxis, buses and a variety of off-airport carparking businesses. Our current charges, at $4 for up to 24 hours' parking, are the lowest of the price-monitored airports and I believe lower than the charges at the non-price monitored FAC and other airports throughout Australia.

Going on to the vexatious issue of aviation refuelling, the current land rentals for on-airport aviation refuelling do not reflect the value of that land to the oil company concession holders. The application of fuel throughput fees or concession payments to land-holders for the right to gain control of land and access extremely valuable market segments is a regular practice in the oil industry and is allowed for in the leases inherited from the FAC. Such concession payments should not be classified as aeronautical revenue.

The market power airports enjoy in terms of on-airport refuelling I would say is similar to the market power that Coles and Woolworths enjoy with the average Australian motorist. Oil companies pay to get access to large and sticky customer bases and this should be the situation at airports. However, oil companies have traditional paid very little for that privilege at airports, no doubt reflective of the relatively non-commercial nature of airport operations in the 1970s and 1980s. The FAC attempted to change this and this was reflected in the long-term leases to the oil

companies that the airport lessee companies inherited. Whether the fee is paid by the oil companies to airports is in the form of rental lease payments, licence fees or fuel throughput fees or a combination of all, it should reflect the value they derive from getting long-term access and the effective lockout of non-participating JUHI oil companies. It is unreasonable for DIA to only recover the equivalent rental of a backstreet transport block in Winnellie, a suburb in the Northern Territory, when we should derive the equivalent value for access to a 20 million litre plus refuelling site elsewhere in Darwin, probably the equivalent to 10 major retail outlets or perhaps in Melbourne terms, an equivalent of being either side of the West Gate Bridge. If the oil companies can easily pass on these costs to its airline customers, then I guess that's a sign of their relative market power.

In terms of the quality of service monitoring and compliance costs for price and quality of service, they are substantial for a small regional airport like Darwin. We've determined that our annual compliance costs in this area are approximately $135,000 per annum or approximately 10 cents per passenger. An exercise like this PC review is estimated to cost another $120,000, utilising in-house and some external resources, and if we had to use the majority of external third party consultancies, the overall cost would have doubled.

We contended in our original submission that the proposed increases in airport landing and terminal charges at DIA pale into insignificance when compared to increases in the safety and security charges for mandated security measures that have or will flow through to airlines and their customers. For example, at Darwin our combined landing and terminal charges today are $13.10, excluding GST. Our safety and security charge averaged over the 12 to 15-month period is about $10 per departing passenger. With the introduction of enhanced inspection area security measures in the foreseeable future, the safety and security charge will increase by another $5 to a total of $15 per pax. Compare that to our $13 for the total landing and terminal charges.

We stated in our submission that during the past five years all disputes have been amicably resolved with the existing dispute resolution mechanisms, and that the imposition of compulsory arbitration provisions will lead airlines to use this method, as indeed they did in the past, with the ACCC adjudicating on questions of necessary new aeronautical investment. To date every dispute between our airport and airlines has been resolved over time without the need for binding arbitration or going to court. In our submission we undertook to introduce a formal mediation process into our published Airport Conditions of Use. Should mediation prove to be unsuccessful, either party has the right to pursue their interest through the normal court process. Our legal system is well placed to consider both sides of a commercial dispute and adjudicate accordingly, as it does for nearly all other businesses.

During the review period DIA has acted in accordance with the federal government's review principles and, because of the strong and growing countervailing market power, the PC found that, even though our prices had risen sharply under the price-monitoring regime, the increases appeared justifiably and not indicative of a misuse of market power. We have negotiated and reached commercial agreements with nine out of 10 RPT airlines servicing Darwin, and it has been done in a commercial manner without the need for an arbitrator.

I was delighted to see in the RAAA, the Regional Aviation Association of Australia, response to the PC draft report that they acknowledge that Darwin's airport behaviour has been exemplary, going on to say that it believes that it is more a reflection of the quality of the present management rather than of an ability to misuse the market power. Unfortunately, they went on to say that we should remain subject to price monitoring, but obviously that was a bridge too far for them at this point in time.

In summary in the 2001 PC review, the ACCC in its analysis of market power enjoyed by the price-regulated airports determined that Darwin's main market segment to destination for interstate travel was holiday. Darwin's potential for destinational substitution was high, Darwin's potential for modal substitution was moderate - and that was before the arrival of the Ghan passenger train to Darwin - but its potential for airport substitution was low; that is, that Darwin enjoys a geographic monopoly and that if airlines have to fly to our region, they have no choice but to use our airport. As a statement that is true, but the real question that the ACCC should have asked is: do airlines have to fly to Darwin? Remember, we're a destination of only 100,000 people, the size of Bendigo, Ballarat or Toowoomba.

Time has provided an answer to that question, and in the relatively short period since the last review Qantas reduced its Singapore capacity by 60 per cent; Malaysian Airlines have stopped flying to Darwin; Royal Brunei has substantially reduced its capacity; the Ansett administrator ceased flying to Darwin - that's when they started operations after the collapse of Ansett - and Tesna, the Ansett Phoenix, stated they wouldn't fly to Darwin anyway; and Virgin Blue has reduced its capacity. Quite simply, airlines can and do choose not to fly to Darwin, and that is why we have seen a concentration of the countervailing airline market power in the Qantas Group during that period and the relative decline of the remaining airlines that service Darwin. Thank you.

MR POTTS: Thanks very much, Ian. Welcome. Of course, in our draft report we did recommend that Darwin International Airport, as you emphasised, be taken out of the price monitoring regime.

MR KEW: We appreciate that.

MR POTTS: We have a few questions on the comments you made then, plus a few more general comments. Firstly, on this issue of countervailing power, which you mentioned a couple of times, I think, through your comments, including at the end, if I could tie together a couple of points you made. One is that Qantas's countervailing power has increased because of its larger share of the market, but I would find it useful if you could put that in the context of how the negotiations actually take place with Qantas, to the extent that you can in a public forum like this, bearing in mind that you said that you were not prepared to provide your financial model to Virgin Airlines unless the majority of airports did.

I was wondering why the majority of airlines would need to do that if you feel that your market power is not particularly significant. You might find it in your interests to be providing it, even if the majority didn't, because you don't think you have very much market power, but given the extent to which Qantas has in your view countervailing power, what sort of information are you willing to provide them that you're not willing to provide other airlines, for instance, like Virgin? There are a few issues there. Just talk around the one generally. That would be very helpful, thank you.

MR KEW: Prior to the collapse of Ansett, Qantas enjoyed I think about 46 per cent of the market in the Northern Territory, so Ansett was the bigger of the two airlines, although there wasn't a great deal of difference. They've gone from 46 per cent to 85 per cent market share at the moment. It was more than that until Virgin established a foothold into the territory. We have the situation of Alice Springs - I know it's not subject to this review - where Qantas is the only domestic airline flying there. I would suggest to you, though, that we provide the same information to all airlines.

When we embarked on our long-term pricing discussions, that covered both Darwin and Alice Springs Airports, so we were talking to Qantas for their services to both airports; and to all of the other airlines at Darwin, we provided a detailed passenger forecast, we provided a forward-looking capital plan, we provided information on our forward-looking operating expenses and details of what we viewed the WACC to be. The same information was provided to all airlines. Virgin Blue has been the only airline that has asked - demanded - a copy of our spreadsheet. None of the other airlines have asked for that.

I presume, but I can't be certain, that the reason why the other airlines haven't done it is they have their model which they've plugged the numbers into and they've worked out whether our charges are fair and reasonable. Maybe Virgin Blue don't have that capability and that's why they're seeking to have a look at our model. But

we're not against giving it to them. We just want them to demonstrate that it is common practice and that other airports have been willing to provide that information to them. If they show us that, then we'll hand over our model. But there's nothing in our model that we want to hide from them. We've shown them the model, we've sat in front of them with the model, we've given them a hard copy output of every page in the model. We've offered to give them an independent auditor's statement that the model calculates correctly. It's I guess just part of the negotiating process, and I think it's in their interests not to agree.

MR POTTS: Do you think Virgin would be able to grow the market out of Darwin, or would it be a matter of the shares, allocations, between Virgin and other airlines, particularly Qantas?

MR KEW: When Virgin came in, they started with federal and Northern Territory government support with one service a day from Brisbane, then they introduced five a week from Sydney and three a week from Melbourne. They found it quite problematic in the NT market. They're probably not alone. We've seen them morph into a new world carrier now because of the difficulties that they've had in the past. I think they've struggled to consolidate their existing business there. They seem to be doing quite well. Don't get me wrong: we want to have strong competitors to Qantas. It's just hard to encourage and achieve that.

Jetstar have only recently commenced operations to the Northern Territory. They've been very aggressive. They've got aircraft with greater capacity. I hope - and we've worked with Virgin to this end - that they will be able to more effectively compete against Jetstar than they have been able to against Qantas. So will they grow their market share? We do wish that they would do that. Have they done it so far? No, it's gone backwards.

MR POTTS: With the advent of Jetstar, the negotiation of landing charges, was that a crucial issue for them in terms of their pricing policy?

MR KEW: Very much so.

MR POTTS: It was.

MR KEW: I guess with every new airline, the pressure to discount airport charges ratchets up. We quite simply have one pricing policy for all airlines. We don't charge a different price to Jetstar or to Virgin Blue or to Qantas or to AirNorth or to SkyWest and we've always stuck by that arrangement. It's been unpopular. Airlines have said to us, "Well, we're not coming unless we get a better deal than the last one." That's the choice that they can make.

We also have incentive schemes for services that commence because that's when they're most vulnerable or less profitable, but the incentive scheme that we offered to Virgin Blue or Jetstar or Tiger are identical, so it's on the table, it's available for any airline to take up, and airlines like Australian Airlines, Jetstar, Tiger, Virgin Blue, SkyWest, have taken up those offers. That's the one pricing regime, whether it's discount or standard for all airlines.

MR POTTS: But you were saying before that you believe that you're facing more competition in the provision of airport services now and I imagine you think that will continue to increase. I presume that that increasing competition is not even across the type of airline ticket that is being sold, so the pressures that you're facing, for argument's sake - and I don't know whether this is true - but they may be greater, for instance, in relation to tourist travel and for business travel or something like that. So wouldn't that imply that perhaps your charging policy needs to take that into account, looking forward?

MR KEW: Our airport charges are only about 4 per cent of the ticket price to the Northern Territory. Obviously the ticket prices are quite a bit dearer than the average tickets than they would be, say, between Melbourne and Launceston. Don't get me wrong, I don't discount that airport charges are important but I think in the scheme of things, our total landing and terminal charges are probably no different to the price of serving a basic economy meal on the plane. I think it depends on the volume multiplier for an airline; if you're looking at Sydney, then the airport charge times 20 million is a big number. The airport charge in our case by 1 million is not such a big number and they can easily - and I hope and pray that they do - recover that in an additional charge on their tickets. Certainly airlines like Jetstar have been quite aggressive in filling the back end of the plane, but they make very good margins on the first two-thirds of the plane, I would have thought. I'm not an expert on airline economics here but as I said, our pricing policy has been the one price for all airlines and so far, that's met the approval of nine out of 10 airlines that fly to Darwin.

MR POTTS: Right. Just moving on to the Part IIIA issue, I'm not sure if you were here for the discussion with Melbourne Airport, for instance.

MR KEW: No, I wasn't.

MR POTTS: But the Federal Court a week or so ago ratified the decision of the Competition Tribunal but went further and reinterpreted the legal meaning of the relevant clauses, provisions in the Trade Practices Act in Part IIIA. I'm not sure if you're aware of that. That's the first question, I suppose, and if you are aware of it - - -

MR KEW: I did read it.

MR POTTS: You're not aware of that?

MR KEW: No, I did read about it.

MR POTTS: You did read about it; not only the confirmation of the earlier decision but the more liberal interpretation that's been - - -

MR KEW: No, I hadn't.

MR POTTS: Right. The interpretation that's been given by the Federal Court many people believe essentially means that under Part IIIA, in terms of whether a declaration can be made or not, will turn on two key issues in the future and they relate not so much to the conduct or the behaviour of an airport, but will relate more to just its structural position within the market. The two issues in future that it will turn on in terms of this interpretation that's been given to it, and I hasten to add that this is only a tentative one and hasn't been tested of course, but the first is that the services - it's not economic to replicate them elsewhere and that's generally regarded to be the case with the major airports, so that test is met, and the other one is - and I'll just read it to you to get it correct - that:

> The facility is of national significance, having regard to the size of the facility or the importance of the facility to constitutional trade or commerce or the importance of the facility to the national economy.

So I guess my question that I'd like to raise is, assuming this is the path that this Part IIIA issue goes down and assuming that there's no change in the legislation made, at least in the foreseeable future, so that we're in a position where issues of declaration would turn on those two particular issues I mentioned and particularly the one I just read out, how your particular company would view Darwin Airport in that context, bearing in mind that it is actually called Darwin International Airport. Would you make any observations on that?

MR KEW: Hobart is called Hobart International Airport and Canberra is called Canberra International Airport too.

MR POTTS: I know that, but you can't have it both ways.

MR KEW: We are an international airport and we appreciate our international status but I would suggest that an airport that enjoys about half of 1 per cent of the international traffic coming into Australia probably isn't of national significance in terms of its size or importance. I'll just go back to the statement that I made during my original talk here. Airlines can choose not to fly to Darwin and they choose not

to fly to Darwin. They have demonstrated that. It's pretty hard for an airline to choose not to fly to Sydney or choose not to fly to Melbourne because those markets are just so important for their overall wellbeing, so I'd be surprised if Part IIIA would be applicable to us under those tests, but I guess that's a matter for others to determine.

MR POTTS: Sure. Anyway, I just mentioned the issue and it's interesting to have your observations. Neil, did you wish to raise some questions too?

DR BYRON: Simply to add to that point, that if Darwin International Airport was declared under Part IIIA under this new legal interpretation, then our draft recommendation about Darwin International not being subjected to monitoring would probably be much less relevant and would probably have quite different implications for your business. So that's I guess one reason for not pursuing you too much further at the moment on detail on the finetuning or your suggestions about how the monitoring process might be improved as it applies to those that would be still subject to a monitoring regime. I guess one point I did want to take further was the dispute resolution, not so much within agreements but about the creation of new agreements. You gave us some detail there about the response to the Virgin Blue statement about not having a signed agreement with you yet after nearly two years.

MR KEW: Two years, that's right.

DR BYRON: Yes. We're trying to envisage what sort of dispute resolution mechanism or ombudsman or process would actually solve this issue of not reaching new agreements. I guess the first question is: is it actually a problem that the agreement hasn't been signed yet? Presumably Virgin is still flying, presumably they're still paying something. Is it actually a crucial issue that needs to be solved that the agreement hasn't been signed yet or is it simply a formality?

MR KEW: No, it is a crucial issue that an agreement hasn't been reached. We seek to reach commercial agreements with all of our airline customers. While we commenced the process two years ago, the long-term pricing path that the other airlines have agreed to only allowed for a price increase effectively from 1 July this year, so some three or four months ago. Now, since that period, Virgin Blue is the only airline that has refused to pay the price increase which I think is about a $1.30 or something like that, so that amount is outstanding. They believe they're not going to pay it. But our view rightly or wrongly - maybe someone else will determine that - is that they have taken advantage of the services, equivalent services to the other airlines, that all of the other airlines are paying for. I think it's unreasonable for them not to pay what the other airlines have all agreed to.

Now, we don't have a policy where the pricing is different. If they continue to

get away with not paying like the others, then all of those other airlines are disadvantaged. I would hope that we will continue to work through these issues with Virgin Blue and they will come to the table and reach agreement with us. I believe that will be the case over time.

DR BYRON: Prior to the recent increase, the fact that the signature hadn't been put on the paper wasn't really a problem, but now it is?

MR KEW: It's more of a problem now because they're short paying the charges that are being levied on them.

DR BYRON: Yes, I appreciate that.

MR KEW: But while the signature may not be on the piece of paper, I believe a contract exists. They're using airport services, our services, and we're charging them for it, so I believe a contract does exist, even though it hasn't been formalised.

DR BYRON: So that still has some distance to go to reach a resolution.

MR KEW: If it only turns on the issue of whether we provide the spreadsheet to them or not, it's probably something that's resolvable because we're not going to die in the ditch on that particular issue; it's just whether that's the final issue that they have in their list of things that they need resolution on. It's the thing that they have mentioned to you and they have mentioned to us.

MR POTTS: It's hard to believe it's a stumbling block.

MR KEW: I would have thought so.

MR POTTS: Given the information you provide and - - -

MR KEW: I certainly agree with you.

MR POTTS: Still, it's a commercial issue.

DR BYRON: Fortunately, it's not our job to get embroiled in those.

MR POTTS: Given the recommendation we made, of course, in the draft report, there's probably less need for us to be asking you as many questions as we might otherwise have done, but it was very useful to have your statement, Ian, and it did provide some additional information. But I would just alert you to this issue that has now arisen and I think all stakeholders will be very interested in it. Are there any additional comments you'd like to make before we conclude?

MR KEW: No, only just to thank yourself, Gary, and Neil, for allowing us to be present at this hearing today. Thank you.

MR POTTS: Thank you very much. This is the last scheduled session for this morning. As I said at the beginning, I would provide anyone who's here with the opportunity to make a statement if they wish. No, I think that concludes today's hearing and we will reconvene in Sydney on Monday. Thank you all.

AT 12.11 PM THE INQUIRY WAS ADJOURNED UNTIL
MONDAY, 30 OCTOBER 2006

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