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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO PRICE REGULATION OF AIRPORT SERVICES

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

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON WEDNESDAY, 4 APRIL 2001, AT 9 AM

Continued from 3/4/01

PROF SNAPE: Welcome to this third day of the hearings in Melbourne, the fourth day in total of hearings of the inquiry into prices regulation of airports conducted by the Productivity Commission. I am Richard Snape and on my right is Dr Neil Byron. There are staff members present who will be pleased to give advice on procedures, et cetera, should it be required. The terms of the inquiry are specified in the terms of reference into the Commission in late December last year by the Assistant Treasurer. The Commission has circulated an issues paper that sets out what we perceive to be the major issues. Copies of the terms of reference and of the issues paper are available near the entrance. We anticipate issuing a draft report in August, while the final report is due with the Government in December. We plan to hold a second round of hearings after the draft report has been digested.

The purpose of this inquiry is to examine where the new regulatory arrangements targeted at those charges for airport services or products where the airport operator has been identified as having the most potential to abuse market power are needed, to ensure that the exercise of any such power may be appropriately counteracted. The Commission is to report on whether there is a need for prices regulation of airports and, if so, the appropriate form of any prices regulation taking into account a number of principles that are set out in the terms of reference.

The public hearings provide the opportunity for interested parties to make oral presentations. Generally this is in the form of speaking to written submissions, these being available on the Commission's website as well as in hard copy. The hearings also provide an opportunity for the Commission to seek clarifications and to pursue with participants matters of interest to the Commission. Transcripts of the hearings are sent to the relevant participants to check for accuracy of reporting. They are normally available on the Commission's website within a few days of the hearings. At the end of the scheduled hearings for today, which in fact is the last day of scheduled hearings prior to the draft report, I shall invite any persons present to make unscheduled presentations should they wish to do so.

We welcome this morning the Australian Council for Infrastructure Development, and the participants representing that body, and we would invite them now each to introduce themselves and their positions separately for the benefit of the transcribers to get the voices on tape, and then to speak to their submission.

MR FITZPATRICK: Mike Fitzpatrick. I'm a board member of AusCID and in another guise I'm the Managing Director of Hastings Fund Management, which is an infrastructure investor.

DR ARNDT: Raphael Arndt. I'm the Director of Policy for AusCID.

MR CROCKER: Matthew Crocker. I'm a Research Associate with AusCID.

PROF SNAPE: Thank you very much, and thank you for your submission, and who is to speak to it?

DR ARNDT: I will start, thanks, Professor Snape. Just by way of introduction, I suppose to make clear who we represent, AusCID is an industry association that represents a bit over a hundred corporate members now, and I think we attached the membership list to our email.

PROF SNAPE: Yes, you did.

DR ARNDT: Essentially we represent owners, financiers, investors, operators of infrastructure across all infrastructure sectors in Australia, and overall our members have about $A60 billion invested in infrastructure assets in Australia. The issue of regulation in general is a major issue for the infrastructure community, not just in airports, as you'd be aware, but across most infrastructure sectors who have got an active interest in that.

Essentially what we would like to put is not the point of view of an airport operator, which I am sure has been adequately covered by most of the airports, or an airport user which I am sure the airlines would be covering, but of an investor in an airport. After all, it's the investors who put forward the capital to make sure that the facilities continue to be upgraded and expanded as required. So I thought I would just run through the dot points, if you like, and then if there is anything to talk about we'll be happy to do so.

Airports are a little bit different than the other types of assets that our members invest in - the other straight-out utilities - because as far as infrastructure is concerned, they are perceived as a growth asset; that is, it gives investors access to tourism, international businesses, trades, other things like that, and it's essentially discretionary expenditure to a large extent. So it is a different type of asset than investing in a gas utility or an electricity utility. Investors invest in those types of assets, then, in order to balance their portfolio so there are particular characteristics associated with airports that make those types of investments attractive.

Just as an aside, I would like to point out that the investment community in Australia, and certainly our members, have had some concern with the regulatory system across the country in general, not just nationally but some of the state-based systems. We did a survey of seven, I think it was, of our institutional investor members which is included in our submission to the National Access Regime inquiry about their intentions for investing in regulated infrastructure assets over the next two years. It was a survey of these seven institutional investor members which collectively already had about $20 billion worth of assets held in Australian infrastructure. They had just over $2 billion worth of equity to invest over the next two years in infrastructure which would fund somewhere between 8 and 10 billion dollars of projects when debt is brought into the equation.

We asked them, "How much have you got to invest in regulated assets?" and the answer was actually none, with the exception of airports. The exception of airports was really the view that airports are two businesses, they're a regulated business and a non-regulated business, and the members saw a good opportunity in investing particularly in the non-regulated aspects of airports because it gave them scope to get those added returns: things like carparks, retail shopping. And in essence I think airports are considered to some extent like retail property development. So it is important to note that from the investor point of view airports are a little bit different to other infrastructure sectors.

The Australian airport sector is essentially owned by superannuation funds largely. Some owners are operators but essentially most of the equity is held by superannuation funds. So they've got a legal obligation as well as a moral obligation to invest on behalf of their members only where they can get an appropriate risk-weighted return for that investment, and they're not in the business of taking unnecessary risk. So the issue of regulatory risk becomes a very significant issue in that context. They're not out there to operate a business or to run an airline or anything like that; they're just there to make a return for their fundholders.

From the point of the view of the investor then, it is absolutely essential for any regulated asset, not just airports, that there is complete clarity and transparency of the regulatory system so that they can make investments on a known basis, which means that the cash flow is relatively certain. Yes, they take risks but the risks that they take are understood and to some extent controllable or at least if they're not controllable, they're understood - for example, demand. Where they are taking those risks, then they can determine what an appropriate return is for that risk and make an investment decision on that basis.

With airports in particular, that return or that flow can be lumpy, you might say, and certainly the expenditure on the assets revenue is very lumpy because you tend to put in large assets that involve a high level of sunk costs, and that might not reach congestion for quite some time. But when they do reach congestion, then there is a significant impact, and there needs to be an incentive to undertake new investment. It's actually not dissimilar to maybe what you might see in the power generation market for base load power generators. So there must be comfort that if there is regulation, and that's a separate issue, then the returns allowed will be sufficient to compensate for that investment, given that that investment will be risky because it will involve large sunk costs with an uncertain return necessarily, and over a significant length of time, far more than any regulatory period usually lasts. So from the investors' point of view anything that gives them cause for concern that the approach of regulation might vary from that which exists at the time of investment, will add to the risk premium and will probably lead them to direct investment elsewhere into other sectors and into other countries.

If there is a regulatory system, then there needs to be a fair and transparent appeals mechanism. We've seen in other sectors of infrastructure where regulation applies that those systems aren't always there, aren't always fair and transparent, and aren't always sufficiently disassociated with the actual regulator themself. Just from the point of view of knowing that you will be treated fairly on behalf of your shareholders, that's essential. I guess the fundamental issue is if there is any perception of regulatory risk, not only will that impact on how investors direct capital to airports - and obviously if capital isn't available to airports then that will have serious ramifications for airport users, both airlines and ultimate consumers - but it also impacts on investor perspectives on other regulated industries, particularly when they're regulated by the same regulator, but even when they're regulated by other regulators. It's our experience in this country that regulators get together every so often and discuss approach and methodologies, while not always consistent, tend to be fairly similar. Certainly the ACCC in this case tends to be one of the leaders in how regulations are applied across different sectors.

Moving on then to regulation and how it applies specifically to airports, we understand that at the time of sale the CPI-X regime, which was installed as an interim measure, would be removed after the regulatory period, which is coming up soon, and that the airport owners would not only be allowed to negotiate commercial outcomes with their customers, predominantly the airlines, but actually would be encouraged to do that. In other words, that was the aim of the sale and the restructuring of the industry in the first place that a competitive market would develop and that the market would be allowed to set the outcomes.

In the case of airports, in most cases, anyway, in Australia the customers on the airside, the airlines, have a significant degree of market power if not more than the airport in some cases, because they are such large organisations. So it is really a bit of a fallacy to say that companies like Qantas and Ansett require the ACCC to act on their behalf to protect their interests in a negotiation with a facility provider that has got far less resources than they do in terms of market power. At least it shouldn't be taken for granted that the airports have that market power, which it is at the moment. So any move to depart from what was put forward at the time of sale would give investors grave cause for concern regarding regulatory risk which is ultimately reflected as sovereign risk premium for investing in Australia generally.

Also investors' experience with regulation in Australia across many sectors is that it is a very lengthy process that is often intrusive in terms of regulators' access to their information, even in areas that would, on the face of it, be unrelated to the issue of concern. It takes a lot of time and a lot of resources on the part of both the regulator, which is ultimately paid for by the taxpayer, and the businesses which devote significant executive time and resources to regulation. The outcomes aren't always consistent and aren't always predictable. Even the ACCC would be the first to admit, I'm sure, that that's not what you should aim for in a regulatory regime in order to encourage ongoing investment and certainty.

It has been the experience of investors across many sectors that regulators such as the ACCC tend to come from a consumer advocacy type of background and tend to think of regulation as an us versus them sort of approach with the ACCC there on behalf of the customer, and in some cases the customer might be individuals. In this case it's airlines. So where regulators have discretion it has almost invariably been the case that that discretion is interpreted against the interests of the investor or the facility owner, insofar as it's legally possible for the regulator to do that, and the sad fact of the matter in Australia today is that investors will treat regulated assets like that when they look at how they will choose to invest in an asset.

In terms of the airport situation, the Sydney Airport draft ruling is a point which I suppose illustrates that because of the single/dual-till debate going on in airport regulation at the moment, and while a dual-till approach was promised at the time of sale and regulation of the non-airside or clearly competitive activities of airports was not regulated, the approach by the ACCC in the Sydney Airport case illustrates that the ACCC and other regulators will always attempt to increase their power and control over outcomes, in their mind - I can only assume - to the best interests of the ultimate consumer. But I'm not sure, if investment dries up and the facilities degrade, that it really is in the long-term best interests of the consumers, and the investment community really has little understanding of the methodology and thought process behind the Sydney Airports decision and the carparking issue as well.

So it really doesn't do a great deal to aid clarity and certainty on the side of the investor, should we invest in a new carpark. Here in Melbourne we've got a brand-new carpark, a new hotel has just opened and the airport is investing a considerable amount of money in a new terminal and why would their board or their investors provide more money for that type of investment if they're uncertain as to the return they can get on it. Why don't they just buy a carpark - a block of land next door and build a carpark and provide a shuttle-bus service. These non-airside activities certainly are competitive because - I can choose to buy a book at the airport or in the city or bring one from home, and the shops that choose to locate at the airport will do so based on pure business calculations. If there's more people going through, sure they might pay a higher rent - the same in any supermarket or shopping centre development - but certainly they're competitive activities, and the carparking is the same. There are other modes of transport that compete with carparking.

In fact, I believe here in Melbourne only about 20 per cent of trips to the airport are undertaken by private car, so it's certainly a competitive activity. So in my mind, and surely from the investor's point of view, there's no reason whatsoever to regulate that type of activity, and the ACCC apparently moving in that type of direction on the Sydney Airports decision caused grave concern among the investment community. So the question that we put to the Productivity Commission is really: is airport regulation necessary at all, bearing in mind that if there is anticompetitive behaviour then that will create some sort of loss, but regulation itself has a cost, so regulation is only justified if the cost of regulation is less than the loss that's being incurred in the first place. That's one issue. The second issue is: is there anticompetitive behaviour taking place and, even, do airports have market power in order to exercise that behaviour? There's certainly many examples of smaller airports where I don't think too much work would have to be done to show that there is no market power; for example, small airports in Tasmania.

For the larger airports on the mainland the airlines, I suppose, could put some argument about market power and the marginal business is certainly competitive — where airlines choose to route their flights through, where they choose to locate hub airports, where they choose to add marginal services — but there will be a base of flights that have to go through the major capital city airports. But is there market power on the airport side? And if there is, are they actually using it to anyone's worst interests, except for the airlines themselves, which is just a competitive bargaining situation?

I guess the view that is taken generally in the economy in the anticompetitive section of the Trade Practices Act is that market power has to be demonstrated and then the Trade Practices Act will apply, and there's no reason why that can't be the case, or that would be the case for airports, but there's no reason why that wouldn't be sufficient for the airport situation, in our view.

Moving on then to the pricing principles and the form of regulation, there's some concern that the current price path as it exists isn't sufficient, particularly for investment and maintenance expenditure and particularly where congestion might exist because the marginal cost or the marginal revenue that the airport can get is just not sufficient to justify the very large expenditures required, for example, to build a new runway or even to upgrade or refurbish a runway. Given that that's such a long-life asset, it's likely that even if the airport was free to set whatever price it chose it wouldn't make a positive return on that for some years after that construction decision.

So the pricing principles, if there is regulation, need to have an effective mechanism that actually encourage investment when it's appropriate and efficient for that investment to occur. Having to go to negotiate with airlines and to negotiate with the ACCC to actually get that expenditure approved is not an efficient way of doing business and it's certainly not what would have been the intention of the policy-makers at the time when they decided the structure of the airport industry in Australia. It's of critical importance that the Productivity Commission considers what pricing signals are actually flowing to airport owners and to investors who allocate funds to make those investments and make sure that those signals are there to encourage new investment. Just fly in to Sydney Airport in a peak hour at the moment - and you know what disruption congestion can be at an airport, and it's probably not in too bad a situation compared to what might happen in a few years in a few different airports around the country if new expenditure isn't undertaken.

If those pricing signals aren't set correctly, and that might be through removing regulation altogether or changing the form of regulation, then the social economic loss from the outcome will be far greater, in our view, than any loss due to marginal - I suppose anticompetitive pricing is what it might be called — then that should be taken into account. So our recommendation is basically — certainly there's no argument for regulation of the non-airside services in airports and I know the airports have been engaged in a debate about exactly what falls into each category, and I will leave them to run that argument.

We believe that there's no coherent argument for ongoing regulation of airport services in general because there's no demonstration of anticompetitive behaviour on the part of the airports. It's really an issue between a monopolist monopsonist, benefit flowing between airlines and airports, rather than to ultimate consumers who don't seem to get any benefit of these decisions anyway, and the sort of charges we're talking about will really have a very, very marginal effect on the actual cost of an air ticket.

If, however, the Commission determines that regulation should continue to be applied to airside services, in some cases on major airports, then it's essential from the investor point of view that the system is consistent with the regulatory regime for other infrastructure assets in Australia, and by that we mean that it has to be very clear, it has to be a dual till, that is only regulated at the air side aspects, it has to only apply to major airports with national significance and it has to be very well defined and understood and there have to be fair appeals mechanisms.

If that's the case then we would argue that the standard anticompetitive parts of the Trade Practices Act should be sufficient, maybe combined with the national access regime components of Part IIIA of the Trade Practices Act, but a caveat there is that AusCID actually has some considerable concern with Part IIIA as it currently applies, which was made clear in our submission to that inquiry, and although we haven't analysed in detail the Productivity Commission's draft report yet, it seems to recognise the need for investor certainty and fair processes, and if that issue is resolved on the cost of regulation as compared to the benefit, then that would be the appropriate mechanism if the Productivity Commission came to the view that some type of regulation was still required.

PROF SNAPE: Thanks very much, Mr Arndt. Do other people wish to speak at this time?

MR FITZPATRICK: I think we're happy with it. We've obviously got some comments on solving regulation but I think the questions will bring some of that out.

PROF SNAPE: You mentioned, Mr Arndt, the draft report on Part IIIA. That was last week. You might like also to have a look at the other two draft reports that were released at the same time on telecoms and prices surveillance. A number of the issues that you were addressing towards the end were in fact addressed in that, and we might be interested to get your responses to those. For example, in telecoms we did, in the draft recommendations, recommend that there be a continuation of industry-specific regulation. We gave very specific reasons why, for that industry, it would be, but the general thrust of those reports was to bring things together and make it as generic as possible, and only depart from the generic when there were very specific reasons for a particular industry. So we've been challenging in the last couple of days those who are arguing for industry-specific regulation in this industry to identify the particular features that would warrant that.

Also, over the last couple of days in these hearings we've had some extensive discussions between the various parties with different views on some of the issues that you were mentioning there, and it might be also fruitful if you have a look over the transcripts to see whether there are features of the points that you were discussing there which were not addressed adequately within those transcripts and, if so, that you might want to make further submission on those matters - preferably, of course, before the draft report so we can get things right - as right as we can. AusCID - I notice you don't use the acronym ACID.

MR FITZPATRICK: We used to.

PROF SNAPE: It doesn't invest in airlines? It invests in airports but not airlines?

MR FITZPATRICK: We wouldn't regard airlines as being a utility or an infrastructure asset.

PROF SNAPE: Yes, so you confine it in fact.

MR FITZPATRICK: It's a different risk profile.

PROF SNAPE: But I guess the risk profiles here are a little bit interrelated, aren't they?

MR FITZPATRICK: They are but they're not. I mean, you can argue that in the gas industry too. Currently on the east coast there are probably two major suppliers and a variety of regulated assets which transport the gas. It's not an unusual structure.

PROF SNAPE: Following the lines of your arguments, where much of your argument and arguments of other parties is that a lot of the debate is between whose dollar - is it going to be the airports' dollar or is it the airlines' dollar? I would have thought it might be a good hedge to invest in airlines as well as airports.

DR ARNDT: First to clarify, AusCID doesn't invest in anything. Our members invest in infrastructure and choose to join us, and if an airline had a significant investment in an infrastructure asset then I'm sure we would welcome them as a member, and I suppose it's arguable whether their terminal facilities would constitute that or not. But a big difference between the major investment of an airline - which is aircraft, I assume - and an airport investor or another infrastructure investor, is the sunk cost aspect of the investment, because aircraft by their very nature are extremely mobile. If your market dries up or the demand characteristics change, then it's a relatively simple process to take that aircraft somewhere else where the demand exists, or even scrap it and sell the parts, if you have to, although that doesn't occur very often.

PROF SNAPE: Often they're leased anyway.

DR ARNDT: With an airport, which is a very, very big sunk cost investment, if the demand characteristics for your airport change, it's very hard to dig up the runway and take it somewhere else where it will be used. So the risk profile of the investment is quite different.

MR FITZPATRICK: To be fair, as a group we were approached by one of the new airlines before they started and we thought very hard about it because we thought it would help to break up what was clearly an oligopoly, and that has actually happened - unfortunately without us investing - but it has been a concern on the airport side that we have been up against an oligopolistic structure which has limited flights, had very high load factors relative to international experience.

DR ARNDT: I haven't gone through any airlines annual reports in detail but I imagine that the landing charges and other regulated charges for airlines makes up a much smaller component of their total cost structure than it makes the revenue structure of an airport, so that makes an airline much more flexible.

PROF SNAPE: That's true. A submission we have just received from Virgin Blue - and they will be presenting it later in the day - points out that for their operations the airport charges are not such - well, a significantly higher proportion of their operating costs than has been put forward by other airlines. In your paper you say you are concerned with regulatory risk, and I understand that, and also that it's time-intensive but I was a little bit surprised about the "lacks intellectual rigour" remark that you had in there.

DR ARNDT: I think that particular comment - well, it comes from two - - -

PROF SNAPE: Lest you feel I am being defensive, the Commission is not a regulator.

DR ARNDT: No. I understand that. However, I guess the regulator has a job to do, which is to impose the pricing principles or other tariff orders or directions that are imposed on it by the policy-makers - in this case the Parliament - and it has quite a considerable degree of discretion in many cases in how it chooses to impose those rules, if you like, and particularly in the draft ruling for Sydney Airport, which is the most recent example we have on how the ACCC would approach the airport industry. The way it has incorporated the carparking revenue situation into its calculations - which I believe are still unclear for the allowable revenue return - is indecipherable from the investor point of view, so that point in the case of airports is really related to that issue.

MR FITZPATRICK: One of the attractions of the airports when we bought in was the dual-till structure and it was very much Government policy and we were also attracted in fringe benefits that we could get out of additional revenues from fuel throughput levies and taxi charges, which were advertised as being outside the cap by the Government when we bought in. What we have found since is the ACCC has gradually sought to bring taxi charges, fuel throughputs under the cap. Can they do that legally? Apparently they may be able to. Certainly it is against Government policy and it has been somewhat of an embarrassment to the Department of Transport.

Now, when we see the SACL draft ruling, it looks as though there is also an effort to break down the dual till. The grabbing of carparks into aeronautical looks like - rather than being an intellectually correct way under their pricing principle, to be the right answer - a way of splitting the difference in terms of what they think the airport wants and what the airlines want.

I think it is quite clear that if you stay on a dual till applying pricing principles used elsewhere, that regulated charges at all airports in Australia will go up. The ACCC are well aware of that and I guess it is our view that it is their consumer bias which is now forcing them into some corrupt intellectual exercise to try and get an answer which would be more acceptable to the airlines. That would be our view of it. From an investor's point of view, as Raph indicated, what you like is transparency and certainty and to at least know what the rules are. At the moment, with 15 months to go before the reset, we have absolutely no idea but what we're seeing in terms of the draft ruling to date doesn't give one much confidence that you're going to get any sort of answer you can understand.

DR ARNDT: That puts at risk discretionary investment and expenditure by airports in further carpark expenditure, for example. Would you, today, on behalf of your fund-holders, if you were a superannuation fund, direct your revenue or your money towards carpark investments at airports or would you choose to invest it somewhere else?

PROF SNAPE: You mention the countervailing market power - and we have had quite a bit of discussion of that over the last couple of days but do you have any specific examples that you can quote to us of the use of countervailing powers by the airlines?

MR FITZPATRICK: I can give you an example. In Perth recently - well, countervailing power.

PROF SNAPE: I might say that we have had a little bit of trouble getting specific examples of this that are in fact in the realm of economics rather than politics. People have spoken about the political power of airlines and how they can use that or a regulatory power by using it - - -

MR FITZPATRICK: They can certainly affect - sure.

PROF SNAPE: - - - but the actual economic negotiating power, the examples have not been so forthcoming.

MR FITZPATRICK: Can they affect your revenue base? Quickly, they obviously can. In Perth recently Qantas cancelled 13 747 flights a week. No consultation, just took them off. They have the potential to do that across a range of flights. Does that affect income to the airport? It obviously does. They can, if they wish to, limit capacity, and indeed our view over the last couple of years to Perth Airport would be that load factors are pretty high and capacity has been limited. Is that countervailing power? Of course it is. It clearly gives them the ability to impact on the revenues of the airport.

PROF SNAPE: The first one, however, was in fact - as I understand it - a commercial decision based simply on having more efficient 747 engines than previously, so that they could overfly Perth to South Africa.

MR FITZPATRICK: It may have been, but you asked whether they have any countervailing power. They clearly have power.

PROF SNAPE: I was asking actually whether it has been exercised.

MR FITZPATRICK: It may be through technology, it may be through other means, but they certainly have the power to influence outcomes at the airport.

DR ARNDT: Just an intuitive approach, I don't have any examples and I think the airport operators would be better placed than us to actually answer that question but, intuitively, seeing an airport as a large sunk-cost investment, then the profit component of that is only a marginal difference, given the level of returns that airports actually make compared to their whole revenue base. So certainly, in scheduling, airlines have some discretion and particularly when airports are acting as hubs and connect through to other destinations and things like that. The airlines have considerable power in that type of decision, and it is not purely landing charges which they'll take into account when they make those decisions but that will be one of the issues that they take into account.

MR FITZPATRICK: I think you missed the second point, which is that if there is no competition on the route or if there are, say, two airlines operating the route, it makes sense for them to control capacity on the route and that gives them a lot of countervailing power. They can look at demand, they can run with high route factors - high load factors - and the route can be extremely profitable, which that route is.

PROF SNAPE: We are in a situation here where there is reference to the potential monopoly power of airports and, as you point out, it is not only a question of whether they have got that potential monopoly power but as to whether they use it. Equally, on the other side, as to whether there is countervailing power, it is not only a question of whether there is the potential of countervailing power but it is whether they are using it.

DR ARNDT: Yes, that's right - I agree with that - but if that countervailing power exists - to finish the argument I was in the process of making - so the airlines clearly then have considerable discretion at the margins in how many aircraft or what charges - revenues - the airports get and, if it is a large sunk-cost investment business with a marginal return, then those margins are considerable with respect to the degree of profit the airport will make, so from the airport's point of view it is a considerable power. Now, whether either the monopoly power or the countervailing monopsony power are used, I guess from the point of view of regulation, the threat of regulation, hopefully, should be enough - and I am talking about just general anticompetitive conduct rules here - to stop that from occurring on both sides.

MR FITZPATRICK: As you may be aware, another example on the political side has been a variety of threats on regional routes in terms of other outcomes at airports. That's very clear, I think, basically saying that regional routes would be removed if other benefits aren't gained and so on.

PROF SNAPE: Do you have specific examples that are in the public domain with that?

MR FITZPATRICK: Not that I want to quote, no.

PROF SNAPE: On the threat of action and so on, one of the things we mentioned in the draft reports last week was in fact having a halfway house between regulation and no regulation as far as access is concerned, and which we call "monitoring". You may wish to have a look at that and see whether that has any attraction to you, as what we are concerned about there is — there is a risk of not regulating when it should be regulated. There is a risk of regulating when it shouldn't be regulated. Is there something in between those two which can be a lower cost? You might again have a look at the transcript discussion that we had with a number of people on that yesterday. It may or may not appeal to you.

DR BYRON: Just a clarification: you're talking about national significance; one of the differences between Part IIIA and section 192 of the Airports Act is that there are different criteria for coverage whereas the specialised access regime applies to basically all the airports. For IIIA to apply there is that national significance test and one might speculate whether Darwin and Hobart, for example, would meet the criteria for coverage under IIIA. Is the gist of what you were saying that if they don't meet the criteria for declaration under IIIA then they shouldn't be covered by any legislation at all?

DR ARNDT: Yes, it is, because - not any legislation. Just the standard anticompetitive - - -

DR BYRON: I'm sorry, special legislation.

DR ARNDT: The issue there is really the cost versus the benefit of regulation. Is the potential for anticompetitive conduct, if it is not picked up by standard Trade Practices Act - and I am sure in this case the customers of those airports have considerable enough resources to make sure that if they were concerned that that conduct was taking place, it would be brought to the ACCC's attention - but is the actual cost to the community or the economy of that behaviour, rather than the airline, sufficient to justify the huge expenditure that goes towards regulating airports, both on the regulator's side and the regulatee's side, if you like.

DR BYRON: Would you also be arguing that there is an asymmetry in the sense of overregulating or excessive regulation forcing prices down has a different consequence to underregulation - you know, failing to regulate?

DR ARNDT: I think that is clear because while the prices may be marginally high and there will be some welfare loss in economic speak, I suppose, if the investment doesn't occur and there is significant congestion - and airports are no different to any other transport system and the economy of Australia grows to rely on them more and more and more - that will have significant repercussions, as with any infrastructure industry, through the entire economy. I mean, I am not very familiar with it but I understand that there were all sorts of problems in the United States with the flow of aircraft and I'm not sure what the reasons were for that - if it was air traffic control or maintenance or what, but just from speaking to some friends of mine who are resident there, aircraft are continually delayed, it takes away from their time doing business and in the office, it's an imposition on holiday-makers, and it causes a great degree of economic loss to the society as a whole. So unless we have a smooth, efficiently operating airport or aircraft, air transport system, both freight and passenger, that will have repercussions, and the continued smooth operation of that system relies on ongoing private investment in the facilities.

DR BYRON: I think all parties would agree that congestion in the air space and lengthy delays at airports is a very inefficient, undesirable way of rationing slots. There's some debate about what the preferred way is, but that seems to be unanimously the least preferred way.

DR ARNDT: Yes.

PROF SNAPE: And none of the other options seems to be attractive to the participants either.

DR ARNDT: That's why it's your job to figure it out.

MR FITZPATRICK: I guess our view is, without regulation there would be an incentive for a commercial solution - and obviously the operators can talk in more detail on this, but I'm only talking from a board member's point of view at an airport - but what we've found is that there will be some commercial negotiations on a variety of issues, in general there won't be agreement, and it will then go to the ACCC, and there's an incentive really on the airlines - and sitting in the airlines' shoes I'd do the same thing - to basically extend it to regulation, because their view is that they will get a better outcome there than they could probably negotiate commercially.

PROF SNAPE: Do you find it worse in airports than in other infrastructure investments?

MR FITZPATRICK: It is now, because airport revenues at the moment are only about a third regulated, under the concept that it will be dual till. It is now, I think, in other assets more clear. In pipelines, where we have another investment, it's more clear as to looking - - -

PROF SNAPE: So it's the clarity of investment rather than - - -

MR FITZPATRICK: At the moment it is absolutely opaque. We have no idea how this is going to play out.

PROF SNAPE: So it is the clarity of the regulation that you're calling for.

MR FITZPATRICK: You want transparency and you want some certainty as to what it - - -

PROF SNAPE: Yes, rather than the existence of regulation as such.

MR FITZPATRICK: Well, the difficulty, if it exists - and I guess from an investor point of view we even have some concerns that monitoring is being used as a wedge to really reconstruct the edifice again - that would be our main concern with it. On the airport side, the advantage if they regulate in an intellectually rigorous way, using dual till, we don't mind in a way because prices will go up in the short term because aeronautical expenditure is underrecovered at the moment. But the reality is, I think, going forward, and in order to create an efficient airport industry, it seems to us that the major impediment to it at the moment is regulation, because most of the time is spent trying to work out what the regulators are going to do rather than looking for the actual commercial outcome.

If you look for a commercial outcome first, you talk to the airlines, you get nowhere. You end up with the ACCC. They take a view. As you know with MUIT and with a variety of other transactions, that still hasn't led to a solution. People are still negotiating and nothing is actually happening on a variety of airport investments.

PROF SNAPE: That is the clarity of regulation even more than the regulation as such, I think is what you're saying.

MR FITZPATRICK: It's not only that. The regulation at the moment doesn't actually send you a conclusion either.

DR ARNDT: But there is another issue. For example, in the electricity industry here in Victoria, the businesses were sold based on what was called a light-handed incentive based regime, and the investors took a particular view based on discussions with the Government as to what that might be, and in this case the Office of the Regulator-General here in Victoria has interpreted that somewhat differently to what the investors would have thought. So saying that we'll have a monitoring system which is light-handed in some thought - the investors will interpret that in a particular way, but they're now very uncertain as to whether ultimately that is what they will end up with.

MR FITZPATRICK: The other point that's probably worth making - I don't know how many people work in airport regulation but it seems to be a lot, and each of the airports basically - certainly at Perth, essentially the CFO does the work on regulation. At Melbourne Airport there's one chap who works specifically on regulation. The airports were set up basically lean, and they're not set up to spend all their time going through tomes of regulatory outcomes. It seems to us the ACCC must have - I don't know how many people, but it must be five or 10. It doesn't strike us that those five or 10 people are going to actually provide better outcomes than can be commercially negotiated, and I guess our view is that that's really where it should go.

PROF SNAPE: Thanks very much. That's given us a very good perspective from the side of investors in infrastructure. Thank you very much for your submission and also speaking to it and, as I say, if you do find that there are other things you would like to respond to out of the discussions here in the last few days, and the other submissions, as well as the draft reports last week of the Commission, then we'd be very appreciative of your reactions to those. So thank you very much, and after a little bit of shuffling we'll then go on to welcome Canberra Airport.

We now welcome Capital Airport Group, who operate Canberra Airport, to the inquiry, and we'd ask the representatives to identify themselves separately for the benefit of the transcript. We thank you for your submission, and whoever is to speak to it can then speak to it.

MR SNOW: Thank you. Terry Snow. I'm the chairman of Capital Airport Group.

MR BYRON: Stephen Byron, the managing director of Capital Airport Group.

MR BROWN: Matthew Brown, manager of new investment, Capital Airport Group.

MR BYRON: And just by way of introduction, Professor, you have our submission. You also have our submissions to the Prices Surveillance Act Inquiry, and in our most recent submission we had a short two and a half-page dot point summary of some of the fundamentals of the issues as we see them, but I'd ask Terry Snow, our chairman, to just touch on a few of those, and Matthew Brown will just touch a few principles of common user, and then we'd like to interact and deal with the questions.

PROF SNAPE: Thank you very much.

MR SNOW: Mr Chairman, Doctor, I bought the airport when it was privatised in phase 2 of the airport sales. When I say I, that's my wife and myself and my family bought the airport. We've been long-time Canberra residents and I have been a very keen aviator and fly, and when the airport came up for sale we saw the real opportunity there. The current infrastructure was very, very poor. In fact, I think it was probably the worst-presented airport in the network, excluding very small country towns; for instance, Tamworth, Wagga, Albury, Armidale, Newcastle, Longreach, Maroochydore. Just about any sizeable regional airport had better terminal facilities than at Canberra Airport, notwithstanding the fact that we handled nearly 2 million passengers a year.

So when we put the bid in we were encouraged to explain to the federal government how we would manage the airport and develop it, and we put in comprehensive architectural studies with architectural renderings of what we intended to do. The main thrust of the airport development which we recognised was the development of a common-user facility. Canberra has only six destinations flying in and out of Canberra, and we thought Canberra, being a large city in regional New South Wales - that we should be able to attract other destinations from smaller carriers outside we might describe as a duopoly, and to do this we had to facilitate a common-user facility.

A common-user facility, in my view, is where airports are going to go, and I notice in the States they say that the biggest bar to competition is the lack of these common-user facilities. As airlines are now coming under increasing pressure for profits, they will have to resort to common-user facilities because that's the only way they can effectively and cheaply deliver airport services to their business. That was a step, when we made the submission, that was accepted by the airlines. We gave a copy of our submissions to the federal government, to both Qantas and Ansett, and explained to them how we proposed moving ahead with this common-user facility.

We went to a great deal of work to do all that, but then we ran straight into a brick wall and that is this necessary new investment veto, this power that's been delivered to the airlines. All our projects at the airport - the airlines refused to negotiate in a sensible, meaningful way, and they let us then fight with them through the ACCC for something that is plainly needed at the airport. For instance, one of the first projects we wanted to do at the airport was put a PAPI lighting system in, which is a landing guidance system which, if the aircraft fly in this lighting system, the series of lights, they will clear the hill satisfactorily to land at the appropriate spot on the runway.

We had that on one of our shorter runways where it is very easy and quick for the airlines to duck in under this runway three zero. We went to the airlines and made a submission that we wanted to put this lighting system in. It cost $76,000, and we got screwed around to an extent that it went on for many, many months. We interviewed the pilots when we put the system in and said, "Do you think it's a good thing?" They said to us, in their words, "It's the best thing that's happened to Canberra Airport." It's point 1 of a cent additional cost, and we had to fight that through the ACCC, and that characterises the whole attitude of the airlines to our investments proposals for the airport.

The airport has not had any major aviation infrastructure built there in 28 years. The aprons were built there 28 years ago, and we wanted to increase the aprons by 40 per cent to facilitate proper handling of the aircraft. Prior to putting the apron in, we had to park aircraft out onto the taxiway and put witches hats around the aircraft so taxiing aircraft wouldn't interfere with them, and it's certainly not good practice. When we made the submission to the ACCC, notwithstanding that all the parking spots at that time were fully occupied during the night and some aircraft were diverted onto the general aviation aircraft to park overnight, Qantas made a submission to the ACCC that this was not necessary investment, which was absolutely ludicrous.

We have now put the 40 per cent increase in the apron and we still need more apron at Canberra Airport. We have not yet seen Impulse fly in there with their large jets, which they propose to do in the next couple of months, and when they park those aircraft overnight at the Canberra Airport, we will have a major problem. Impulse have committed to build a major maintenance facility at Canberra Airport and this will necessitate them parking a number of aircraft on the apron overnight. So what's become patently clear to us is that the airlines are using the necessary investment criteria and the veto power to stifle competition, and that's the only reason that we can discern why they would do this. It is in their interests to restrict the development of the airport to facilitate access for other carriers. But this causes us an enormous amount of heartache. I think we've done nearly everything at the airport now that we can do with the minor things that we've done. We've spent $35 million there to improve the facilities, a new cafe at the front of the airport, which was glaringly required.

We made application to the ACCC to have this approved and we were knocked back, so we have now lost our return on our investment of $2.5 million. That's something which is clearly needed. We had a situation at the airport where the only access to the common-user facility was through a single glass door through the back of the gift shop. We were experiencing enormous amounts of frustration. We have done numbers of architectural schemes and engineering schemes to be put forward to the airlines, to be knocked back. I am at the stage now, in the development of the airport, where I am considering just walking away from the aviation side - the provision for aviation infrastructure - and continue with the development of the other aspects of the airport which will be the commercial and business park, hangar facilities for those people who want to do maintenance there.

The investment in aeronautical infrastructure just cannot continue the way we're doing it. We cannot put any more resources into it. It's not just the two people that we have doing this work, it involves a whole team in formulating and coming up with these plans. Working on the terminal we could well have 60 per cent of our administrative staff working on these projects and they just go to the wall. We don't see any future for investing in there if the airlines are continually vetoing - Ansett and Qantas - our investment proposals and development proposals for the airport. That's a big let-down for us but it's going to be a big let-down for the community.

The little development we've done in the common-user facility - we've been able to facilitate Impulse coming into Canberra, we've had 52 per cent or more growth in aircraft landings at Canberra because of competition, and this competition was delivered because we took a bold step - we were intimidated by Qantas not to do what we did but we provided a facility in the common-user area exclusive for Impulse, about one-third the size of this room. Qantas retaliated by walking away from all existing commercial contracts and withdrew from the common area screening. I can tell you that was an horrific experience for me to go through and had a devastating impact directly with Qantas' withdrawal from there - it was about $300,000 a year, which was money that was a big risk for me in a small airport like Canberra.

I think that as an owner of the airport and as an investor the whole concept of this necessary new investment and the veto that goes with it is in fact misjudged. I think the idea of the airports rampantly developing infrastructure and somehow pinning it onto the airlines was going to be a real problem - or was anticipated to be a real problem. That is not the case. Aeronautical infrastructure investment at the airport for me is a loss leader. It is the lowest returning element of the entire airport investment. I think that it works against the consumers - the ultimate consumers - who are the Canberra travellers. It's just delivered another weapon for the major airlines to use to entrench their positions by restricting the infrastructure investment.

That is all I would like say, because that's the main thorn in us trying to meet the expectations of the Canberra community in delivering a - God forbid, you couldn't call it a national airport when you compare it with Paris or Copenhagen or Oslo or New Zealand, for that matter - but we are trying to build an acceptable airport in Canberra to meet their expectations. From the limited amount of work we've done on our common-user facility I think we've delivered over $20 million just in reduced airfares to the Canberra community.

If we could do it better - Virgin Airlines have approached us and we can't engage with them because we just don't have any facilities at the airport to facilitate them. That could bring more competitive airfare pricing. We don't have the competitive airfares between Canberra and Brisbane because Impulse don't fly there yet. In fact, I notice Qantas put their fare up again in that sector recently, while in the rest of the country - where Impulse are flying or Virgin - they have reduced it. We cannot accommodate Virgin unfortunately and I feel disappointed to have let down the Canberra community with that, but we just cannot develop the infrastructure.

I think this is well meaning legislation, but I think it's missed the plot. The ultimate consumer, of course, is the general public and I don't think they have got any benefit from this legislation. In fact, Professor Fels was asked at an airport conference 18 months ago by Hobart Airport, has he seen any evidence of the airlines' passing through the savings of the CPI-X - those efficiency dividends were meant to flow through to the public - and Professor Fels said that he wasn't aware of it, and he didn't think it was his mandate to actually take that into cognisance because the legislation didn't - I mean, his charter is airports somehow mistreating the airlines. Given that the business is owned by my wife and my family, and we've got a staff of 20 - and you line that up against Ansett and Qantas - I don't think anyone has got a fear about who is going to win push and shove with Ansett and Qantas. With that, I'd just like to pass on to the other gentleman who might like to make some comments.

PROF SNAPE: Thank you, Mr Snow. Yes, Mr Brown.

MR BROWN: I think the main criticism we have of the regulatory prices is that it is impeding the airports' ability to deliver efficient and competitive outcomes to the market for air travel in Canberra. In particular, I think with an airport the size of Canberra we are relatively small, we have low passenger volume by comparison, and dedicated infrastructure for each individual airline is not a viable option in Canberra. The most efficient way to provide for growth and access for new entrants in the markets is the provision of common-use infrastructure.

In the past, duopolistic market conditions have enabled Qantas and Ansett to impose an inefficiency on travellers by way of dedicating separate terminal facilities and support facilities in the terminal. A demonstration of that would be the independent flight information display systems that were in place in the terminal. Qantas and Ansett had separate arrivals and departures screens and that resulted in four screens in the common areas of the terminal and with Impulse coming that would mean six screens. Apart from being not overly visually pleasing, it is an inefficient use of resources and there is a better way of doing it by allowing airlines to share generic facilities.

That's been the whole rationale behind the development of Canberra Airport to date. We're pushing ahead with common-use infrastructure development. Importantly, it provides access for new entrants. Airport facilities have been recognised as a major barrier to entry for new entrants, and that came out of a report by the US Department of Transportation, which I'll touch on briefly a bit later. But not only does it deliver benefits to new entrant airlines, in terms of access, but it also provides significant benefits to the major airlines in that a common-use terminal avoids a situation where the major airlines are forced to invest in substantial additional terminal infrastructure.

Terminal infrastructure has traditionally been classified as a lumpy type of investment where large incremental additions to terminal capacity are required and, for a period, they are underutilised. If you have a common-use terminal facility, that enables airlines to better manage peaks in demand and to accommodate incremental levels of growth up to a stage where they can make efficient use of an additional terminal or incremental terminal facility.

In terms of competition impacts, I think a lot can be learnt from the experience to date in the United States. Deregulation of the airline industry in the US precedes the Australian experience by some 10 to 15 years. What they have found is that airline competition is delivering substantial benefits to sectors of the market. However, that is relatively isolated to routes that are serviced by airlines such as South West - a low-cost operator in the US. The US Department of Transportation, wanting to extend these benefits to other areas in the United States and deliver those benefits to the communities, commissioned a report by the Federal Aviation Administration. That report was tasked with the opportunity of finding out why airline competition wasn't more prevalent in the US market.

The primary finding of that report was that airports play a critical role in the competitive nature of the airline industry. What that meant was that airports are a barrier to entry for low-cost operators. They didn't have the access that was required and there was an inclination by airports - while state-owned in the US - to not develop those facilities. Their report identified a number of best practice initiatives that would promote competition in the market for air services. Broadly, those were airports becoming advocates for competition, the development of common-use infrastructure, the abolishment of majority and interest clauses - which operate very similar to the user support criteria here on necessary new investment, whereby an airport wanting to develop infrastructure had to have the support from the dominant carrier. The report concludes that the US government will have to develop an incentive framework to promote the development of common-use infrastructure at airports.

I think that's in stark contrast to what is happening here in Australia. Airports are willing to invest in common-use infrastructure. They are willing to accommodate the requirements of new entrants and for growth in the incumbent operator's operations. However, we're not being permitted to do that by the current regulation. The stumbling block for us has been the user support criteria. You have a common-use infrastructure project that will have shared benefits, for use by all airlines, incumbent operators, new entrant airlines - such as Virgin and Impulse. However, majority user support is not sufficient. The ACCC shows a reluctance to move forward without full user support. User support of a new entrant airline alone is not sufficient.

We've gone forward with support from Ansett and from Impulse. Qantas have not supported one project at Canberra Airport. What that means for us is that it's an uncertain regulatory outcome. Canberra Airport has to get on and provide these facilities for growth and competition in the market, and for that to occur in a timely manner. Construction basically has to start from the day that Impulse and Virgin say they want to be here. Impulse gave us six weeks' notice that they were going to start up operations in Canberra. We had six weeks to develop the necessary terminal infrastructure.

That meant that stage 1 works in the development of this common-use facility, that we'd discussed with Qantas and Ansett over the previous two years, had to start basically immediately and to engage in the regulatory process and get user support from each and every airline just could not be achieved in that time frame.

What we're faced with now is, as Terry said, we have a 2 and a half million dollar facility. Stage 1 is completed. We're facing a zero recovery and there's a 3 and a half million dollar second stage planned, which is where the benefits will really come to the incumbent operators and new entrants in terms of dealing with these capacity constraints that they're experiencing in the departure lounges. That's a further 3 and a half million dollars, and if it was my money I wouldn't be spending it without regulatory approval. That's our main criticism - the current regulations not permitting this critical infrastructure to proceed, and basically something has to be done about it.

PROF SNAPE: Let me get a clarification there. I understand that in order to get approval for the price for any direct cost recovery on it you need approval. It's not as if you can't proceed as a loss leader, as Mr Snow was mentioning, and get the return on unregulated activities. It's not that you cannot invest; it's just to say you cannot put a direct charge on for your investment unless the approval is given.

MR SNOW: Correct.

MR BYRON: Can I go back to the start of all this, and that is that when we bought the airports the whole thrust was about how you're going to develop it, and I think that came from the philosophy of recognising the big problem in aviation worldwide is a lack of infrastructure. So the focus was on development, and the clear policy said, "If you build necessary new investment, you can put on a charge." Really the incentive or what they were trying to say was, "You should get out there and build this necessary new investment." So, yes, we need the approval to get the charge, but something that we started with was that if you built new investment that was necessary you'd be able to put on a charge.

There might be some blues about whether you got 10 per cent or 11 per cent return - they've been pretty much sorted out. The arguments aren't about the rate of return. The arguments are about whether you get the regular rate of return or whether you get negative 100 per cent return. We don't think that's fair and, whilst we might have done some things at the front end here to facilitate competition to meet our commitments to the Canberra community, as far as it's concerned now the game's up. We are going to wait until we are able to put a charge on for those things and recover our previous capital investment before we even think of some new stuff. We will keep waiting.

If the ACCC knock us back, we'll wait until after the new regime comes in and we will seek to impose a charge, a reasonable charge, to recover our capital investment now on this terminal. If you go back to the fundamental, the reason you might need regulation on a monopoly business is because of prices being set at levels which significantly exceed cost. No-one has ever raised the spectre of that at Canberra Airport, yet we get a negative 100 per cent return.

PROF SNAPE: The negative 100 per cent return. That of course depends upon how much additional throughput you've generated through your investments as a loss leader.

MR BYRON: Let me share that with you in terms of the retail revenue.

PROF SNAPE: Yes.

MR BYRON: Airports, they say, are all about shopping centres, and that might be fine for Sydney.

PROF SNAPE: And parking.

MR BYRON: At Canberra Airport it's a very different game. We do have a new cafe operator and the fit-out was all paid for, and that is separate to the aeronautical investment that we're seeking to recover. But we're not getting any greater level of rental return from that business at all. Its total return anyway is about $150,000 per year for us. We're hoping that might get to $155,000. We lost our newsagency through all of this because of what Qantas did. We've been successful in finally, after nine months, signing one up and that revenue should be about the $70,000 that we used to get before. So within the terminal as a whole there's not a big boost.

PROF SNAPE: And parking?

MR BYRON: And parking, yes.

MR SNOW: Parking is a positive. But the concessions we made to attract Impulse wasn't whether we charge a couple of cents extra for the front of the terminal per passenger. We made very substantial concessions to Impulse to have them fly to Canberra, which is outside this debate but they were very very considerable, and includes provision of hangar facilities, site and what have you. So the pitch to Impulse to attract them, to attract this extra business if you're talking about loss leaders, was not through the provision of this facility, though if we couldn't have built it Impulse couldn't have operated there at all.

MR BYRON: Can I also address the parking comment, because I left it sitting there after you threw it back at us twice. Fundamentally, in terms of parking, we've had to spend an absolute fortune - over 8 and a half million dollars - redesigning the road system and expanding the carparks and certainly, as we've seen passenger growth increase at about 8 and a half per cent, that has contributed to help us recover in that area. So there is a bit of an offset there. But given we've had to spend a lot of capital in the carparking area as well, we haven't found the windfall that one might hope for or see from an outsider's point of view.

PROF SNAPE: Have either Qantas or Ansett threatened to quit Canberra?

MR BYRON: No, they haven't. If I can extend that to an answer on countervailing market power.

PROF SNAPE: What it's about?

MR BYRON: We don't deny that we have a monopoly. We're not denying that these airlines don't have any choice or alternative but to fly to Canberra and to land at the airport that we own. What we do say is that they exhibit their countervailing market power very strongly in their negotiations. Put aside the way in which they operate with the current regulator and the way they go there. Put aside even for the moment the vigour and strength of response by Qantas in threatening to walk away from commercial arrangements when we introduced Impulse. Just focus on some fundamentals. We ought to have at Canberra Airport a conditions of use, a document that governs what the rules are and the fact that when they land they'll pay a charge.

Every time we try and say that there is one, they refuse to negotiate, but just send it back. So there is this massive question of there being no contractual arrangement over their use of the airport, and they carry that through into every other area of their business, where they refuse to sign contracts, refuse to negotiate the contracts, refuse to negotiate changes, refuse to sign anything, and ultimately actually refuse to pay. For example, there is a consent for the airlines - both of them - to have advertising businesses within their terminal, on the basis that we do a revenue share. The documents are unsigned. They refuse to sign them. They also pay from time to time, but they get up to 15 months behind in paying.

So they have this other weapon where they just don't pay for anything and one says, "We have the ultimate response to that and that is we shut them out." That is just theoretical. Even when they don't pay their staff carparking fees - and that went on for 15 months - there was no way I could lock the gates and say, "You're not paying for the facility under a contract that exists but you won't sign. I'll lock the gates and you can't use it." There would have been a massive public uproar. There would have been strikes, there would have been massive disruption.

I can't even go in there and say, "Well, you're not allowed to have the advertising signs unless you comply with an agreement you have with us. You're not paying us for that agreement. I'm going to stop you having that." I can't even go in there and peel them off the walls. So far be it for me to wake up one day and say, "Listen, Ansett, you're not paying your bills. We're now not going to let you use Canberra Airport." It just doesn't work that way. We don't have that ultimate response.

PROF SNAPE: Not even to impound a plane?

MR SNOW: Heavens above. I'd be hit with a loss of profit. I don't think that's where I'd want to go. Let me tell you something else about how they conduct their business. We had a major dispute with them when they moved out of the common area and the security arrangements. It wasn't doing any of us any good so rational men get together and they try and sort it out. We came to an arrangement. It was all bar the minutia of, "Well, we haven't got a subleasing area planned for that and this, but yes, we'll sort all that out." That was - - -

MR BYRON: 29 May last year.

MR SNOW: - - - 29 May last year. We've been continually with our solicitors preparing a lease document to sign to ratify the agreement so that we all know exactly where we stand. They haven't signed it, but when we go back and continually talk about, "Would you please pay us your outstanding money and what about signing this arrangement?" they say to us, "By the way, we want another slab of land next to our facility for future growth." We're saying, "Well, we'll talk to you about that, but what about signing the agreement of last May?" So it's an ongoing negotiation.

We've got an agreement in place, verbal agreement, and this is to tidy up an arrangement that's been going on for years and years with the FAC, and we said, "Right, well, this is nonsense. Let's sort it out and have it executed, a proper agreement, so we all know exactly where we stand." They won't sign it, they won't negotiate it, but then when you go down, then they're rolling other things into it and varying the arrangements.

MR BYRON: Renegotiation all the - - -

PROF SNAPE: How would a change in the regulations affect that? That may be simply commercial negotiations of a big player playing against a small player. How would a change of regulations affect that?

MR BYRON: It may not affect that. But what it would do is it would allow us to get on with our fundamental job of ensuring we provide enough aviation infrastructure for whatever customers there may be to grow and to use our airport, because not only do they not want growth in terms of new entrants, fundamentally they're not interested in significant growth in their markets anyway, because they want little bit by little bit, steady growth, little bit of crowding, force the price up. The two main players have put themselves in the quadrant - or graph, whatever it's called - in the volume versus profit, the profit-maximising graph.

They've put themselves up there in the low volume, high price part. That's not good for consumers, not good for us certainly, so we're more interested in the other quadrant of the graph. I think fundamentally what this has to be is not an argument about who gets the dollars and the share of the dollars between airport and airline but what quadrant of the graph we end up in and where's the consumer surplus.

MR SNOW: To pick up on a point: when we were talking about the lease arrangements, that was the answer to whether we were being monopolists.

PROF SNAPE: Countervailing power, yes.

MR SNOW: Yes, and I think we clearly demonstrate that our negotiating skills or our monopolistic position doesn't favour us where we can bully Qantas into doing what they want, because let me reassure you that's not the case. When Steve and myself go and negotiate this, they turn up with three lawyers plus a squad of people, so there's nine against two at all these meetings - and lawyers, not that you see any legal documents come out of it, unfortunately. But I can tell you that Terry Snow and Janette Snow and Stephen Byron aren't doing Qantas in the eye, you can rest assured.

PROF SNAPE: Good. Yesterday I pointed out to Qantas that we'd had a number of airports making statements about the way they'd been treated, but we were tending to hear one side of the picture and I was challenging them - as they haven't yet made a submission in writing - to try to give us the other side of that picture. So we'll wait for that development.

DR BYRON: In the absence of the current price regulatory system and the NNI controls and so on, hypothetically - just assuming all that regulatory stuff wasn't there - you would then proceed to your stage 2 additional 3 and a half million (indistinct) investment that you've been talking about. Approximately how much is that likely to add to fares assuming it was all passed on, or to charges? I know you've got to have forecasts in there of what user numbers will be and growth rates and so on.

MR BROWN: Stage 1, which we had knocked back, was 14 cents per passenger on top of an airfare. Stage 2, which is the 3 and a half million dollar project, if every cent of that gets passed through, is 30 cents per passenger.

PROF SNAPE: In and out?

MR BROWN: Correct.

MR BYRON: Can I give an asymmetry of that?

PROF SNAPE: Yes.

MR BYRON: Two. One is obviously to compare it to air fares, and we've done that, but I underline the fact that last weekend Qantas increased the normal full economy air fare between Canberra and Brisbane return from $635 to $815. It's a 30 per cent increase - whack. The increases between Sydney and Melbourne are not so severe because there's a bit of competition there. The other interesting asymmetry - and if this is all about protecting the consumers - is in things they use at the airport. The smart card trolleys, the trolleys for your baggage, are operated by a separate company and they have deals with Ansett and Qantas. We let them operate free at our airport, but so be it, and they charge $2 per trolley. At Canberra you don't take your trolley very far so you think $2 mightn't get you a lot of value, but that's life. Qantas and Ansett did it with smart card overnight to change it to $3. They didn't consult me, they didn't consult the community, they didn't consult the ACCC - whack, $3. So we're struggling in this massive process for 45 cents when we're developing millions of dollars of infrastructure and something else is just - - -

MR SNOW: We did $20,000 worth of cards, let me tell you.

PROF SNAPE: How long do the leases run for?

MR BYRON: Which ones?

PROF SNAPE: The leases for Ansett and Qantas.

MR BYRON: 17 more years.

DR BYRON: Just onto the trolleys, if you wanted to have some sort of concession fee for the operation of the trolley service on your site - let's say it was 5 cents or something out of that $3 - presumably that would have to be approved by somebody?

MR BYRON: Presumably. At Canberra we've taken a different approach because we're the only airport where this hasn't gone through because I sort of went ballistic at them and said, "That's not on, it's not appropriate," because I think $3 overall is a bit much, I don't think overall it's a fair price, and it's now on hold. But what I would also look at is maybe doing it separately ourselves, although apparently the operators don't want to supply me with the trolleys, and Ansett and Qantas may not let me put the trolleys in their baggage areas which is, naturally enough, where you'd like to have them.

DR BYRON: Yes, sure. But I would imagine that most of the passengers using Canberra would assume that the trolley service is actually operated by you, unless somebody tells them, and if the cost of the trolley went up from 2 to 3 dollars, then I imagine it would be you that was getting the complaints rather than Qantas and Ansett.

MR BYRON: That's exactly right, and I think that touches on the other area of countervailing market power, that ultimately there needs to be very significant transparency in the airport charges and, further, there needs to be a huge amount of integrity in the system. I worked this through when I was thinking about California. If the communities involved and the users of airports, being passengers, don't have faith in the integrity of the system, the airport will never be allowed to increase its charges. That's why it just won't be the threat of regulation that will keep us charging fair prices. But ostensibly from the critical media, the public charges do have to be fair. You just can't put up charges without delivering on your product.

DR BYRON: Just coming back to the PAPI lighting system for runway 30, 0.1 of a cent per passenger? I'm amazed that anybody even bothers to haggle, let alone refuse - - -

MR SNOW: 1 cent, I think, isn't it?

DR BYRON: 1 cent.

MR BYRON: He did say 1 cent.

DR BYRON: Well, even 1 cent - why bother?

MR BYRON: The effect that they haggled was - .002 of a cent, is what the reduction was over nine months. But fundamentally the airlines are established with areas that want to do things and operate the airline and they include people in their property and terminal sections, that they are positive. Then they have their other divisions there, charges or "Dr No" people as we call them, and they are there to stop every single thing. They are totally underresourced in terms of doing any negotiation and deal-making and that's why they can't cope with all of this as well. But that area, their one objective and charter is to say no to everything, no matter how sensible it is or how small it is.

MR SNOW: To pick up on that, Doctor, by not landing on 30, they have to go right around onto 35.

DR BYRON: It costs a lot more.

MR SNOW: Exactly. It would probably put something like 45 kilometres on the trip, and bigger taxiways. We could put taxiways off the runway 30 and that would make the system really simple and very workable, but it's about $300,000 and I said to Stephen, "We should do it," and he said, "Why would we go through the hassle, because they're not going to say yes?" Because if we've had the fight on the PAPI and we've had the fight on everything else we're not going to do it, so we're going to wait until they come and ask us. But it's not sensible or rational.

PROF SNAPE: There seem to be poisonous relationships here that the regulations may have contributed to, but it seems to me from a lot of the things that you've been saying, that even without the regulations those poisonous relationships might remain.

MR SNOW: We don't have a poisonous relationship with Impulse, we have a very workable relationship with Impulse. We don't have a poisonous relationship with Ansett, we have a workable relationship with Ansett. It's very tedious, it's very bureaucratic but it's conducted with goodwill and good faith. But I think you will find if you ask any other airport what their relationship is with Qantas, they will be the same. They play the game so tough and use this NNI veto power ruthlessly, so that it just makes it difficult for any airport to move ahead.

MR BYRON: I might say we have a very good relationship with the local Canberra manager of Qantas, but of course the way the airlines structure themselves is they don't let the people on the ground who know what needs to happen operationally and how to deal with people cordially - they refuse to give them any negotiation power or decision-making power.

PROF SNAPE: Do you see this in essence as caused by the regulations or is it quite independent of the regulations?

MR SNOW: The regulations have given them the greatest weapon that they have to use against the airport and that is this right of veto and necessary new investment.

MR BYRON: I think it mightn't be the sole cause but I think it is a very substantial contributor and it is certainly the thing that is standing in the way of taking things forward, because ultimately airports and airlines have very much to be gained from working cooperatively together. As the domestic duopoly dissolves with the introduction of competition, there are so many savings that can be accrued by the major airlines from changing the way they run their operations at an airport, that that can happen, and it will certainly take time. At the moment the regulatory structure would prevent that relationship evolving.

PROF SNAPE: What is the barrier to Virgin starting? You mentioned that earlier and you said you would have to build new facilities for them. Is it a regulatory problem?

MR BYRON: It's twofold, to be quite clear. One is our enthusiasm and appetite and being able to handle all this. Our management time is totally diverted by these processes in getting NNI approvals. We almost don't have the time to deal with that. The second thing is there does need to be a substantial change in the terminal to introduce four check-in desks rather than the existing two. There is also an issue of apron parking space, where we need to park them. We do need to build some more apron, probably at both the Qantas and Ansett ends, because of the pressure of the introduction of new larger jets. Quite frankly, Terry and I don't know if we have the appetite for this fight any more. We're trying to win our previous fights and we can't handle it. You just don't have the enthusiasm for it.

MR BROWN: I think especially important as well is that Virgin cannot be accommodated without the stage 2 works that come from this common user terminal development. Stage 2 works deliver the departure lounge facilities, and at the moment there is a single departure lounge that has seating for about 30 people, and that services the needs of all operators at the airport at the moment. That's clearly insufficient, and if Virgin come to Canberra we have to provide adequate facilities. If we cannot get necessary new investments passed through the price cap, those facilities will not be provided.

PROF SNAPE: So let's assume that Canberra were to become unregulated, so you don't have to divert all your attention and energy to arguing NNIs and all of that. Would you then be able to move to allow Virgin to come in?

MR BYRON: Not only to cater for them but also for Ansett and Qantas and Impulse's growth. We could move quickly and effectively to focus on the need to develop new apron. The way we would see things is that we would have an obligation to provide necessary infrastructure. That would be actually the starting point. So we would build apron and we would facilitate the terminal development immediately. We would have the right to charge the airlines a charge that was not excessive, and that could be settled through negotiation.

PROF SNAPE: We're not into rights here, we're into commercial negotiations. We're talking in a unregulated environment and we're saying, "Okay, you want to build a new apron, you want to build the terminal space," et cetera. One or two of those, if not all three, would perhaps be reluctant to have more competition, so you're going to be putting charges upon them to facilitate the competition, just the same as at the moment, and they will be no more enthusiastic about the competition than they are at the moment. So they will say, "No, we don't want to pay that extra charge that you want to charge us. You don't have an inalienable right to charge us. This is a matter of commercial negotiation." So aren't we back in the same sort of situation as we are the moment?

MR SNOW: No. Can I say why? We have got approximately 11 parking spots at Canberra Airport at the moment. At the moment Impulse coming in - turbo props, small aircraft ducking in and out regularly but they don't take up large footprints. And we have said to the ACT government that we will provide access to all airlines. We will try and provide access for airlines - Impulse, Ansett and Qantas. So when Impulse fly in their big jets, and if we were able to accommodate Virgin, Qantas and Ansett would have to say - they would have to dead leg back home to Sydney or Melbourne at night with empty aircraft or don't have the last flight at night and leave aircraft at Canberra.

It suits them to park their aircraft in Canberra at the moment. They park there for free. They don't pay us a red razoo for it; that is gratis. Of course, to get out of Canberra in the morning, we often have fogs - 10 or 15 days a year - the aircraft can depart in fog but can't land in fog, so they can get out on the first flight, 6.30, 7 o'clock, and off they go. If we were able to build more apron, then we would be able to accommodate the other people. But at the moment we can't enter into that debate because we will have the whole process all over again. We've been there, we've seen it.

MR BYRON: Can I give a further answer to that?

PROF SNAPE: Yes.

MR BYRON: I think part of what Terry said is the answer, and that is that if the airlines don't want to negotiate and agree to paying for new apron, then you don't build it. Then what you have is your existing 12 spots and you're able to offer them for sale at different prices, and you can negotiate with all four carriers about what they want to pay. If Qantas don't want to pay as much as other people, then when I need to park 14 aircraft on 12 spaces, then those two aircraft from Qantas will miss out, and when they miss out they might change their views on how much they want to pay. That is how commercial negotiation ought to work, and there will come a point where they will want to build another two.

The only overriding check that we have a view that one might need is an overarching review every three to five years based on annual financial returns that say, "Here are all your aeronautical assets, here's your aeronautical revenue. Are you earning an overall excessive rate of return?" This test to say, "Do we need regulation because that appears to be the thing we need to protect against? You ought to check against it, that ought to be reasonable." But in the interim we think there is a fair prospect that if we can negotiate and say to Qantas, "This is the price that I've just sold the 12 spaces for. We don't have one to sell you because you don't want to pay the price," then we end up having an actual market where people buy and sell things and you don't have, as you call them, people flagging rights and refusing rights.

PROF SNAPE: Thank you. On that monitoring, as I mentioned before, you might want to have a look at the draft reports that we have put out.

MR BYRON: We've only been able to peruse one so far, sir. We'll have a look at the others.

PROF SNAPE: Have a look at the others as well. There may be something of interest there.

MR BYRON: Just on that - that sort of headed in the direction that for the telcos you had a view that there was a need for industry specific regulation. I suppose one of the things we would advocate is that if there is an issue of industry-specific regulation for airports, we acknowledge that Sydney and Melbourne are in a different industry to what we're in - there's a different question of scale and there must be some measure of cut-off. Where there might be, I don't know.

PROF SNAPE: No, we weren't going to propose the same regulation for Kalgoorlie, even if we come at that sentence a different way.

MR BYRON: Exactly.

PROF SNAPE: We do not propose having any views at the moment, that we're not going to consider all airports in the same basket, no.

MR BYRON: Cairns seems to have grown most successfully for its local community without a degree of regulation, so I think these things can actually work.

DR BYRON: We've had lots of discussion over the last few days about what a small percentage of the total airfare landing charges represent. On the one hand it says that even if you double the landing charges it doesn't make a hell of a lot of difference if the traffic is there, if it's a profitable route for the airline and so on. But the opposite side of that coin is on the other hand if you lower your landing charges it doesn't necessarily compensate for what's an unattractive route. One of the submissions that we'll be hearing later today is the Northern Territory and they're pointing out that Alice Springs traffic is going down because the airlines are using Uluru instead of Alice Springs even though I think Uluru is, you know, ten times the landing fees or something like that.

MR BYRON: I think that's exactly right, and in our submission we in fact specifically said in the first part of it these landing charges are so irrelevant, and actually the point is, as you say, that if we reduce them to zero we take $2 off a ticket, so it is negligible and doesn't attract business and create routes. Therefore you've got to recognise that an airport is a business that has no control over the ultimate outcome. I mean, it can do certain things with facilities and investment to help that, but fundamentally it has no control over where the aviation market to a community ends up in that profit maximising diagram.

The only thing we've got control over and the only way we can affect the whole equation is to deliver competition, and we can't deliver it on price. It's not the price signal, but it's everything else we do, and fundamentally allowing access and having facilities there.

PROF SNAPE: That's been very helpful and a very helpful submission, which I gather we take the "confidential" off it. I sort of had to read it with my eyes closed last night. Thank you very much for that and for that discussion, which has been very helpful for us, and if you do have further thoughts, as I said before, then we'd appreciate supplementary submissions before the draft report. It's best if we can get it before the draft if you do have additional thoughts in relation to the things I've been discussing.

MR BYRON: Thank you. One comment that was a question in the last session was on this question of why do you invest in airports and not invest in airlines. What was not pointed out was that airports are prevented from investing in airlines and so are airport investors. We in fact, to fulfil our regional hub aspirations, had a very keen interest in investing in Hazelton and relocating them to Canberra, and we wrote to the government to try and encourage that process to change but that was not successful. So we're not against an interest in investing in airlines, but to date we've been prevented from opportunities to do so.

PROF SNAPE: I think it's above a ceiling. A superannuation fund I think can invest in both so long as, for example, it's below a certain level

MR SNOW: Yes, 5 per cent, but we wanted more because we wanted to influence the outcome that they move their maintenance base to Canberra.

PROF SNAPE: And that's why they took the ruling.

MR SNOW: We went and saw John Anderson about it and he said, "No, that's not cricket." It would have been a good move for them, anyway.

PROF SNAPE: Yes, well, thank you very much and we'll now adjourn for about 30 minutes and resume at 11.15.

PROF SNAPE: We will now resume and we welcome now Westralia Airports Corporation and their representative and we thank you for the submission which you have given to us; if you could identify yourself and position for the transcript and then speak to the submission. Thanks very much.

MR TICEHURST: Wayne Ticehurst, chief financial officer for Westralia Airports Corporation, the owner and operator of Perth International Airport. I've actually been with the organisation for the three and a half years since privatisation as CFO. Prior to that I was with the FAC as manager of finance at Perth Airport for approximately six years. Firstly today I'd like to offer an apology from our CEO, Mr Graham Muir. Graham has other commitments and is unable to be present today. I can assure you that Graham's absence has nothing to do with the prohibitively high domestic airfares between Perth and Melbourne.

On a serious note, thank you for the opportunity to present WAC's views in regard to the Productivity Commission's inquiry. There are four main issues that I would like to address today that WAC considers central to this inquiry. Those issues are, firstly, the incentives for investment in aeronautical infrastructure; secondly, starting point prices; thirdly, market power and its abuse and, fourthly, WAC's vision for pricing of currently regulated services.

Can I just point out revenues from aeronautical and aeronautical related services at Perth are expected to exceed $32 million in 2001 financial year and that constitutes about 42 per cent of our total revenues. Clearly the outcome of this inquiry will potentially have a material impact on WAC's revenues and profitability and therefore on returns to the predominantly Australian shareholders of WAC. It's relevant to note, however, that the relative contribution from regulated services to total WAC revenues is declining. In the 2000 financial year the revenues from these services constituted approximately 45 per cent of WAC's total revenues and for the 98 financial year 47 per cent of revenues, and prior to the privatisation of the airport under FAC this ratio exceeded 50 per cent.

What that shows to us is that there's an increasingly greater percentage of WAC's revenues being derived from other contestable activities and, in particular, property development. That trend towards an increasingly greater share of WAC revenues coming from those contestable activities we see being attributable to two main factors. The first of those of course is intuitive and that is that there has been a relative decline in aeronautical revenues arising from the CPI-X regime. The X factor of 5 and a half per cent at Perth is the highest of any airport in the country.

WAC's submission demonstrates that the reduction in aeronautical charges to airlines brought about through the price cap has been substantial and there is little evidence that these substantial reductions have been passed back to the travelling public through lower airfares, and that's an observation that seems to be consistent with many other submissions to this inquiry which I have read so far.

Secondly, and significantly, WAC shareholders have directed their limited capital to investments in a non-regulated area of the business and particularly property development where such investments provide more acceptable levels of risk and return. Just to give you a flavour for that, in the three and a half years of our existence to date we've invested in total about $36 million of capital; of that approximately $6 million has been in aeronautical infrastructure and $30 million has been in non-aeronautical and other types of infrastructure not regulated.

We believe that the currently regulatory framework does not provide adequate incentives for investment in aeronautical and aeronautically related infrastructure beyond a level necessary to maintain a minimum acceptable level of quality and service. The ACCC-mandated level of return on necessary new aeronautical investment falls considerably short of a level of return required by the company. Moreover, the ACCC's restrictive definition of NNI does not support replacement of assets and the current ACCC approval process provides airlines with the incentive to collectively disagree to proposals knowing that by doing so the ACCC will be unable to approve the proposal. Further, the recent draft decision by the ACCC in relation to Sydney Airport which effectively places carpark revenues into a single till would provide an additional disincentive to invest in these services if this was applied to airports such as Perth.

WAC wants to invest in aeronautical infrastructure provided it has the incentives to do so. We have key stakeholders in Western Australia such as tourism groups, the state government, local councils and businesses generally, all having a vital interest in a viable airport which provides a level of efficiency, convenience and ambience, provides capacity to accommodate future growth and competition.

Turning to starting point prices, our submission sets out a history to the aeronautical prices subject to CPI-X reduction. It shows that the starting point prices for aeronautical services at Perth Airport did not fully recover the operating costs of providing aeronautical services at Perth Airport and did not recover to any extent a return on the capital value of the underlying assets. Using a simplified single period building block approach and the ACCC's mandated rate of return we estimate that WAC's aeronautical charges will have failed to recover in excess of $27 million of costs by June 2001. WAC can see no reason why it should not be able to price aeronautical services at a level that recovers efficiently incurred and properly allocated operating costs and a return on capital invested in aeronautical assets.

Thirdly, the issue of market power and its abuse in the context of aeronautical and aeronautical related services are of major issues for this review. We maintain that the mere existence of market power should not prima facie give rise to regulation of a particular service. This has been acknowledged by the PSA in previous decisions, and I refer to one in our submission in 1994. WAC is not aware of any conclusive studies that have been conducted at Perth Airport to determine whether market power exists and, if so, whether the potential also exists for the airport to abuse this market power.

Using the Productivity Commission's guidelines WAC has considered the currently regulated aeronautical and aeronautical related services provided at Perth Airport both in the context of whether market power exists and the potential for WAC to abuse market power that it may possess. I won't propose to discuss each of these respective services here as the submission provides a certain amount of detail in respect to each service, but as an overriding comment I would say that it is WAC's view that given Perth Airport's operating characteristics, which we see as being one where we have adequate capacity, little congestion and an abundant supply of land for aeronautical and aeronautical related activities, there's little incentive for WAC to abuse whatever market power it may possess.

Moreover, apart from the fuel throughput charge, the ACCC has not felt that the information provided as part of the regulatory accounts package that we present every year in respect of aero and aero related services has warranted further action. I'd also like to emphasise here the significant countervailing market power of airlines highlighted in the submission and we applaud the Productivity Commission's apparent willingness to recognise this factor in its review.

Finally, I'd like to make some comments regarding the future of price regulation. WAC believes that there should be no explicit form of regulation of either aeronautical or aeronautical related services at Perth Airport. We are strongly supportive of negotiated commercial outcomes with airlines supported by the development of an aeronautical services agreement. The negotiated agreement would provide for the parties to submit to an independent private binding arbitration process in the event of dispute. We are firmly of the view, however, that the triggering of arbitration should be a last resort and should be structured in a way that the parties have no incentive to rely on this as a convenient means to resolving disputes, as is currently the case with the ACCC.

We also recognise, however, that negotiation of commercial outcomes will, in our opinion, require support from a government policy framework or a policy directive. In particular, this framework should provide explicit guidelines for determining the abuse of market power and should be constructed on the basis that services provided by the airport operator are contestable unless proven otherwise. We see the policy directive as also defining the key parameters of the airport-airline consultation environment which would apply in the absence of agreement between the parties.

In conclusion, WAC is committed to working in a partnership with their major stakeholders to secure an environment that provides appropriate incentives for investment in aeronautical infrastructure, encourages airline competition, is administratively efficient and encourages negotiation rather than intrusive regulation. I would be happy to take any questions now.

PROF SNAPE: Thanks very much, Mr Ticehurst. I wonder if to begin you might elaborate somewhat more your thinking on this policy directive that you have in mind.

MR TICEHURST: Yes, I would like to preface by saying that we thought long and hard about specifying a vision, if you like, for the post-regulatory period in this submission. I'm aware that some other reports have perhaps backed away from that. We would certainly say that our thinking on this is still evolving but at the present time we felt that it was appropriate to put something basically on the board, into play, so that there can be some discussion. We see that the policy directive would need to be there to underpin a commercial negotiated outcome. We certainly recognise the fact that commercial negotiations with the airlines will be difficult. It has been difficult to date and we say we see no reason why it's necessarily going to get any easier.

Having said that, we do believe that there is the prospect of - and we certainly are committed to trying to make that process work. The policy directive we see as setting aside a framework - which in the absence of agreement on major issues could apply to assist with that negotiation process, and I've highlighted in our submission the sorts of things that that might cover. Certainly we see the policy framework, as I've said, covering explicit guidelines as to the abuse of market power and ideally the sorts of behaviour or characteristics that that might actually trigger but, moreover, and I think more importantly, it sets out the ground rules, if you like, that the airlines and the airports are working to, and that might cover, for example, a rate of return on investment. It might cover the carry-forward of pricing in the event that we're unable to agree aeronautical charges going forward, and that may be, for example, a CPI based charge. We haven't firmed our views up on those issues at this stage.

It also, we think, would cover other chestnuts, I suppose, that come out typically on a negotiation table, and these are things like asset valuations of aeronautical assets. So we see that these things would probably need to be defined up-front in this sort of policy directive and thereby, hopefully, avoid having these issues being put back on the table every time we try and talk to the airlines about it.

PROF SNAPE: Where you speak about airport-specific you mean airports-specific, I think, do you? You don't want a framework for each airport.

MR TICEHURST: No, I think it probably would be more likely and more appropriate to be general airport-specific.

PROF SNAPE: Would this work just across the major airports or would it go to all airports?

MR TICEHURST: Again, we really haven't developed further views on that. I think we would probably want to consider that one a little bit further.

PROF SNAPE: If you have further thoughts on that, in light of the discussion that we've been having in the last few days and other submissions, and also in the light of the three draft reports that the Commission issued last week where we talk about monitoring as an intermediate step between no regulation and declaration, then that would also be helpful.

MR TICEHURST: We are aware of the Productivity Commission's decisions on the other inquiries. We haven't caught up with the actual text of it yet.

PROF SNAPE: Draft recommendations they are, yes. We unfortunately don't have the power to decide anything, or not much anyway. Neil.

DR BYRON: One of the topics that has come up for quite a lot of debate and some conjecture over the last few days is about the fuel throughput levy and where that expectation came from at the time of bidding for the airport leases and I guess the airlines are saying that they have no evidence that there was ever any suggestion that these possibilities were offered by the Commonwealth as part of the bidding process. You mentioned an information memorandum.

MR TICEHURST: Yes, I have it here. This is the Commonwealth information memorandum for Perth Airport. On page 19 under Business Potential there are a number of activities which are identified and one of those is refuelling services and, as I said, this comes in under the heading of Providing Competition as a Business Opportunity, or Business Potential, and it says:

> And regards to refuelling services; refuelling services at Perth Airport are not managed by PIA as a concession and no fuel throughput fee is levied.

I should preface that by reading the starting paragraph there:

> There are many activities carried out at Perth Airport by third parties in respect of which there are a limited number of service providers. PIA may expand its activities to provide a new source of competition to existing service providers. Examples of such areas include ramp handling, refuelling services and retail concessions.

So we interpret that statement - and I think there are other factors that add to our strong belief that the fuel levy was certainly something that the purchasers of Perth Airport had reasonable expectation would not be in fact overturned, as it appears that it may be if the Commission's decision is accepted. That is one. The other one is the fact that the fuel levy was in fact part of an agreement that had been previously executed by FAC and the oil companies and we note that subsequent to the sale of the airport - well, we understand that similar-type agreements have been executed between the oil companies and one or two other privatised airports. So we believe that it was an existing contractual arrangement that was in place.

DR BYRON: That's what Brisbane told us the other day too, that there was an existing contract between FAC even though it hadn't been exercised or operationalised.

MR TICEHURST: It hadn't been operationalised, yes, that's correct.

DR BYRON: On page 7 of your submission you mention that WAC has experienced frustration in its efforts to secure airline agreement on major redevelopments in the international terminal.

MR TICEHURST: Yes.

DR BYRON: Could you elaborate any more on that, please.

MR TICEHURST: Certainly. We have on foot at the moment a proposal to redevelop the international terminal. The international terminal at Perth was built in 1986 and since that time we have had a significant growth in passenger volume through that terminal. It has been identified that there is a need to both reconfigure and expand the international terminal to cater for projected international passenger growth. Just to give you a perspective on that, by 2010 Perth International Airport will process as many international passengers as what Melbourne does today, which is, I think, a bit over 3 million passengers. Currently we're sitting at about 1.5.

With all these investments of course, they're very lumpy and they take quite a lot of time to negotiate and to undertake. We've identified that we need to redevelop the international terminal to cater for that growth. At the operational level - and there's certainly some operational issues with the international terminal at the moment - there is some congestion. Our busy hour in the afternoon is causing some bottlenecks in check-in and in passenger processing areas, so we've identified that to resolve some of those bottlenecks and also to cater for future growth we need to redevelop the terminal. It's fair to say that the relationship between Perth Airport and the airlines at the local level, the operational level, is very good, and in fact we have reasonably unqualified support from the local airline operating committee for the operational things that we want to do to the terminal.

The issue of course - and this is an issue that has gone right back through the process - is with the airlines rates and charges people, and they take an entirely different view, and their view is that they would prefer not to have to pay for any expansion of the terminal, any modifications to the terminal, any facilitation of passenger flows to the terminal at this point in time. I must say that Perth is probably a fair way down on the radar screen for the major carriers. Certainly they concentrate primarily on Sydney first and then Melbourne and Brisbane and then we come in a fair way down the chain with their considerations.

But having said that the difficulty we have experienced with them is certainly bringing back to the negotiation table the same sorts of issues they're raising everywhere. It's single till and the complementarities of duty free and other revenues; it's the rate of return on the investment; it's one carrier wanting to pay for something that the others don't want to pay for. It's a range of issues. We are working through those issues with the airlines but it's proving to be quite a difficult process. I would also perhaps just like to add as part of the NNI process we've had some measure of, I suppose, success with NNI to date, not as much as we would have hoped for, but certainly our experience has been to seek to have the airlines agree to a materiality level with necessary new investment, such that we're not all bogged down in charges that frankly amount to four-fifths of not very much.

So we've sought to try and introduce a materiality threshold and a general acceptance that the airport will undertake a certain level of capital expenditure anyway every year, but unfortunately we've had - one of the airlines in particular are arguing about projects as low as 15, 20 thousand dollars, which in terms of a rate per ton would probably be something like 0.l of a cent per ton. So these are the sorts of issues and the sorts of problems that we have.

PROF SNAPE: When you say they're prepared to accept a charge for such small investments in that threshold, that they're not going to quibble about under that threshold. Is that right?

MR TICEHURST: I suppose that's our wish. We think that there's a lot of intellectual - and a lot of resources that go into these sorts of arguments and we see that basically with the policy framework that's in place the ACCC have to become involved in virtually every single NNI project that goes up, and we think that there's a strong argument that, when you look at the dollars that are involved in terms of resources and costs, there should be some level of minimum investment that everybody accepts will be undertaken and that there is a recovery for under the NNI framework.

PROF SNAPE: And everyone agrees with that, except one.

MR TICEHURST: No, that's not the case. One airline in particular has argued about a load project but we do understand that all airlines, or the major carriers, I should say, are in general opposed to really any investments unless they see a direct benefit for themselves.

DR BYRON: I mean you can understand airlines not wanting to pay for services and facilities that they don't use, or worse still, services and facilities that will benefit their competitors relatively more than themselves, and the other thing I imagine that worries them is to pay for some expansion of a facility when they think that that capacity expansion is unjustified, that maybe you have rosy expectations of future traffic growth and they have some knowledge that makes them think that it's going to be less. So again they don't want to be stuck with paying increased charges for what they might consider is a prospective white elephant.

MR TICEHURST: I think there's two issues I would like to respond to there. The first of those is in fact what we call user-pays principles, and in our charging we try, wherever possible, to set our charges on the basis of user pays, so that if there is a particular group of aeronautical users that are benefiting from a project to the exclusion of others then those users will pay for those projects, and an example of that was a general aviation project where only that sector of the general aviation community was going to be benefiting so we targeted the charge to those users.

However, in a lot of aeronautical infrastructure, particularly runways, taxiways, aprons and airfield movement areas, as a general rule we can't get ourselves down to a position where we'll charge some airlines because they happen to use a particular taxiway more than others, so we've taken a general policy view that, in regard to that type of investment, everyone will pay, and when it comes down to the dollars it's a very small component of their charges.

In regard to the question of international terminal expansion - and I guess the issue of the white elephant - we base our forecasts on using a very respected company in Australia called Tourism Futures International, and Tourism Futures' history in terms of aeronautical traffic forecasts, from our experience, has been very accurate. We tend to use low to central forecasts, we certainly don't use their high forecasts in terms of predicting what traffic levels will be. So we tend to use a range somewhere between the low and the central forecasts in terms of predicting future investments.

Of course the other control, from our point of view, is that we have shareholders whom I have to look in the eye once a month at the board meetings, and we have to justify to them why they should be committing these funds to these investments before- perhaps - time, if that's what we're looking to do. So we think there are some significant controls in place to ensure that doesn't happen.

DR BYRON: Sorry, I didn't mean to imply that I thought that your new international terminal - anything about that. But coming back to the very small investments, is that problem partly a result of the starting prices and the level of X that was chosen? If the starting prices had been a bit higher and if the X had been a bit lower than 5.5, could the airport owner have just absorbed the cost of making those minor capital works?

MR TICEHURST: I think that would be unlikely. I think our position would be - or is - that the level of X - we don't know how X was calculated, and we certainly have an issue with that, in that we believe that given it's such a high figure, and it's a big part of our revenues, that we ought to have had the opportunity of at least knowing how it was calculated. But that's history. We believe that we are so far off the mark - and I think we've shown this in some numbers that we've calculated - with aeronautical charges in terms of providing what we think is a fair return on aeronautical assets, that I wouldn't be looking at asking our shareholders to put their hands in their pockets for any additional aeronautical investment without an appropriate level of recovery on that.

I think had we got to a full cost recovery on starting point prices, maybe it's arguable, but - I certainly wouldn't want to necessarily commit that that's the shareholders' view on the world - I think they probably would want to have recovery on the investment as well, bearing in mind there's other alternatives for them to invest their money.

DR BYRON: That seems to me to be one of the most fundamental problems in terms of the efficient provision of future aero infrastructure - is that if investments in aero are regulated, and tightly regulated, and you have all sorts of other investments open to you, including airport investments off the site, the logical conclusion seems to me - the slow, gradual decline of aeronautical assets, or certainly not investment in their replacement or expansion.

MR TICEHURST: I think what we see is that the present regime doesn't encourage investment in aeronautical infrastructure, for the reasons that I have indicated. I think if we were to see a rate of return that was more in line with the risk and the return requirements - and we specified through our consultants, NECG, in our original submission to the ACCC that we're looking for a pre-tax real rate of return of a bit over 10 per cent - I think it was 10.3 per cent. If we were able to obtain that sort of return, I think that would certainly be an incentive for our investors to invest in aeronautical infrastructure, notwithstanding the availability or, if you like, the alternative investments that might be available.

But I think you also would appreciate that there are other imperatives for investing in aeronautical infrastructure, and we have other stakeholders who exert quite considerable influence on Perth Airport, and you will hear from the state government this afternoon, for example, which has a considerable interest in seeing Perth Airport develop, and seeing us as the airport owner invest in infrastructure. And I can assure you that in fact they do exert that influence in many ways on the airport.

We also have stakeholders and I think there's a submission from the Perth Airport municipalities group as well. These stakeholders can all, if you like, make life quite difficult for us as an airport operator if they don't believe that we are providing an appropriate level of investment in the airport. We're certainly very sensitive to that and our shareholders are sensitive to that as well.

PROF SNAPE: On the initial point, the starting point of the prices, of course what you paid for the airport was related to those starting prices, and to the X and CPI-X - that's all information that you've had. So your quibble is then not so much about presumably the return that you got on that initial investment because, after all, you had the full information or most of the information - I mean, you may have had a couple of surprises, but essentially that - but it's more with the incentive to invest in the future that is not being given an adequate return under the "necessary new investment" because the "new investment" is covered by "necessary new investment", presumably.

MR TICEHURST: Yes.

PROF SNAPE: Whereas what is there already was covered by what you paid for it.

MR TICEHURST: Yes.

PROF SNAPE: And so you already knew that, and you knew the risks after - five years' hence on that. So the real quibble is then with the NNI formula, is it?

MR TICEHURST: I think certainly the quibble we have is in terms of the rate of return and we believe that we had a very strong argument in terms of defence of the rate of return that we had sought from the ACCC. We also have seen the definition of "new investment" very much truncated from what the bidders, when they lodged their bid for Perth Airport, understood would be the case. So we have effectively seen all the replacement capex on aeronautical infrastructure wiped out by the ACCC in their decision on what is NNI, and that was certainly something that the bidders did not sign up for.

We have also seen CPI work very much against us. Now, we realise that that's an external fact, but the reality is that the average rate of CPI in the lead-up to the privatisation of the airport - and we would think that was in some way taken into account in the CPI-X determination - has certainly deteriorated from our point of view quite significantly, and CPI is in fact the largest single-value driver of our business. So we have seen a combination of factors and I am - - -

PROF SNAPE: Could I just interrupt you there. That must to a large extent be because your expenses are not going at the same rate as CPI; you don't find that as the appropriate deflater.

MR TICEHURST: That is exactly right.

PROF SNAPE: Do you have another deflater that you would think is better?

MR TICEHURST: We are not arguing the fact of whether it's CPI or whether it's another measure, all we're saying is that the actual outcome of CPI in the period since privatisation has been - we've been in a very low CPI environment, and that has adverse impacts on not only aeronautical revenues, but other revenues such as duty-free income, property rents, and so on, which are in many respects linked to CPI. Our expenses, on the other hand, as I have noted, largely are fixed, so the CPI impact on those expenses is pretty irrelevant.

But can I just say, going back a step, that the other measures that the owners of Perth Airport signed up for were, in fact, the fuel throughout fee and the ground facilities fees, and these things have been pulled out from under our feet along the way.

PROF SNAPE: Yes, well, they were surprises.

MR TICEHURST: They were surprises, yes.

PROF SNAPE: If you had an unregulated environment so that you could package your charges, or unpack your charges as you liked - you could charge for this activity or you could just roll it into a total package of charges - in those circumstances, would you be looking at a fuel levy? Or would you just roll that into a more general charge? In other words, is the fact that you're charging a fuel levy at all related to the regulations?

MR TICEHURST: No - very clear on that - the fuel levy - and there's been some suggestion, I believe, with one of the other airports by the Australian Competition and Consumer Commission that in fact the fuel levy was in some way a means to try and claw back some of what they've lost under CPI-X. I have stated why we believe the fuel levy is fundamentally an appropriate charge, with its contractually based nature and so on - the reality is that at Perth Airport the fuel levy gets us approximately $700,000 of revenue this year. We're losing or passing back considerably more than that in revenues through the CPI-X regime. So there's no way this was introduced as a means to try and claw back, if you like, some of that loss.

We see the fuel levy as being a completely different and a fundamentally contractually based charge. It's not inconsistent with charges at our other airports around the world. We have had that confirmed by an independent arbitrator. The charge is certainly part of - it's really a concession fee, as we see it, for the business the fuel companies are deriving from their presence in the airport. That is certainly no different, in our view, to other concession fees that are charged to other operators. So we would see that continuing.

DR BYRON: There was some discussion yesterday about which airports might have how much market power and with regard to what services, and niches and so on. The suggestion was made that Perth might be in a rather unusual situation as the major West Coast airport, whereas there is a certain amount of substitutability, perhaps, between Brisbane, Sydney and Melbourne. Anything that's heading to Africa - up until recently - involved Perth.

MR TICEHURST: Used to, yes.

DR BYRON: No, well, the point is, does Perth have a particular sort of monopoly power because of its location on the West Coast?

MR TICEHURST: I assume you're talking in terms of aeronautical services as opposed to non-aeronautical services?

DR BYRON: Yes - sorry - aeronautical services.

MR TICEHURST: Look, we don't necessarily disagree - and I think I've said this in the submission - that we possess market power in relation to aeronautical services. It's very hard to fly into Perth - or to get to Perth unless you fly. We don't have the numbers, but there are a high proportion of visitors to Western Australia that would arrive in Perth through air travel. So certainly the geographical argument for market power, if you put it in that context, is pretty hard to argue with.

But what we argue is there are some mitigating circumstances against that and it is relevant to point out, for example, that there are other Australian ports where Australians - and, indeed, foreign travellers - can exit the country, particularly if you're travelling to the United States or to destinations east of Perth. Generally speaking, you won't travel to the United States from Perth unless you go through either Sydney, Melbourne, or Brisbane. In fact, you won't. There's no direct flights from Perth to the United States. So there is, if you like, a little bit of a bleed, we see, of passengers through other airports out of Perth.

I guess more to the point is the fact that whilst we think and accept that there probably is a degree of market power in aeronautical services, it is counterbalanced, in our view, very strongly by a countervailing market power from the airlines. But we think the question is, what's the potential for WAC to abuse that market power, and I guess our argument is that if you look at the three criteria that the Productivity Commission has indicated as underscoring the potential to abuse market power - do we charge at price levels that are higher than our underlying and properly allocated costs - the answer is, no, we're a long way under that.

Do we restrict capacity? The answer is no. In fact, we're currently involved in negotiations with a new entrant, along with the state government, in competition with one other major Australian airport, to attract that entrant. We are being looked at to provide, as part of an overall package, a pretty aggressive landing charge structure to try and attract that entrant. We certainly, in that respect, could well be a price taker rather than a price maker in charging for landing fees for that new entrant.

Do we look at quality of service, and what are the outcomes on that? The ACCC's quality of service report shows that we've actually maintained, at an acceptable level, our quality of service. We think the three criteria we satisfy in terms of the fact that we do not abuse the market power that we may possess.

DR BYRON: Somebody would say that's simply because the current regulatory regime is keeping it firmly under control.

MR TICEHURST: We don't see it that way.

DR BYRON: No, okay.

PROF SNAPE: Have the projections that you've made to 2010 before - when it was going to be as big as Melbourne is today in 2010 - were they affected or did they take into account the recent decision not to call at Perth en route to South Africa?

MR TICEHURST: That decision did not affect our outbound and inbound passengers per se, because most of the passengers on those aircraft were transit and domestic on-carriage.

PROF SNAPE: And you weren't counting your transit passengers?

MR TICEHURST: No, we weren't. But what it did affect was our tonnage, of course, in a big way.

PROF SNAPE: They have to land and take off, yes.

MR TICEHURST: Correct. So in answer to your question, really, that decision didn't really form an impact on the traffic projections going forward.

PROF SNAPE: Okay. When you speak about the countervailing power - and you probably heard the earlier discussion that we had about this - you talk about the countervailing power of airlines and you give some examples. You do refer to the political power that they have. I think your comments, at least in part, are in the context of the existing regulations; that they can in fact use the existing regulatory environment to exert power against the airports. But what we haven't had much of are examples of countervailing power that are, if you like, outside the context of politics or the existing regulatory framework.

In other words, what countervailing power is being exercised outside those frameworks? One answer, of course, is if you've got those frameworks, perhaps you don't have to use the others. But if we're talking about a situation in which there is no regulation - which of course is where we have to start our contemplation in this - then the ways in which countervailing power in an economic sense could be used outside the regulatory framework are of interest. If you have examples of those, or if you're thinking that you can further provide examples, that would be helpful. Or, if there are none, that would be helpful also.

MR TICEHURST: I think, Professor, we've touched on this in our submission in regards to the dependence, if you like, of our revenues - certainly in terms of Qantas and Ansett and in terms of the various alliances. I think that seems to me to probably be - if you take yourself outside of the regulatory environment - probably the most significant element or avenue for market power that the airlines possess. What I'm saying there is that by accounting for, I think it's 80-odd per cent of our total aeronautical revenues, that's between the two alliances, and over 60 per cent of our total property revenues, they do constitute a significant negotiating - I won't say "foe" - but on the other side of the table.

We found this in our discussions with the airlines on domestic terminal leases for example. It has been quite a difficult process in trying to secure increases through our DTLs. Unfortunately those documents are not the best drafted in terms of some of the legal issues. Certainly we've encountered that sort of level of market power, if you will. We have very little remedy under the leases generally to be able to enforce, and it certainly would be a very brave decision for us to lock the doors on the domestic terminals and prevent them access to terminals. I think intuitively that's probably the main area where we would see market power falling outside of the political and the regulatory.

PROF SNAPE: Do the alliances negotiate as alliances?

MR TICEHURST: We're seeing a little bit more of that. For example - and I guess this will unfold with the development with Ansett, Air New Zealand and Singapore Airlines, but we're starting to see where they are starting to band together and be presenting to us on a united front on some of our lease negotiations and outgoings. I think we're going to see more and more of this as the alliances start to cement together.

PROF SNAPE: Of course, in that case there are ownership links rather than just alliances.

MR TICEHURST: Yes.

PROF SNAPE: I was trying to think outside the ownership links, but within alliances.

MR TICEHURST: Yes. There is evidence of it at Perth in terms of some of the property negotiations that we've seen. Can I also say, though, that there's probably - there's another area in terms of the countervailing power of particularly the two big airlines - Ansett and Qantas - and that's their ability to withstand protracted legal action, if they were to call on it. They have a far greater capacity and a preparedness to be able to take on legal action against us if they feel that there is an incentive at the end of it for them; whereas our shareholders have limited levels of resources and the ability to be able to counter those significant legal actions is certainly constrained at Perth Airport.

PROF SNAPE: I suppose they're more worried about precedents across airports than you would be.

MR TICEHURST: They are, yes. That's a fair comment.

DR BYRON: I was wondering if you could tell us anything about the differences between the landing charges and passenger handling and so on between Perth and some of the other Western Australian regional airports. I'm thinking particularly of the New South Wales example, which we've had some information on, where the charges for the aircraft when it takes off at the smaller country town, you know, 10, 15 or 20 times more than what they are when they get into the capital city airport. Does anything like that occur in WA?

MR TICEHURST: I don't have that information with me today, but I'm happy to provide that subsequently. We do understand that, as a general rule, the charges for regional airports in Australia are significantly higher on either a per passenger - and it's generally per passenger - basis than what it is at Perth Airport. But I'd be happy to provide that information through. I just don't have it with me today.

DR BYRON: Thanks.

PROF SNAPE: Thank you very much. I think your submission has been very instructive and we have learnt a lot from that, thank you very much - and for the discussion of it. If there are other things that you think about afterwards we would welcome a supplementary submission.

MR TICEHURST: Okay.

PROF SNAPE: Thank you very much for your presentation today and paying a very hefty fee to come across, unlike our next participant, who has come from Hobart for $58 and paid more for the taxi from the airport to here, than he did to come from Hobart to Tullamarine. At any rate, thank you very much.

MR TICEHURST: Thank you very much, Professor. Thank you, doctor.

PROF SNAPE: We have already introduced you as Hobart International coming in and at a remarkably cheap rate. We welcome you. It's a wonder you didn't bring several friends at that price.

MR TUCKER: We have limited resources.

PROF SNAPE: We welcome Hobart International Airport and we would be grateful if the representative could introduce himself and his position for the transcript, and then speak to the submission, thank you.

MR TUCKER: My name is Wayne Tucker and I'm the CEO of Hobart Airport and have been, except for a brief hiatus of six months, since the airport was privatised.

PROF SNAPE: Thank you. If you would like to speak to your submission, thanks, Mr Tucker.

MR TUCKER: Right. Having read some of the other submissions - with a great deal of technical detail - and as I just said, we have limited resources, we focused our submission basically on the unique Tasmanian situation. We endorse the AAA's submission and the capital city airports group submission, which is more technically based, I suppose. We certainly having given ours an emphasis on the Tasmanian situation.

You would be aware that we have Launceston Airport two hours up the road - and I suppose there is a great deal of the population of New South Wales and Victoria who wish that they were within two hours of a major jet airport. We have evidence already which suggests that traffic moves between Launceston and Hobart, depending on the marketing I suppose of the two destinations and the airports themselves - the behaviour of the airports. For instance, most of the freight goes into Launceston Airport because it's cheaper to freight - the road freight which isn't so handling sensitive - via semitrailers, et cetera, rather than fly that extra 20 minutes to Hobart Airport. However, we've managed to claw some of that back by competitive means, and Impulse will certainly help that as well.

Going through this, talking about countervailing power, we've mentioned briefly in our submission - I mean, the day before yesterday, one of the airlines threatened that since we and the state are encouraging Impulse, they will now leave the state. It was made by a middle manager, with supposedly the imprimatur of higher management, but I don't think it's realistic - but these sort of things are bandied around.

PROF SNAPE: You don't regard that as a credible threat?

MR TUCKER: No. But it was certainly made in the presence of very senior government bureaucrats and myself. I don't regard it as credible, but these things are bandied around on a regular basis whenever there is a new entrant. Also, the effect of hubbing - if Hobartians die we go to heaven and hell via Melbourne, I suppose, because everything goes via Melbourne. It's very difficult to get direct flights to any other destination. There is always the threat by the airlines to withdraw services if we so-call misbehave.

I notice in the national access submission we talk about the provision of lounges. Once again, Impulse and Virgin are providing evidence that lounges aren't necessary in the scheme of things so I'd argue that we don't have market power in those areas. We've had a recent interesting situation that we took reversion on our freight facility - the FAC had the right to do that two years prior to our ownership of the airport and for obscure reasons that we haven't been able to determine, they didn't. We did recently. For six months the airline has just – those concerned refused to communicate with us. There are emails, phone calls, et cetera. They pay the old rent but completely ignore all our communications and threats of legal action, et cetera, and they're still paying the same rent. So this is the sort of power that they can exert on a small airport such as Hobart.

PROF SNAPE: You haven't impounded an aircraft yet?

MR TUCKER: No, or closed the freight doors, for the same reason that Wayne suggested - it's a fairly brave person that closes the hangar doors or impounds an aircraft, or wheel-clamps an aircraft - a 727 in this case. Likewise with refuelling - we are in a unique situation with refuelling, where the hydrants blew up, so the solution was to fill them with concrete and all the refuelling is done by trucks. Now, this is unique to Hobart because we had a fairly small fuel throughput, but we've already had a fuel company suggest that they will set up off the airport and drive into our airport, which totally obviates the situation that - it's often claimed that they are a captive audience on the airport. We have freehold land directly opposite us and one of the fuel companies has suggested that they may well do that; set up off the airport and truck the fuel in via our roads.

We see the fuel throughput levy, which we haven't imposed, and maybe won't - once again, because of the competitive pressures, because the airport up the road has said that they won't. So it leaves us in the situation that we would be very brave if we did. So in our situation we feel there is considerable countervailing power for a small airport such as ourselves. The effect on regulation I would like to address briefly, too, is that the CPI-X formula - I know Professor Fels quite often states the savings that have been made for the airlines. We haven't seen any evidence of that flowing through to what I call "the airport consumers" being the airlines' passengers, and so our ability - we haven't invested any new investment at this stage, mainly because I see the evidence of what occurs on the major airports and we have a situation arising where we will need to expand our freight apron and, looking at the submissions and countersubmissions, et cetera, from the major airports, I find what we are going to have to go through rather frightening. We simply don't have the resources to deal with that, so we're not sure where we are going to go with that.

PROF SNAPE: You wouldn't locate them across the road?

MR TUCKER: Not the freight aprons, no.

PROF SNAPE: Aprons, you said, I'm sorry.

MR TUCKER: Yes, there's a freight apron.

PROF SNAPE: I'm sorry.

MR TUCKER: The freight facility could, yes. I thought that was facetious. It has inhibited our ability to invest aeronautical investment on the airport, mainly through fear, I guess - that I don't want to have to go through the dramas I have seen other airports go through. Basically that is the strength of our submission.

PROF SNAPE: What would happen if you doubled your airport charges?

MR TUCKER: I honestly believe we would see a considerable excess- I have lost the word. At any rate, I think they would all go to Launceston. I mean, obviously there would be a demand for Hobart traffic, but I think we would lose considerable traffic to Launceston. I honestly believe that.

PROF SNAPE: So even though the airport charges are a relatively small part of the total charge, it's really as sensitive as that - a small portion of the total cost of flying.

MR TUCKER: Our charge at present with the old fee structure, if you say there was an average fare of four hundred and something dollars return Melbourne to Hobart - I mean, that is one seat basically, and there is a fairly average sort of fare with discounted fares, et cetera, of around about $400 return, so that is one seat. The Airservices charges add another three seats because they are three times dearer than we are, so there's four seats they have lost. I don't know whether the airlines think like that, to be honest, but that's the way I have been calculating it myself.

If they then lose another seat that they don't need to, plus 20 minutes flying time, which I gather is quite expensive - and we are a tourist based destination basically. More than 50 per cent of our traffic is tourist based. Tasmania is a small island. For instance, Virgin probably now won't come to Hobart because Impulse gazumped them. They are now talking to Devonport Airport as their alternative, and of course Launceston Airport, but they are having serious conversations with Devonport Airport now.

DR BYRON: And Devonport is not only unregulated but they don't have the same Airservices Australia fees.

MR TUCKER: That's right. They don't have the fire service fees or the control tower fees. They have the en route charges.

PROF SNAPE: They don't have a control tower or fire service.

MR TUCKER: That's right.

PROF SNAPE: They're prepared to fly without those.

MR TUCKER: I gather, yes, and Impulse are also talking to Launceston Airport regarding going to Launceston, as well - not in a competitive sense, but as well as. We obviously won it because somebody had the foresight many years ago to give us a redundant terminal building.

PROF SNAPE: So they're getting that on a pretty good lease, I would guess, given its opportunity cost. Would you like to describe the process of getting Impulse to come there?

MR TUCKER: To be candid, there was no process. We'd had long and arduous talks to Virgin but the state government - virtually unknown to me - was negotiating with Impulse in the background. To be quite candid, it was announced to me one day that they would be arriving on 2 April, and that was not so long ago. We'd had some meetings with Impulse and given them an indication of what we had to offer and that was about the strength of the negotiations.

PROF SNAPE: Did the state government offer the terminal or did you offer the terminal?

MR TUCKER: We offered the terminal. We told them what we could do commercially with the terminal, and the landing charges, which of course is commercially sensitive. We had told them that but that was virtually the extent of our negotiation.

PROF SNAPE: They don't have sole occupancy of that international terminal then?

MR TUCKER: No, they don't have exclusive use.

PROF SNAPE: So you will be using it as a common user terminal?

MR TUCKER: That's right. I mean, we are still an international airport because we have six international flights a year from Singapore, but we still do talk to other carriers and we are still hopeful of getting international flights again one day and we will still be able to facilitate those flights.

PROF SNAPE: You will be able to manage both the domestic and the international out of that terminal?

MR TUCKER: That's right, yes, and any other new entrant airlines.

PROF SNAPE: Was there opposition from the incumbents?

MR TUCKER: To the new entrant?

PROF SNAPE: Yes, to you in allowing the new entrant in.

MR TUCKER: Verbally there was. In practice, in little ways. There was a whole lot of equipment that was left in the international terminal building the airlines thought may have been handy. As it turned out, that was whipped out summarily. I mean, we don't have an argument with that - obviously anybody would do that - but there's just little - all of a sudden we have extra aircraft parked on the apron at night and - - -

PROF SNAPE: Is there an aerobridge at that international - - -

MR TUCKER: No, no.

PROF SNAPE: So the facilities are fairly much the same as the domestic terminal?

MR TUCKER: That's right, yes. It's just an extra parking position at the end of the apron.

DR BYRON: I was intrigued about you talking about the new runway overlay on page 9 of your submission at the cost of 3 million. Could you explain a bit more about how that has been excluded by the ACCC as a necessary new investment and, if that is the case, how are you going to fund the overlay?

MR TUCKER: Our runway hasn't specifically been excluded by the ACCC but we have seen the evidence at other airports where overlays have been excluded from necessary new investment, so we're assuming we're in the same boat. To be honest, when the airport was bought that was factored into the future cash flows, although there was an expectation that it would be included as new investment. That hasn't been documented but, speaking to the people who put the bid in, there was an expectation, since the regime is a cost-plus regime when it's air side, that that would be allowed.

DR BYRON: I guess the question is whether it's new or whether it was known it was coming up and was factored into the purchase price anyway, in which case I can understand the ACCC not wanting to see double dipping.

MR TUCKER: I believe in our case it wasn't factored into it. The borrowing was there but they thought that the additional revenue would be there, which hasn't transpired.

PROF SNAPE: Along with Launceston you have the highest Airservices Australia charges.

MR TUCKER: Yes.

PROF SNAPE: Do they average it out? Is it simply because there is not so much traffic?

MR TUCKER: Yes, an economy of scale. I mean, our fire service, for instance, is seven dollars something per landed time for the fire service. At last count it was 26 people to service a fairly small amount of landed times, so they could handle many times more landed times for the same number of people. They are now working an 18-hour shift with the advent of Impulse, so it really is an economy of scale. The control tower is only a one-person tower now, incredibly, considering we have a GA airport next door, which they also handle, but it really is just an economy of scale issue, yes. Having said that, that is already a subsidised rate, which I was surprised to learn fairly recently.

DR BYRON: But the way Airservices Australia calculates that generally tends to discriminate against the smaller airports.

MR TUCKER: Yes, it's location specific, so what they do is - my understanding is they're a cost per airport, and then they divide that by the number of landed times on average, and then I think there is a $25 million subsidy that is dispersed around regional airports. I guess there are enough regional airports that that wouldn't go all that far anyway.

DR BYRON: Those ASA charges could dwarf whatever you do or don't do with your airport charges.

MR TUCKER: There is certainly that propensity, yes, and, as I say, our fares are roughly a quarter or a third of theirs, sorry, so it does tend to dwarf that but, having major jet airports within such location to us, in basically a tourism market, there is a great deal of flexibility there as to where - I have actually driven to Launceston and used my frequent flyer points because that is where they are available from and not from Hobart. A very embarrassing admission, but a fact of life, and I am not the only one to have done it, and I guess it works in reverse.

PROF SNAPE: Can you choose not to have the fire services and the control tower?

MR TUCKER: No.

PROF SNAPE: You can't choose to be difficult?

MR TUCKER: No. The level of traffic is such that - and it is based on the category of airport.

PROF SNAPE: Traffic.

MR TUCKER: For instance, with no input from myself we just got upgraded summarily by Airservices to a category 7 because there were enough 767s coming in to warrant it.

DR BYRON: I was wondering to what extent your ability to earn non-aero income is sort of an accident of history and geography - you've got all that freehold land all around. You're in a very different position to, say, Kingsford Smith or whatever with built-up areas.

MR TUCKER: That's right. Having said that, we have done fairly well. I mean, we have got three developments and another couple coming up, which were the first ones in 20 years, and we have achieved that in three years and we don't feel ourselves having the market power that maybe the FAC did, so we do get developments there. They are all airport related, of course. I think we have lowered some barriers there and people have come onto the airport that may not have otherwise, but it is a hard task, that's for sure.

PROF SNAPE: It has actually been very helpful to have a submission from one of the smaller airports and to be able to see the situation it is in. As I said before, we're certainly not treating all the airports as a basket - or thinking about them - so it is very helpful to have an experience of one of the smaller airports, so thank you very much for your submission and for the discussion of it. We will take a break now, to resume at 1.45 when we will be having the Northern Territory with us.

(Luncheon adjournment)

PROF SNAPE: Welcome back after lunch. We particularly welcome Northern Territory Airports who have come a long way. Thank you for your submission and we now invite both of you to introduce yourselves and your positions for the benefit of the transcribers and ask if you would then speak to your submission, please.

MR KEW: Thank you, Richard, and thank you for the opportunity to come here today to present and talk to the Northern Territory Airports submission. My name is Ian Kew. I'm the CEO of Northern Territory Airports, and sitting next to me is Tom Ganley. Tom is the General Manager Finance and Company Secretary.

PROF SNAPE: His voice has to be separate on the tape.

MR GANLEY: Good afternoon also. My name is Tom Ganley and, as Ian has indicated, I'm the Company Secretary and General Manager Finance.

PROF SNAPE: Thank you very much. Who's to speak to the submission?

MR KEW: I'll talk. Northern Territory Airports operates Darwin International Airport, Alice Springs Airport and Tennant Creek Airport. For the purposes of our submission and the discussion today I'll be talking about Darwin International Airport and Alice Springs Airport. Both airports are privatised, and those two airports are subject to price regulation. Darwin International Airport and Alice Springs Airport are small regional airports and I think it's fair to say that both airports are vital to the economy of Central Australia and Northern Australia. Indeed, they have the position of acting as a funnel in some ways for economic development in both of those regions.

Darwin International Airport has an additional challenge, in that it is a joint user facility with the RAAF who operate a major military base from their side of Darwin Airport. Both Darwin and Alice Springs airports are struggling at the moment to maintain growth. They both have significant excess capacity. They operate 24 hours a day and, to date, they've offered poor returns to their shareholders - I think some 2 per cent return on assets at this point in time. We are very keen to grow the business in both airports, and we would like to see a regulatory framework or just an environment where investment decisions can be taken without incumbent regulatory risk, which is what we're seeing at the moment.

Both airports have limited market power. We've made that claim in our submission. We say that it's limited to the extent that we can abuse our market power, enter into reasonable discussions and reasonable negotiations with the airlines. We believe that the airlines have significant countervailing power and that, indeed, is demonstrated in a number of ways: firstly, by their refusal to pay fees such as the counter-terrorist first response fee that we had to pick up for the first 12 months until such time as they were obligated to pay it.

We see instances where they refuse to provide information to us that's vital for our business - for example, passenger numbers in the terminal, which they're obligated to provide to us. They are not willing to provide that information in a timely fashion for us. We know that they can withdraw services with very little or, indeed, no consultation with the airports and that puts us at some financial risk. We see evidence where they provide limited service offerings to the end users, the customers, and I suppose that's probably just a reflection of the lack of competition that exists amongst airlines in the Top End and Central Australia at this point in time.

We're heavily dependent on airlines for our income. Certainly in the case of Darwin, 69 per cent of our aeronautical revenue comes from Qantas and from Ansett - that's just aeronautical revenue. If you add on top of that the lease payments that they pay for the infrastructure, that would be significantly greater. In Alice Springs Airport, Qantas and Ansett provide 89 per cent of all aeronautical revenue, so it makes sense that we need to have very good relationships with those customers, and we certainly at a local level do the best. We have good relationships with them. It's in our best interests to maintain effective relationships with those customers.

As I said, both airports are struggling at this point in time. Darwin's numbers are growing, but I think its growth is being masked by the East Timor crisis, which has added a significant number of additional services and passengers moving in and out of Darwin Airport. We see in the case of Alice Springs their volume is declining as time goes by. That makes a CPI-X regime particularly difficult to operate and live under. We see aeronautical revenue falling every year, both from a unit rate perspective and from a volume perspective, and we have to live with that for the next two and a half years.

But we have the circumstance next door where Ayers Rock, which is not a regulated airport, charges some $36 per passenger in landing fees and passenger terminal charges there. The equivalent fee at Alice Springs Airport is $3. It's some 12 times more than Alice Springs and I can assure you that passenger numbers at Ayers Rock Airport are growing rapidly and it doesn't seem to have any impact on airlines and their patronage of that airport at this point in time. As I said before, we have significant excess capacity and we're trying to do everything that we can to grow the numbers of passengers and planes that land at both airports.

In summary, our view is that we have limited market power. We would hope that price regulation is walked away from at the end of the five-year period. We think in the case of small airports like Darwin and Alice Springs airports there is a very strong argument for that to be the case. We believe that the CPI-X regime is inappropriate for airports that have declining volumes. We contend that the aero charges are minuscule in the total scheme of things. For example, we flew down here from Darwin. A return economy air ticket from Darwin to Melbourne is $1601. Our landing fee for half of that one-way is $3 out of $800 - 0.4 of a per cent. The airlines would spend more on the morning tea served on the plane than on our airport landing charges, and in the scheme of things we struggle to understand why there is so much debate and conjecture and effort and cost associated with managing what should be a pretty basic process.

Last year we also went through the process of trying to get a necessary new aeronautical investment up and running in Darwin. Some $1 million was finally approved by the ACCC. We've got a very small team. It's hard to resource, it's hard to cost those activities, and at the end of the day it's certainly a process that's not contributory to putting in place appropriate new investments. In essence, that's the basis of our submission. We certainly hope that at the end of the five years we will be able to move to an environment and a climate where we can come to agreements on how to operate airports with airlines, based on commercial negotiation and sound commercial outcomes that reflect the interests of both parties, as opposed to the process that we're going through at the moment. Thank you.

PROF SNAPE: Thanks very much, Mr Kew. Could I ask you whether, with respect to Alice Springs Airport, the regulatory system is in any way inhibiting you in competing with Yulara.

MR KEW: I think it is, in the sense that Yulara has the opportunity to increase its prices. It just needs to get its board approval, I would imagine. I don't think it's subject to any formal government regulation down there, although the Northern Territory government, I understand, is on the board of the Yulara resort. It does mean that Ayers Rock Resort has been able to increase capacity at the airport. For example, I think they put an extra 600 metres on the runway back in 1995 to take 737s, was it, Tom?

MR GANLEY: Yes, it was.

MR KEW: They are going through a process now of increasing the services, increasing the terminal capacity to take larger jets, so they can just put in place the necessary investment to grow their business, without going through the regulatory process that we need to.

PROF SNAPE: In other words, if there had been regulation of Yulara Airport that would have benefited you, insofar as for the extension of the runway, for example, they would have had to go through the NNI processes.

MR KEW: That may well be an outcome that would benefit us. But we're not arguing that Ayers Rock should be subject to regulation. We're arguing that we should have the same rules as them, and that neither airport should be subject to regulation.

PROF SNAPE: In fact, that probably wouldn't improve your competitive position - Ayers Rock versus Yulara - at the moment, in that you're not really being inhibited by regulation in competition.

MR KEW: I think the problems at Alice Springs are that we're probably making a minuscule return for their services that we're providing. If you've been to Alice Springs Airport, it's a very good airport. We get $3 for providing services that Ayers Rock can quite legally charge $36 up the road. If we could increase our revenue base there, then I think we could provide additional services that would help attract consumers and airlines to Alice Springs in total.

PROF SNAPE: I was rather surprised at the low proportion of non-aeronautical revenue to aeronautical at Darwin. Why is that? I thought that would be quite a possibility for retail shopping at Darwin Airport.

MR GANLEY: Aeronautical revenue for our group represents 40 per cent of our income, so in fact property and trading and infrastructure services such as electricity, recharges, represent 60 per cent of our income. We actually get 40 per cent of our income from aeronautical and then, say, some 28 per cent from trading and some further 29 per cent from property incomes.

PROF SNAPE: I must have misheard at the beginning. I obviously got something a bit wrong from what you said at the beginning.

MR KEW: I was talking about percentage of aeronautical revenue that was contributed by Qantas and by Ansett.

PROF SNAPE: Okay. You own Tennant Creek Airport and operate that. That's an unregulated airport?

MR KEW: That's right.

PROF SNAPE: Do you find that easier to operate than the regulated ones? What's your experience in comparing an unregulated and regulated, insofar as you can?

MR KEW: I think it's fair to say that Tennant Creek came with the deal of taking Darwin and Alice Springs airports. It has two RPT services per day. We had to increase the charges, the aeronautical charges, on RPT services purely to cover the costs. It's quite honest of me to say that we make no income, or very little income, out of Tennant Creek. There isn't much opportunity to grow either aeronautical income or property or retail income in Tennant Creek.

DR BYRON: I have a number of things. I found this very interesting in many ways. Towards the end of the submission, on page 19, I'm not sure if I understand this correctly - the ACCC decision on your application. I guess that's an NNI. At the top of page 19:

> On 2 October 2000 NT Airports received the final decision indicating 0.177 for Darwin and 0.018, GST inclusive, for Alice Springs.

That's 1.8 cents per passenger?

MR KEW: Per landed tonne.

DR BYRON: Per landed tonne?

MR KEW: That's right. We charge on a per landed tonne rather than a per passenger basis.

DR BYRON: Is 1.8 cents a significant figure?

MR KEW: I wouldn't have thought it was worth writing the submission for 1.8 cents per landed tonne.

DR BYRON: That's exactly my point. The regulators have presumably worked very hard and spent a great deal of time and gone through all the calculations.

MR KEW: I can tell you that we spent a great deal of time on it.

PROF SNAPE: Why did you bother?

MR KEW: It was put up as a package of necessary new investment for both airports, and that was the outcome of it.

DR BYRON: I wanted to make sure that it wasn't a typo.

MR KEW: No.

DR BYRON: With the decimal point in the wrong place.

MR KEW: Indeed, 17 cents per landed time is not a great deal either.

DR BYRON: No, true.

PROF SNAPE: That would hardly justify the effort, on your part, of going through the whole process, would it?

MR KEW: It was certainly before my time. Tom was here. I think it's fair to say that it was quite an expensive process. As I said before, we've only got a small number of people in NT Airports. We had to use outside consultants to help us put our submission together. We put up a number of projects. Tom, how many was it?

MR GANLEY: I believe 19.

MR KEW: And how many were approved?

MR GANLEY: I think we got about 19 approved.

MR KEW: I think we had 9 out of 19 projects approved.

PROF SNAPE: This was part of a bundle of things that you put up?

MR KEW: Yes, it was.

PROF SNAPE: You weren't going light pole by light pole?

MR KEW: No. That was the outcome of it. Yes, the light pole was an interesting one. We got about 1 million dollars worth of NNAI approved by the ACCC for 18 cents a tonne increase. I would have to say, though, that we haven't spent that million dollars at this point in time. It's taken such a long time to prepare the proposal, such a long time to get the proposal approved, after we had to go back and defend our arguments in a number of circumstances. We have the situation now where we have to go back and recost all of these engineering projects, and we'll find that they've substantially increased from the second half of 1999 when we put these together, and we'll probably have to go back to the ACCC for a variation and we'll probably encounter the same sort of gaming by airlines that will resist our proposal again.

DR BYRON: On a different point, the discussion about Alice Springs relative to Yulara and also about the Brunei flights into and out of Darwin seems to me to confirm the point you're trying to make - that the routes, the frequency, the aircraft gauge, et cetera, basically depend on the traffic and the yield for the airlines, rather than the landing charges.

MR KEW: I have absolutely no doubt of that whatsoever.

DR BYRON: If a route is profitable to fly, the airline is likely to absorb a higher landing charge. If the route is not profitable to fly, even if you gave them zero landing charge, they wouldn't come.

MR KEW: I personally don't think there's much difference between $3 and zero on an $800 ticket. But in the case of Ayers Rock, it's evidence that if consumers want to fly there, at the end of the day that's the market and they're willing to pay, then airlines are quite happy to put that into the ticket price and fly their planes there.

DR BYRON: A number of airports have given us examples of airlines doing their sums and, perhaps quite reasonably, deciding that a certain route was no longer worth flying and unilateral announcements of reduction in services, if not outright cancellation. You've had that experience in the Northern Territory also, have you?

MR KEW: We certainly have and I think we make mention of it. The Royal Brunei example there, where they want to change their scheduled services to Darwin; at the moment they're flying a 767 Brunei, Darwin to Brisbane, and they wanted to vary that service so that they fly direct 757s, two services to Darwin and two services to Brisbane direct, cutting out that leg. That has quite a financial impact on our airport operations and we heard about that through Department of Transport and Regional Services - the request had obviously been fed through government - and they proposed to implement that change within - I think it was three weeks originally. We're going through a process of talking to Royal Brunei about that change at this stage.

DR BYRON: That was going to be my next question. What, if anything, can you do to influence that decision?

MR KEW: As an affected stakeholder we've been asked to comment on the change, but in all honesty I think at the end of the day it will be a decision made by governments, both Federal and Territory government, in terms of their relationships with Royal Brunei and the Brunei government. I think the pain that we will take from an airport's perspective will be insignificant in terms of the other questions that they will decide that matter upon.

PROF SNAPE: If you were able to - that is, at Alice Springs - would you put your charges up then to the same level as Yulara?

MR KEW: We haven't considered that and I don't think we would, no. I mean, at the end of the day, we want to encourage planes and passengers to come to Alice Springs in total. If by moving the prices by such a level discouraged airlines to fly to Alice, then it wouldn't be in our best interests.

PROF SNAPE: You have both Ansett and Qantas flying through Alice Springs?

MR KEW: Yes.

PROF SNAPE: Would you regard a threat by one of them to withdraw services as credible?

MR GANLEY: We've actually seen, I suppose, a transition to utilising regional carriers. Ansett, for instance, is using Flight West and Airnorth. Airnorth is the regional carrier for the Northern Territory, utilising 28-seater aircraft, so what we're seeing is a downsizing of aircraft and, in fact, we've also seen Qantas do similar initiatives through the utilisation of Airlink, their regional carrier. They've used Dash 8 aircraft between Alice Springs and Ayers Rock. We've also seen capacity at critical times also relocate from Alice Springs, such as at Christmas, where Airlink may take a service off the run and use the 146 to service Melbourne and Hobart, when it may be a peak time for local travel for people of the community to travel back home.

PROF SNAPE: Substitute what?

MR GANLEY: They actually took the aircraft out of service altogether.

PROF SNAPE: So they didn't substitute anything.

MR GANLEY: No, but there is substitution using smaller aircraft.

PROF SNAPE: Generally speaking, they're not threatening to remove the services, but there is substitution going on?

MR KEW: They're substituting to regional carriers on their behalf who operate smaller planes and because we charge on a landed-tonne basis, that has a negative impact on our revenue. I don't think either airline would seriously contemplate a withdrawal of services from Alice Springs. It's still the second largest city in the Northern Territory and many of their planes don't have the capacity to fly from the eastern states to Darwin without stopping down there anyway. As a transit point, I think it will always be there and probably is well regarded by them because it's so cheap. You wouldn't want to transit through Ayers Rock at $36 a passenger, when you can do it through Alice Springs at $3 a passenger. Plus the majority of air travel in the Northern Territory is actually government business, it's a strong government regional town, so you'd be cutting off a large part of their revenue base if they stopped flying there.

DR BYRON: A couple of airports in the last few days raised the point about access to passenger data, which is also mentioned in your submission. I find it a bit difficult to understand why. Is there a reason why they cannot give that information?

MR KEW: They obviously have the information, but the reason why they tell us they will not provide it to us is because it's sensitive market share information and they're not comfortable or convinced that the information, if given to us, would be secure.

DR BYRON: What is your reason for wanting or needing that information?

MR KEW: In the case of Darwin and Alice Springs airports, where we don't have a fee structure based on passenger throughput through dedicated terminals, we do though charge both Ansett and Qantas on a per-passenger basis for a percentage of the outgoings, electricity and power, those outgoings that can't be attributable to a specific area of floor space that they lease, so we actually have a charging mechanism on a per-passenger basis that apply to both airlines. At the moment, we estimate it and we might get the information 12 months later and then have to make a variation to it.

MR GANLEY: Also, we require the information for government mandated security requirements for checked-bag screening. We need to know the number of international passengers utilising checked-bag services and also we are now, as a terminal operator, responsible for doing all the hand luggage screening, so that's actually charged on a passenger basis, so we need to know percentage shares of passengers to effect that charge. Currently, we're having to estimate that and we're getting payments that are not consistent with our estimate, so it's a shemozzle.

PROF SNAPE: On page 17 you refer to that rather vexed question of taxis and taxi charges and we've been accustomed to thinking of this, I guess in relation to Canberra Airport and to Melbourne Airport, for example - perhaps Brisbane - but you're reporting your experience there is that the ACCC insisted on including charges generated by operators such as taxis in the revenue for the price cap calculations, so you had already run into this problem, if you like. You accepted that, you didn't challenge it legally?

MR GANLEY: We introduced the system in February 1999 and we had had liaison with the ACCC when we introduced that charge and we were actually going to provide some additional services as well related to this charge. The taxis were actually able to apply this charge to their meters and we weren't talking huge amounts of money. I believe it was 40 cents per cab fare at Darwin Airport and 80 cents at Alice Springs. When we submitted our June 99 regulatory report to the ACCC we received it back many months later and then we realised we'd overrecovered our revenues when we finally did get the reports back. I suppose it was disappointing, in fact, when we believed we had actually underrecovered revenues.

Really it was just, I suppose, a shift of revenue. The initiative was there to provide toilets and shade and other infrastructure for taxi operators and by putting these new investment initiatives on board and providing additional services for the community and the taxi operators, we were then seeing a reduction in our aeronautical fees.

PROF SNAPE: Was it your understanding that you would be able to charge for those when the lease was tendered for?

MR GANLEY: I suppose it's something our founding shareholders would be clearer to answer on, but it has certainly been factored into our model that we operate with, that we'd have new investment on line and were going to have some revenues flowing from that new investment.

PROF SNAPE: Will you attempt to reinstate that charge?

MR KEW: For taxis, no, not at the moment. At the moment we don't have any facilities for them. There are no toilets, no drink machines, no shade. We've got a dedicated parking area for them. It was an unpopular charge at that point in time. It was levied and never paid. I think it would be a bold management team to try and introduce it in the current regulatory environment.

PROF SNAPE: It was never paid?

MR KEW: It was levied on the taxis. Because we didn't have a system where we could charge them as they drove in and drove out, it was an annual licence fee or it was a permit that we were going to charge them $480 a year or whatever the case was, levied on all of the taxis. Most of them didn't pay it, so it's been written off since.

PROF SNAPE: They knew a thing or two about the regulatory system that you didn't, perhaps.

MR KEW: Well, they knew something about something. We don't make much money out of carparking and those sorts of things, although obviously the opportunity to grow property and retail revenues are important to us, particularly when aeronautical revenues are controlled and capped, but we don't operate - I think the sum total of carparking revenue is some half a million dollars. It's not much to contribute towards a total airport operation.

PROF SNAPE: In trying to get Brunei to continue their existing services, will you enter into commercial negotiations with them, essentially competing, I guess, with Brisbane to some extent?

MR KEW: Our income loss from Royal Brunei is because of the change in the planes that they operate. They're going to change from 767s with their heavier tare weight than the 757s. It probably won't be a big difference in the number of passengers. We lose because it's a transit aircraft that drops down in Darwin and then flies to Brisbane. Yes, we are talking to Royal Brunei and we're doing what we can with Royal Brunei and the Territorian government to grow the market; that is, to stimulate demand in Darwin and stimulate demand at the Brunei end, so that we get more passengers flying through our airport and that would deliver some additional revenues for us from duty free and retail and all those other things. But unless we change our entire pricing structure on aeronautical services from landed tonnes to passengers, we won't pick up that lost income.

PROF SNAPE: You don't get any cabotage traffic - or you're not permitted to as a general rule, are you?

MR KEW: My understanding is that it's not allowed. I don't think it's going to be supported at this point in time and I think the only cabotage opportunity is that maybe Ansett or Air New Zealand have one leg where they pick up domestic passengers between Darwin and Cairns, but certainly international carriers are not allowed to do that.

PROF SNAPE: What about the passengers who come in on a Brunei flight one day, stay a couple of days and then fly on to Brisbane? Is Brunei able to carry them on their own planes or not? Do you have ongoing rights or not?

MR GANLEY: I believe not. Certainly Qantas has domestic on-carriage rights, but certainly the other international carriers - it's my belief that once they terminate or cease a journey, they're to be carried domestically thereon.

MR KEW: Yes, I was wrong. It was Qantas, not Ansett/Air New Zealand, that have the on-carriage rights. The proposed arrangements for Royal Brunei will be that they will just fly direct services between Brunei and Darwin and Brunei and Brisbane and there won't be any opportunity for carriage in between.

DR BYRON: I'm just wondering about what else an airport might do in terms of growing a business, given that what you do or don't do with regard to landing charges doesn't seem to have a great deal of impact on the airline's decision to include Darwin on their routes or the frequency or type of aircraft they choose.

MR KEW: I think if we were looking at reductions in landing charges from where they are today to where we might want to move them to, if you thought that that would stimulate demand, I think you would be wrong, but what we are doing is working closely with the government up there. We're working closely with the tourism industry, we're working closely with the Chamber of Commerce to try and grow the market in total, and from that market growth do a lot of work in route development, demonstrate to the airlines that there are profitable markets that haven't been tapped, and encourage them to come to Darwin and Alice Springs on that basis.

DR BYRON: But that doesn't sound very much like the classic textbook behaviour of a monopolist, if you don't mind my saying so.

MR KEW: I don't think we fit the definition of a classic textbook monopoly.

DR BYRON: Yes, but one of the things that we need to explore in this inquiry is somewhat hypothetical, what might happen in the absence of a regulatory system like the one that we have at the moment, and I guess some of the airlines have painted a picture that if there was no form of airport-specific price regulation then each airport would exercise its market power and charge extremely high prices. I'm not attempting to influence you, but could you elaborate a little on how Darwin and Alice Springs pricing might evolve in the absence of a specific price control system?

MR KEW: I think the first thing we would do is go back and look at what was the cost of providing the aeronautical services versus the revenues that we're gaining from them, and if there is an inequality there, if we're underrecovering, then we would maybe seek to move towards, over a period of time, full recovery of services relating to the aeronautical investments there. We haven't done that exercise yet. I don't know that we're underrecovering, but I suspect from the anecdotal evidence that probably is the case.

I don't think we are a monopoly in the sense that while it's pretty hard for them to fly to another airport in the case of Darwin, I think predatory pricing behaviour there would be easily countered in terms of its effect on our revenue by just the removal of one or two services. It would certainly put us behind the eight ball, so to speak. So it's in our best interests having an airport with 24-hour capacity. They're relatively new terminals in both circumstances to try and increase volume going through there, and we would like to price in such a way that it encourages that.

DR BYRON: So by increasing the volume you get the sort of economies of scale, lower unit cost, plus you get the flow-on from the retail traffic and carparking and that sort of thing.

MR KEW: And that's significant, yes. It's not in our interests to raise prices and discourage airline services.

PROF SNAPE: You have not had any substantial interest from any discount airline?

MR KEW: Was it Virgin that said that it was their intent one day to fly to every city in Australia with over 50,000 people? But, no, we haven't had any formal discussions with them.

PROF SNAPE: Do you regard it as a viable option? When you talked about the cost of your fare down to Melbourne, it of course sounds pretty high.

MR KEW: Well, it is, and if you're a family flying from Darwin to Melbourne return, or from Melbourne to Darwin return, five people, and you've got to spend $8000 in air fares, who would go to Darwin for a holiday? So I think there is a latent, pent-up demand for people who would like to travel to the Top End and Central Australia for holidays, but it just hasn't been tapped at this point in time because of the air fare structure that's in place at the moment. So I would hope that discount air fares will come. Whether it's through new market entrants or whether the current airlines will decide to change their fee structure, time will tell.

But it's certainly in our interests to encourage lower air fares. Certainly the minus X factor probably hasn't contributed a lot to lowering the air fares up there over a period of time, but we would hope that lower air fares will prevail and that will create a much greater market for us to service our airports.

PROF SNAPE: Presumably the experience elsewhere is that lower fares haven't come without the entry of a new airline, so it would seem to be in your interests to try and encourage one.

MR KEW: It's definitely in our interests to encourage as many airlines to fly to Darwin and Alice Springs as possible, and if we can do that with new market entrants, we will encourage them, without doubt. Obviously there are some operational issues because we don't have full control over our terminals. Passenger check-in facilities are limited, and in the case of Darwin they're provided and covered under leases by Ansett and Qantas, and in the case of Alice Springs it's a similar circumstance. So to accommodate new market entrants we would have to either renegotiate those arrangements with the incumbent airlines or we would have to provide additional infrastructure to support them, which would be somewhat difficult for us in the short term, because of the sort of returns we're getting out of the business at the moment.

PROF SNAPE: Well, Virgin operated out of a marquee at Adelaide for quite a while.

MR KEW: Well, yes, and if a marquee would suffice at Darwin, that would be fine. I don't think in the wet season, in the cyclone season, it would survive long. So I think in practice we probably have to provide somewhat different facilities in Central and Northern Australia than they get away with in the eastern estates.

PROF SNAPE: Do you have problems being a joint user at Darwin?

MR KEW: Well, yes and no. I won't say problems, but there is the issue of managing ongoing relationships with the military, who quite rightly see that the runway in the middle is vital to their operations as well as ours. We have a joint user deed, a legal agreement, that delineates both parties' responsibilities, and also with operating out of Darwin Airport. I think the runway there is three and a half kilometres long and 60 metres wide. It's the biggest runway in Australia, I think, the width. It can accommodate VLAs at this point in time. But there are some onerous responsibilities associated with maintenance on that airfield, particularly in a climate like the Top End, with the heat and the rain. Significant maintenance costs are either being borne at the moment or aren't too far away, and of course they're paid for out of our operating revenue, and that's not classified as a necessary new aeronautical investment if we go and spend $6 million resealing that runway.

PROF SNAPE: Okay, and how will you share that expense with the other user?

MR KEW: Well, under the current agreement the share basis is on the number of civilian versus military planes, and I think that roughly equates to about 80 per cent civilian and 20 per cent military, so we're up for about 80 per cent of the cost.

PROF SNAPE: So you don't have ongoing squabbles of any magnitude with respect to the sharing of costs, et cetera, or who can park where and so on?

MR KEW: Who can park where is quite clear. The air force park their planes on their side of the airfield and we park on ours. Now, we might be able to put one of our planes on their side for a day or two to cover an emergency situation, but they will not provide free parking for us and we will not be able to use that as an opportunity to say, "We've increased our capacity. We'd just like to park two or three jets over there on a regular basis." They will not allow that. But in terms of squabbles, no, it's in our best interests and indeed it's an obligation as ALCs there that we maintain effective working relationships with the RAAF, and if you don't do that at an operational level, it makes your life pretty difficult there.

PROF SNAPE: Well, there are some bad relations between airports and airlines at a number of airports around Australia. You might also have expected them to operate fairly harmoniously.

MR KEW: Well, we do operate fairly harmoniously at an operational level. I think the bad relationships perhaps have been created by the umpiring or adversarial regime that's been created at the moment. If it was just normal commercial negotiations, I would expect the relationships would be a lot more sound than they are at this stage.

PROF SNAPE: Your preferred position is no regulation but you then go on to say, "If there must be, then let's improve it." If there were to be regulation, which airports would you see the regulation at?

MR KEW: I certainly see it would not apply to small regional airports like Alice Springs and Darwin.

PROF SNAPE: So you'd include Darwin in that?

MR KEW: Definitely.

PROF SNAPE: Okay. Well, that's been very helpful and a helpful submission, again giving a perspective of one or two of the smaller ones. You do regard Darwin Airport as being of national significance, I suppose.

MR KEW: Without doubt. It's of national significance, particularly for the people who live in the Top End. I think, though, that it has the market characteristics of a small regional airport in terms of its size, its ability to influence outcomes and its ability to project market power.

PROF SNAPE: So it could pass the national significance test of a say Part IIIA Trade Practices criterion?

MR KEW: Well, our position is clear in the sense that we would prefer to see no price regulation, rather to decide whether it meets a particular test.

PROF SNAPE: Okay. Thanks very much for that and the submission. That's very helpful - and also for coming down so far. Thank you.

MR KEW: Thank you very much.

MR GANLEY: Thank you.

PROF SNAPE: As we shuffle around, Virgin Blue. It is 2.30. That's when they said they'd be here. Is Virgin Blue here? It is. Good. We now welcome Virgin Blue and have received a submission from them this morning which we have attempted to digest over lunch and so thank you very much for that and thank you for coming down. If representatives would now separately identify themselves so the voices are on the tape for the transcribers, and describe your position, please.

MR SWIFT: My name is Scott Swift from Virgin Blue. I'm the head of the contracts department.

MR WOODWARD: My name is Luke Woodward. I'm a partner at Gilbert and Tobin, advisers to Virgin Blue on regulatory matters.

PROF SNAPE: We were wondering where the expertise on some of these matters was and thank you very much. Mr Swift, you will be speaking to the submission, will you?

MR SWIFT: Thanks very much, Professor Snape. As I said, my name is Scott Swift from Virgin Blue, together with Luke Woodward from Gilbert and Tobin, partner of the law firm who is our regulatory adviser. He was the former general counsel to the ACCC and had 10 years' experience with the ACCC. Once again, thanks for allowing us to make this presentation, and apologies it wasn't received until quite late. As most people are probably aware now, Virgin Blue is a low-fare carrier which launched into the Australian market in August 2000. It's owned and controlled by Sir Richard Branson and it's one of four airlines now in his fleet.

We're a point-to-point trunk operator in Australia, operating predominantly between the capital cities and are very pleased to be in the Australian environment. Currently Virgin Blue is operating six Boeing 737/400 aircraft with 162 seats each and on today's rotations we're doing 16 Brisbane-Sydney, 10 Brisbane-Melbourne, four Brisbane-Adelaide, six Adelaide-Sydney and two Brisbane-Townsville services a day. We're also commencing six Adelaide-Melbourne services in May and are committed to an additional 14 aircraft joining our fleet in Australia over the next 19 months. As you can see, it's a substantial commitment by the Virgin group to establishing a low-fare operator in Australia.

We currently, within the last 12 months, have expanded to in excess of 600 staff and hope to turn over in excess of 150 million in our first 12 months of operations. I said we're a low-fare carrier, and what does that mean? Low-fare carriers are the fastest growing market in the aviation industry around the world. They have very significant growth in Europe, in America and Canada and some of the airlines, such as easyJet, RyanAir, Southwest Airlines and WestJet have shown significant - between 20 and 100 per cent - growth year-on-year since their establishment only a few years ago. It's a very big growing market and we've seen that in Australia already.

As part of our submission we included a copy of the Department of Transport statistics which showed that, based on the January figures this year to last year, there has been a 40 per cent increase in passengers travelling on routes where there are three or more operators operating in Australia. I think that's a significant increase in the passenger volumes for Australia.

PROF SNAPE: The annex isn't in my copy.

DR BYRON: Mine neither.

MR SWIFT: We will arrange to get them sent to you - the Department of Transport statistics.

PROF SNAPE: Thank you.

MR SWIFT: So what is a low-fare carrier? It's one that operates on trunk routes. It's a point-to-point carrier. We pride ourselves on operating on time - very reliable. We have very friendly staff and we offer a discount or a low fare. We offer that low fare to encourage more people to fly, and I think with the 40 per cent increase a lot more people are flying. How do we do it is the question. We do it several ways. The first is to utilise our fixed assets very well. We have very quick turnarounds and we utilise our aircraft every day, thereby spreading the fixed costs across a wider network. We cut out all the unnecessary extras. We don't have frequent flyers. We don't have corporate lounges. We don't have big head offices. We don't have a sausage surprise on board that you're forced to eat.

We cut out all the extras and we pass those savings back to passengers. So once you take out the extras and you pass those savings back, we're able to offer low fares and encourage more people to fly. I think you would have seen that fares have come down by greater than 50 per cent since the entry of the low-fare carriers into Australia. To quote an example, my wife travelled to Sydney on another carrier earlier this week and paid $240 each way. You can get fares as low as $39 - 55 between Brisbane and Sydney one way at the moment - so there's a significant difference.

So Virgin Blue is offering a different product to the majors. We're offering one that needs some flexibility from airports to cater for our different needs and our different product mix. Airports are critically important to the development of new entrants in Australia. We need facilities to operate at those airports. That is one of the critical and fundamental propositions that we put forward. We also need facilities at those airports which sit in line with our business proposition of being a low-fare carrier, one that's easily accessible, one that's quick to pass through, one that gets people on planes quickly.

Some airports upon our introduction into Australia have been very helpful enabling us to get started and launched. We've been able to do reasonably good deals with some of the airports, such as Sydney and Brisbane, who were quite reasonable with their negotiations with us. They still have an amount of monopolistic power and sometimes need and do use it. However, we have been able to come to reasonable commercial settlements on a lot of issues with those airports. Other airports in Australia have been somewhat opportunistic with the launch of new low-fare carriers in Australia. Melbourne is one and the upcoming or proposed MUIT at Adelaide would be a second. Those airports have seen to derive every benefit they can from the current regulatory framework and from the entry of new airlines.

Airports have a natural monopoly in Australia because there's very few alternatives. There is no alternative to most of the major capital city airports and currently we can't land them on anything else but airports. People in Australia want to and need to fly between these major cities. We needed to fly to Melbourne today for business. Either I flew down here or you flew up to Brisbane, which you did last time. So there is a large amount of demand that is inelastic to price that is required for travel in Australia. There's also a large demand for people that want to go to these respective cities. There is a substantial amount of demand that's not price sensitive.

On the other hand, from the 40 per cent increase you can see there's a large amount of demand that is very price sensitive and with the lowering of fares in Australia a lot more people have had the opportunity to fly. That's the area where low-fare carriers try to tap into the market. Our interest is to stimulate the market and from that stimulation derive our profits. We believe Australia has been constrained with their capacity and had high prices for a long time, and identified an opportunity to come to the market to not only stimulate it, but stimulate it by lowering fares and having more people fly. I think we're doing a reasonably good job at that. There's a substantial risk with a new entrant coming into a market which is already established and has some incumbent airlines. That risk has all been borne by Virgin at this stage and not by the airports.

My proposition is that the airline is taking a considerable risk and the risk for the airports in the entry of new airlines is far less than that of the airline. If we continue to have high-cost airports, or the airports deriving the profits from the new entrants, then there's going to be a stifling of competition and a lack of new entrants coming into this marketplace. We end up with high-cost airports, we end up with high-cost airlines, high prices for airline travel and fewer people travelling, and I don't think Australia wants that.

When I first considered "do I think airports are monopolistic", I thought, "Well, what's the easiest and simplest example?" and probably one is today. I drove to the airport and parked the car; I fly back tonight. Parking today will cost me $20. Our office is just out of the city of Brisbane and it costs us $4 a day to park. If I parked in the city it would cost me $10, so I think with something that's unregulated, such as parking, they certainly are exerting monopolistic influences and charging monopolistic prices. If there was no regulation I have some serious reservations as to what prices we would be paying for access to those airports.

The single-till argument isn't a focus of our submission. It relates predominantly to the aeronautical services, and I believe there's several other examples within aeronautical services that show that where they have an opportunity to, they can exert monopolistic prices. One of the propositions in the paper was that airlines have countervailing market power to airports. That may or may not be the case for the major airlines and it's not my position to comment on that. However, from the perspective of a new entrant we have very little countervailing market power. We need facilities and we need suitable facilities, and in a lot of cases there aren't any.

Airports won't allow us to build those facilities and they won't allow us to control those facilities. We need them to build facilities for us that are suitable for our needs at a reasonable price. We are happy for a reasonable price to be charged but we're not happy for an exorbitant one to be charged. One of the other propositions is the impact on the cost for new entrants and the consumer. Airport costs represent up to 13 per cent of our variable cost of operating at respective places. It can represent up to 10 per cent or in excess of 10 per cent of our revenue on a particular fare. Fares between Melbourne and Brisbane, where I came from today, are less than $100 at the moment. The cost to transit through that airport for one of our passengers is between $7 and $8. So, as you can see, that's 8 per cent of our return. Eight per cent of our revenue on that flight is going to the airport operator.

How does that impact on the consumer? Either we have to pass it on to the consumer or we have to absorb it. As we said in our proposition earlier, low fares operate by us keeping costs low, passing them back to the consumer and enabling them to fly. I ask the question, why does it cost someone five times as much to go from Melbourne to Sydney as Sydney to Melbourne? The facilities are reasonably comparable. Why will it cost, if the MUIT is built at Adelaide, 15 times as much for the person to leave Adelaide to go to Sydney as it does to go back from Sydney to Adelaide? They're questions, I think, that need to be addressed.

In relation to the current regulatory regime, there's some definite uncertainty in the framework that we have existing at the moment. There's uncertainty in the Prices Surveillance Act and what items are covered by the price cap. Price surveillance interestingly only accounts for price increases. There is no mechanism or control of any price decreases. There is very much uncertainty in some of the regulatory framework but in particular I would like to bring to note the necessary new investment provisions of the regulation. The necessary new investment provisions as they currently stand provide an incentive for airports to take things out of the price cap regime. They provide an incentive for airports to hold up investment and put pressure on the users, being the airlines, to agree that it's a necessary new investment and therefore it's outside the price cap.

There's an incentive for them to charge as much as possible on that facility and build as big or as expensive a facility as possible, because that's what they derive their return on. When you add to that that there's a failing by the airports to take into account any other revenue, apart from, say, a passenger facility fee for the actual passenger terminal, and add to that that there's extremely conservative forecasting and projections associated with new facilities, I think we have a pretty difficult regime to work within. There's no provision at the moment for any price reduction, so if an airport is able to obtain a return or a price based on very conservative estimates with the 40 per cent growth that we're exhibiting at the moment, that is a windfall benefit for the airport to the detriment of the airline.

There's certainly also some uncertainty in relation to the arbitration rights under the legislation, and that's currently one of our problems we have with Melbourne. So how do we change it? Our recommendation is that there's a legislative framework specifically for airports with a price cap for all the capital airports, capital city airports, and airports where there's significant influence. Some of the regional ones, we believe, have significant influence. However, it's the capital cities that we're particularly interested in. Within that price cap we believe it should include all essential aeronautical charges. Anything that is essential to the operation of an airline should be included in the price cap. There should be provision in the legislation for future investment in airports, and there needs to be a periodic review of that legislative framework, and also the price charged under that price cap.

There needs to be some solid legal framework to support the framework and we believe there should be a limited test in relation to the necessary new investment criteria. We believe it should only apply if a facility or an undertaking would not otherwise have been undertaken. Finally, Part IIIA as it currently stands should be used as a default. There should be some mechanism within the legislative framework for arbitration. That's the proposition of Virgin Blue Airlines.

We've come to the market as a new entrant airline offering a new product. I think we've stimulated the market tremendously and I think the Australian public is responding to it; some airports have been very helpful, some have been somewhat opportunistic against us. We would like to see a certain regulatory framework that we can all operate within and go forward and end up flying to my colleague's airport in Darwin and as many other airports in Australia as possible.

PROF SNAPE: Thanks very much, Mr Swift, for that. Would you judge the existing regulatory framework to have been a help or a hindrance for your entry?

MR SWIFT: It's a hindrance in relation to people who aren't prepared to be commercial. Sorry, it's a help in relation to where an airport won't be commercial; it's a hindrance with one that is prepared to be commercial, and unfortunately that's a fairly hard one to know until you actually meet and deal with the respective airports.

PROF SNAPE: That's the airports. I was thinking of your competitors as well and the way that your entry may have been facilitated or inhibited by the regulatory system in the way that your competitors may have used the regulatory system.

MR SWIFT: It's probably a question you should direct to them as well as myself. There has been an instance where we are concerned as to the power that another airline may be able to exert over an airport. As a low-fare airline we need to deal directly with the airport and our competition is against the other airlines, so it's a tough one for me to say yes or no to.

PROF SNAPE: But in some cases it may be that another airline has used the regulatory system as a lever in influencing the airport.

MR SWIFT: You've really got to direct the question to the airport. We certainly sometimes feel that way, yes, but the price regime as it currently is is a cap. We would much rather see them do a deal on a commercial basis inside that framework; sometimes they may be forced by the other airlines to use power against us. You really do have to direct it to the airport.

PROF SNAPE: Yes, but nevertheless there's the power, for example, under the regulation to have regulations to have to get the approval of the existing airlines for some additional facilities, or attempt to get it, before going to the ACCC. Now, that would seem to be - and we have had some participants put to us that that in fact has been used as a blockage or as a delaying tactic or as a gaming tactic against the entry of new entrants such as yourselves.

MR SWIFT: Yes, it could certainly be said that has occurred.

MR WOODWARD: I think there's a specific example which relates, I think, to Canberra Airport which is not a matter which Virgin has directly had experience of. I think there are a number of areas in which the existing regulatory framework may be favourable to major airlines. Firstly, the ability to have a pass-through of necessary new investments for terminal facilities means that to the extent that airports have market power they're able to exercise that with respect to new entrants. But given the long-term leases that they have with the major airlines, that's an area in which they are unable to exercise that market power. So to the extent that there is market power it's actually able to be exercised against new entrants, so that's one, I think, regulatory distortion.

The requirement for user support or the regard to user support for necessary new investment proposals to be passed through the price cap could be used opportunistically and I think we're aware of the concerns of Impulse with respect to Canberra Airport. Another issue which Scott I think was just touching on and is touched on in the paper is the ability for the major airlines to operate in their dealings with airports in a way which is likely to increase the cost base for new entrant airlines, and there is some, I guess, concern that Virgin Blue has with respect to the apparent circumstance that Qantas was refusing to agree or to participate in the Adelaide terminal unless Virgin Blue did.

The Adelaide terminal is one which is considerably out of whack with the operating strategy of Virgin Blue and is a significantly higher cost, and that is a very real concern, where a major incumbent airline actually might have the capacity to impose a significant increase in the operating costs of a new entrant airline. So I think, Professor, you're right to note that there are aspects of the existing regulatory regime which surprisingly under a price cap actually may work to the benefit of a major airline against a new entrant airline.

PROF SNAPE: That was really why I was trying to say in total whether it has worked for you or against you, the regulatory system as a whole. But with respect to Adelaide, who have you really been negotiating with there? Have you been negotiating with the airport?

MR SWIFT: Yes, that's correct.

PROF SNAPE: Have you really been negotiating with the incumbent airlines through the airport, or have you been negotiating effectively with the South Australian government?

MR SWIFT: It's been a combination of both the South Australian government and the Adelaide Airport.

PROF SNAPE: But taking into account the remarks that Mr Woodward just made about the way that at least one of the incumbent airlines was negotiating, then it would seem that you are also indirectly really negotiating with an incumbent.

MR WOODWARD: I was careful to say that what appeared to be the cases related back to Virgin Blue, but certainly that was something in those discussions which appeared to be a factor influencing the airport's dealings with Virgin Blue, or was said to be a factor.

PROF SNAPE: You might well have been able to negotiate a deal with the airport if you weren't also negotiating effectively with those at least two other parties.

MR SWIFT: That may be the case and it certainly has been in our interim arrangements we have until the proposed facility will be built.

DR BYRON: I was really struck with the top paragraph on page 10 of your submission about common interests, that airlines and airports are in effect partners in providing a final travel product. I think that paragraph is one of the most clear statements of commonsense that I've heard in all these hearings. To elaborate on that, I've read similar paragraphs though in many of the submissions from other airlines and from most of the airports, that are commonsense — that there is a mutual dependency and a joint interest in growing the aviation business and so on. I don't think there's very much disagreement about that as a general goal, but after that it seems to diverge fairly quickly.

You talk there about the common interest but different risk profiles. One of the points that one of the investors in major airports made to us this morning was that the real difference between airports and airlines was that airlines' principal assets - silver birds – are very mobile by definition, whereas airports are sunk investments - they are immobile - and that really changes, if you like, the flexibility in negotiation positions. A number of the airports have basically said to us in the last three days that they're relatively defenceless in that an airline can unilaterally cancel a route or reduce flight frequencies or downgrade aircraft gauge and so on, and the airport can basically do nothing at all except wear it. They've got a sunk investment. They can't pick up their tarmac and take it somewhere else.

MR SWIFT: That may be the case on some very small airports, but certainly if you look at the capital cities in Australia there is a very high volume of traffic in Australia and airlines need to service those particular routes.

DR BYRON: Perth told us just before lunch that there was a decision that they had read about in the newspaper one morning that four 747s per week are no longer going to stop in Perth. That presumably has a fairly substantial influence on their revenues, and the point that they were trying to make is that, even as the major western gateway to the continent, they have no choice when an airline for perfectly sound commercial reasons decides to alter its frequency and route structure; all they can do is wear the consequences. So it's entirely a risk-free enterprise.

MR WOODWARD: Doctor, I don't think we suggested that it was risk-free, but the mere fact that the asset is fixed in a geographical location doesn't, I think, bear on the level of riskiness of it, particularly if you bear in mind that in fact largely the population is also fixed in that area and there's also a largely fixed demand for travel to and from that area. Similarly, with electricity networks and gas networks, one can't pick those up and move them, but in fact they're actually one of the least risky investments.

The critical difference in terms of risk profiles which we sought to draw out in this paper was that airlines do compete, do operate in a highly competitive market and furthermore new entrant airlines actually face a much higher degree of demand elasticity for their services than for an airport. So all other things being equal, the returns that an investor might want - well, if an investor was in a situation where they could invest the same dollar for the same return in an airport or in Virgin Blue - with no offence to my client - I mean, one would suspect that you'd probably put it in the airport or, to put it another way, that one would require a higher anticipated return for a new entrant airline to actually stimulate the levels of investment that we've seen from Virgin Blue.

DR BYRON: I appreciate that the airlines take a great deal of commercial risk, but they also get potentially substantially higher rewards. I assume that Virgin would not be in this business if the regulatory framework said, "Thou shalt get 8.12 per cent per annum and if you make one dollar more than that you have to hand it back to your customers." It's a different risk-reward profile between the airports and the airlines quite obviously, but I don't see why that necessarily means that they can't negotiate sensibly and come to mutually amicable commercial outcomes and why there has to be by definition a regulator involved in achieving mutually amicable outcomes.

MR SWIFT: We have been able to come to commercial arrangements with several airports. Other airports have sat across the table from us and said, "We acknowledge all other revenues and we're not prepared to take you into account", and when we do our numbers we're not prepared to allow an airport to derive an excessive return, and our numbers show 125 per cent return per annum, when we're taking a substantial amount of the risk. Therefore we feel that there needs to be a regulatory framework where we face those situations. We never want to go to the regulators. However, we need some mechanism when we do face monopolistic issues.

PROF SNAPE: You're a pretty valuable asset for an airport to have. I mean, you're sought after to come into airports which must give you a fair bit of negotiating power.

MR SWIFT: We're sought after by some; others know that we need to fly there. As we add 14 more jets we're going to need to fly to a lot more airports in Australia, and the airport can sit and wait and say, "I know you need to come because you've got to put those aircraft somewhere."

PROF SNAPE: Do you need to in the same way that some other airlines need to? I mean, if one is operating a network system of interconnected flights and feeding internationals, et cetera, et cetera, then one - in the sense that you're using it - would seem to have a much greater need than you would. You can choose where you go because you're essentially involved, as I understand it, in point to point - - -

MR SWIFT: That's correct.

PROF SNAPE: - - - and nothing else, no frills, no add-ons, no connections.

MR SWIFT: We don't use that word "no frills". We - - -

PROF SNAPE: I'm sorry. If you want an extra thing you have your face painted.

MR SWIFT: We offer people choice. If they'd like to have something to eat, we'll sell them something; if they'd like to have their face painted, well, that's free of charge.

PROF SNAPE: So with that one frill.

DR BYRON: And a cheap frill it is, too.

PROF SNAPE: Yes. But I would have thought that you had less need to fly to particular airports in the way that other airlines might, and so that then gives you - for your size - a much stronger negotiating position.

MR SWIFT: We are intending to grow significantly, as, I believe, Impulse are. We believe the Australian market will sustain 30 jets and we're looking at - the statement from Richard was to fly to every airport that could hold a bit more than 50,000 people. We have committed to 14 more aircraft and we need to expand throughout Australia. We can't fly 50 times a day between Brisbane and Sydney because we will saturate the market, so we do need to look at other opportunities and that's where the other airports can either choose to be commercial with us, or they can choose to be opportunistic and say, "No," and, as we slowly grow, we will need to deal with them.

We would have put more services into Melbourne far earlier than we have at the moment if the price had been different. We are forced, with the next two aircraft - the next one - one of the aircraft is dedicated to an Adelaide-Melbourne service. That's part of our growth. They are part of our patterns of growth. But in our growth plans we will be forced to deal with opportunistic airports.

PROF SNAPE: Yes, but I still think that as against one that's operating a network and interconnections, et cetera, you are in a much stronger position.

MR WOODWARD: It is the case that one additional route doesn't have to feed into the other routes to maintain, I guess, the commercial position, but those routes aren't flown by reason of need; they're flown by an expectation that there's a return that could be achieved and so in that way there is a common interest with airports.

Can I also maybe just clarify one point: I don't think Virgin Blue's position would be that airports be fixed to a fixed rate of return and once they earnt it, that that dollar immediately be returned back. I mean, I think the situation would be that they would see that appropriate incentive regulations would offer airports the opportunity to outperform - the significant thing is that airport charges can actually represent quite a significant component of the variable costs and, ultimately, the return per passenger to a new-entrant airline. Therefore an airport which is profit maximising won't necessarily kill the golden goose, but does have an interest in restricting output or putting its prices up to some level, and will necessarily have an impact on the investment incentives for a new-entrant airline.

DR BYRON: We have just been talking to the Northern Territory previously. I'm trying to understand how the airport charging system feeds into the choice of an airline - about route structures and frequency and so on. So hypothetically - and I emphasise purely hypothetically - Virgin is thinking of flying, say, Brisbane to Ayers Rock - Yulara, and they say, "Well, our landing charges are $36 per person." Do you just say, "Oh, my God, that's ridiculous. Forget it." Or do you do the sums and say, "Even if we had to pay that, given the traffic volumes we anticipate, that might be worth doing"? Or do you say, "Well, we can fly into Alice Springs and it's only $3 landing charges. Maybe we should be putting on Alice Springs plus a backpackers' camping tour as a package or something"? I mean, how do you actually work it out and how influential is that landing charge? Even if Uluru is 12 times the price of Alice Springs, does it really matter if you're trying to decide whether to fly to Alice Springs or Uluru - or neither of them?

MR SWIFT: A lot of factors come in to deciding route development. It's a combination of what price we believe the market will support, what stimulation we believe we can put into the market, and the costs are factored in on the other side and we do a comparison of the respective routes. So cost is certainly factored in and, with higher costs, effectively you have to offer a higher price. Do we think that higher price will impact on the stimulation and the return? It is a numbers game and it's deriving a return. A lot of places don't have comparable places next to each other.

DR BYRON: That leads to another example. I think on page 10 you also talk about there being no substitute for a whole list of capital city airports, including Hobart. The CEO of Hobart Airport told us just before lunch that at least once he drove his car to Launceston to catch a flight, which seems to imply that - at least in that situation - Launceston was a very good substitute for Hobart, even for him. There were times when there was a $10 per passenger differential between Melbourne-Launceston and Melbourne-Hobart, but now that differential has gone. There's a lot of evidence that says that Launceston and Hobart are pretty close substitutes, and Wynyard and Devonport are also close substitutes to Launceston. Given that the leisure traveller is going to "do" Tasmania, and is going to rent a car and drive around for seven days and fly out, it really doesn't matter which of those four airports he flies into.

MR SWIFT: That's on the assumption that you're only taking the leisure market, when you - - -

DR BYRON: Well, for the leisure market, not the businessman who has to do work in Hobart.

MR SWIFT: Yes, but if you're putting a plane down there, you want to be - and Virgin is the airline for all people. We target both the leisure and the business market. So it's fundamentally important that you can maximise that by tapping into both markets, and therefore Hobart would be the right destination for you.

DR BYRON: So you don't think that Launceston is a close substitute?

MR SWIFT: We've considered it. We have spoken to Launceston. We have spoken to a lot of airports around Australia. Certainly we will use our ability to negotiate and end up at airports sooner rather than later than others - they're the ones that are prepared to do commercial deals. But, as we grow, then we potentially may need both the Launceston and the Hobart service.

DR BYRON: Well, I guess the final question on that theme is whether the commercial negotiations between your airline and the airport would be very much different in character absent a regulatory framework, that it's still basically going to come down to how profitable do you think that route will be and how willing are they to negotiate. You know, some will be conciliatory and some will be pig-headed and stubborn, and you'll still end up - you would have a similar commercial negotiation process even absent the current framework.

MR SWIFT: I think there's a lot of airports that we need to fly to to grow in this country, and some will be stubborn and obstinate and may effectively price us out of that market.

PROF SNAPE: Whether you've got a regulatory system or not.

MR SWIFT: Well, we believe there should be a regulatory system to enable that - when we do sit across the table from someone and they say, "Yes, we acknowledge all of those other revenues. We're not going to take them into account. We want to exact 125 per cent return from you," we believe we need to turn to someone at that stage. We're happy for them to make a return, an incentive return, but we don't believe it should be excessive, and moving all the risk associated with our venture from ourselves onto an excessive return for them.

PROF SNAPE: I think the new entrants are of course a new breed, but the evidence from earlier in the 90s about new entrants was that any facilities that were built for them were built at substantial risk by an airport. So I'm not sure that one can speak about there being no risk for an airport.

MR SWIFT: I think that regulatory regime has also been looked at in Australia in light of some of the experiences overseas.

PROF SNAPE: On page 14 you say:

> When airports seek to expand their non-aeronautical revenues, it's largely at the expense of new entrants.

MR SWIFT: Sorry, could you repeat that, Professor?

PROF SNAPE: Yes. I'll just find it. I'm quoting from something else. We got the troops on to writing out a few questions for us, because we had to get through it fairly quickly, but they tell me on page 14, and I do recall reading it, but where is it?

MR WOODWARD: I can't immediately, as I just quickly scan the page, find it.

PROF SNAPE: Yes, I've got it.

MR WOODWARD: You've got it?

PROF SNAPE: No, I haven't.

MR WOODWARD: But I think the point that's been made is that the - - -

PROF SNAPE: Who wrote this? I'm sorry. Go on.

MR WOODWARD: I think the point is that the new-entrant airlines have a greater exposure to airport market power than a major incumbent airline in circumstances where they have long-term terminal leases, and so that we see that the current regulatory arrangements provide incentives for airports to contend that -well, to seek to have terminal facilities and so on pass through - outside the price cap, and that inherently exposes the new-entrant airlines to the prospects of a greater degree of exercise of market power than the major airlines.

PROF SNAPE: The quote in fact began right at the bottom of page 14 and goes on to 15 -

> "expand their non-aeronautical revenues, it is largely at the expense of the new entrants."

MR WOODWARD: That is simply that there is scope to expand their - I think we actually touch on it - - -

MR SWIFT: With the new terminals, for example, all of those non-aeronautical returns go directly to the airport, whereas a lot of them in the - as we understand the existing facilities with Qantas and Ansett - they're actually able to derive a return - Qantas and Ansett are able to derive the return, so therefore they look at expanding new terminals for new entrants, but also to taking the benefit of the non-aeronautical revenues associated therewith.

PROF SNAPE: And it's because of the long leases that Qantas and Ansett have with them - - -

MR SWIFT: That's correct.

PROF SNAPE: - - - which again - - -

MR SWIFT: Airports want to take out additional seating capacity for passengers to put in additional shops so they make a return.

DR BYRON: Yes, but presumably if you owned a terminal - - -

MR SWIFT: But so far we do not own any terminals.

DR BYRON: No, but if you did you would then get the cash flow that comes from the retail and the commercial and the food outlets and so on.

MR SWIFT: Yes.

PROF SNAPE: Which you wanted to do at Melbourne.

MR SWIFT: We proposed several times to do.

PROF SNAPE: At Melbourne - and while you were going to guarantee access for any other airline that needed to do it, nevertheless you would have been, in this case, the landlord.

MR SWIFT: That's correct.

PROF SNAPE: Charging - doing to them what you feel is being done to you.

MR SWIFT: Well, Impulse has continually come out and told us that they have wanted to pay more money at Melbourne Airport so, should we be the landlord, we may ask them again.

DR BYRON: I wasn't clear on pages 8 and 9 where there's a quite lengthy list of all the aeronautical charges that Virgin Blue has to meet. Are there any of those that you don't think you should have to pay? The related question is, is there sufficient flexibility in the structure of the airport charges to enable you to pay only for those services that you use or that you require? Is the point you're making that things are too bundled and you can't unbundle them? Or was it that some of those user - - -

MR SWIFT: A lot of the odd things are actually excluded from the price regime, and we sometimes have to separately negotiate. If I look down, the first one I come to is check-in counters, and the use of them. That is actually outside the regime, and we have been in situations - and we currently are - where we're forced to pay - and if I use the normal example - $20 an hour to use a check-in counter. A check-in counter is effectively a piece of timber where we install a computer, but if you say $20 an hour by 10 hours a day by 365 days a year, that's $70,000-odd that we are paying for a check-in counter, and we have four or six of them. So it's not part of the regulation and sometimes because of that - it's an essential part of processing a passenger — sometimes you not only have to do the aeronautical ones, but some of the other essential ones which aren't classified as aeronautical.

MR WOODWARD: And I think the point is that all of those go into the cost of doing business and the cost of providing a commercial passenger service at that airport, and to the extent that they're not within the price cap, you inevitably create an incentive, as we said on page 14, to expand the revenues in those areas at the expense of the new entrants. I think there is an example given in relation to signage - rental charges - over check-in facilities, so it creates an incentive to create charges outside of the price cap.

DR BYRON: But is that an anomaly that arises because of the price cap? That is, if there wasn't the price cap there wouldn't be all those ancillary charges.

MR WOODWARD: It's a two-step problem. Firstly, it arises because the airports have market power, and it then flows from that because of the incomplete design of the price cap that they can exercise it in these distorted ways outside of the price cap, so it's a two-step problem.

DR BYRON: Does that basically mean that every service that you pay for at the airport should be capped?

MR WOODWARD: It means that, as a minimum, the exposure of Virgin Blue to market power of an airport - and I accept that's an issue for you, but assume for this point that they do have such market power - that they have an exposure to them wherever it's a cost of doing business for them at the airport. Therefore, if one finds that airports have market power, one should actually define the price cap regime to cover the full circumstances in which that market power could be exercised, and therefore should include really all those things.

DR BYRON: But what you're suggesting is that it was a failure in the definition of coverage at the time that the cap was put together, that there were some elements left outside the cap.

MR WOODWARD: The definition of coverage - it may well have just been a convenience. I think they just picked up those things which the old Federal Airports Authority could charge for and they could list them. No coherent analysis of the circumstances in which an airport could exercise market power I think was really undertaken, so therefore one has left things out of the price cap and then, not surprisingly, the result ensures that market power gets exercised in those areas not covered by the price cap.

DR BYRON: That is perfectly rational behaviour for the airport owner, given the existence of the cap on the others.

MR WOODWARD: It's a demonstration of market power.

DR BYRON: And it is equally rational for you to object to it.

MR WOODWARD: It's more a criticism of the current scope of the regulatory framework. If one has market power and one can use it, one expects your shareholders would want you to use it.

DR BYRON: But absent a regulatory framework in those sort of commercial negotiations, the airline could sit down with the management of an airport and either go through every conceivable charge that it could possibly levy and come to an agreement on all of them, or you might just bundle it all up in one figure and say, "Okay, there's not going to be staff parking, signage, advertising or anything else. This is an all-embracing fee" and sign off on it. The reason you get down to the micro detail there is itself an artefact of the regulatory framework.

MR WOODWARD: Scott will speak from experience that in fact different airports do things differently. That's right, but it wouldn't address the first problem that they've still got market power over the operations of the new entrant airline. But it is the case.

PROF SNAPE: In general you would prefer things to be separated, I think, wouldn't you? Because you don't necessarily want the same package of services that other airlines want.

MR SWIFT: That's correct, but we would like anything that's essential for the operation of a standard airline to be included.

PROF SNAPE: And a clear definition of what's in the bundle and get a charge for that bundle - you'd be perfectly happy with that, rather than having to itemise the costs of each component of it and separately assess the charges for each.

MR SWIFT: Absolutely.

MR WOODWARD: I think one of the generally recognised strengths of an overall price cap is that it does offer, within price cap flexibility, as to how one prices particular services and it should lead to an increase in efficiency for that. But the principal thing is to get the cap right. We haven't weighed into the debate in here about the treatment of commercial revenues - we understand that's a significant debate - but we have just said, "Let's not miss the point at the moment that even in fact the current aeronautical revenues - leave aside the single-till debate - are currently quite incomplete."

PROF SNAPE: I would just like to check that the attachments are part of your public submission?

MR WOODWARD: They are. I believe they were faxed to you last night, and then an electronic version was sent, but we will ensure that - - -

PROF SNAPE: No, we've got the second of those, it's just the first that we - - -

MR WOODWARD: Yes.

PROF SNAPE: But I was just checking that they are part of the public submission before asking a question on that. I understand that you have lodged an application with the ACCC for access at the terminal at Melbourne.

MR WOODWARD: That's correct. It's the step before that. It's simply to have it designated as a declared airport service. It would be a separate and additional step to go and then seek to initiate an access dispute but the precursor is - if you like, the equivalent to Part IIIA is to actually have the service declared, and it's simply that step which Virgin Blue has sought to initiate.

PROF SNAPE: So you are seeking to have the service associated with the common user terminal, or the one that you're using, declared. You're not seeking to have all terminals declared?

MR WOODWARD: It's a technical and legal question, I think. It follows from the operation of the Airports Act and probably also Part IIIA that when one wants to seek access to services they're services provided by facilities, so it requires a specification of facility, and substantive economic issues are assessed in the context of that facility - is that facility economic to duplicate or not? - and that will be a matter that Virgin Blue has put submissions on. So it's in the context of a facility, so accordingly the application for designation of the airport services in the context of a facility, the relevant facility being the Melbourne domestic express terminal.

PROF SNAPE: You, therefore, are implicitly arguing that the existence of the other terminals at Melbourne Airport are in fact not duplicating that same service?

MR WOODWARD: Firstly, I should say that the Virgin Blue submission in relation to this is publicly available but we will take steps to provide it to you so you can see how it's put. The test is one of economic duplication and it's a forward looking test, and it also reflects the decision of the Australian Competition Tribunal and the Sydney Airport matters where it looks at the social concept of what is economic to duplicate. So it goes to the question as to whether or not it would be socially desirable for the question framed here, for another Melbourne domestic express terminal to be constructed, and we've contended that that's not the case.

PROF SNAPE: As you say, we can read that for the details. But the essence of that will then be - I take it this is a preliminary step to have the service declared at that facility. Since you have already got that service, it's not as if it's being denied to you.

MR WOODWARD: No, it is a very curious situation that has arisen. The situation is that in relation to Melbourne Airport's pricing proposal for the new Melbourne terminal, they proposed a review of the charges after two years, which may well have been a very sensible suggestion, and thereafter there ensued a bit of a difference of opinion between Virgin Blue as to how one might make real the obligation or the commitment to have a review at the end of two years. I think Melbourne Airport took the position, as I understand it, that you have got your rights - firstly, I should say that there is no capacity for approval under the Prices Surveillance Act for any review to be taken after two years.

Once the price is approved, provided you never go higher than it, you don't need to come back, so there was no mechanism in the Prices Surveillance Act to make good that commitment for a review at the end of the two years. I think Melbourne Airport took the position that if you have an access right there you can rely on that. Virgin Blue said, "That's a pretty uncertain right. What about a commercial review clause?" and Melbourne Airport took the position, "No, if you've got access rights you rely on those," and so Virgin Blue then set out trying to satisfy whether it did in fact have those rights. So it's quite a special case. And it's certainly not the situation that it reflects any intent by Virgin Blue or Melbourne Airport to revisit, within that two-year period, the pricing.

PROF SNAPE: So it's essentially directed to the conditions of use after that initial period.

MR WOODWARD: It's directed to the two-year review.

PROF SNAPE: It sounds like a fairly expensive path to go down.

MR WOODWARD: It is.

MR SWIFT: It has been an unfortunate situation that we don't have a good relationship with them, and despite our best efforts things don't seem to be changing there.

DR BYRON: I was going to ask you about the need for flexibility from airports that you mentioned in your opening statement. I don't want to seem to be harping on this but that applies either with or without the CPI-X regulatory framework, doesn't it? You still basically need flexibility in terms of providing you with a particular bundle of services that you need which is distinctive from what others might need, and at prices that you think are reasonable. So it still requires that flexibility in commercial negotiation.

MR SWIFT: Yes, it does.

DR BYRON: The question in my mind is the extent to which the regulatory framework either assists or impedes that. I guess that's one of the things that we've got to grapple with.

MR WOODWARD: We would set it up as a two-step problem: (1) should there be regulation - we're obviously here because we say yes - and secondly, what that form of regulation should be. Currently I think Virgin Blue's experiences are, to some extent, consistent with some of the airports' level of dissatisfaction with the way the current framework works, and there's a difference of opinion as to why that is so. So we would go back and say, "Should that be regulated or not?" We think there's a compelling case for that. Let's improve the model of regulation going forward.

DR BYRON: Perhaps you can make a suggestion as to how we proceed in terms of the benchmark for comparison. I imagine on one hand we could say, "Let's look at the status quo and the arguments for and against retaining or departing from that." Another way would be to say, "Well, let's look at a deregulated system where there is Part IV of the Trade Practices Act and Part IIIA as very general mechanisms, the Prices Surveillance Act if amended or if retained or whatever, and then argue the need for special airport-specific regulation and why that is necessary, what it would do and how it would best work and think through the objectives and the best mechanisms for achieving that." Do you think we should take as the comparator the status quo or an assumption that airports are like any other industry unless there is a prima facie case established that they need some special legislation?

MR WOODWARD: We are like some other industries — gas and electricity networks and so on. But I can understand that you're setting up the problem in that way. You say if we had no regulation we'd have Part IV of the Trade Practices Act and Part IIIA. That's true. I think there are significantly overblown claims for what Part IV might do, and we actually haven't really commented on that in this report, because as a trade practices lawyer I fail to see what work it would really do in practice. So then one would fall back on Part IIIA which is the arbitrate/negotiate model. It's a very high-cost model.

It has a number of features to it which would tend to, we think, maximise disputation and probably actually result in perverse sort of forms of cost-plus regulation. In fact, that is why one sees in significant natural monopoly areas that other forms of price regulation have effectively been established under Part IIIA in terms of the national gas code and the national electricity code. So we would say if you looked at that as a default you're actually probably likely to lead to an increase in disputes and I think I have declared my interest on those matters to Scott and he is more interested in having a sensible general price regulatory framework to deal with it.

DR BYRON: Could you envisage an international airports code rather like the gas or electricity code?

MR WOODWARD: I think theirs are interconnected. I mean, you could envisage a specific airports price regulation framework, and then what the price cap outcomes - or whatever the pricing outcomes - one would imagine would have to be determined on an airport by airport basis, just as they're determined on a gas distribution network versus gas distribution network basis, for example.

PROF SNAPE: The three draft reports that we released last week - the theme in that was an attempt to get convergence in the systems as much as possible, or as much as reasonable, and to only have industry-specific regimes when there was a substantial reason for doing so. In telecoms we said yes and gave the reasons for doing so in that. If you are exercising your mind further in this direction you might wish to give a thought to it and to argue what are the specific reasons for airports as distinct from other industries.

MR WOODWARD: That is what we have attempted to do in terms of their natural monopoly characteristics but also in terms of their competitive significance, their national significance, and that is really the key plank of it.

PROF SNAPE: You may or may not want to do this in this context or elsewhere, but I just mention that to you. What you were talking about was your preferred framework for price regulation - or regulation of airports - and you said there should be an overall price cap for all essential air services and essential, of course, is something in which there may be a few legal fees spent within that context, and the other - you wanted a solid legal framework and you wanted within that a provision for ordinary investment return but you gave an out. You said there would have to be special provision for investment which would not otherwise have been undertaken and there would be a provision for having a price increase outside that cap. Now, that does seem to me to be the scenario for a great gain. Do you see any way around that?

MR WOODWARD: Currently we have, I think, a great gain.

PROF SNAPE: Yes.

MR WOODWARD: We're trying to reduce it.

PROF SNAPE: One of the things we are trying to do, I think, is reduce the scope for that gain, but this one seems to be just as great as the ones that might be there already.

MR SWIFT: The necessary new investment, we think, should be limited to if it would not otherwise be undertaken, and that is whether it be by the airport or by an entrant itself. If you take the scenario of Melbourne Airport - which unfortunately we do keep coming back to - we offered to build it ourselves. They kept saying no, we can't, but there's significant commercial risk associated with us building it. We don't believe that that is necessary new investment because we would have undertaken it ourselves and, if you look at what has been generated from that actual facility being built as far as landing fees only, it's probably going to be $3 million a year.

PROF SNAPE: Yes, but if I were Melbourne Airport, and just hypothetically arguing this in the context of your scenario, I would say, "You may be prepared to build a
very low-cost and low-service facility, but that's going to be a multi-user facility and we have to cater for a range of demands and you may be prepared to invest in that - to undertake for that - but that's not what we want on our airport. We want in fact something that is rather bigger, better than that, and unless we get a provision for that we won't invest in that." Straightaway you are in a game of saying, "Is it this one or is it that one?" and, as the airport, what I regard as desirable would not be built, so it doesn't seem to me that you are getting far away from the gaming in this one.

MR WOODWARD: In a number of respects we are but, firstly, the price cap would be set with expectations forward-looking of the capital expenditure one would expect. Secondly, that - in fact it is important to note that, as I understand it, Virgin Blue actually offered to purchase, in fact they offered a range of financial instruments, including right through to purchase of the actual terminal proposed by Melbourne Airport, but other ones which addressed the risk, up side and down side of passenger numbers — so one would really need to test the extent to which the incremental revenues and returns to the airport from building it would justify it being built within the price cap. The strong submission from Virgin Blue is that those incremental returns would have comfortably justified the increase - the investment - in the new terminal within the existing price cap.

It's an attempt, if you like, to narrow down the potential for hold-up but it doesn't fully address it because there may always be circumstances in which an investment would not be warranted within the existing price cap but otherwise be economically desirable. That's a problem which one actually sees grappled with in a range of regulatory frameworks and I would have to say better than in airports. If one has a look at the national gas code - that issue is attempted to be addressed there and it's done in a superior way, but is it perfect? No, it's not.

DR BYRON: Just the one point going back to the Prices Surveillance Act. I meant to comment before when we were talking about that. You've got a reference to our draft report on page 19, the draft recommendation that, "Price control, where required, should be established through separate industry-specific legislation." I think I need to emphasise that that is "but only after full exploration of all the feasible alternatives and confirmation that the benefits of price regulation will actually outweigh the costs of price regulation". We did put a fair bit of effort into establishing that regulation is not costless and that there are risks of both overregulating and underregulating, so we haven't proposed immediately industry-specific regulation, but there would be some sort of process for establishing - if there was no other alternative and there really was abuse of market power — then the best way, once the price regulation has been warranted, might be industry specific, but that wasn't meant to pre-empt the outcome of this inquiry.

PROF SNAPE: You said that your relations with Sydney Airport are very good and yet of course you are not able to fly from Melbourne to Sydney. Could you tell us about the slot - - -

MR SWIFT: We choose not to fly between Melbourne and Sydney at this stage.

PROF SNAPE: You do have slots that you could use?

MR SWIFT: Our slots are currently being used on our Brisbane and Adelaide runs. We've said to Sydney that as we get more slots we will put more planes in there. That's a fundamental of our business - that we will fly more into Sydney once we have available slots, and slots in peak times is obviously the critical time you are talking about, not in the middle of the day.

PROF SNAPE: Singapore Airlines own 59 per cent of Virgin Atlantic.

MR SWIFT: That's correct.

PROF SNAPE: And now they have an ownership relationship with Ansett.

MR SWIFT: That's correct, through Air New Zealand.

PROF SNAPE: Do you see possible conflicts occurring there affecting the competition between Virgin Blue and Ansett?

MR SWIFT: No. There's certainly nothing we've seen at this stage. Singapore competes against Virgin Atlantic itself, I believe, and they do it at arm's length. We're run independently at arm's length from Virgin Atlantic and Virgin Express and Ansett and Singapore, so certainly we have not experienced any of that at any stage.

PROF SNAPE: You said you would have been prepared to fly into Essendon Airport, only these days they don't take 737s. They used to take 707s, which are much noisier than the 737s.

MR SWIFT: Yes. There was a concerted effort by our team to get access to Essendon initially and that was eventually declined.

PROF SNAPE: What about Avalon?

MR SWIFT: Avalon is a bit like Launceston-Hobart. Yes, it would cater for the leisure market but it certainly wouldn't cater for the combination of the leisure and business market, and we don't think it is a suitable alternative to people wanting to fly to Melbourne at this stage.

PROF SNAPE: You would probably get it very cheaply, wouldn't you?

MR SWIFT: You may but you may also lose a substantial amount of your passenger volume.

PROF SNAPE: Thank you very much for that and putting up with some questions.

MR SWIFT: A pleasure.

PROF SNAPE: We are very grateful for your submission, and we shall digest it more over time, and also for your elaboration of the arguments. We mentioned a few points to which you may wish to give some additional consideration. If you do decide to respond to those then it is helpful to have any supplementary submission fairly soon so that we can take it into account for the draft report and not just be told we've got it all wrong at that stage.

MR SWIFT: Sure.

PROF SNAPE: Thank you very much. We will now have a short intermission and at 4 o'clock we will resume with Gold Coast Airport.

PROF SNAPE: Let's resume and welcome Gold Coast Airport, Coolangatta, to the hearings. We invite their representative to identify himself and his position and then speak to the submission they have kindly sent us. Thank you.

MR CHANT: Thank you, Commissioners. Dennis Chant, managing director, Gold Coast Airport Ltd. We are the lessee and operator of Coolangatta Airport, part of the second tranche of airports. We are regarded as a core regulated airport so we are subject to the CPI-X price regulation regime. What I propose to do is just fairly briefly go through the submission picking out a couple of salient points and maybe just enlarging on a couple and making a few observations at the end.

Coolangatta Airport obviously services the City of Gold Coast. It's actually located half in New South Wales and half in Queensland, so we have some interesting jurisdictional problems, not the least is daylight saving and how to interpret our curfew times.

PROF SNAPE: Geneva Airport, of course, is located in France.

MR CHANT: We are the eighth busiest airport in Australia. Until last year we were the seventh. Canberra has now moved ahead of us. We are obviously predominantly a tourism and leisure port. We did grow very rapidly in the first half of the 90s, virtually from 91 through to 95 doubling the airport traffic. Interestingly, that was in a very similar environment to what we have now, where there is a heap of capacity out there and a lot of people taking advantage of low fares. We have, however, tended to stagnate for the last four or five years. We attribute that largely to the, I suppose, better performance of the airlines in terms of managing their yield and putting their equipment where it makes most money. We virtually have been in a no-growth situation for the last four or five years. Because of the competition through Impulse and Virgin in Brisbane this year, we are suffering significant leakage of traffic and we expect to be down 6 or 7 per cent on last year.

We do anticipate, though, that as this extra capacity comes on board we should pick up one or other of the carriers, and certainly we're benefiting just only recently in the last month from the competitive pricing situation that Qantas and Ansett have started to develop out of the Gold Coast. So the story of woe that was told in our carpark figures there has turned a little bit and our carpark has been full for the first time since July last year - several times in the last month. Qantas and Ansett are putting on fares of about $66 which are co-rated with what they're putting through Brisbane, so we are benefiting from that - but their load factors are going sky high; they're not actually putting on any more capacity, but it is putting more numbers through.

I think our table there was designed to give you a bit of a feel as to how we see the way the two majors have operated through our port in the last couple of years - that is table 2.1 - where we have had basically a constraint in the number of seats provided and an increase in load factors and obviously related to yield. I think Gold

Coast is one of those airports where there is actually a supply constraint. We do have quite considerable capacity in the destination to absorb large numbers of visitors, apart from three or four peak times of the year. So in the long run we are reasonably confident. The big question, of course, is whether - as is happening now - most of that increased traffic to the Gold Coast comes through Brisbane, or comes through our airport, and I'll touch on that a little bit later.

I mentioned we are subject to the CPI-X. We have an X of 4.5 which is right up there with the big boys. In preparing our submission - and some time ago foreshadowing a need to prepare a submission of this type - we did endeavour to seek some information on why or how those Xs were calculated and that information wasn't forthcoming. We've been looking at maybe using freedom of information to get that, but this opportunity to present our case has come up before we could go through those machinations so we have to live without it.

Our charges have come down in line with that CPI-X over the last few years. Together with the reduction in landed tonnes our revenue has decreased as well - our aeronautical revenue. We have significantly improved our profitability, but at this stage it has been very largely based on reducing costs. We've virtually got to the stage where we can not reduce costs, I don't think, any further to any significant extent, so obviously we have to increase our revenue. As I think has been alluded to before, there are a number of non-airport landing charges that are imposed on users of our airport who aren't subject to regulation. The one that causes us the most angst of course is Airservices Australia charges, and we have the not enviable reputation or position of being the highest charged air traffic control facility in Australia. We also are trying to seek advice from Airservices as to why that is and how they structure their accounts, so that that should be the case.

Our estimates are that they would get some 9.3 million in landing charges a year, ex-GST, versus our 2 million - sorry, 4 million. Interestingly, 100 kilometres or less north of Brisbane there is an airport that is not too dissimilar from ours in Maroochydore, or Sunshine Coast, where the total revenue, I would estimate, is somewhere around about 900,000. For the life of me I can't see why two airports in such similar environments are up there with a factor of eight to 10 in differential in those charges.

The APS charges: also that's a charge imposed on us that we have to recover from the airlines. Those charges continually seem to just creep up as well. Any savings that we've made are alone pretty well eaten up by the increase in charges of those. Our charges are not overly significant.

The issue of market power: we would argue very strongly that we have very little, if any, market power; (1) basically from the size of our operation - I mean, we have two and a half per cent roughly of the national market; we're a company of 30 people with a turnover of about $12 million a year. We're not in the big league of anything by any stretch of the imagination.

The airlines really have, I would think, significantly more scope to manipulate the traffic through our airport than we have. Their assets, I think - as has been alluded to before - are very mobile and they rightly move those where they make the most money. We have no problem with that. What we have to do is ensure that we do things that are relevant to keeping them there.

Competition can come in several ways for a leisure destination such as ours. I mean, we are probably the most popular tourism destination in Australia, but the tourism market is reasonably fickle. I think Gold Coast is seen as a bit passe in the last five or six years. We're working very hard as a region to change that perception and make ourselves more relevant to current requirements.

South-east Queensland and northern New South Wales, I think, are a very good example of where airports of various types do compete. I think that competition has been increased since the dispersal of the FAC network. I might just review very briefly a couple of Web pages that might be useful to just include in the transcript, if you like, Commissioners. I might just briefly read one or two extracts from them. I have an extract from the Tourism Queensland website for regional towns in Queensland.

Under the Gold Coast region they have a number of the towns within the Gold Coast city: Coolangatta I just picked out because that happens to be where the airport is located - and they give data on that and look at the facilities that are there. We have, "Air - Coolangatta and Brisbane airports." That's specifically looking at the southern end of the Gold Coast, the furthermost distance away from Brisbane Airport. Tourism Queensland, "Airtrain express" - that is the new facility that will start operating from Brisbane Airport to Brisbane city and Gold Coast next month:

> Airtrain supporting tourism in Queensland. Airtrain recognises the vital importance of tourism through its membership and support of associations such as Brisbane marketing and Gold Coast Tourism Bureau. The future is bright for Brisbane Airport. From 7 May Airtrain Services will provide yet another enhancement to Brisbane Airport's status as a hub airport and gateway to both Queensland and Australia.

There is a very pervasive argument put by many people that they service the Gold Coast out of Brisbane and that's from all parts of the industry. The Gold Coast Tourism Bureau - of which I'm a board member - their own Web page referring to the Gold Coast generally, some characteristics of it - air:

> For domestic arrivals there are two ports of entry, Coolangatta Airport and Brisbane Domestic Airport.

Qantas Web page, travel tips for the Gold Coast:

> The Gold Coast can be accessed via both Brisbane and Coolangatta Airports.

Clearly, competition is alive and well in south-east Queensland. In the broader transportation sense we do have to compete against other modes and I made the point that Queensland Rail finishes 15 minutes north of us, the New South Wales XPT system finishes 20 minutes south of us. Those other modes are very effective. The competition, I think, and the substitution effects we have addressed there. In some ways that's reflected in what I had mentioned a moment ago. I think also it's interesting - referring to probably the same set of stats that Virgin referred to, and that's the Department of Transport and Regional Services graphs which I've included in attachment 1 there - I think it's about the clearest illustration you could get of the impact of the new entrants on the various routes. If you look at Coolangatta-Sydney, again it reflects very clearly the leakage that we're currently getting to Brisbane.

We have some fairly big competitors. Again, quoting from a brochure from Airtrain:

> Airtrain links us to Brisbane Airport. Airtrain, a convenient new rail service linking Brisbane Airport with the Gold Coast, will commence services on May 7th. Direct Airtrain services between Brisbane Airport's international and domestic terminals will run approximately twice an hour in both directions. Airtrain is promising that its services, which are partly subsidised by the Queensland state government, will be affordable, fast, reliable and punctual. Initial fares from Brisbane Airport to the Gold Coast have been set at $17.70.

So we are fighting the Queensland Government as well. Again, I think competition is alive and well in southern Queensland. It's interesting in figure 5.1 where we have shown the impact on the numbers of cars using the carpark, or the change. You can very clearly see there the change that has occurred from the start of the competition in Brisbane. What was interesting was that we actually lost a lot of our outbound market. Anecdotally and from talking with businesses what we found was that a lot of small businesses - particularly from northern New South Wales, not the large corporates but those people who pay for their own fares - were actually going up to Brisbane where they could get a walk-up fare of about $170 one way to Sydney versus 350 for the equivalent fare through Gold Coast and that really hurt us in a big way in terms of the nonaviation-type activities.

Talking to cab drivers on the Gold Coast - I remember I had two in one particular night that had both driven people to Brisbane for $125 fares to get on a cheap airfare. I mean, that's the intensity of the competition that we were facing. But, as I say, that has changed a bit because the airlines have now responded and certainly the changes in the scope of fares - you look at what they're advertising now - anything we did to try and manipulate price could have no effect in any way approaching the effect of having competition up the road. We're not really complaining about competition; basically we're making the point that there is competition there and, I suppose, trying to get away from this premise that all airports are natural monopolies and we would argue very strongly that that's not the case on our part and maybe Brisbane would argue the other way, but I don't see on any of the Brisbane tourism brochures that Gold Coast Airport is a gateway to Brisbane.

In looking at the beneficiaries of airport price regulation, we've dropped our costs - the cost savings of approximately $280,000 a year to the airlines through the CPI-X formula application, but there's no indication that that has resulted in any reduced fares. In fact, I think the standard economy and business fares have actually gone up. We recognise that we're a low-yield port and as a business, if we're to be successful, we have to be value for money, a very cost-effective operation. We've worked with the airlines to try and improve their profitability out of the airport and I've quoted several examples there and probably the best example is the work we've been doing with Freedom Air, who are a no-frills operator doing trans-Tasman routes to central North Island of New Zealand who are owned by Air New Zealand, and we've invested in a new terminal facility which has enabled us to get customs permanently on the Gold Coast; that has created significant savings for them.

We've worked very hard with them in marketing our destination in their catchment areas and similarly, we've worked with the tourism authorities on the other side of the Tasman to get services going the other way. Since July last year, since we opened that new facility, we've actually increased traffic by some 80 per cent on those routes and looking at our last cooperative marketing program, about two weeks ago I think, on the first weekend we sold some 1500 seats, so this partnership thing that Virgin alluded to, I think is extremely important. We've also, in the case of Freedom, negotiated with both Australian Protective Services and the security contractors to create significant cost savings for them in terms of security screening. Currently, we're negotiating with Qantas and Ansett to scale down significantly the developments that they were obliged to undertake when we assumed control of the airport, with a view again to not just reducing their capital expenditure, but to coming up with a common use of facilities to significantly reduce their operating costs.

They're finding it a bit hard to come to grips with the fact that an airport is trying to help them, but I think we're getting there. Just touching on investment in airport facilities, I find it hard to reconcile the concerns that airlines have that privatised airports are going to go out and spend a bundle on Taj Mahals. I mean, our view is that we have to work our assets just as hard as the airlines do and certainly speaking for my board, we have to justify to them and to our shareholders any expenditure; it has to be a good commercial proposition. Architectural showpieces are not high on the categories by which we judge an investment. The commercial discipline that we're under, I think limits the propensity for us to want to go spending money unwisely.

That having been said, we did spend about one and a half million on a small international terminal last year for Freedom, with the consequence that we did get permanent customs facilities there and subsequently a very significant cost reduction for their operations. It also has given us a common user capability that we didn't have when we purchased the airport because the major terminal was leased for many years to both Qantas and Ansett, so there was no room to accommodate independent operators there. Interestingly, we have prepared a submission to the ACCC to justify the cost. We virtually had to build this thing on spec and we're now trying to get the approval through the ACCC for the charges for that and we've spent something like $35,000 on consulting fees so far; we're much too small to have that sort of expertise in-house, as a larger airport might have.

It's interesting to look at that case, because what we inherited for an international terminal when we took over the airport was a tent. That tent has been there for four years and the rack rate set by the FAC for turnaround in that tent was $1200 a turnaround. We, in this new facility - even though we haven't as yet had the prices approved, so effectively we're still working on the old regime - have actually reduced that to $600 rack rate and of course there are other incentives that you tend to negotiate on new route development, so we're spending $35,000 to justify reducing the rack rate from $1200 to some $600 which seems to me to be a pretty interesting concept. The main terminal itself, we inherited proposals approved by the Federal Airports Corporation and then locked into the domestic terminal leases which had the effect of triggering the option for Qantas and Ansett to get their extra 10 years to extend their leases from 2008 to 2018.

The proposals involved their doing significant upgrades to their terminal facilities and I would estimate it somewhere in the region of some $30 million between the two of them, which the airport then had to commit some $6 million in associated infrastructure and that was effectively locked in contractually. The terminal has had little work done to it in the last 20 years and those of you who have used the terminal recently can easily see that it's very tired, so the level of service is very ordinary. The airlines have been procrastinating on spending any money on it. They've taken the benefits of the extended lease, but now when it comes to delivering, we're finding it very hard to get them to do it. In the interests of not overcapitalising, we have offered to allocate the funds, the $6 million that would have been used for infrastructure, for actually upgrading and better utilising the existing facilities there and creating a common-user facility, as I mentioned before, which would reduce their operating costs as well.

We've done that recognising that we have to really sharpen our pencil if we're going to keep them there and make it worthwhile their being there and so that's not just a case with the new entrants, it's also looking after the ones that are there already. Maybe just in concluding, I might just relate that I've been in the airport management area for some 20 years now, but except for the last 18 months, outside of both the FAC regime and this type of regulatory regime and I thought maybe it's just useful to recount some of the experiences at some of the airports that haven't been subject to that regime. Obviously I can't purport to be speaking any longer for those airports. I'm just recounting my experience when I was there. Probably the one that is most relevant is Cairns, because I understand there was some reference to that yesterday.

I was with the Cairns Port Authority when we took over Cairns in 1981 and I was the inaugural general manager of that airport and for the first nine years of its operation, which was a time of some considerable growth. The first stage of development - I think things were a little different in those days, when the government was trying to give away airports under the Local Ownership Scheme - the Port Authority was given that airport free of charge with a carrot that probably in today's dollars was about $80 million to upgrade that facility, so that involved construction of a new terminal with a small international facility within it and some runway extensions and we were very proactive in terms of - - -

PROF SNAPE: Did you say 80 or 18?

MR CHANT: 80. In 1991 dollars it was something around $26 million, so I think it would be up around 80 million in today's dollars; a considerable amount of money, a lot different from the 103 million we actually paid for Coolangatta. We worked very closely with the tourism authorities and the airlines to promote Cairns and I think that was a good investment for the Government. Cairns traffic grew from just over 300,000 to about a million in the time I was there and continued to grow significantly after I left. I think probably what is more relevant to this is the case of where we got to a stage that the first terminal we built was just rapidly becoming too small, particularly in the international area, and so we had negotiations with our major international carrier at the time, Qantas, to look at options for how we proceeded to get out of the bind and the constraints that we were in.

We developed and costed a number of development scenarios, one of which was to do some modest expansion of the current terminal and another option at the other end was a totally new terminal facility altogether. These options were costed, various charging regimes were developed; this ran in parallel with a runway extension and I think in those dollars the terminal building, the new facility, was about a 30 million investment, whereas it would have been about 6 or 7 million for the domestic terminal expansion and certainly we, at the Authority, were very much in favour of the smaller option, but we were encouraged by Qantas, that before that was built it would be too small and that we really should be going for the major facility, so two consenting adults signed up to a partnership and that terminal was constructed.

The two domestic airlines at the time said, "We want nothing to do with this. We won't use the extended runway." Their charges were left exactly how they were, which seems to be different from what the airline lobby group was saying yesterday about the genesis of the new airport terminal in Cairns now. I can't speak for the subsequent expansion to that in the mid-90s, but certainly the case to go to the new terminal was very much driven by Qantas and there would still be people working within Qantas and there would be files that show quite clearly that that was the process that was gone through at that particular stage. I think it's quite intuitive to look at what's happening in Cairns now, where that major development that was driven initially by the airlines is now regarded by some of those same airlines as a bit of a white elephant, as airlines are pulling out there and they're suffering the same problem as we are to a certain extent, that a full-service airline finds it difficult to make money on a tourism route, and strategically we recognise that ourselves and we are really, I suppose, gearing ourselves up to be very much a value-for-money airport.

The last thing we want to do is increase charges. We want to make more money, but we've got to do that through traffic growth and that's not just in aeronautical revenue, it's in non-aeronautical revenue as well, so we would argue that really an airport such as ours should really be left free to work with our partners to grow business for both of us, to give our customers direct services. We're focusing very heavily at the moment on the New Zealand market, and I've found a survey that was conducted by the FAC of passengers from New Zealand to various Australian ports when they were looking at trying to synthesise the impact of closer economic relationships on the air market across the Tasman. Surveys that were taken at Brisbane Airport would indicate that 70 per cent of the people that flew into Brisbane Airport would prefer to fly direct to the Gold Coast.

PROF SNAPE: That is from New Zealand

MR CHANT: Two months ago we had a series of supplementary flights in from New Caledonia. Again, they normally would have flown into Brisbane. It's a very peaking market, New Caledonia. It's up like that in January and February and then it bubbles along at a lower rate for the rest of the year. Surveys that we took of those people indicated that some 70 per cent of those people preferred to fly directly into the Gold Coast. The market wants to come there. It's just that it doesn't overly suit the airline networks to fly there.

Looking at another smaller airport that I set up a business for was Newcastle Airport. That was taken over by Port Stephens and Newcastle city councils. That was a small airport of 50,000 passengers per year. In fact, it was 26 hectares appended to the Williamtown RAAF base. We developed a strategy after talking to the local businesses on what services they wanted. They wanted direct flights to Brisbane and Melbourne. It was almost impossible to even talk to the two majors about that. Their focus was bringing everybody through Sydney. In fact, Eastern, a subsidiary of Qantas, had one daily flight to Brisbane and they cut that out and everything was going through Sydney.

Sydney in the mid-90s was a terrible place to get in and out of, people were missing their connections, so we worked very cooperatively with Impulse Airlines.

It was then a regional carrier in those days, and really developed Melbourne-Newcastle-Brisbane as a route. Newcastle then became the fastest-growing airport in Australia for a number of years. Now you see jet equipment on that. That was a route that was pioneered by thinking outside the square and working together in partnership. We would quote Freedom Air on the Gold Coast as another example of working in partnership. In none of those cases have we needed a regulatory regime to impose its will on us.

Thinking back, in nearly 20 years of dealing with airlines outside the regime, I've spent more money on consultants in trying to justify a price decrease on one project than I have in legal disputes with airlines. Hopefully that might put the regime in some sort of perspective about the benefits, or disbenefits. Certainly we find it a very significant impost, out of all proportion to the benefit to any of the users. We don't just have price regulation; we have fairly stringent development regulations, the MDP process, and all of these things require an extraordinary amount of effort. We pay the Commonwealth to have a full-time building regulator and a full-time environmental regulator on the airport.

It was interesting talking to somebody from the Department of Transport once who made the observation that, "Yes, well, we know that you're under a fairly tight regime because of the privatised airports but, you know, this bill went to the Senate and what came out was very different from what went in", and I would tend to think that the pricing regime reflects that a little bit as well. Certainly the way that it's been interpreted in the 18 months that I've been involved in a regulated airport is a lot different from what my understanding was of the light-handed regulation that was proposed during the sale of the airports. So, Commissioners, I'm happy to take any questions.

PROF SNAPE: Thank you very much for that. That's very interesting. You also have a curfew. Did that push your aircraft movements down when that was introduced? It was introduced, as I recall, in the middle of the sale process.

MR CHANT: Yes. There was a voluntary curfew on the airport and that was acknowledged at the time of going through the due diligence. But some time after the due diligence was completed but before the sale was finalised through some local political pressure, I'd be bold enough to say, it was foreshadowed that there would be an administrative curfew imposed on the airport, even though the literature said that it was a curfew-free airport. Obviously you're not going to revise your bid two days before the sale is about to be finalised. In the event, it was then endorsed as a regulatory curfew, and I might add it's the most restrictive curfew in Australia.

I wouldn't say that it has caused us a lot of problems, but Virgin - Brett Godfrey was quoted at a function on the Gold Coast as saying that, because the curfew is in Queensland time and most of our links are with Sydney, it means effectively on New South Wales time that aircraft can't get off the ground until 7 o'clock in the morning. That does keep the aircraft out of the system. According to the way Godfrey was quoted, it meant if they were going to use this slot to service the Gold Coast, they would have missed their slot in Sydney. It is hard, and talking to the new entrants that differential is a problem during daylight-saving time.

PROF SNAPE: One of the relevant factors in competition, I guess, is what you mentioned at the beginning - that Ansett and Qantas have now decreased their prices, not because Virgin is flying or Impulse is flying into Coolangatta, but because they're flying cheaply into Brisbane. So that price decrease into Brisbane has now affected the price into Coolangatta.

MR CHANT: Exactly, yes.

PROF SNAPE: Which suggests something about competition. Have they put on any extra capacity with the cheaper flights?

MR CHANT: No.

PROF SNAPE: If they're operating at 85 per cent capacity already, as you say in 2.1 - - -

MR CHANT: The 85 per cent was prior to these fares coming on. Without giving away any secrets, just from travelling on the aircraft out of there, I know it would be much higher now. Certainly well into the 90s.

PROF SNAPE: Even 85 is a pretty high load factor.

MR CHANT: Yes, and that's traditionally our average. One of the things we've been talking about for some time is how they allocate the cost of their frequent flyer recoveries. I understand they are looking at that to a certain extent. It might make us look a little more favourable in terms of yield. Obviously we are a very attractive destination for a lot of their frequent flyers in terms of redeeming their points, so to that extent we are a very important port for them.

PROF SNAPE: On the other hand, if they've got frequent flyers, they're going to fly somewhere. It would not seem appropriate to charge all that no-revenue traffic against that route because if they weren't on that route they'd be on another route.

MR CHANT: That's right. You have to redeem those somewhere. I think some of the airlines in the US are looking at how they allocate those points. One of them did allocate the costs to the routes on which they were earned and that apparently had some quite interesting results for route economics.

PROF SNAPE: In your table on your revenue you've got your aeronautical revenue in there but you don't have your non-aeronautical revenue. This is table 3.2. As you point out there, your aeronautical revenue has been decreasing in the last couple of financial years. What has been happening to your non-aeronautical revenue?

MR CHANT: Except for the last few months where we've taken a big hit in terms of the rental car revenues and the carparking revenue, it's been holding up reasonably well. We've invested a fair bit of money in creating undercover carparking. Most of our longer-term carparking before was done off-airport, where there are a number of operators who have undercover facilities who bus people on and off the airport. We built 250-odd undercover carparks adjacent to the terminal and locked them, so they were secure. The old ad that used to be on the television locally, when we inherited from the FAC, the long-term carpark was lines painted on the lawn and beyond the sealed carpark. The local undercover carpark operators were saying, "This is a security risk and you can lock it up."

We invested quite a bit of money in that, and that increased our yield fairly significantly. The return on the carpark has actually increased. It's not as bad as the numbers of cars. Where our airport is located is very desirable from a property perspective, so we're taking advantage of being right beside the Pacific Highway to develop a number of properties which are, you could say, almost totally independent of anything to do with the airport. It's more a commercial venture. It's a risk venture by us. I suppose if you were looking at it as a true single-till situation, we would be reluctant to get involved in that sort of venture if we had to share that with the airlines who are not sharing any of the risk.

PROF SNAPE: In fact, as you described it, its locational advantage is that it's on the highway, rather than being adjacent to the airport.

MR CHANT: Exactly, yes.

PROF SNAPE: What is your split between aeronautical and non-aeronautical revenue?

MR CHANT: Depending on what you'd class as aeronautical and non-aeronautical, if you throw in the airline terminal rentals - which are the long-term rents - it's probably about 60:40.

PROF SNAPE: 60 which side?

MR CHANT: 60 aeronautical and 40 per cent non-aeronautical.

PROF SNAPE: That's quite a low non-aeronautical percentage.

MR CHANT: At this stage. But then if you threw the terminal rent in as non-aeronautical, it skews it around. Certainly it's nowhere near the potential it has to improve. One of the problems we have - and several other airports have it - is that as part of the domestic terminal leases we don't operate the concessions within the airport. They're operated jointly by Qantas and Ansett. We get a fixed rental for the right for them to trade there, but we don't get any of the upside.

PROF SNAPE: It's mixed into the rental itself, which is a long-term negotiated one.

MR CHANT: Yes.

PROF SNAPE: You've got a very interesting sentence in there, quoting a Qantas person, saying that generally these long-term rentals have been regarded as a bit of a burden by airports but in your case you're thinking it's actually locked the airline in to staying at Coolangatta.

MR CHANT: Yes. That was an interesting observation made by a person who was trying to negotiate a position. That does hang over our head. The substitution effect is real there. The fact that they are locked into a long-term lease is some comfort for us, but it lessens our [indistinct], if you like. The question is, if they don't do the terminal upgrades that they're supposed to do in accordance with the lease and they're in breach of the lease, what sanctions are available to us? This person who made that statement was very much trying to get across that message.

It's interesting talking to the airlines. You talk to the people on one floor and you get one perspective; you talk to the people on another floor and you get a different perspective. It all depends on what their particular intention is at the time.

PROF SNAPE: Would you regard withdrawal by Qantas or Ansett from Coolangatta as a credible threat?

MR CHANT: I don't think so. Talking to some other people within the airlines, they see it as a strategic base for them. But it's a threat, coming from a senior person like that, not said apparently in jest, that we would have to take seriously. We have a very big exposure to that asset there and when a major customer makes statements like that, and when you know that it conceivably could happen - - -

PROF SNAPE: The gap wouldn't be filled immediately by someone else?

MR CHANT: There really is nothing, the way the things are structured at the moment, for them to keep paying us their rent on that facility, even if they're not flying any aircraft in there, and they could play spoiling tactics and keep the facility and pay - you know, it costs one and a half or 2 million a year and rent is probably small beer if it can keep out a competitor. That's why we've really had to invest to give us some flexibility.

PROF SNAPE: Yes, but you've got another terminal now that you can use.

MR CHANT: Yes, but I mean that can handle one aircraft at a time, it can't handle the sort of numbers that you can handle through the major terminal. So, yes, there are some interesting games that can be played there, but that's where I think we -

I think they're starting to understand that we have the best interests of both them and ourselves at heart in terms of trying to look at alternatives and come up with solutions that can help them make some money, and we don't need a regulatory regime to tell us that that's what we need to do to make our business successful. I would prefer to spend $35,000, rather than on a consultant to do a bid to the ACCC, to working on marketing with those airlines in other destinations.

PROF SNAPE: You do say the regulatory regime does give some degree of certainty in the establishment of aeronautical charges, so you get a bit of comfort out of it.

MR CHANT: Well, yes, that's a proposition that has been put to us and there is - and I think somebody else quoted - it might have been Ian Keene from Darwin who quoted the instance of the Australian Protective Services charges where the only real way that they were able to be enforced was that it did go through the ACCC, but it was actually an increase because there was a direct pass-on from those, and so that gave us that level of comfort, that we could recover that. That having been said, one of the airlines refused to pay it for some six months - just refused to pay it - even with the endorsement of the regulator.

So I suppose for a small airport - and probably Darwin and ourselves may be a little bit vulnerable to big customers like that - if we felt we were going to be exposed, there is some level of comfort - and I know some of the UK operators see that there is some level of comfort in that that actually gets endorsed by somebody, you know, if it's necessary new investment or whatever; there is a mechanism in place. However, I see the costs to us as a small airport of being in that regime nowhere near giving us the benefits that that somewhat nebulous assurance might give us. I would prefer to deal with them in the market scenario.

DR BYRON: I don't think I actually have anything else.

PROF SNAPE: The ASA charges, why are they so high for you?

MR CHANT: I would like to be able to answer that question, and when we can get information from Airservices - we have indicated our willingness to sign their confidentiality agreement - we might be able to understand a little more why it is so high. As I say, you know, the fact that it's a factor of seven or eight times more than Maroochydore, which is 100 miles north - and we're 100 miles south of Brisbane - would seem to indicate that there's - I mean, I know there is some subsidy for Maroochydore, but it's a bit of a mystery to us when we've actually done an exercise that would indicate that those costs should be significantly less, but until we can actually get the information from Airservices, we really can't - I mean, there is some indication that they're moving towards competition, but whether or not that happens - I mean, that's again in the hands of the Senate.

So we are left in this hiatus - that they've gone to site-specific charging, but is the Government getting cold feet now on going the rest of the way, which is actually to go to competition of those services? The various vested interest groups have done a pretty good job in lobbying the Senate. What we're worried about is if this hiatus remains where it is. At least if it's under our control we might be able to do something about it, but where it is now at the moment, where there's no transparency whatsoever, it's very hard, and that's a big impost when we're negotiating with carriers of the type that we are, and when you start off with that cost disadvantage over Brisbane, with Freedom and Virgin and Impulse.

DR BYRON: But that dwarfs the charges that you - or any concessions to charges, landing fees, that you might make that are under your control.

MR CHANT: Yes - yes, exactly. I mean, we take a holistic view when we're talking with the Freedoms of the world. We do look at what the spin-offs are going to be in terms of non-aviation revenue, and to be as sharp as possible we have to take those into account in making these investments. But then you look at what Airservices do to us - I mean, we have to be extra sharp, then, to match up to our big brother up the road.

DR BYRON: The revenue from the international services that you have approximate what you get from the domestic flights? Without wanting to reveal too many secrets, is it - - -

MR CHANT: It's a bit hard to compare apples with apples there. We have adopted a policy basically where there are common facilities used, such as the movement areas, that those charges - whether they're the incumbent carriers or new entrants - those are the same, and we would just get into too many arguments. Where we are using totally different facilities, where we have different cost structures and where we're able to differentiate those prices - but with the current fairly low frequency of service that we have there at the moment - I mean, we are only looking at four services a week, and we do have Impulse regional services operating through there - I think they wouldn't be too different, you know, from - - -

DR BYRON: Do you have any other Freedom Airs around?

MR CHANT: Sorry?

DR BYRON: Are there many other airlines around like Freedom?

MR CHANT: No, Freedom is a pretty rare bird - until Virgin and Impulse came along. In fact, they were created by Air New Zealand to combat Kiwi Airlines, and they have managed to maintain that niche market and develop that niche market, and we see very much that that's the type of carrier that we need to service our market, and they can make money out of the $400 fares across the Tasman, whereas it would be arguable if one of the major operators, with their full service requirements, could make money at that level of charges.

DR BYRON: You talk about the Gold Coast as a tourism destination. It makes me wonder if, you know, from a Melbourne perspective - your competitors are probably Vanuatu or Nandi or Bali or somewhere like that.

MR CHANT: I think again the Freedom one is a very good example of where we captured two extra flights last year purely because of the problems in Fiji. So we're working very hard to ensure that this year we keep those services, and we actually fill the aircraft, and we've been successful in doing that.

PROF SNAPE: You mean you've got people in Fiji?

DR BYRON: The Solomon Islands, Bougainville?

PROF SNAPE: With the strategies we've heard described, that wouldn't surprise us. Now, I think that I am through with mine, too, so thank you very much, Mr Chant, for the very interesting account of the Gold Coast, and also your comments on Cairns and Newcastle were very helpful, too.

MR CHANT: Good. Thank you.

PROF SNAPE: We will now move from Queensland to Western Australia, and the Western Australian Government will be with us.

PROF SNAPE: Okay, let's resume with the Western Australian government making their submission. We welcome the representative and in the usual way ask him to identify himself, his position, and then speak to the submission.

MR BELYEA: Thank you, Professor Snape and Dr Byron. My name is Nick Belyea. I'm the director of aviation policy with the Department of Transport of the Western Australian government. We do appreciate the opportunity to support our submission. We think it's very important that the government did make a submission that - if you've read it, you'll see it's not just confined to Perth Airport. It also looks at Jandakot Airport, which is the major general aviation airport in Perth, and indeed we talk about regional airports, including Broome in the north-west of the state. But I'll go through this as per our submission and start with Perth Airport.

Perth Airport, to the state government, is probably the most important piece of transport infrastructure in Western Australia, responsible for our international and domestic flights. We take a very keen interest in its operations. As is indicated in our submission, we have recently, prior to the change of government, signed a memorandum of understanding with Westralia Airports Corporation in how they develop their land and how they handle environmental issues on the airport. That was driven primarily because they are not subject to state law, they are under Commonwealth law. So that was a very good exercise and we'll be doing something similar at Jandakot.

We do work closely with Westralia Airports Corporation for tourism development. The airport is very important in the state for economic growth, supports arrivals for our vast mineral resources in the north of the state, so we take the operation of Perth Airport most seriously.

It is important to the state that the airport has good business relations with its key aeronautical stakeholders. In our view the current process for identifying and implementing necessary new infrastructure is not working. I have been an interested person in a few of the meetings between the airport and its stakeholders when they have talked about airside infrastructure and various other things, and have seen first-hand that impasses really don't get past those meetings where there's a reluctance by the airlines to support what they want to do, and certainly a reluctance in terms of their return on investment. But I won't go into a lot of detail on that.

I guess our view is that Perth Airport is almost like a small city in itself. The airport has a responsibility to upgrade its infrastructure, whether it be runways, taxiways, aprons, for the whole airport, covering not just the international area or the domestic area but covering general aviation and other areas of the airport. It's akin to a small town, I suppose. You just can't upgrade a street in one area and not do it in the other, for the benefit of one group and not over the other.

We are a supporter of CPI-X being done away with, but we certainly have a desire to see the airport stay competitive, where they are able to attract business, and indeed they work as hard as they can to keep their prices down so they do attract customers and particularly airlines to the state.

We are supporters of looking at some form of benchmarking and a process - this is in terms of the base aeronautical charges - and a process whereby the charges reflect productivity gains and other improvements. Now, I know they have been able to do that in their first years of operation, and I guess they would say that there will come a point where they may not be able to make those improvements each year. But that is something that we see as most important; that the airport is compared with others. Although the airport is one of the cheapest in terms of landing charges, it's important to us that they do focus on that. So as I said, it's very important in that regard.

There needs to be a better process, from the government's perspective, on how they handle necessary new infrastructure. I think the consultative process that works, where they all get around the table and discuss it, is okay, but blockages do occur at meetings and there are disagreements at those meetings and really they don't advance - and I guess the inquiry would have heard about the O6/24 runway experience in Perth, where it just reached a stalemate, which ultimately found its way to the ACCC and a decision was made I guess largely in favour of the airlines.

But that in itself was a very lengthy process which - the runway was basically limited only up to I think A320 aircraft. Anything bigger had to use the main runway, unless the captain elected to - or decided that he needed to use that runway because of the weather conditions. But Perth is an airport that is subject to what we all commonly refer to as the Fremantle doctor. That can intensify, depending on how strong it is. We were concerned that we may have a safety situation. But at the end of the day we wanted to see a situation where the airport could use all its facilities productively. We were most concerned that the airport and its customers weren't getting on to a point where they could reach agreement.

In terms of necessary new infrastructure, a proposal we have put in there is that we would like to see a percentage being added to the aeronautical charge to cover agreed necessary new infrastructure. That would work by way of the airport sitting down with its stakeholders and outlining what it needed, say, over a five-year period in terms of infrastructure and saying how much they needed to charge over that period of time. That could be identified as a percentage. But the emphasis would be on them to try and do that productively as they could, and any savings would be offset against future charges.

We are particularly concerned with this because in the master plan for the airport, which admittedly goes out a long way - but sensitive points to the state government is we would ultimately like to see the integration of the domestic and international terminals into the middle of the airport. That is what the plan was even prior to the FAC coming into being - was that was where all the terminal development would go. Prior to the FAC, the domestic terminal leases were entered into, and those leases will be there until at least 2018.

PROF SNAPE: Prior to the FAC or prior to - - -

MR BELYEA: About two days prior to the FAC those leases were signed by the government.

PROF SNAPE: Prior to the FAC taking - - -

MR BELYEA: Taking over the airport. So it was back in about the end of 1987, I think it was.

PROF SNAPE: Okay.

MR BELYEA: So I know that the airport has approached both Qantas and Ansett. They haven't got too far, in terms of looking at that. But certainly the state government has identified that we see that as important, as we do a future parallel runway to the east of the existing international terminal building. So our view is that these two items could be looked at, where they could actually start accruing for the development of those facilities when they're needed. I'm not sure how that would actually happen in terms of who would have the dollars, but it would go into some form of trust.

We do support the twin till arrangements until it can be proven that single till is the best way to go for the airport. We are aware that the airport bid, on a twin-till approach - and unless this is causing major problems, we believe it should stay for a period of time. We do support the PSA, Prices Surveillance Authority, and the ACCC being the watchdogs. However, we would also like to see a speedy resolution to issues, particularly to those that could impact on the operational efficiency of the airport. In our view the situation with the O6/24 took just too long.

So, Professor Snape, in terms of Perth Airport, I might just read out our summary points. The point was made earlier - and I just haven't said it there - but market power in our view should be recognised as applying to airlines as well as the airport owners. I mean, Ansett and Qantas certainly have a big say, as they have a right to, in the operation and development of the airport. The new pricing regime should relax pricing restrictions to allow for greater flexibility in pricing decisions, while protecting the interests of airport users.

Stakeholders should agree upon future strategic airport infrastructure requirements and determine funding options that will allow the airport to properly plan and implement new infrastructure; that the ACCC continue its role of watchdog and arbiter, provided certain standards of timeliness and flexibility are met, particularly in regard to the speedy resolution of disputes, and that the double till regime should remain for the time being but be open to review in the future.

I might just move a little bit north now and talk about other airports in the state. It might be of interest to the inquiry about Broome Airport. Broome Airport was sold on a full tender basis by the Commonwealth in about 1991, to a company now known as Broome International Airport Holdings. As part of that sale process, the airport were allowed to collect - and still do collect - fees for a new airport. Part of my role was to be the chairman of selecting a new site for that airport, which we have done. That airport is expected to cost at least $40 million. But that accrual of funds to develop a new airport has been going on since the new owners took over.

The airport is a contributor to tourism and currently underwrite an international service to Bali, which they do with Ansett. They actively try to support smaller services to Broome. Our understanding is that the airport consults with its customers on infrastructure and other charges. But that is probably the most important airport to the state, outside of Perth. It is the northern gateway to Western Australia. That airport is particularly active in trying to develop its business. But there has been a decision taken where they will shift the airport out to a new site. Those that have been to Broome would probably regret seeing that, because the aircraft just go straight over the theatre and you can just about touch its wheels. But it is inhibiting the development of Broome and will shift.

Regional airports - when Dennis spoke earlier he did touch on the airport local ownership plan, which was a Commonwealth initiative where a lot of the regional airports were handed over to local government. We are concerned that some airports - and I don't wish to name airports - are using their monopoly position to maintain and increase charges. We are aware, certainly from the airlines and other sectors of the industry, there is little consultation when this takes place. We do have examples in Western Australia where infrastructure and key infrastructure has gone in ahead of time, as to when it was needed.

An area of concern to us - as has been shown in other parts of Australia - is that airport revenue is being used to fund non-airport related plant and infrastructure. To this end, Professor Snape, the West Australian government will be undertaking an inquiry this year, to look at local government airports in Western Australia and to review their charges and the way they apply their funds.

I might just say here that there is a scheme in Western Australia which the government has called the regional airport development scheme. It's a fund that has been going since 1994, in which the state government makes about $2 million a year available for various areas of the state, to help them upgrade their airports. That also applies to these airports that have been handed over under the ALOP scheme. But in recent years we are now asking for evidence of the airport reserve account, so that we're not just handing out funds to an airport that is probably better off than some of the smaller ones. So I guess the point we're making here is that we are concerned that market power from regional airports can apply equally as much as it can to major airports. So that's a point I wanted to make.

The last point I wanted to make was regarding Jandakot Airport. Jandakot was purchased from the Commonwealth for about $7.5 million. That figure in itself was a concern to the state government. We were aware that there were other airports similar to Jandakot that went for a few hundred thousand dollars. The view that we have is that the airport - they paid way too much for the airport. It has been expressed that we feel that there should have been a duty of care as to whether the Commonwealth should have in fact accepted those sort of dollars for an airport that never ever made a profit.

But subsequently their charges went up higher than any others, of similar airports in Australia, and subsequently their operations declined. Now, Jandakot Airport is an important airport to Western Australia. It's our major general aviation airport. We did look several years ago at trying to establish a second general aviation airport around the Perth metropolitan area, and it was dropped like a hot scone from the government because it was just too difficult. The NIMBY theory came in - not in my backyard. So we have an airport that we're working very hard to ensure the airport works in with the community, particularly on noise issues. Those who would be aware of these sort of airports - they can be far more annoying than major airports, particularly the circuit traffic and things like that.

The airport does support all forms of commercial operations, including operations such as the Royal Flying Doctor Service. So it is an important airport to us. But we were concerned, when the airport was sold, that the ACCC virtually said they had no interest in Jandakot Airport. The state certainly has an interest. As Dennis mentioned earlier, the airport also - operators at the airport have to pay Air Services Australia charges. We haven't been able to find out exactly the basis for that, but Air Services Australia will say that Jandakot is subsidised by other airports or other operations in Australia.

I guess, in summary with Jandakot, we support deregulation for Jandakot, as we do for Perth and regional airports. But importantly to us, we would like to see the inquiry consider some form of benchmarking be adopted for airports, and importantly that the industry and airports for that matter would be able to have avenues of appeal that's available to all players. Thank you.

PROF SNAPE: Thanks very much, Mr Belyea. It's very good of you to be taking us around the regional ones, as well as the Perth Airport. The regional airports, apart from Broome, are they predominantly owned by local councils?

MR BELYEA: Yes, virtually all of them.

PROF SNAPE: So one might expect local councils to be trying to attract traffic.

MR BELYEA: Probably not as actively as you would think. Western Australia has changed dramatically since the early 90s. I mean, many ports that receive jet services are now - some have lost jet services, like Derby. Kununurra had a daily jet service in the morning and again in the afternoon and now receive about three services a week, jet services. Places like Port Hedland are finding it very difficult to operate, to maintain their airport to a standard and to attract the traffic. Up till about a year or so ago, Port Hedland had both Ansett and Airlink going and now it's just Ansett.

PROF SNAPE: That's an international airport too, is it?

MR BELYEA: Yes, it's international standard. They used to have Merpati going in there but Merpati have pulled out. They just weren't getting enough traffic. So we are concerned and in fact we have got another inquiry going, starting shortly under this new government, is to look at air services in the north-west of Western Australia because some of them are under threat and the airlines aren't finding it easy. A concern for us is the fare battles that are going on over east, over here, could be impacting on the operations in Western Australia, so that is a concern to us.

PROF SNAPE: Generally the airport charges are fairly small beer in the total expenses of running of a ticket or running - - -

MR BELYEA: Yes.

PROF SNAPE: Are the airport charges of these regional airports being significant deterrents, having a significant effect on air transport?

MR BELYEA: I think the airlines go in there because they have to go in there. They have advised the government on a few occasions that they are concerned at the quantum of the charges, and although in most cases they're identified on the ticket, the airlines have to collect the charges and quite often seem to receive the criticism because it goes onto the price of the ticket. Importantly though, we think there could be better consultation with those airport operators to talk to the airlines before they consider putting up their charges.

PROF SNAPE: Demand would be pretty price inelastic into a lot of these regional airports, wouldn't it?

MR BELYEA: Yes.

PROF SNAPE: So it wouldn't really be affecting the amount of traffic very much.

MR BELYEA: No, I guess what they're concerned about, Professor Snape, like in the Port Hedland situation where they had two airlines going in there and now have got one.

PROF SNAPE: Was that in any sense related to the charges that the airport were putting - - -

MR BELYEA: In part it was. I guess they were forced to a situation where they had to sit down, particularly with Ansett, and work out the charge because Ansett were of the view that they would reduce services rather than pay the charge. But it's also fair to say that in the north-west of Western Australia, I mean, Ansett has major mining contracts. If you have those major mining contracts then you're going to be the dominant carrier; a bit like Mount Isa with whoever has the Mt Isa Mines contract would be the major carrier into Mount Isa, and I think they're still Ansett.

PROF SNAPE: Indeed they have an airbus there. They run up a 320 there actually.

MR BELYEA: Yes. It used to be a 737 or an F28 but now it's actually grown which is good to see.

PROF SNAPE: Your view is that it is actually the charges that are having a significant effect. It's not just a claim about whether it's to be the airports' dollar or the airlines' dollar, they are having in fact significant effects.

MR BELYEA: I don't know that I'd call it significant. They do have an effect and it is a cause of concern to the airlines and it is a cause of concern to us.

PROF SNAPE: The airlines of course are accused by the airports of saying it is of grave concern, but in fact the major airports would argue that the charges are such a trivial part of the whole thing that it's really not going to have any significant efficiency effect on who gets that dollar, but nevertheless if it's your dollar or my dollar we're going to squabble about it.

MR BELYEA: Yes. I think that's part of it. Probably a bit more squabbling needs to take place, I think, more consultation, but that's something that the government is going to look at. But as far as regional airports are concerned we thought we'd make that point to you because the charges for a lot of our regional airports, compared to the east coast, are significantly higher.

PROF SNAPE: The other question there of course is whether getting the regulator into this will in fact simply provide an avenue for gaming that it will in fact not help to solve, or shorten the dispute, but just give another avenue through which the dispute may be played.

MR BELYEA: True, could do. Yes, accept that.

PROF SNAPE: We released three draft reports last week - the Commission did - one was on telecoms, one was on price surveillance, the third one was on the access provisions. Part of the proposals on the access provisions and PSA were to introduce a monitoring of prices and conditions that should be a halfway house between regulating and not regulating or declaring. I wondered whether - it's rather early to ask for a reaction but on reflection you might have a look at that and see whether that would be the appropriate form of shadow regulation perhaps that you might endorse.

MR BELYEA: Yes. We have discussed that and that's probably - that's something that we'll be considering because they're not published, the charges, and that's something that we would certainly look at.

PROF SNAPE: Okay. Are the local governments required to report publicly on profits or losses earned on airports?

MR BELYEA: I'm not sure of the detail they go into but they have a section in their reports - under the Local Government Act they need to report on their airport operations. But I don't think it goes into enough detail in my view to be full disclosure.

PROF SNAPE: You don't have a collation of those, a time series of those?

MR BELYEA: No.

PROF SNAPE: You'll probably collate one as part of your review, I should imagine.

MR BELYEA: I'd say that will happen, yes.

PROF SNAPE: If it's a public document. While we're still in business we'd probably like to have a look at it - "in business" on this inquiry, I meant. Neil?

DR BYRON: Coming back to the regional airports and your comment that the ACCC didn't see any role for itself in Jandakot, does that reflect a view that it's only the phase 1 and phase 2 airports that have monopoly power and everybody else doesn't, or that they couldn't be bothered about the smaller ones exercising their monopoly powers?

MR BELYEA: Dr Byron, we took the view that they couldn't be bothered. In fairness though we're not aware of any of the operators writing to the Administrative Appeals Tribunal or the ACCC for that matter. In fairness to the airport they sat down with the operators and justified their prices. It was a concern to us under the previous FAC regime where charges were standard across the country at those size airports. At least they went through that process. There was a decline in movements and things like that. We were aware of several operators from the airport who were concerned because it's a domino effect on the general aviation airports. If a flying school closes down then it affects a maintenance organisation and various other things. But it does seem to have levelled out. We've said in our submission that the movements are coming back up again. But there are a few airports around Jandakot - one at Murray Field which is down near Mandurah which is actually owned by the aero club and is taking some traffic away, and again at Northern. Now, both of those airports, the state government has put money into under the scheme I mentioned in terms of infrastructure. I mean, we do have a good working relationship with Jandakot, but if we're looking at fairness across the industry then we think they should be considered and perhaps the ACCC needs to think, "Well, we might have a role at places like Jandakot as well.

DR BYRON: As I said this morning, or maybe yesterday, in New South Wales we've had evidence that the charges at some of the regional airports are 10, 12, 15 times what the same aircraft pays when it lands in Kingsford Smith, and everybody is concerned about Kingsford Smith abusing monopoly power but nobody seems to think that the regionals might also do a bit of the same and use that to cross-subsidise council swimming pools or anything else.

MR BELYEA: Yes, that's right. I guess that's the point I'm making. I think it was Wagga - I'm not absolutely sure - where I think the ACCC found that airport funds were used for a swimming pool or something like that and some of the regional airports in Western Australia, the charges are high compared to similar airports on the east coast. They're not subject to what Perth Airport are subject to, whereas Perth Airport contains its funds on the airport. We're aware - and we aren't able to prove it yet - that those funds are used elsewhere.

DR BYRON: We haven't mentioned Kalgoorlie this afternoon but I've heard - it may only be a rumour - that the flights from Adelaide, Kalgoorlie, Perth are going to be cut or stopped or something and that the only way to get to Kalgoorlie is going to be from Perth. That may well have the effect of sort of halving a number of flights in and out of Kalgoorlie. That seems to be yet another example of an airport being very vulnerable to changes in schedules, routes by the airlines which may be perfectly reasonable changes from the airlines' point of view but with significant consequences for the airports' revenue streams.

MR BELYEA: Sure. We were aware that Kalgoorlie - Qantas were providing a service Perth, Kalgoorlie, Adelaide and back again with a 146 - and Professor Snape asked me this earlier - but those flights are now only weekend flights, as we understand it. So the week days have been dropped. I'm not aware that they're going to totally take them out but that happened very suddenly. So you're right, Kalgoorlie have worked hard to develop their services. I mean, like other airports around the country they would like to see new operators coming to Kalgoorlie as well and Airlink to us. We're doing quite well into Kalgoorlie and we're providing competition with Ansett. But, yes, it is an indication where - I mean, they are an airport that has the benefit of at least a couple of carriers where Port Hedland has only got one airline going in and out. But, yes, we appreciate that the airports can be vulnerable as well, and they have spent significant dollars up there on infrastructure.

PROF SNAPE: Does the Western Australian government have power to have price control over regional airports?

MR BELYEA: It would happen under the Local Government Act or through the

Ministry of Fair Trading. The advice we've had is that it would be a difficult process and they haven't really considered it too deeply. But the review that we're undertaking we'll be doing with the Department of Local Government.

DR BYRON: I guess I was thinking along - slightly a different variation on that. If the federal regulatory regime was to change so that there was no airport specific regulation, that it was simply Trade Practices Act - Part IV, Part IIIA et cetera - does a state government have an option under fair trading and so on of bringing in a state based regulatory regime because - just to elaborate, from our point of view it may not make a great deal of sense to recommend removal of a national regulatory regime if one or more states were then going to introduce their own to simply replace it.

MR BELYEA: I guess they probably could. I haven't given it enough thought but I guess our view is that it's just something that this inquiry would need to consider the best way of doing. But it may be that we probably need to stay with the Trade Practices Act.

PROF SNAPE: Does the Western Australian government subsidise particular air services within Western Australia?

MR BELYEA: Yes. We subsidise - up until the end of this month - a service down to Busselton and Margaret River, but that was more of a developmental service.

PROF SNAPE: Margaret River? That doesn't sound very remote.

MR BELYEA: It's not remote, no. It was, as I said, a developmental service - hopefully it would stand on its own two feet - but it hasn't done as well as we had thought, so that will be terminated. But in the north of the state we subsidise between Broome and Fitzroy Crossing and Halls Creek. They're two remote community services. Broome to Derby is subsidised. That used to be a jet route. Derby was an airport that till the early 90s had about 15,000 passengers and now get about 6500 or 7000 passengers a year. We've also got a developmental subsidy going between Broome, Port Hedland, Karratha and Exmouth.

So the government does put funds into services, but it is becoming an increasing problem for us - to ensure that we get air services into areas in the north of the state. In fact we have an inquiry going on at the moment, looking at air service into the Gascoyne area, up around the Carnarvon, Exmouth area, which was also an area that had jet services but are now struggling to probably keep daily Fokker 50 type services.

PROF SNAPE: You would think I guess that it might be easier to sustain them now than in the past, with more efficient aircraft and a greater variety of aircraft that are around, but that's not the way it is.

MR BELYEA: No, and I think the other thing too is that airlines are in a very competitive situation at the moment. As I said earlier, we're concerned that the struggles that are going on over here may impact on Western Australia. I mean, neither Virgin nor Impulse, despite having spoken to us, in the short term would be looking at Western Australia.

PROF SNAPE: Yes.

MR BELYEA: They need to get settled here first.

DR BYRON: But there may well be aircraft taken off WA routes to add to capacity on contested routes here?

MR BELYEA: I'm not sure - taken off WA. I mean, if we look at a regional airline, Skywest is our regional airline and they use Fokker 50. They do well on some routes; on others they struggle. But Perth for instance is becoming a regular 747 domestic airport, particularly on weekends, by Qantas. So there's quite good capacity between Perth and the east coast, and there are some good fares in the market. That is something the airlines have done, but it has always been a bone of contention as to air fares in the north of Western Australia, which are quite high. I guess, tying in with the submission, our concern is that in working with the airlines we are prepared to look at trying doing something about airport charges, provided the air fares stay competitive as well. But it is a competitive market.

DR BYRON: But these regional airports that are struggling to retain services and retain airlines - that doesn't sound very much like abuse of market power, does it?

MR BELYEA: No. In fact probably, to quote the example of Derby - I mean, Derby charges a head tax, but part of that head tax goes back in their part of subsidising the airline to come in. That airline is a third level operator, Skippers Aviation. So they make a contribution. It's not just all a state government subsidy for the airline. The destination - ie, Derby - is required to put some money up themselves. So that's how they do it. So they actually plough some of it back into subsidising the service.

PROF SNAPE: It would be simpler just to lower the fee, wouldn't it, if you're taking the money with one hand and giving it back with the other?

MR BELYEA: Yes. It's only a head tax. They don't charge a landing charge. That's just what they elected to do.

PROF SNAPE: Yes.

MR BELYEA: There's a few other ingredients in there as well, Professor Snape, that have been going into that.

PROF SNAPE: It sounds intriguing. Perhaps you will go to Western Australia - Broome and up there - after all.

DR BYRON: I will be in Broome in May.

PROF SNAPE: On business?

DR BYRON: On holidays.

PROF SNAPE: Okay, well, thank you very much for that very interesting account of things in Western Australia. We're very grateful for your submission and also for coming across here and presenting it to us.

At the beginning of today's proceedings I said that at this stage I would ask anyone who is present, who wished to make an unscheduled submission - and it better not be any of the staff members of the Productivity Commission - then I would invite them to do so at this time. We have no takers. There was one occasion on which I gave that invitation - not in this inquiry - in which the invitation was accepted. I did get a bit worried but it turned out all right. So I would now thank participants very much for their participation. This is in fact the last day of this round of hearings. There will be another set of hearings after the draft report. We thank you very much for the participation and now close this set of hearings. Thank you.

AT 5.40 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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