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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON PRICE REGULATION OF AIRPORT SERVICES

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

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON WEDNESDAY, 17 OCTOBER 2001, AT 9.08 AM
Continued from 4/4/01

PROF SNAPE: Welcome to this, the first day of the public hearings on the Productivity Commission's draft report on prices regulation of airports. There's probably no need to go through introductions but if there's anyone new here, I'm 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. As you know, the Commission is to report on whether there is a need for prices regulation of airports and if so the appropriate form of any prices regulation, taking into account a number of principles that are set out in the terms of reference. The final report is due to be submitted to the government by 21 December.

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

As you know, transcripts of the hearings are sent to the relevant participants to check for accuracy of reporting and are normally available on the Commission's web site within a few days of the hearing. At the end of the scheduled hearings for today I shall invite any persons present to make unscheduled presentations should they wish to do so. I invite our first participant for the day which is Melbourne Airport - that's the short title of it anyway - and we welcome Dr Warren Mundy and invite him to introduce himself for the tape and then to speak as you wish on the draft report.

DR MUNDY: Thanks, Richard. Dr Warren Mundy, manager strategy for Australia Pacific Airports Corporation, being Melbourne Airport and Launceston Airports at the moment. Just having made some public comments about the importance of submissions being made available to the Commission on a timely basis, I do apologise that we haven't yet done so in relation to the draft report. We were close to it until a regulatory event occurred which distracted me from completing that preparation but I hope to have it available for the Commission if not by the end of the next week then certainly very shortly thereafter.

This debate, as far as we can see, has largely now fallen into - the participants fall into two camps. There are those who are really talking about efficient pricing outcomes for the industry as a whole, and we see ourselves in that camp, we see the Commission in that camp and we see BARA in that camp and some others.

PROF SNAPE: Which Commission are you speaking of?

DR MUNDY: This one, and to be fair to the other one I think they've got a foot in this camp as well. On the other hand there are those who either want price increases or don't want price increases and what they're concerned about is price increases per se rather than efficient outcomes. I think the really important issues in this actually lie in the first camp, Richard, where we want this debate to be focused and where we've tried to keep it focused. So coming out of that, the most important thing that needs to come out of the draft report in this inquiry process from our point of view are mechanisms that will get us as close to efficient pricing incomes as are possible.

We see that both options as presented by the Commission have the potential to do that, depending on how they're structured but we do see that the Commission's preferred option B is a much more effective way of getting to that. Before I make some comments about the details in particular of the draft report and recent developments in the market and the regulatory system, I'd just like to make a couple of comments about where we think the real meat in these issues are now. There seems to be a tendency on the part of some participants in this inquiry to want to constantly re-till old ground and in particular a lot of issues about Sydney Airport. Whilst we accept they're very important issues, we actually see the issues now relating to the arrangements for phase 1 airports as much more important, obviously from our own point of view, but I think also from the point of view of the industry as a whole. But in any event, we see the issues relating to Sydney Airport are fundamentally different both in the point in time of the reform process and also the issue of congestion and the question of scarcity of slots.

Having said that, I think the delay of the sale of Sydney Airport may help focus on getting a sensible set of arrangements in place for all concerned prior to that outcome taking place. As I said, we see that there is some potential for both the options that the Commission has presented to deliver a vast improvement on the current arrangements. That said, we think that significant work on both the administrative and legislative arrangements around both proposals, and particularly how they relate to the national access regime, need to be addressed. In our supplementary submission we've set out a framework for how we think that may well be proceeded with, building on the work that Sydney Airport put forward on a price and quality undertaking.

In relation to option A, we really think that for it to be a goer, although it's not preferred, we need to get more development on the proposition of how the regime won't hold prices below efficient levels. We believe that prices currently are below efficient levels. The question is, how do we get a regime that doesn't hold them there and gets them up to what you might believe are efficient levels. That's not an easy question to answer and we accept that. In our written submission we'll be trying to flesh out some thoughts on that. We've always argued that the necessary new investment regime is a reflection of the fact that prices may well be efficiently too low.

We note that the Commission has been somewhat ambivalent as to whether a better approach is to build investment into a price cap regime through the value of X of CPI minus X plus K arrangement, or whether to maintain the NNI principles. We see that the approach that's been suggested by the ACCC, what it calls its hybrid model, relying upon some of the major development planning provisions of the Airports Act, is probably actually quite a sensible way forward, and subject to the details and there being enough clarity going into such an arrangement, we actually think that that would probably be an acceptable way for us to go. It would also be an arrangement obviously which if parties were able to freely contract with each other that they may well arrive at by themselves anyway. Certainly in discussions that we've had with airlines in relation to how a set of pricing arrangements by agreement may be constructed in a period beyond 1 July 2002, that seems to be a mechanism which parties would - subject again to the detail - be happy to buy into.

PROF SNAPE: With arbitration or without it?

DR MUNDY: With arbitration formed on the basis of contract, yes; with provisions for commercial arbitration within the terms of the contract is something which we'd be looking at quite closely. We see this Commission has accepted the case that regulatory intervention can be safely reduced. What remains unclear to us, as I said before, is how the path to efficient prices can be perceived. We're of the very strong view that the argument must be about arriving at efficient prices, not dealing with what people may consider to be fair or unfair.

In particular there needs to be adopted a forward looking approach about what is needed in the future, not what needs to be recovered as a result of the current regime. In particular we would not support any price-setting mechanisms that reference back to previous period volumes, unless that was arrived at by individual airports agreeing with their customers. We wouldn't support a situation where people said, for example, volumes have been lower than what we thought it would be and therefore we should have a price increase because for those airports which have out-performed those forecasts, which are certainly available to the Commonwealth, they were provided by the bidding process, that would presumably be confiscating revenue from them. That, to us, seems to be exactly the wrong way to go.

Since the Commission's draft report was made available there's been just a few events along the way which certainly focused the minds of ourselves and I suspect all other participants. In the short term, the Ansett situation is presenting very real cash flow issues for airports and, to be fair, all other suppliers of Ansett. We've seen Gate Gourmet go into administration. As Melbourne was Ansett's headquarters, the impact of property incomes and traffic generally will probably be more severe here in terms of its totality than at other airports, although obviously our size and our sound financial policies will mitigate against some of those impacts. Deteriorating global conditions will be felt most starkly at the major international airports, and these will be further compounded particularly if there is an ongoing demise in the trading position of Air New Zealand. We have seen the northern winter schedules released for Air New Zealand and there is a significant reduction of traffic arising out of those schedules.

In the longer term we'll be operating in an industry which is just fundamentally different from the one we were used to. There will be a range of impacts, such as the future of Ansett's terminals, the loss of Star alliance's Australian member and the emerging market position of Qantas in both international and domestic markets, and these will all profoundly affect the industry. Our view is that it's now more important than ever that the stance of regulatory policy in Australian airports and Australian aviation more generally is correct.

Our response to these events has been in the first instance to look at ourselves, not to look to relief from others. We've deferred significant amounts of capital expenditure, discretionary expenditure has been reduced and, regrettably, we've had to move on labour costs in a number of ways, including compulsory redundancy.

I'd just like to now move on to the recent policy decisions that were made by Minister Hockey just before the prime minister journeyed to Yarralumla. We didn't seek any regulatory concessions from the Commonwealth government in relation to the demise of Ansett and the deteriorating position in international markets. We are aware that other airports, a significant number of other airports, did so, and we don't support the views that they put to government about the necessity of the changes that were implemented. We don't believe that it's in the long-term interest of airports, airlines and the public for a policy process such as the one that the Commission is currently engaged with to be displaced and disrupted in this way. We are particularly concerned with the lack of consultation that was undertaken with the major stakeholders in the industry by the Commonwealth. As far as I can ascertain there was virtually no consultation with airlines, and there was certainly no consultation about the outcome of this policy prescription with the country's largest privatised airport company, that is, ourselves.

We don't believe that regulatory policy should be changed just because some companies are experiencing difficulty. If policy is wrong it should be fixed, but it should be reformed in an orderly way for the right reasons. The Commonwealth shouldn't be altering regulatory policy simply because some airports are distressed. It may well be simply because of a failure of their own corporate or financial policies and not of the regulatory system. While APAC does support and has indeed advocated the deregulation of phase 2 airports, we feel that this could have perhaps been done in a more orderly way and that some notice of the change may have assisted all the parties adjust to the new circumstances.

To be frank, it's not clear to us why the price increase that the minister has allowed to phase 1 airports was necessary to stave off even commercial distress. Ratings agencies have made it clear that there is no imminent risk of default on the part of phase 1 airports, and I'm happy if the Commission wants to provide them with copies of those views of the rating agencies.

PROF SNAPE: Yes, please.

DR MUNDY: I'll fax them to you. In our view in particular the Treasury should make clear the reasons and the methodology used to arrive at this situation, because otherwise we're just going to end up with another situation which is exactly analogous to that debate around what's in the value of X. A week has passed now since I sought advice from the Treasury as to what the reasoning and the methodology was and I have yet to receive a response.

Even if there was a risk of default and that was the right reason for a policy change, neither of which we actually believe is the case, the price increase doesn't generate a volume of revenue that would be sufficient at the three airports in question to stave off the fall. So it's very hard for us to see what's happening. Indeed, all that's happened really is that regulatory uncertainty has been increased and both airlines and airports have been distracted from dealing with the really serious critical issues that face the industry at this time. Indeed, we noticed in the ACCC's most recent submission to this inquiry that they say that the adoption of option A is the best way to go to ensure that there is no increased uncertainty, that the regime as understood is well in place. We agree with the ACCC on the need for regulatory certainty, but we understand that they had some involvement in this process and it's just, quite frankly, concerning to us that we've now got a decision in an environment of massive uncertainty which no-one understands or has had explained to them.

We won't be rushing to increase prices at Launceston or Melbourne airports. We will be consulting with our customers and looking at the long-term strategic issues for us. We need to consider the developments in the markets that we serve, both in Tasmania and in Victoria, and look at what the most sensible way forward is. That's not to say that we don't think pricing policies and structures should have been changed or that the current level of prices is right. What it does say is that these are important long-term strategic issues and should not be rushed at hastily.

I'd just like now to probably move on to some issues that have been current in the debate and that arise out of the draft report. We, I think as many others do, agree with the Commission's overall analysis of market power, its sources and consequences. We're pleased that the Commission has properly identified also reasons why airports may not use market power. We feel that the treatment of the issue of countervailing market power is a bit underdone but, having a look at the sort of criteria that was established by Prof King, I think it's fair to say that if you accept those criteria - and I think they have some merit - then you could only form the view that, irrespective of how much market power you thought there was to start with, you could reasonably form the view that there's a fair amount more of it around at the moment.

Airline markets in our view are likely to become less competitive in the short to medium term. Commentators are suggesting that Qantas's market share is likely to be in the range of 70 to 90 per cent. In addition, market segmentation is likely to occur given that there will probably be only one full service vertically integrated network carrier in the form of Qantas, which has strong international links, whilst Virgin Blue will dominate the discount market sector, possibly with some sort of offspring of Ansett. Prof King drew attention to the issue of the level of customer lock-in, and we actually think this developing market circumstance may actually increase customer lock-in rather than decrease it as these segments become actually more clearly defined with carriers in one segment or the other.

Whilst entry in the domestic market the resuscitation of Ansett is obviously a medium-term possibility, there's likely to be a fairly strong global reluctance to invest in airlines over the next while, which will probably see Qantas and Virgin able to consolidate their market positions. The sort of competition we saw during 2000 and 2001 probably will never emerge again. Indeed, in the short term, with the sort of segmentation we're seeing it may actually be possible that competition will be less intense than was even the case prior to the entry of Virgin and Impulse, but that again depends critically on what happens with Ansett.

The international markets, the CEO of Qantas has indicated that there will be some consolidation of international carriers. We are experiencing lower load factors for departing and arriving international services, and we are aware that some carriers are looking at consolidating or abandoning not only their route development plans, but also their existing services. The loss of Ansett's domestic network will significantly reduce the ability of the Star alliance carriers to compete with Oneworld carriers because of the on-carriage issue. They won't be able to offer airline packages to tourists travelling within Australia between major capital cities and indeed regional centres, and that will reduce ultimately the ability of Star alliance members to service Australia and their ability to compete with Oneworld carriers.

The issue of Air New Zealand's future which probably has become a bit clearer but obviously is somewhat scaled back, not only poses issues for services on the Tasman, but also into the United States. Recent media comments by airlines have been somewhat illuminating to the fairly fundamental question about substitution. Airlines have argued to this inquiry they have very little choice but to use airports, although it seems that this is not quite as important to them as it seems. Indeed we have noted recent comments in the media by airlines that would indicate that there is a degree of substitution available to them. I quote the comment of Mr Warren Bennett, the executive director of BARA on 12 October - Friday of last week - where he says:

> Airports need to be aware that airlines are sensitive enough to charge increases to take their services elsewhere.

I would suggest, as we have argued, that international carriers do have a degree of substitution opportunity between major entry ports.

We have been disappointed when the question of countervailing market power has been discussed that it seems to have been dominated almost by Prof Forsayth's fairly colourful dismissal of the proposition being floored in theory. We have some problems with this analysis. We think it's flawed principally because it seems to be an all or nothing thing and not an analysis that occurs at the margin, a point that Dr Byron has obviously made in the transcript at one point. We think there is also some empirical evidence for this arising from the recent comments of Virgin Blue who have some aircraft in the pipe we understand which will be here in the late part of the year. Virgin Blue say this in relation to recent increases in airport charges, particularly at the Gold Coast, and they say:

> With this in mind the company -

that's Virgin Blue -

> will have no option but to operate its new Boeing aircraft on routes where the relevant airports act as responsible members of the community instead of as opportunistic monopolies.

Again clearly airlines are taking decisions at the margin about the allocation of routes to aircraft on the basis of price. This is what we have always argued is the nature of the bargaining conduct between airports and airlines.

I would just like now to turn to pricing outcomes. The Commission I think rightly has said that if you were to take away price controls, whether you would end up with prices above or below efficient levels is pretty hard to tell. We share that view. What you would be able to assume is that if prices are, if you accept, inefficiently low at the moment, prices would certainly move towards them. Whether they would move over or not again is a difficult conclusion to draw with any clarity.

We feel that in a set of negotiated arrangements, such an outcome may well occur, although again there is no guarantee that there wouldn't be excessive prices, or certainly we would argue that there are conduct examples around where airports possess market power where they have not chosen to use it and may not choose to use it again for the reasons the Commission has set out at length. There has been a debate also which we find interesting which is certainly exercising our mind as to the issue of pricing structure. We tend to share the view of both BARA and the ACCC; if not the view, then certainly the scepticism about the overriding idea that efficient Ramsey prices are represented by tonnage-based charges.

I think that may well have been sort of a first proxy many years ago, but increasingly we see the debate about airport charges and airport charging structures as being one about understanding the fixed and variable cost natures of airline cost bases which they are trying to do, and that's probably why they seek to move on to passenger-based charges to move on to a variable cost basis, but also increasingly as a method of rationing various pieces of scarce capacity in various parts of the airport network. I mean, the airlines and the ACCC have drawn attention correctly to the provision of airport services being a bundle of interconnected bits. It's a network in a sense.

The peculiar thing about the network and certainly the networks that were required was that they were over capacity in some places and pretty close to capacity in others, and the way the capacity develops through that network is different at different times, and in different places. It also depends on the type of users at the airport. For example we have very little general aviation traffic, both of the private and what you might call the professional end, whereas somewhere like Perth has a lot more of it because of the needs to service mining interests and things in the north of the State.

We think there is also an issue about the relative sharing of risk between airports and airlines, and that that may differ in different places. We have a very strong disposition to taking on volume risk, and I think it's probably fair to say from some of the material that has been presented to the Commission others have a lesser disposition to that risk. The best allocation of that risk in our view between airlines and airports is arrived by them trying to work it out together. Inviting the regulators to determine that disposition of risk, I think, will not get us very far at all.

So we don't particularly see the debate about passenger-based charges as something that needs to be resolved in coming out of the Commission. There is a sense in which passenger base prices may well look like Ramsey charges if you form the view that carriers with low load factors are the most marginal and therefore the most price elastic. That has typically been our experience in relation to international carriers, although obviously the comments of Virgin Blue in relation to the Sydney Airport pricing proposal is a novel position in that regard.

I would just like to make some concluding comments about access. I think it's very important when looking at access issues to ensure that you understand the difference - and it varies from cases to case - of a dispute which is about market power and a dispute which is about the orderly operation of the airport and trying to ensure that everyone gets a fair go, and that congestion and safety are managed properly. We accept and we're strongly of the view that the real access issue for an unintegrated firm such as ourselves is price. Issues which have been raised about the collusion of an airport with airlines to damage competitors or exclude competitors in our view is something that can and should properly be dealt with under Part IV of the Trade Practices Act which deals with these sorts of issues

We note that there have been many comments made by airlines and their representatives that there have been all sorts of access problems and access issues that have emerged. With the exception of the Virgin Blue access application for the declaration of the domestic express terminal at Melbourne Airport, none of these matters have been brought to the ACCC for determination of section 192 or more generally Part IIIA of the Trade Practices Act. We would have thought that if these problems were as severe as are alleged, that people would have taken action to have them resolved, and to date they haven't.

What is more important than the access situation in our view and what is critical is that whatever set of arrangements the Commonwealth puts in place coming out of this inquiry is that we end up with one regulatory system, not two or not three. Whatever emerges or whatever the Commonwealth puts in place here has to be seen as an effective regime for the purpose of Part IIIA so that everyone has certainty. We agree with the ACCC that the Part IIIA arbitration provisions are expensive for all concerned. We understand the experience in telecommunications. The problem that we have had with this regime and in negotiating outcomes is that there has always been an easy option, a cheap and easy option for one side of the debate to go to the ACCC and get an outcome.

The one attraction of Part IIIA is that it puts costs on both sides and is therefore likely to discourage spurious disputes which we have seen to some extent under the necessary new investment arrangements. Mr Chairman, I think that's where we'll leave it. We are strongly in favour of the pursuit of option B as a way through this. We will be making some further suggestions in writing about how that regime might be fitted within the general national access regime although we're minded that some of your colleague Commissioners are turning your mind to that issue as well so it's a little bit hard to say. The most important thing we think is to get efficient prices out of this or certainly get closer to it and the challenge is to find a way through that maze and that's not an easy question.

PROF SNAPE: Thank you very much, Dr Mundy. That was very helpful running through and elaborating upon your notes and as I say, we look forward very much to the full submission and as I mentioned earlier, the sooner the better from our perspective, although obviously more difficult from your perspective but perhaps we can get it into our consideration. I was going to start by asking a question on the matter on which you actually finished and that is, in your notes and in most of your comments you didn't address our preferred option, option B, very much, but you just then said that you would be addressing that more in the written submission. Is there anything else that you could add to it at this juncture?

DR MUNDY: I think the best way forward with option B is for airlines and airports to sit down, sort out a deal, take it to the ACCC, get it accepted as an access application for the purposes of Part IIIA with effect from 1 July 2002. That then provides everyone with certainty.

PROF SNAPE: As an undertaking.

DR MUNDY: As an undertaking. The difficulty, as you would be aware, is that there have been some challenges associated with getting access undertakings agreed to and provided by the ACCC and I think if that was to become the preferred option then we would have to look hard at the arrangements around the acceptance of access undertakings and I know that has been a matter that has been in question, the national access regime inquiry. The alternative to that approach is an approach which would place a statutory obligation upon airports to consult and to provide information along the lines of what we've seen described as a price and quality undertaking. It's a similar device to which Sydney Airport has provided and then for that package, including issues of quality - and we strongly agree with the airlines that something has got to be done about quality and commitments to quality and levels of standards, service.

We believe that the current arrangements are weak and provide little contractual certainty, frankly to either side. What we don't agree with the airlines is that the lack of these things are evidence of market power on the part of airports because we have on a number of occasions sought to ascertain from airlines the answer to the simple question: what levels of quality for what services are important to you? To date we have not received an answer. We think this is very important and clearly on any contractual basis needs to be resolved. What I guess worries us is again this problem about incentives to conclude negotiation. I mean, we have a big incentive to conclude this negotiation as we have with most of the negotiations we've undertaken under the current regime. The incentive to conclude these matters does not seem to be felt as strongly by the airlines, nor to be fair is a uniformity in the importance of these things to airlines.

PROF SNAPE: To airlines or airports?

DR MUNDY: Yes, different airlines - I mean, to be fair, certain airlines are prompt and helpful in responding to our attempts to discuss issues with them. Others quite frankly simply ignore our requests and we don't see what their thoughts on matters are until submissions are being made to the ACCC. So there's a problem in the bargaining conduct which I'm not sure that any regime will fix but there is clearly an obligation to consult. We've got a good framework for statutory consultation within the Airports Act in relation to a number of matters which could easily be picked up and used in this way. The attraction of an arrangement like that also is that it does provide all parties with a level playing field and a set of transparent arrangements and yes, it does leave decision-making in the hands of ministers but then the current regime is effectively in the hands of ministers as we saw on 5 October and at least a regime under the Airports Act would give us some rights for administrative review which are very difficult to get up under the process available.

So that's another way forward. I mean, we would see an arrangement of that type covering quality, general contractual terms and conditions of supply, consultation, payment arrangements and pricing and we think that's a relatively simple duty of care to negotiate out and conclude, certainly possible within the time frames involved. The trick is going to be understanding the arrangement under which it's going to be put in place which in all likelihood a decision from government response to the Commission's final report is probably not going to be seen until I would have thought probably February.

PROF SNAPE: In the option B we did speak about conditions of good behaviour as being part of the monitoring thing. Would you like to comment on that?

DR MUNDY: Well, we don't have problems with conditions of good behaviour because we believe we behave well.

PROF SNAPE: But if one - you may say that.

DR MUNDY: I think it's possibly fair to say that others might say that of us as well. I think the question of what constitutes good behaviour - I mean, I accept that the Commission's recommendations are about good behaviour on both sides and I think that's important. I just sort of struggle to work out how you may define it without getting into situations like is correspondence replied to within seven days or 14 days. These sort of outcomes, I think, trying to regulate this sort of behaviour to me looks like possibly - and the danger is it may well be the first step down the path of a very intrusive sort of quality and conduct regime, examples of which we have seen in the United Kingdom with respect to rail travel.

PROF SNAPE: That was really the reason that we said that the requirements of a monitoring regime should be specified at the beginning and not amended thereafter.

DR MUNDY: Indeed, and that's obviously important. I think there need to be some objective tests. If your primary issue you believe is about price, then you know, some sort of pricing arrangements. In contemplation of what offer we may make to the airlines, clearly airports may choose to enter into some form of voluntary price cap to which they would contract themselves. That's what the Scottish airports in the UK do. So that you would have a pricing policy that would involve a price cap in our view is not something that we would have a problem with.

I think the important thing is to try and get a set of arrangements which enables different airports to put in place different pricing structures depending on their issues and needs, and from our experience of operating a major Australian airport and quite a smaller one, which is in a peculiar competitive environment, our approach to thinking about pricing issues are very different. So therefore a one-size-fits-all approach is really not going to work, and it may not also serve the interests of all airlines equally either. I have to say that I think a lot of the conduct issues that are being referred to through the course of this inquiry occurred in the early part of the regime rather than towards the back end of the regime.

Now, some would say that's because of the imminence of this inquiry, it has focused minds on conduct. I think there's some of that; I think there's also an extent really to which a lot of the conduct we saw early on was trying to sort the rules of the game out, and because the rules - and principally because the rules of the game were just so unclear, that's whatever arrangement comes out and a proposition we will be making very strongly in our written submission is that if the Commonwealth intends to continue to regulate this industry in a way similar to what it has, it should get the draft instruments out with the parameters as soon as possible so that there can be full consultation and understanding of what is meant rather than a situation which we had in 1997 and, quite frankly, which we had on 5 October this year, when the rules just were changed. As I said, airlines have got every right in the world to be unhappy about the lack of consultation and indeed we are unhappy about the lack of consultation, even though the outcome was relatively favourable to our business.

DR BYRON: Your comments about Launceston and not having a "one strategy fits all airports", as the most recent amendments are basically that the phase 2s are to be separately subjected to monitoring, do you see that as basically sorting out or resolving the question of future price regulation of the phase 2 airports? You made comments about Sydney being a special case, which seems to suggest to me that you think that the major unresolved area to work through is the future for the phase 1 airports. The corollary to that is that wouldn't a privatised Sydney Airport simply be a slightly bigger, larger phase 1 type airport?

DR MUNDY: I'll start with phase 2s. We've advocated the deregulation of phase 2 airports and in particular Launceston.

PROF SNAPE: I think that sometimes people at the back may not be able to hear you.

DR MUNDY: Sorry. We've advocated the deregulation of phase 2 airports. We just would have preferred that, rather than waking up and discovering it's all gone, there had been a period between the decision to deregulate and when that happened so that there might have been some orderly conduct in the interim. It's the transition that we - - -

PROF SNAPE: You did have our draft report earlier, which recommended that.

DR MUNDY: Indeed we did, but I have to say that it's not been my experience in the great sweep that the Commission's draft reports are so enthusiastically embraced by the Commonwealth at all times. I think it's wrong to say indeed that phase 2s have been totally deregulated, because they're still subject to the section 192 declaration under the Airports Act. If phase 2 airports get out of control, they may be the first people to discover what an arbitration under Part IIIA of the Trade Practices Act is all about, because that declaration doesn't expire until 30 June 2003, five years after sale. So those people who are running around saying they've got carte blanche are slightly misrepresenting the situation. They also aren't subject to price monitoring in the same way, all of them. Launceston isn't. The only monitoring now will be the statutory monitoring arrangements under the regulations and the Airports Act, so that will mainly be presentation of formal account. So we think that's the right decision; we just would have probably preferred the implementation to be slightly different.

The issues with Sydney, though - I think Sydney is different, and I think

Sydney is different for two reasons mainly. The first is that once Melbourne, Brisbane or Perth find significant congestion in a major part of their asset network, let's say runways because that's what the real crunch is, there is no difficulty subject to the necessary environmental approvals. There are no physical site constraints to the construction of an additional runway and in our case of an additional two runways, subject to the environmental law being as - now, that may be in five, 10, 15, 20 years' time. So I think that's the first question. There seems to be little issue about the construction of a second airport, so the businesses are not physically constrained. So once demand gets to a level it will be profitable to build another runway at Melbourne Airport at some point. The situation is different in Sydney.

The second thing I think for the purposes of this inquiry is that it seems to me that the price levels at Sydney Airport could be expected on today's number to be closer to efficient levels than what they are at other airports, phase 1 airports.

PROF SNAPE: Even with the congestion there?

DR MUNDY: Possibly, but congestion is a different issue. There is no complaint coming from the shareholders of Sydney Airport about the inadequacies of their returns and the fact that on their regulated business they earn less than the bond rate. That's not that I advocate, nor have we - and in fact we advocate the opposite - that there needs to be a full mark-up to cost of capital of phase 1 airports coming out of this review. We don't think that's appropriate, but I think the point at where Sydney is in its pricing cycle is fundamentally very different. If you see the reason for inefficient prices at Australian airports arising historically from the imposition of the network single till under the FAC, I think it's fair to say that that's been fixed at Sydney. Whether it's been fixed to the extent of congestion, as Prof Snape raises, is a different question, but certainly as far as the issue of the single till is concerned, which is what we have argued is the primary source of any inefficient pricing of phase 1, that issue has I think to a large extent been addressed. So that's why we see them as different.

PROF SNAPE: Thank you.

DR BYRON: I guess I was just trying to clarify where you think we should focus our attention on finalising the draft report between those three categories of airports.

DR MUNDY: Absolutely regulation of phase 1 airports. To say anything else would not be pursuing the interests of my shareholders.

PROF SNAPE: You do have one that isn't a phase 1, though.

DR MUNDY: Yes, but, as I say, we think there's relatively little more work required on phase 2. Our concern has basically been one of process. I mean, the bigger issues, quite frankly, facing phase 2 airports is the volume of traffic and how they grow their businesses, not the regulatory system. We didn't find the regulatory system at Launceston to be our biggest problem in the business.

PROF SNAPE: Could I draw you out a little bit more on competition in the future between airlines as you perceive it. Your picture was I think of only one - domestic we're talking about - full service airline with competition in some market segments with the low-cost airlines. So presumably if one is thinking of the current structure of fares, of business class, full economy and then the rest, then the competition would be on the rest rather more. Now, would that provide effective competition in general? Would being able to compete or having competitors focused on just segments on it be a sufficient, in your view, degree of competition because of a substitution that can occur between the various segments - if the differential between full economy and the rest increases too much then there's substitution at the margin, and similarly between business class and full economy or of course the rest. In your view would that be an efficiently competitive structure?

DR MUNDY: The real question is, do you need two business class products on the market to make sure that the business product isn't excessively priced, because at some point people will switch away? That may well be the case. One of the big issues we see with the demise of Ansett is that membership of the Star alliance as currently structured requires two class carriers, and if you accept - and I think the Commission has turned its mind to international alliances before - the inability of Star to then effectively have an Australian-based carrier then significantly impacts on their ability to compete more generally. So I don't think the domestic and international markets are actually separate. I think, Prof Snape, the honest answer to that question is that I suspect the real issue for competition is going to be the ready availability of seats between Australian capital cities on short notice. We witnessed recently situations where you couldn't get a seat between Sydney and Melbourne on five days' notice and that sort of situation from the business travellers' point of view as opposed to the business class travellers' point of view is clearly unacceptable. There has been by Qantas significant augmentation of capacity in their domestic network, obviously seeking out those high-yielding routes replacing Ansett's business traffic.

I think the lack of availability of a business class product at the end of the day is in a welfare sense probably not all that overwhelming but I don't have a very strong view on it. I think it's one of those things where if you sat down you could see reasons why it might and reasons why it mightn't and really it will be the conduct at the end of the day that's the issue. I mean, you could ask the question, does it matter that there's no business class seats between Sydney - if there was no business class travel would it actually matter.

PROF SNAPE: That wasn't quite the question I was asking. I was asking with product differentiation that does include full economy and business class, was there going to be enough competition at the margin to pick up your earlier emphasis, talking about competing at the margin; was there going to be enough competition at the margin between those two so that the competition for the discount, for the low cost thing, would in fact filter through to provide competition right throughout the structure.

DR MUNDY: I think potentially there may well be. I think the other thing is the extent to which we have seen the demand for domestic air travel is probably - as certainly I think the entry of Impulse and Virgin showed, it was probably more elastic than I believed it was. So I think the attempts to - Qantas will continue to yield manage. I mean, it is wrong to say that every Qantas aircraft departing Melbourne Airport today is full to the gunnels; it's not. But I think the real issue is going to be the ability of people to enter certain markets and again the fate of certain terminal assets arising out of the demise of Ansett is a very important issue and how that pans out is a matter that's in the hands of the administrator at the moment.

PROF SNAPE: Could I pick that point up actually - and you may or may not be prepared to answer this - that relates to the lease of Ansett terminals. What we haven't heard about is what happens to those leases with the demise of Ansett? Is the demise of Ansett a breach of the lease or is the lease an asset that's now in the hands of the administrator to dispose of or do those terminals now revert to the airport? What is the status of what has been a very valuable asset?

DR MUNDY: I think, given your preamble, we have a general policy of not disclosing the contents of our contracts with our customers and the administrator of Ansett today is our customer and I don't think it would be really proper for me to disclose the contractual conditions of that lease or any other that we hold.

PROF SNAPE: I thought I might get that answer. I'd still like to know the answer.

DR MUNDY: Indeed, many people would, Prof Snape.

PROF SNAPE: Yes. Since those leases dated back to about 1987-88 and they were sort of forced upon you all I think in those days - well, it was a different regime in those days.

DR MUNDY: I think they were willingly entered into by the Commonwealth and the airlines concerned.

PROF SNAPE: You inherited those. So presumably similar conditions would have applied across all the airports.

DR MUNDY: I think it's fair to say that the phase 1 airport leases were simplified and restructured prior to the phase 1 sale. The phase 2 leases, certainly in the case of - the only knowledge I have is the one of Launceston - was not so restructured, simply because they weren't particularly complicated. So whilst I think you would expect to find them similar in their structure they are not the same and they have been altered as circumstances in different places changed over time. I would imagine that the lease in Sydney may be different - certainly the Ansett lease in

Sydney - simply because of the large amount of works that was done on the Sydney terminal for the Olympics.

So these are organic growing documents that have represented a fairly substantial commercial relationship between first the Commonwealth, then the FAC and now ourselves. So I think your basic proposition that they're fairly similar in their form is probably fairly close to the mark, although I wouldn't be surprised to find significant differences and significant ambiguities.

PROF SNAPE: I notice at Melbourne Airport there has been a significant growth of late in the retailing properties located within, what I imagine, is the leased space by the airlines. For example, if one goes to the Qantas lounge these days, one passes Henry Bucks and various other - - -

DR MUNDY: In the Qantas terminal?

PROF SNAPE: In the Qantas terminal. In the part of our report that we emphasised - and it was part of the submissions that were made - was the incentive for airports to be looking after the retailing that was located on the airport property and that that provided a significant part of the revenue of airports. Does the growth of the retailing apparently within the leased areas of the airlines detract from that or does it change? How has that been accommodated within the leases?

DR MUNDY: The domestic terminal leases - certainly the major ones - are structured in such a way where the development of retail activity in the domestic terminals are the sole province of the airline. That's their business, not ours. So obviously the retail revenue we get out of those, obviously there's consideration in the lease for the right to conduct that activity, just as there's consideration in the lease to conduct the business of operating an airline through the lease. There is consideration in the lease for those matters. I think that's probably about as far as we go. The airline is subject to a range of development and safety issues obviously entitled to the quiet enjoyment of its premises. We do not reasonably withhold consent for how they wish to develop that terminal within the boundaries of their leasehold tenancy.

PROF SNAPE: So the price that you are charging them for the lease would in fact take into account the fact that they are able, through this, to get some advantage from the locational rent?

DR MUNDY: There is consideration in the lease for their right to develop retail activities within the demise of that lease, and they were in the contract from day one, and obviously our foregoing of the rights to develop retail within those terminals was - well, within the Commonwealth Department of Aviation was a factor in the negotiation that arrived at the structure of the lease. So we received consideration for their right to develop retail activity within the lease.

PROF SNAPE: But as you say, the terms and conditions have been an ongoing thing, so you are not necessarily saying that all of that, including the prices, were set back in 1988?

DR MUNDY: I would be surprised if those fundamental arrangements have changed particularly since 1988. There is a price-setting formula.

PROF SNAPE: There was a rental formula?

DR MUNDY: There was a formula for rent which depended on a whole range of things including the development and floor area of the terminals and things like that. If this is a matter that is important to the Commission, I am happy to have a think about whether I could provide you with some more information about the structure of the lease, even if I was able to do that confidentially.

PROF SNAPE: It does have some implications for what has been a bit of a theme pending some report of the analysis.

DR MUNDY: Maybe I could take this off line and perhaps discuss it with officers of the Commission to see if there was a way that we could - - -

PROF SNAPE: Okay.

DR MUNDY: I'm not quite sure what exact facts you're after, so we may be able to find one.

PROF SNAPE: The thrust of it is the relationship between aeronautical and non-aeronautical. The thrust has been in the pricing of airports, airport charges that airports would take into account their earnings from the non-aeronautical that is generated by the aeronautical. Here we have in fact some of these aeronautical revenues being captured apparently by the airline rather than the airport which relates quite a bit to what the airlines have been saying about the locational rents.

DR MUNDY: Indeed.

PROF SNAPE: So that is the thrust of the questions and as to whether these developments prick that balloon or whatever.

DR MUNDY: Yes, and obviously if the arrangements were different in different places - for example in relation to the domestic express terminal - this is on the public record - we are simply paid a per-passenger charge and retain the beneficiary of whatever retail income is in that terminal.

PROF SNAPE: We would like to be able to understand all that relationship rather more, and it was in fact the growth of those new retailing facilities at Melbourne alerted us to that.

DR MUNDY: Simply they're in the demise of Qantas' lease and they are entitled to develop those as they wish.

DR BYRON: We have got another few minutes, but just a brief one: one of the important points that it seems to me you're making this morning is the question of the distribution of risk, and in these uncertain times and given it may be some time before we, if ever, get back to certainty or greater certainty, it seems to me that much of the negotiations should be not just about prices between airports and airlines, but some sort of agreement on risk sharing given volatility in the marketplace. I was wondering if you wanted to expand at all on the distribution of risk between the parties and on your comment that you didn't think a regulator should be making those sorts of determinations about which party should share how much of the risk.

DR MUNDY: Yes. I just make the simple observation - one of the big issues that has been in this inquiry is passenger charges as opposed to tonnage-based charges. If load factors are variable, then there's the question of who bears the variability and load factors. If you charge on a tonnage basis, then the airline bears the risk of load factors. If you charge on a per-passenger basis, the airport bears the risk of load factors. Against that the airline already has significant exposure to passenger risk because it's selling tickets, but the airport already has significant exposure to passenger risk through its non-aeronautical income, its retail income, its carpark income, which is essentially driven by passenger numbers.

So there is an issue; the issue here is who should bear that risk. Historically that passenger risk has been put on the airlines, and airports have been not accepting of that. There is a view amongst some airports that you want to charge on a passenger basis because they are going to grow more quickly than tonnages simply because aircraft in the long run you could expect to become more efficient in terms of weight. We don't think that's the real issue to be quite frank, and clearly if you were in a negotiating situation, you will trade that risk against the expected return. I mean, that's a fairly simple proposition.

I think coupled with that though is the appetite and the approach to developing business that the individual airports now have. I think historically airport charges were set on a tonnage basis because they were simple, they were non-discriminatory, and the business of the airport was essentially making sure the airport was there and recovering the costs of operating the airport when they were public utilities. Indeed all these arrangements grew up in a period quite frankly when the airlines were largely run as public utilities and compliance with ICAO standards was the thing that really mattered.

The world has changed now; airports are private companies - certainly in this country, airlines are typically private companies. So there is much more concern about the distribution of risk because quite frankly the risk before wasn't an issue because it was borne by the state. The infinite insurance capacity of the state was brought out and away they went. So I think that issue of risk is very important. It's an issue from our point of view that it certainly focuses our mind on issues - if we are going to accept things like passenger risk, which we are prepared to accept, then it focuses our mind on things like how do we develop Melbourne as a place, not only for tourist traffic, but also as an alternative primary landing point in Australia to, say, Sydney.

You have a similar consideration with relation to tonnages, but it's not quite as focused, and obviously the issues of on-carriage then becomes more important as well, and you may actually discriminate on that basis. So I think the issues of risk are really important, and the reason why a regulator can't chop up the risk is because a regulator can't determine the disposition of risk to the parties concerned, and the classic case in point was the domestic express terminal. We said to the regulator that this was a set of prices that we would be happy to bear giving due consideration of our board's disposition to risk, and their very legitimate concern that one or both of the carriers who were going to use that facility may either fold or access terminal capacity from somebody else.

The simple fact of the matter is one of them did; it folded, and its aeroplanes are now operating off the terminal of one of its two competitors. We didn't, in this sort of great foresight, perceive the demise of Ansett, but again obviously we are now left with significant exposure potentially going forwards of very large amounts of surplus terminal capacity, at least in the medium term. So regulators just can't deal with the appetite, if you like, for risk that people have. Now, we would have - and we still on principle - just go back a sec, we have a situation now where the Ansett terminal is under a leased arrangement, and it is possible to conceive of scenarios in the future where it might not be, for whatever reason.

We're of the view that - and how we derive revenue out of what is a very significant asset, and an important strategic asset to us, how that is charged for is very important. To have the regulator determine what that is in our view is just - determining what our disposition to risk is is very difficult, and similarly what the disposition of airlines is is very difficult. We know from evidence to this inquiry that some airlines want passenger-based domestic charges. We know that others don't because their perception of risks and the incidents of the costs are different, and the regulator is going to struggle to resolve that. It's a bit like the comment the ACCC has made about, "Airports will never effectively price discriminate because they haven't got enough information." The fact that we do, I would have thought, is indication of the fact that we're able to and that we've got enough information and perhaps the amount of information that we need to take commercial decisions is actually a bit less than the information that's required by a regulator to take a regulatory decision.

PROF SNAPE: Thank you very much. Time is breathing down our necks, but just to ask about pricing, you have taken a position which seems to be rather different from many other airports on it and you're apparently not particularly interested in being able to increase by 6.2 per cent of the starting prices. Would such an price increase have been sufficient to compensate for the loss of volume?

DR MUNDY: It's difficult to say. It depends on what the prospective loss of volume is. If you believe that the market will ultimately adjust, if you look at what happened during the Gulf War, where there was a significant loss of international traffic volume, it's a blip under the trend line. The trend line didn't move. As one of my colleagues is apt to say, there are still three and a bit million people in Melbourne and there's a pile more that want to come here, for whatever reason, and they're still all out there, and presumably the market will in the medium term adjust to help them out. We don't think we can walk both sides of the street on this. We don't think we can argue the case that we're entitled to the benefits of our good work to get volume growth and not therefore effectively have what you might call rate of return revenue regulation so if volumes go up prices come down. We're opposed to that proposition and we think we can't walk both sides of the street.

PROF SNAPE: Even when they're extraordinary events on the other side of the street?

DR MUNDY: But the consequence of the extraordinary events is that shareholders are not quite earning what they thought they were going to earn. We haven't seen any airports go over. We haven't seen ratings agencies saying that there's imminent risk of default, and we're of the view that we are in this business for a long time and that we share the risk of this business with our business partners. Now, if others are unwilling to do that, then a sensible arrangement would be for them to negotiate that away. If they're unable to do that, then they have to look to themselves, as we have done, in some cases in a fairly painful way.

PROF SNAPE: So being able to increase by 6.2 per cent of the starting price won't affect your pricing policy?

DR MUNDY: The impact of that decision is a matter that our board is yet to consider.

PROF SNAPE: Good. Thank you very much. That's been a very helpful discussion and we look forward to the full version.

DR MUNDY: Yes. I do apologise for it - - -

PROF SNAPE: No, it's quite understandable in the circumstances.

DR MUNDY: I haven't got all the split infinitives out of it yet.

PROF SNAPE: My reputation is getting around, is it? Thank you very much. We're now moving to the Northern Territory and we're doing that by video-link. We'll probably need a few moments to establish that link, so we'll just have a moment or two break until we get it.

PROF SNAPE: Thank you very much for being with us up there, and I'm sorry if we kept you waiting for a few minutes. Now, let me introduce ourselves here. I'm Richard Snape. On my right here is Dr Neil Byron, and you of course have made three submissions now to us, and in this current submission, you do say that the third one that the - I'm just finding it for a moment. There we are. You do say that this one is still confidential. Is that just confidential until today, or does it become - are you prepared to take the confidentiality off it from now?

MR KEW: Richard, I mentioned in the note that I sent to you yesterday that our third submission, which will be lodged after today's hearing, will be confidential. The bullet points that I've provided today, I'm quite happy to talk about in a public hearing.

PROF SNAPE: Okay. Well, we might come back to discuss that a little bit more. The staff may discuss it with you.

MR KEW: Fine.

PROF SNAPE: We should in fact ask you now to introduce yourselves for the transcript, and to say your positions within the organisation please. Each of you can do it separately so the voices are on the tape, thanks.

MR KEW: Thank you. My name is Ian Kew. I'm the chief executive officer of Northern Territory Airports, and Northern Territory Airports are responsible for managing Darwin International Airport and Alice Springs Airport. I'm also responsible for Tennant Creek Airport.

PROF SNAPE: Thank you.

MR GANLEY: Good morning, Dr Byron. Good morning, Prof Snape. My name is Tom Ganley. I'm the general manager, finance, and the company secretary for the three airports mentioned.

MR REISS: Good morning, gentlemen. My name is Brett Reiss. I'm the commercial director of Northern Territory Airports.

PROF SNAPE: I'm sorry, we had a thump occur in the middle of that. Perhaps if you could say it again.

MR REISS: Good morning, yes. I'm Brett Reiss, the commercial director of Northern Territory Airports.

PROF SNAPE: Thank you very much. You just have to be a bit careful of papers and things near the microphones, because that tends to take precedence in the system. So, Ian, would you be speaking - who will be speaking to the submissions?

MR KEW: I'll speak to the submission, Richard, and I'll start now, if that's okay with you.

PROF SNAPE: That's fine, thank you.

MR KEW: Firstly, thanks very much for the opportunity to present to the Productivity Commission our details of our third submission. I'll also briefly go back over submission number 1 and 2. I particularly would like to thank the Commission for allowing us to attend this hearing by videoconference. You might appreciate that by allowing us to attend by videoconference, it saved us $1670 each in airfares, which at the moment comprises some $1500 for the airfare component, $135 for the GST, $10 for the airport tax associated for Ansett, and depending on whether we just go via Adelaide or Sydney, up to $13, or that could be $26, for the insurance tax. So on return back to Darwin of that $1500, the equivalent of $2.64 for our airport charges out of that $1670. So we do appreciate the fact that the Productivity Commission has allowed us to save over $6000 by attending by videoconference.

PROF SNAPE: Pleasure.

MR KEW: Perhaps if I go through our submissions there. Originally, back in March, we put in our first submission where Northern Territory Airports argued that in spite of passing on the CPI minus X price reductions, we had experienced at Alice Springs Airport a negative growth over that period and positive growth at Darwin, and that we thought that there were reducing opportunities to further decrease charges and still provide the appropriate levels of service that were required to run our airports effectively. We also argue that airlines had substantive countervailing market power, and we argued that the NNI process that we had participated up until that point hadn't provided the appropriate mechanism to facilitate appropriate new aeronautical investments.

At that stage, I talked about the 19 projects that we submitted to the ACCC for approval. Of those, nine were approved for a total increase in our landing charges of some 17 cents per tonne at Darwin and 1.6 cents per tonne at Alice Springs. I'm not happy to report that only two of those 19 projects have been completed since then. We argued that post 2003, there should be no price regulation for Darwin and Alice Springs Airports, and we suggested that the way the future would be for - for our airports to negotiate commercial outcomes with airlines, based on the principles of fair pricing and investment, to provide appropriate infrastructure that would provide long-term benefit to our communities.

In submission number 2 - we specifically lodged submission number 2 to talk about the ACCC's response to the Productivity Commission, in which the ACCC, we thought quite rightly, recognised that Alice Springs had very limited market power, but that Darwin had substantial market power and therefore should be subject to a continued price regulation. We looked at the ACCC's methodology for their analysis and we looked at things like - they talked about airports that had a greater preponderance of tourists - would therefore be more sensitive to price changes, and as a consequence, they probably had less market power. Darwin, for example, with 68 per cent tourists and a very small percentage, obviously, of visiting friends and relatives and business, by definition has less market power, but it was still recommended that it remained regulated.

We argued at that point in time, and we provided details, that the relatively tiny component of the total airfare that related to airport charges - but even if we were predatory in terms of pricing there, it probably wouldn't have had much impact on the total ticket price and probably little impact on what customers would do in terms of travelling to the airports at that stage. We also talked about the fact that while airlines have argued that they don't have countervailing market power, we identified practices where we believe that they did have substantial market power, and it reminds me of the quote that's in the Qantas submission to the national access regime inquiry, where they state:

> *Provided customers want to fly, airlines have no choice but to use the services of the airport available in the relevant city.*

They go on to say:

> *No airline is in a position to bypass or otherwise facilitate new entry into the provision of airport services in Australia.*

We know from fact that there are many instances where passengers would like to fly directly to Darwin, and they have no choice but to fly to Sydney or to other destinations first and then come back to Darwin. So we know that in the absence - or where there is little competitive pressure on airlines, then they can fly passengers to the airport of their choice, according to what suits best their operation. So we argue that under those circumstances, it's quite clear that airlines do have substantial market power. We talked about the hub and spoke operations and we talked about the fact that cabotage introduced relative disparities in power for airlines, international airlines - are not allowed to on-carry customers under normal circumstances, so they fly empty seats between Darwin and locations on the east coast. Qantas has the opportunity to fill those seats; therefore, they have an advantage over other international airlines, and they also have an advantage over domestic airlines that may operate to the Territory, because they can marginally cost those seats.

Finally, we argue there that we believe that even with Darwin's growth in traffic, if we took out the impact of the Dili crisis and the additional volume that that has generated for Darwin Airport, our growth would have been very flat, and we have actually seen since that time Royal Brunei Airlines are reducing their transit services, Malaysian Airlines have announced that from 1 February next year, they're going to cease flying to Darwin, and we know that Qantas are reducing, on 1 December, their daily service from Singapore-Darwin-Cairns to a three times a week service from Singapore-Darwin-Adelaide return. That brings me to the final list of bullet points that I've provided in submission number 3, and as I've suggested, we will follow up with our written submission after today, and perhaps I can go through that in more detail.

The thrust of our third submission will be to do two things. It will be to suggest that Darwin Airport should be considered, along with Alice Springs Airport, as not being subject to further price monitoring. We believe that any analysis that was done, for example, by the ACCC was not very detailed and we would respectfully request the Productivity Commission that if it is deemed that Darwin does have more market power, or significant market power to continue to be regulated, that a specific review be undertaken to determine that that's the case. Of course we would argue that Darwin does not possess that market power and should not be price-regulated.

We will also comment in our third submission about the current price oversight arrangements and what effect and impact that has on Darwin and Alice Springs airports. So perhaps if I can go through the bullet points now. Firstly, we believe that the compliance costs of regulation are substantial. We argued in our second submission that it's costing us about between 50 and 80 thousand dollars a year. Our total aeronautical revenue at Darwin Airport was - no longer is - about $5 million dollars. So that's between 1 to 1 and a half per cent of the total revenue base just in terms of complying with regulation.

I've already argued about the countervailing power of Qantas back in August when we had two airlines flying to the Northern Territory, two domestic airlines. Unfortunately now we only have one airline flying to the Northern Territory. Qantas has 100 per cent of the market. There is a tiny little bit of trade that has been picked up by Air North and they're flying from Darwin to places like Kununurra and Broome but it really is insignificant in terms of the total number of passengers. Even with the proposed introduction of Virgin Blue services, which I understand arrangements with the Northern Territory government are due to commence at the end of March next year where they propose to fly a daily service between Darwin and Brisbane, with the introduction of that service, Qantas will still have 96 per cent of the total market in the Northern Territory for domestic transport.

The issue of cabotage has certainly raised its head since 12 September and you would be aware that the federal government has allowed Royal Brunei and Malaysian to on-carry domestic passengers from Darwin to Brisbane and to Cairns. I can suggest to you that that hasn't been a particularly successful exercise. By the time it took them to ramp up to sell the tickets, Malaysia's announcement that they intend to cease services anyway to Darwin from 1 February. They weren't particularly keen to do any particular marketing exercise to provide or to fill those empty seats. Royal Brunei had received federal government consent to cease the transiting arrangements at the end of October and I understand they will just be flying two services direct to Darwin and two services direct to Brisbane. So that on-carriage capability and the seats that that would have provided from Royal Brunei will cease at the end of this month.

What it does mean though is that Qantas still has the capacity to carry customers to the east coast through Darwin on their international services, I believe that they will continue to do that, and indeed if Australian Airlines, their low-cost international flyer gets up, then that will certainly be one of their strategies. It just puts any international carrier that wants to land in Darwin and potentially fly onto the east coast at a substantial disadvantage compared to the incumbent carrier.

We argued in our second submission that CPI minus X imposed risks on our airports in the face of flat or declining growth. I don't think anyone really appreciated what sort of impact that would have on smaller airports if there was a major shift or shock. We only have to see the events of 11 September and 12 September to understand just how substantial those shocks have been for airports at Darwin and Alice Springs, and we'll provide details of that in our third submission when we send it to you. But it does indicate that CPI minus X as a forward-looking regime perhaps has less applicability for smaller airports who are less able to withstand those shocks than it is for larger airports.

I've talked previously about the NNI provisions and how they have failed to achieve their original intentions or their original outcomes and we certainly endorse the Commission's finding that they haven't been as successful as they should have been and in our case they have perhaps been quite counterproductive. I make the point there that the collapse of Ansett and the international aviation crisis has impacted on our immediate financial viability - that's a statement of fact - and that we as a responsible business need to have the opportunity to be able to respond. That response needs to allow us to move our prices as indeed any other business would be allowed to do under normal circumstances so that we could continue to provide an appropriate level of service and hopefully achieve some measure of a return on our aeronautical assets.

We will be introducing interim prices and we're working through them at the moment. The reason why we haven't announced them at this stage is you might appreciate that the airline schedules that have been published by Qantas are fairly fluid at the moment. They are not quite sure of what capacity they will have in the Territory and that's (1) according to plane availability and (2) demand is moving everywhere at the moment. So I can appreciate their difficulties in providing firm service schedules for the next six months. We need to know what the quantum of those services will be so that we can adjust our aeronautical charges accordingly. No doubt if those services return back at a later stage then we will make appropriate adjustments then. But we have lost significant income. Ansett was a dominant carrier in the Northern Territory and their loss has been substantial to our two airports.

In addition we have faced increased compliance costs with federal government security measures that have been applied across all airports, but certainly the impact on Darwin and Alice Springs has been quite marked. I give the example of Alice Springs which I think only generates about $1.8 million of aeronautical revenue a year with the latest requirements to provide security guards as the cost of the additional guards is $1 million a year. At this stage we have not been advised by the federal government that those costs are recoverable in any other way.

We will finalise our submission by suggesting that as per our original submission we would like to negotiate long-term commercial arrangements after these interim prices have settled down with airlines. The underlying premise for our position will be in line with the dual-till principles on which the federal government privatised airports, and our appropriate desire to achieve justifiable returns on our aeronautical assets over time. The final point that I've made in my bullet point there to you is that we would respectfully recommend that the current temporary pricing oversight arrangements at airports or whatever changes are made to them or recommendations by the Productivity Commission come into effect immediately as opposed to June 2003 when they were originally contemplated. Gentlemen, that's the thrust of one, two and indeed the third submission that you're yet to receive.

PROF SNAPE: Thank you very much for that. Would your colleagues like to add anything at this stage?

MR GANLEY: Only that we certainly support and indeed agree with what Ian has said. We are certainly experiencing declining growth and we certainly need to review our pricing arrangements. Indeed we strongly support the immediate introduction of the Productivity Commission findings.

PROF SNAPE: Okay. Thanks very much for that. I was interested in the way you described the interim prices a moment ago. As you described it, you were waiting until - if I've got it right - Qantas had determined their schedule because you needed to know those schedules before determining the prices, in other words you needed to get some feeling of how many planes would be coming in, I guess. So that then suggests that your pricing strategy is that you know what your costs are, you hope to know how many planes will be coming in and then your prices are set on a basis of covering costs and getting a return. In other words, you don't seem to be picturing to that that the demand for landing at the airport may be related to the prices.

MR KEW: Let me just go through those points. We know that Qantas have published up until this point in time their schedule until, we believe, 16 December. But even then that schedule seems to be changing weekly and we understand the reason why that is the case. In Darwin, for example, prior to 11 September there were 80 flights a week between Qantas and Ansett. At the moment they're up and scheduled until the 16th of the 12th. There are 39 flights a week. It's a slightly better situation in Alice Springs, but 49 per cent of the flights at the moment in Darwin has had quite an impact on our pricing. Unfortunately airports are a relatively fixed-cost business. We still need to provide runways, taxiways and aprons, and the airfield lighting systems 24 hours a day. The costs of providing security both landside and airside at the airports has increased dramatically with the current provisions of the aviation security branch and things like - particularly at this time of the year in Darwin - airconditioning terminals. The costs don't go away whether we have one plane land an hour or 10.

We have yet to finalise what our interim prices will be, but the quantum of them will probably be quite large. For example as I mentioned at the very start of our hearing today, the equivalent per-Pax charge - and in Darwin and Alice Springs we do not charge on a per-Pax charge, we charge on a landed tonne basis, but the equivalent per-Pax charge for a 737 operation is $2.64 per passenger, and the quantum of charges that we think will need to go through for Darwin is potentially a doubling of that to some $5.60, $5.70, and slightly more than that for Alice, depending on what happens with the schedules.

PROF SNAPE: You would now have a great deal of price freedom under the recent decision, and as you pointed out, the landing charges are a minuscule part of the total fare. So why don't you put your price up to $20?

MR KEW: There's probably some in our company that would love to do that, Richard, but the position that we will take is to be reasonable about it, and we have indeed had discussions already with the airlines - Qantas and with Air North, two domestic airlines operating out of Darwin - advising them roughly at this stage of what the quantum of the changes will be, and talk to them about the timing and the methodology of those changes, but to go back to your point, we don't think it's appropriate to increase our prices to $20, even though it may well be able to be absorbed by the ticket price by consumers.

As I talked to you previously at the last hearing, the current charge for flying into Ayers Rock is $22 a passenger, and when they fly out it's another $22 a passenger; so a total of $44 versus the $2.60 at Alice Springs, but what we need to do is we need to maintain some semblance of our original aeronautical income and we need to also recover the additional security costs that have been imposed upon our airports, and it's on that basis that we are reviewing our interim prices.

PROF SNAPE: Yes, but you have been privatised and you have shareholders, and the shareholders presumably are not interested in being, reasonable, but in fact are making as much profit as they can. So why aren't you shareholders demanding that you increase that price of landing at Darwin very, very substantially in the light of the fact that it would seem that the elasticity of demand or the responsiveness of the demand to a price increase is likely to be very low?

MR KEW: We do have reasonable shareholders, Richard, and the position that they are taking is that a level of increase to the one that you suggested would be unreasonable. We are not proposing to increase our prices to that level, and we can - - -

PROF SNAPE: Is this because they think that there would be a pay-back somehow and in fact that they would in fact get - you know, there would be retaliation by the airlines to such an increase?

MR KEW: I think there's a couple of points there. Firstly the market knows what the true elasticity of demand is, and we certainly wouldn't want to do anything that would damage the growth of our market or the recovery of our market here anyway, depending on what particular view we might take, an impact of a $20 increase in land charges would be. I think in all businesses here we need to show as much restraint as any other business, whether it be airlines in terms of working out the yields that they need to get for any tickets or any other operation at our airport so that we don't damage in the longer term sense what I should say at this stage is a very fragile tourist market here, and we just think that the quantum of the price changes that we have suggested are what we need to get through this interim period. Obviously in the longer term, we would like to move to aeronautical charges that reflect the aeronautical asset base and the operating costs for providing those services, and that would obviously require aeronautical charges that are in excess of the ones that I have talked about, but we would prefer to go through the process of negotiation with the airlines.

I do think that we potentially run the risk - although I'm not saying that Qantas would do that, but we are wholly dependent now on one airline and the patronage that provides to our airport, and we are very sensitive to their views at this stage about what are acceptable or unacceptable increases in our aeronautical charges.

DR BYRON: Could I just come back to the points you were making earlier about the cover charge. Were you suggesting that perhaps any international carrier that flies into Darwin should have the right to uplift domestic carriers onto eastern-coast ports?

PROF SNAPE: Domestic passengers?

DR BYRON: Yes.

MR KEW: Yes.

DR BYRON: Rather than just the offer to MAS and Brunei which wasn't much of an offer in practice.

MR KEW: Well, MAS and Brunei are the only ones that are actually landing in Darwin and then flying onto the east coast. We don't have many international services now, and indeed we're going to have far less international services from February next year. The only other service that comes in is from Denpasar with Garuda Airlines, and they don't fly past Darwin. We believe that at the moment, any Oneworld customer worldwide has to fly Qantas, and Qantas can choose to route that customer through Singapore three times a week and drop them into Darwin. What's more likely is that those passengers will be flown straight to Sydney and have to incur a five and a half hour flight, and another 8 or 9 hundred dollar one-way airfare to get back there. Of course any Star alliance customer in the world now can't get to Darwin at all.

We think that any aircraft flying empty seats in a structural basis is a kiss of death for that service at the end of the day, and we think that it would be great to see airlines like Singapore and others having the opportunity to fly into Darwin, which they can't at the moment or they don't at the moment I should say, and then be able to on-fly to other destinations in Australia which - Singapore is, what, three and a half hours from Darwin, and then fly on to other destinations rather than have to fly to those destinations empty. At the moment we would actually be disadvantaged by our current pricing structure because we only charge for the landed tonnes of that plane, but we would have to review our pricing structures so that we would charge on a per-Pax basis. It's not necessarily to the airport's benefit on a one-off thing, but what it will do is it will grow the market and generate demand in the territory if international carriers were allowed to carry domestic passengers.

DR BYRON: That also relates to your point about the kangaroo route. What I keep reading is that passengers want to have as many non-stop services as possible so that people going Sydney, Singapore, UK wouldn't be particularly interested in a stop-over in Darwin on the way through. Have you got evidence to suggest that Darwin does have a role to play as an intermediate point on that route?

PROF SNAPE: Perhaps instead of Singapore?

MR KEW: That's our point there indeed in making that statement with the introduction of the wide-bodied jets, the Airbus A380s, and I understand existing jets. They could fly to Darwin instead of to Singapore as a destination. Singapore is constrained in terms of flight capacity. We believe - obviously it doesn't happen at the moment, but we believe that maybe Darwin could be - certainly from a physical location perspective it could be an alternative stop-down destination between the trip from London to Sydney, and we would like to encourage that obviously.

DR BYRON: Thanks.

PROF SNAPE: You're implying I think that if cabotage was opened up, then other international airlines may be interested in coming into Darwin and carrying domestic passengers on, that those domestic passengers may give them the incentive then to land at Darwin. Is that correct? So we're not just - - -

MR KEW: Yes.

PROF SNAPE: So it would in fact induce more?

MR KEW: Yes, it is.

PROF SNAPE: Right.

MR KEW: Yes, it is. I mean, we understand that other international airlines are flying out of destinations where they're not full at the moment. If they provide - for example, fly from Adelaide to Darwin with domestic passengers and then pick up international passengers from Darwin and fly on, then we think that would be to their advantage. That would just grow the market for traffic in the Northern Territory and would be to our advantage.

PROF SNAPE: It has always seemed to me that if airlines were able to carry a substantial number of domestic passengers on cabotage, then there would be a problem with Customs and that you would tend to have to have first port of call clearance, and so all - if you are envisaging, for example, a flight that was going from let us say from KL to Darwin and then on to Adelaide, and picking up a substantial number of passengers, potentially, in Darwin, that you would need to have first port of call clearance there and you would have to unload the plane and all the passengers and spend, you know, a couple of hours clearing then through Customs and then waiting for everyone to be cleared and then putting the luggage back on the plane, et cetera, et cetera. That would seem to be an additional cost and inconvenience that could outweigh - that could in fact discourage the passengers who were really wanting to fly KL to Adelaide, and they would find another flight rather than take that with that first port of call clearance.

MR KEW: The current situation, I understand, at the moment, professor, is that passengers that are coming in on those international flights with Royal Brunei and Malaysian Airlines, they come into our transit lounge at the moment and they're managed there, and then they get back onto the plane. So they don't have the first port of clearance.

PROF SNAPE: Yes. I understand that, but if you're going to do it in substantial numbers, then you've got obvious smuggling possibilities, that you slip something to a domestic passenger on the plane who is coming through, and that would seem to me an absolute bonanza for smugglers, that Customs would not in fact tolerate it for very long. Have I got this wrong?

MR KEW: I think - two things. Firstly, obviously transit passengers or domestic cabotage is, as being currently managed at this stage - in terms of airport infrastructure to accommodate that, we're looking at that, and indeed, we are having discussions with Customs at the moment about the very things that you're talking about.

PROF SNAPE: Okay, so are you - - -

MR KEW: The reasons why we're having those discussions is that we're in a fortunate position at Darwin in that we have one terminal, and we're looking at the prospect of introducing a combined domestic and international departure lounge.

PROF SNAPE: I can understand that you can keep people separate in the terminal. You can't keep them separate on the plane, and that's where, it would seem to me, the opportunities would exist for bypassing the Customs, unless you had first port of call clearance.

MR KEW: We understand that there are issues there that would need to be resolved to the satisfaction of the boarder agencies, but we don't believe that they are insurmountable.

PROF SNAPE: So do you - well, perhaps it's a bit of a detour, but I haven't really heard any way yet that would solve that problem and that we could be forced into first port of call clearance, which would clearly be very unpopular with passengers and the airlines.

MR KEW: If it's unpopular with passengers and airlines, then they won't provide the service. So we understand that, but we do believe there are ways of accommodating those requirements.

PROF SNAPE: Okay. Now, the point was then, even if you opened it up for cabotage, that in fact the opportunity may not be taken in a substantial manner, because it would lead to that problem.

MR KEW: If that is the case, then you would be right.

DR BYRON: Just coming back to your comments earlier about Alice Springs Airport. Does the result of Minister Hockey's decision of early this month have implications for future pricing strategy at Alice Springs? Is there anything there that you can tell us at this stage in public?

MR KEW: Certainly. As I said in the submission, we are looking at interim prices there, and the interim prices will apply for both Darwin and Alice Springs Airports. Our intent behind the interim price - and they will be increases, obviously - is to recover some of the lost aeronautical income that we've incurred at both airports, and to cover the increased security costs. It does mean that the quantum of change at Alice is slightly higher than at Darwin, and that's because the respective costs have much greater impact at Alice, and, of course, we've probably lose in effect more services at Alice. So we will be introducing interim prices for Alice as well, but once again, for both Alice and Darwin - you know, we would like to move to a situation where we'd negotiate commercial outcomes with airlines for both airports, reflecting the aeronautical investment, which is different at both airports, and the level of patronage and the level of services that we're going to get at those airports.

DR BYRON: I may not be - I could be mistaken on this, but if Alice Springs is still, as a core regulated airport, under the Airports Act, is it still subject to section

192, not withstanding Minister Hockey's changes, and if so, do you have any expectations of whether section 192 could be activated, if it still applies? Are you thinking about that at all?

MR GANLEY: We are certainly reviewing the regulation that applies to Alice Springs. Certainly, in the prior arrangements, prior to Minister Hockey's announcement, Alice Springs and Darwin were governed by the same principles of regulation and the same reporting requirements were required at both locations. We're certainly looking at the ongoing arrangements for Alice Springs in that two separate provisions apply at both Alice and Darwin, and we're looking at the provisions certainly of the Trade Practices Act and of section 192 as well.

DR BYRON: Thanks.

PROF SNAPE: You were suggesting, I think, in the previous submission, your second submission, that the fact that Qantas withdrew services without consultation, withdrew services at Darwin without consultation, suggested that Darwin Airport doesn't have market power. Airlines argue also that the fact that some airports increased charges without consultation is an indication of airport market power. Do you see consultation as a key to whether you've got market power or not?

MR KEW: I think consultation shows, for the respective parties, how important they think discussing issues with the other party is. Let me just say that in the instance of Qantas withdrawing services to the Territory, we didn't have any consultation with them, and indeed, I think we found out the same day when we were sent a press release. But in the case here, where we are proposing to introduce interim prices, I have met with the CEO of Air North and I've met with the regional manager of Qantas, and I've discussed the issues that are confronting our airports at the moment. I've talked about the quantum of the interim price changes.

I've asked them to consider what would be the best way for them to either absorb or to pass on to the marketplace those charges, whether it would be a continuation of our current pricing regime of charging by the landed tonne, or whether they wish to move to a per passenger charge or a combination of the two, and I've also talked to them about the timing of the introduction. Those discussions have gone quite well at this stage, but we are in consultation, and I think that does reflect the fact that Qantas and Air North do have market power, but also, we want to create meaningful and valued business relationships with our airlines. We're totally dependent on their income. We should have those good relations.

PROF SNAPE: But the consultation itself would not be a determining criterion as to whether there is market power or not, would it? I mean, I occasionally buy toothpaste but I've never been consulted by the toothpaste seller before he increases the prices but I don't think that - - -

MR KEW: Maybe it's just an indication of the relationship or the respect or whatever, but I believe consultation between two parties - airports and airlines - is where we need to move towards, and I think obviously - and we have argued - that airlines have market power.

PROF SNAPE: Could I go back to what you said fairly early on where you were referring to Virgin Blue proposing to come into Darwin, and you said that the consultations there or the arrangements were with the Northern Territory government rather than with you. Would you like to elaborate?

MR KEW: Yes, that's right. My understanding is that the Northern Territory government has provided some incentive for Virgin Blue to commence operations to the territory. I think it's a matter for public record, and I'm not sure what the level of support is, but I understand that the agreement has been put in place and they intend to commence I think from memory the end of March next year.

PROF SNAPE: So you are not party to those discussions? It's not as if Virgin are trying to get - - -

MR KEW: I'm certainly not party to the discussions between Virgin Blue and the Northern Territory government, no.

PROF SNAPE: So it's not as if the Northern Territory government and you together are trying to offer some incentives.

MR KEW: You might appreciate the confidential nature of this but we have been in discussion obviously with Virgin Blue.

PROF SNAPE: I should indicate that this is a public hearing; there is an audience down here.

MR KEW: That's right. We have been in consultation with Virgin Blue. We would love to see Virgin Blue and indeed any other airline come to Darwin and Alice Springs, but at this stage we have not offered any discounts or incentives to Virgin Blue for them to commence using our airport. Before Virgin Blue can fly here, they need to get provision of services. They need to have baggage handling and passenger check-in and ground service equipment and all of those sorts of things, and I'm not quite sure where they're at with that, but if there's anything that, as an airport, we can do to help facilitate their early entry to the Northern Territory market, particularly at the moment where we have suffered a dramatic reduction in the number of airline services to us, then we would do what we can to help.

PROF SNAPE: You don't have a common user terminal or do you?

MR KEW: We have one terminal which is in effect a common user terminal, but at Darwin for example the passenger check-in facilities are leased by the airlines. The airlines are the organisations that own the ground service equipment, so they have the capability, and they provide the staff to handle the bags. At Alice Springs it's a similar situation, but in addition, the airlines there owned the baggage handling systems as well.

PROF SNAPE: Any problem with them gaining access?

MR KEW: Those facilities are covered by existing leases with Qantas and with Ansett.

PROF SNAPE: Yes, and?

MR KEW: Well, it depends on the outcome of discussions I guess with Ansett and the administrator whether any of those facilities become available. It is possible to bypass the existing facilities, but it would be at a cost; that is you would have to put in some alternative methods to manage it - not impossible, but expensive.

PROF SNAPE: Okay.

DR BYRON: We had some discussion earlier this morning with Melbourne Airport about how different sort of pricing structures have different implications for the sharing of risk between the airports and the airlines, and what the events of the last month or so have shown is that this can be a very volatile industry. So who shares the risk of major downturns in traffic volumes and who gets the rewards in the boom times is a fairy important issue. Is the distribution of risk between the various parties a major consideration in terms of your discussions with your airline customers over price increases?

MR KEW: It hasn't been a subject of discussion formally between us - that is we haven't talked about it, but I think that the fact that the risks are not the same for airlines and for airports is quite valid. Obviously airports really don't have the flexibility at the moment - well, they do since 8 October - to rapidly respond. Airlines can move their planes around as they see fit. I think obviously in the instance of Qantas, since 11 September and 12 September they have been very fortunate to have probably improved their position substantially, whereas airports have shown that they are risky investments when you have dramatic downturns in patronage, but it hasn't been a topic of discussion in terms of how we adjust or implement our interim charges.

DR BYRON: I guess I was just thinking of a statement that was made in our previous public hearings - the first hearings in this inquiry. I think from memory it was from Virgin that said something like running an airport is a totally risk-free business. That statement doesn't seem as plausible or as valid as it did then.

MR KEW: If I showed you my financial results for September and October, you would see that the risk is definitely there for airports.

DR BYRON: Thank you.

PROF SNAPE: Okay. I think that I have got through the questions I have and so has Neil, unless there's any final statement you would like to make.

MR KEW: No, only to reiterate firstly our thanks for the opportunity to appear at the hearing, and secondly that we fully support the recommendations of the draft report from the Productivity Commission, our desire which is reflected in our bullet points today - and there will be in our third submission for Darwin to be tipped into the basket with other airports like Alice Springs and Townsville and others, and not be subject to the price monitoring regime that has been proposed. We don't think that it warrants it, and if indeed it does or if it's considered that it does, then perhaps a separate analysis to determine that would be appropriate.

Our final view is that whatever the recommendations are, they should be placed in effect immediately as opposed to June 2003, recognising that the current pricing oversight arrangements as we understand it at this stage are temporary, but once again we thank you for the opportunity to present today.

PROF SNAPE: Thanks very much to you all up there, and we do look forward to the written submission. We hope as much as possible of that can not be commercial in confidence, and obviously we cannot use things directly if they are commercial in confidence, and so we hope as much as possible can not be commercial in confidence, but if there are commercial in confidence parts of it, then we will leave that to discussions with the staff and talk about it. Thank you very much, and we will now break for a little while for morning tea, and review at 11.35 - we will crib an extra five minutes there perhaps - with the Australian Airports Association.

PROF SNAPE: We resume and welcome the Australian Airports Association. If Mr Keech and Mr Forrest would like to introduce themselves for the transcript, thank you.

MR KEECH: Thank you very much, professor. My name is Ken Keech and I'm the CEO of the Australian Airports Association.

MR FORREST: My name is Bill Forrest and I'm a consultant to the Australian Airports Association.

PROF SNAPE: Thanks very much. We've got a very short note from you at this juncture and we understand the problems of getting anything more substantial in light of the events that have been occurring, but we hope we are going to get a larger one in. In any case, if you'd like to speak to it now.

MR KEECH: Thank you very much, professor. In the first instance I'd just like to reflect upon the view of the association that the draft report more generally represents a realistic assessment of the past relationships within the Australian aviation industry. The recommendations seem a fair and balanced approach to any future regulatory regime, whilst retaining a high level of commercial relationship commonsense. We might come back to that in a little while. However, in terms of the airport's perceived - and this is something being pushed by the airlines particularly - monopolistic marketplace dominance and given the impact of the Ansett Australia group demise, it's now likely that the Commission may wish to reconsider some of its findings and recommendations.

This particular question is asked on the basis of the millions of dollars now owed by Ansett to airports throughout Australia. I might also say that the association has encouraged all of the privatised airports to make their own further submissions on the contents of, and the recommendations contained in, the draft report, with particular emphasis on their own local circumstances. I think an example of varying views, if you like, from within the airport membership of the association has been admirably demonstrated by what's been said this morning.

We'd like to, with your concurrence, elaborate and comment further on some of the issues that we've just touched upon. We also believe that nothing of specific concern for the industry seems to have been omitted from the draft report. We do acknowledge that the scope has been wide-ranging and by and large there's been some fairly clear identification of the industry issues and those issues that will be confronting the industry in the near future in the final report.

I'd like to pick up, if I may, and comment on the market power or the perceived market power of the airlines, particularly in view of the query that you raised a little earlier on today, professor, with regard to the sharing of risk. You might be interested to know - and this is a question you could probably ask each of the individual airports - but I think you'll find in general terms that even as of today that the airlines are still refusing to sign conditions of use documentation with the airports. In terms of sharing of risk I think, if nothing else, the demise of Ansett has admirably demonstrated, if you like, exactly the risk exposure that some of the airports experience.

I have recently in the last 10 days conducted a fairly comprehensive survey of the airports around Australia that are owed money by Ansett. There has been a lot of media speculation and a lot of anecdotal commentary about the exact position. I'm able to offer you now, on the basis of commercial-in-confidence, a table of the various airports around Australia, how much they are owed in landing fees, head taxes and other fees, the total amount owed by the Ansett group. The other thing I think is important in terms of marketplace dominance, there has been a knock-on effect which I don't think anybody has appreciated with some of the smaller businesses around Australia that have been left owing substantial amounts of money that could also put these small businesses to the wall. One example that comes to mind is a newsagent in Canberra - a small family newsagent in Canberra - is owed $22,000 by Ansett. People might say, "So what?" That newsagent provided the daily newspapers for the Golden Wing and the various lounges and the magazines. That money has been owed over considerable months. That has the potential to put a small business like that in a very, very financially onerous position. There are lots of stories like that around the country.

What we've also done is we have estimated the impact of the loss of the AN Group revenue on the airport's operating revenue up until the end of the current financial year, 30 June next year, as best we can. We've also done it on the basis of either an Ansett mark I, mark II or mark III or the two Mark twins that are running it, having some sort of an operation that will service the airports and I would offer this in general terms: you might be interested to learn that out of some 50 airports around Australia and also essentially the airports that are subject to this inquiry there is over almost $15 million that is currently owed by Ansett; there's 7 and a half million dollars owed to the small ma and pa businesses around Australia that have their business hanging off an airport, and the likely effect through until the end of June, even with a small operational environment from a renewed Ansett, in whatever form that might take, there's an exposure there of over $82 million. I think in terms of sharing the risk that these figures which I will provide to you confidentially more than admirably demonstrate that there is considerable risk.

MR FORREST: I think too there's a point to note that many of those amounts are long-standing debts and it's interesting that the airports and the other businesses at airports do not have the power or the ability to collect those debts easily from major airlines.

PROF SNAPE: I wonder if it would be possible to put the aggregates - for you to give us a submission with perhaps the aggregates in there that would not be commercial-in-confidence.

MR KEECH: I'm more than happy to do that and that's why I'm waiting to - yes.

PROF SNAPE: Perhaps the aggregates by category if that would be - - -

MR KEECH: Yes, that's fine.

PROF SNAPE: In other words, to disaggregate it as far as possible.

MR KEECH: I understand, without breeching any confidentiality from the membership, yes.

PROF SNAPE: If you could, please. It makes us much easier for us to substantiate things.

MR FORREST: It's just that that information was sought on a commercial-in-confidence basis and that was the willingness of airports to give us that information.

PROF SNAPE: Yes. You may need to clear it but if - - -

MR KEECH: No, there's no problem with the totals.

MR FORREST: Not for cumulative.

PROF SNAPE: Thank you very much. If we could have that. Perhaps you could give that to us separately as a submission with the aggregates in so that that can go along with our regular submissions.

MR KEECH: Okay, that's fine. Also in terms of the perceived market power of the airports with the airlines, I still have a view that perhaps a large number of the airlines - they're quite interesting, aren't they?

PROF SNAPE: Yes.

MR KEECH: Have an appreciation of exactly what the CPI minus X regime has produced for them in terms of cost savings over the last few years. I also would like to offer - this is fairly recent correspondence. It will have to remain confidential on the basis that it is to a third party, it is not to the association, although in most instances you'll find that our name has been taken in vain. But these are some documents that you might find of interest in terms of the airlines exercising market power and also a prime example of the arrogance with which some of the airlines conduct their business activities with the airports.

PROF SNAPE: Thank you. They would have to stay commercial-in-confidence.

MR KEECH: They do, because they are to other parties - third parties - professor.

MR FORREST: It's important for you to see the sort of environment that exists at the present time. One of the things that we have concentrated on in the Airports Association is to get our member airports to deal in particular with the requests for information that are in the draft report, and to that end we are relying on those individual submissions. There's one in particular thought that I wanted to mention, and that was the Part IIIA process of the access regime, and as you will realise from the submissions from the individual airports, the member airports have differing views about the best form of an access regime. However, I think it's fair to say that the overall view is still that Part IIIA provides an appropriate regulatory structure for the future.

I would add to that though that it does need the proposed amendments which you refer to in the draft report which are the national access regime inquiry suggestions that have come from that, and in particular the multiple arbitrations part which has been referred to this morning. I think there's a need for that to be in, but the strong preference that we are hearing from member airports is that Part IIIA does provide the appropriate regulatory structure for the future, and that's of course why the decided preference that has come through from the Australian Airports Association as a preference for option B.

PROF SNAPE: Of course the final report on the access regime is now of course resting with the government, and the government is of course in caretaker mode at the moment. So it will probably take a while for that final report to surface, and without meaning to imply one way or the other, the final recommendations are not necessarily the same as the draft recommendations.

MR KEECH: One of the issues that has been of concern to the airports since the demise of Ansett also is the capacity constraints that have been inflicted, if you like, upon some communities where for one reason or another Qantas have decided that they really would only like to ramp up capacity where there is a competitive environment, be it with Virgin or with the rather restrictive flying of Ansett Mark whatever it might be called. There has also been - and I understand that individual airports will be giving you examples of this, but I would also want to talk about bulkheading which in the industry has a lot to do with yield management, and over the last - to give you an example of what I'm talking about, it really means that carriers can ramp up their yield management or can increase the yield on any particular flight by the movement of the bulkhead between what is normally conceived to be the economy class cabin and the business class cabin. Bulkheading is a term that the airlines use to move that bulkhead around to maximise revenue opportunities.

During the last two weeks I have had occasion to travel to Canberra twice. As you might expect I was unable to get any discount fares, and in fact to be perfectly frank I was unable to get a normal economy fare. However, I - fortunately someone else was paying for this, not the association - I should make that clear. I was able to, on both occasions however, get a business class fare, and when I boarded the aircraft, having had some experience in this business, I was rather amazed to see at what row the bulkhead had been moved to to configure the business class compartment. I think on a 737 when you have got almost 36 seats in a business class configuration, that to me is really making the most of yield management opportunities I think you will find that that is just not an isolated case. So the yield management system of the airlines seems to be working very, very well and particularly over those city pairs where there is a high component of business class travel. They're just force-feeding that front part of the aircraft.

We would like to comment on the issues that you raised regarding guidelines, dispute settlement mechanisms, and also sort of touched upon what might be broadly referred to as a code of conduct for the industry. As an association, by and large most of our members are in favour of pursuing that course of action, although one would assume it would be very difficult to accomplish in the present climate. We would support the comments that Warren Mundy made earlier this morning about how there are some advantages in pursuing that sort of a line, but we really think that at the present time, even with the best wills in the world from the airports, that it would be difficult to accomplish such a monumental issue of having a code of conduct.

As has already been said, the association has a decided preference in general terms for option B. Each individual airport will no doubt reflect upon that in the next day or so, but by and large option B is the preferred position of the association. We would welcome any questions, queries or comments that the Commissioners might wish to ask of us.

PROF SNAPE: Thank you very much, Mr Keech. I guess we would appreciate some more comment on what we have suggested is the monitoring process under option B and what might be regarded as good conduct for example.

MR KEECH: Our view was that the issues that you raised in the draft report may essentially - in any other business could be regarded as just good common commercial sense, but unfortunately in our industry that's not the way the wind is prevailing at the present time, and I might say that this has been raised with the members going back some time ago about the need, if you like, for something that could be referred to as a code of conduct, but I think experience has taught us that the airlines during the past few years have been gaming the regulator, and whilst that continues, it would seem to be very difficult to - the goodwill may be on the side of the airports, but it may not necessarily be reciprocated.

PROF SNAPE: Yes. Well, we were seeking guidance on good behaviour from all parties and not just the airlines as to what you are saying about normal commercial behaviour. There was a sentence in the overview of the draft report which said exactly that.

MR KEECH: That's exactly right.

PROF SNAPE:

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

Well, that's where we are, and what we have been trying to seek is a way out of that situation.

MR FORREST: It may be best in the sense that Melbourne Airport this morning referred to those undertakings and the development of those because I think that's where a role that the Australian Airports Association might be involved, but that is going to depend on effectively negotiations between airlines and airports and start to develop those so that you work out what it is that people expect in the undertakings that gives you in effect a code of conduct, because I guess you are saying in the end that you are going to hold parties to those undertakings.

PROF SNAPE: Well, if they are in fact approved by the ACCC they would be, but that line has not had any success in the airports industry up to now. There were two early attempts, but they were early attempts which didn't get anywhere. It's a question I guess whether attitudes might have changed all around that they could be successful in the future.

DR BYRON: The circumstances have certainly changed a lot in the last three years.

MR KEECH: They have, and within the last month. But the thing is that there may well be a view elsewhere that because of the way those circumstances have changed, that, "Well, why should we bother ourselves too much with wanting to" - I mean, we're essentially talking about just a handful of airlines, if that, at this stage.

PROF SNAPE: You did say that they are still - airlines, as you put it, still refusing to sign conditions of use.

MR KEECH: I think that's a question, Prof Snape, that - I mean, without breaching confidentiality, I'm not in a position to identify those individual airports. But I am sure that if you were to ask the question of them during their presentations, they would give you some indication as to what the current situation is.

PROF SNAPE: I am not asking you to identify the existing ones, but can you give us a bit more flavour of that situation that may not identify but - give us some information but not identify the particular airports?

MR KEECH: Well, there are occasions where there have been discussions with the local airport manager, general agreement, giving due regard to the local conditions, then correspondence is entered into with the appropriate people in head office. You wait six weeks, you then chase up, et cetera. By and large, the initiation of the consultative process on the one hand is totally ignored by other parties on the other, and it makes it very, very difficult. Conditions of use documents have been to try and formalise the relationship that exists and the way the facility at the airports are to be used. It makes it very difficult if one party refuses to sign it.

PROF SNAPE: Are these conditions of use generally of a general nature at an airport? For example, if an airport has got both regular commercial traffic and small aircraft as well, general aviation, using both, is it the practice to try and have a common condition of use that goes across all users, or do they distinguish according to the nature of the business?

MR KEECH: They usually distinguish with the nature of the business, and you're talking about a condition of use document that would be specific to an airport with an RPT operation. General aviation people are very reluctant to pay their way - sorry about this, Commissioner - very reluctant to pay their way at any airport, I might add. So to collect money out of - if you're successful in collecting money out of a lot of the general aviation people, you're doing very, very well - present company excluded, of course.

PROF SNAPE: Thank you. From one that we viewed, a tentative condition of use, a proposed condition of use - it included such things as a right to move planes, which might have seemed to be quite a reasonable thing if you're talking about general aviation where the plane, a small plane, was parked somewhere that they - you know, is parked for several months, perhaps, in a particular place, but may not have been as reasonable a condition to have for a 737 operated by a commercial aircraft.

MR KEECH: I must say that, to be perfectly honest, I'm not aware of any such clause in any conditions of use about where the airport owner or operator has made a determination that under whatever circumstances, they should move an aircraft.

PROF SNAPE: Well, we can't pursue that any more.

MR KEECH: No.

DR BYRON: Yes. Following up the earlier comment about the politicisation, I guess, of this debate. I was wondering if I could get an on-the-record reaction to a statement that was attributed to the chief executive of the Federation of Travel Agents in the Australian Financial Review last Friday:

> *There is no excuse for what happened on the Gold Coast this week when Coolangatta Airport put up its fees for passenger jets by 70 per cent. A lot of these private airports are setting out to gouge the travelling public,*

just when we need to encourage foreign and domestic tourism.

There does seem to be an argument, particularly from the airlines, that in the very dire sort of commercial circumstances in the whole industry, maybe airports should be talking about lowering charges rather than increasing them. Any comment?

MR KEECH: Well, I don't have a personal view. My views would be the reflection of the vast majority of the members, and there are some different views within the membership, for which I - you know, they are running their own businesses and they are entitled to call the shots as they see fit, for whatever reason. I did see that article to which you refer in the Fin Review. I think it was Ian Carew-Reid - was the person that was quoted. Of course, you know, everybody at the present time, when they go for a headline in the newspaper or the media, have got their own particular barrow to push, and travel agents, as you know, there are - there has always traditionally been two camps, if you like, within the travel agency industry. One supported Qantas and one supported Ansett and the various affiliates. So I guess it depends on which particular barrow one is pushing, because it does have a significant impact on the bottom line of travel agents. So I don't think they ought to be concerned too much on what the airports are doing. The point you raise though, with regard to the Gold Coast putting their prices up by 70 per cent, I am not aware that that has been the level of increase, and I think they're coming tomorrow, aren't they?

DR BYRON: Yes.

MR KEECH: Perhaps they might be able to answer that in more detail than what I can.

MR FORREST: There are two things though that I think can be borne in mind right now. One is that you've heard from Northern Territory Airports this morning of the framework within which they're working, and I doubt that that's any different for Gold Coast Airport, and the other thing is that Gold Coast in particular is subject to competition with Brisbane Airport and transport services from Brisbane Airport to the Gold Coast. So it sounds unlikely to me that Gold Coast Airport would be going out of its way, because it doesn't have that market power that perhaps another airport does have.

DR BYRON: I guess the general point is that many of the phase 2 airports, as a result of Minister Hockey's decision, will now be seriously re-examining their level of charges and, I imagine, assessing what they think the market can bear and what they need or would like to earn, and presumably enter into some sort of a negotiation or discussion with their major customers. But we can expect to see substantial amounts of movement, possibly both up and down, as airports around Australia implement their own commercial strategies.

MR KEECH: I'm not so sure that it may necessarily be substantial. I mean, what

Ian Kew from Darwin said this morning was that they want to sort of responsibly go about the way they handle this whole process, and I think you will find that by and large, most of the other airports will conduct themselves in much the same way. I don't believe that you will find that the airports will be, to quote the words used in that newspaper article, "Gouging the market," because they're just not able to. There are other people gouging the market in a much more effective way that what the airports are.

PROF SNAPE: You referred to the amount of money which is owed, and as you said, it totals about $15 million to the airports. Where do airports stand in the line-up of creditors?

MR FORREST: I think they're general unsecured creditors - - -

MR KEECH: Unsecured.

MR FORREST: - - -and that's true even for the airport charges, in some cases. - not in all necessarily. If it has been collected on behalf of the airport, then there is an argument that it's a trust amount that needs to be segregated.

PROF SNAPE: Okay. Are you aware of a situation with respect to the domestic terminal leases at the airports?

MR KEECH: I think you will find that in a number of instances, the administrator has ensured that he protects as much of what is likely to be a future business activity as possible, and that they - when I say they, the domestic terminals - are, in some small way, quarantined at the moment by either advanced payments or the rent being paid or whatever. But that's - - -

PROF SNAPE: So you're suggesting that they're not in fact owed on the leases.

MR KEECH: In some instances they are.

PROF SNAPE: But as a general - - -

MR KEECH: I think it would be more appropriate - I can't comment but some airports may wish to comment on the record or even off the record, professor, to make life easier in terms of your assessment of the situation.

MR FORREST: But if it was a matter of legal advice generally, if you pay the rent then there's no grounds for the airport to intervene or affect that situation.

PROF SNAPE: Pay the rent and they can't throw you out.

MR KEECH: In simple terms, yes.

PROF SNAPE: A number of the regional airports may be in dangerous positions - perhaps the phase 2 ones we were told this morning, and you heard the Melbourne comments on that as regard the phase 1 airports, or the principal ones. What could you imagine would happen to phase 2 airports if in fact they can't continue operating?

MR KEECH: I think it has the potential to become a very serious situation, particularly when you look at some of the amounts of money that's outstanding, that is owed, and with little likelihood of recovery. I think it could have a serious impact. It does concern me.

PROF SNAPE: But the airport will remain there, won't it? It's not as if the airport is going to be taken up and put somewhere else. It's not a movable asset.

MR KEECH: No.

PROF SNAPE: The airport will remain there. So long as it's maintained in some way or other, planes can still land there. So what would you be seeing down the track if the bleak scenario is there, that they're taken over by local authorities or what? We know that the airlines themselves can't purchase them under the current regulations. What would you see? In a sense you could say that so long as the airport is going to continue to operate in some manner then an airline may not worry about the current owners going bankrupt.

MR KEECH: I mean, if I was in an airlines shoes it wouldn't bother me in the slightest. As long as I've got access to a facility that I can carry my passengers to and from. Ownership of a facility - - -

PROF SNAPE: But you'd have to be confident that that facility was going to continue there. So how would you - have you got any thoughts as to how in those circumstances that asset might be managed?

MR FORREST: In the short term - I think we heard from Northern Territory Airports that there are negotiations with the airline or airlines and the airport owner as to how the cost of running that airport can be apportioned. That was really, I think you pointed out, a cost plus basis for the time being and that probably makes good sense to an airline to agree to that to have the airport open. If the airport owners went into liquidation, I mean any other operator is going to have to recover those costs of the aeronautical services at least.

PROF SNAPE: Of the aeronautical services but not of course the cost of what was initially paid for the - - -

MR FORREST: No, that's correct. But, I mean, basically what I was hearing this morning from Northern Territory Airports was that they were looking at their costs of operating the aeronautical services and apportioning that to the sole surviving airline. The comment from Gold Coast in respect of that with a 70 per cent increase is perfectly understandable if you had the bulk of your business coming from Ansett. You'd get a price increase of that order simply to cover the costs.

PROF SNAPE: If you were operating on cost plus and not taking account of the competition from Brisbane perhaps, as you pointed out before.

MR FORREST: But you're looking probably in the short term at your variable costs and recovering them to keep operating and that would be true of whoever was trying to operate that airport.

MR KEECH: There are also some serious implications with regard to the licensing of the airport, the staff concerned. You've got to maintain standards to CASA's requirements and in many instances ICAO requirements. That also has liability issues. There are a lot of things that can impact upon how the airport continues to operate. But some of them, as you'll see from those figures there, are in a very serious situation.

PROF SNAPE: Yes, okay. That has been very helpful and, as I say, we look forward to those other submissions that I referred to - sanitised as little as possible.

MR KEECH: Thank you, professor. Can I just apologise that I won't be here this afternoon or tomorrow and it's through no lack of interest but as you probably are aware, the industry lost one of its great identities over the weekend in Don Kendell and it's his funeral first thing tomorrow morning in Wagga and I'll be up there to represent the membership.

PROF SNAPE: Having already attended two funerals this week I appreciate your position.

MR KEECH: Thank you very much.

PROF SNAPE: We will now adjourn for lunch and we'll resume after lunch at 1.30 pm with Sydney Airport.

(Luncheon adjournment)

PROF SNAPE: We resume our hearings and we welcome Sydney Airport Corporation Ltd and we have Mr Schuster, if you would like to identify yourself for the transcript please.

MR SCHUSTER: I'm Dominic Schuster, manager of economics for Sydney Airport.

PROF SNAPE: We have a short summary of a submission which we hope we get a longer one subsequently.

MR SCHUSTER: Indeed you will.

PROF SNAPE: Good, and if you would like to speak to it or elaborate on it, we would be very interested to hear.

MR SCHUSTER: Thank you. Just for those of you that are used to seeing Steven Fitzgerald in this role, I have recently taken over the position of manager economics after Steven was lured to another job at Sydney Airport. Sydney Airport strongly endorsed the Productivity Commission's recommended approach of a five-year probationary period of light-handed regulation involving prices monitoring of various airport services. This regime recognises that the best economic outcome is not achieved by maintaining artificially low prices, but by ensuring economically efficient prices. Airports do not have a significant degree of market power in all areas of their business, and where airports do possess market power, there are sufficient balances to prevent them from misusing that power.

Against the existing framework of price regulation, it's both likely and reasonable that aeronautical charges will rise for at least some airports. Most Australian airports feature inefficient pricing structures derived from the former Federal Airport Corporation's network charge structure and single till, and these are unlikely to provide a satisfactory return to airport operators or appropriate incentives to invest. Indeed the government's objectives for the sale of the phase 1 airports of Brisbane, Melbourne and Perth included the provision of quality airport services and responsive economic development of the airports. Clearly these objectives will be difficult to achieve without an appropriate long-term regulatory regime.

While Sydney Airport's charges have recently been brought much closer to efficient levels, the airport will need to be able to respond over time to increasing capacity constraints. Non-price rationing will not ensure the most desired slots go to those who value them most, and a failure to react to capacity constraint will lead to a sub-optimal use of airport capacity and incorrect signals of the need for additional investment. It is particularly important with decision on a second Sydney airport not expected before 2005. While we will look first to rebalance charges between peak and off-peak, over time and as capacity becomes increasingly constrained, this may not be feasible.

Sufficient incentives exist under the proposed light-handed monitoring regime for airports not to misuse market power by raising charges above efficient levels. The thread of reintroduction of a more onerous regime at the end of the five-year period is a very real disincentive. The price notification process is cumbersome, it's very time consuming, and it has highly uncertain outcomes. The ACCC or other regulator will have ample information under price monitoring to assess behaviour and keep government, industry and the public well informed, and airlines will continue to have and exercise countervailing power. Individually and collectively, airlines represent a powerful, well-informed and well-resourced customer group. 20 of Sydney Airport's airline customers recently demonstrated this in their recent litigation and the commercial settlement of that.

Airports have strong commercial incentives to increase airline traffic. Additional air services not only increase aeronautical earnings, but they boost revenues in areas such as retail and carparks, and for Sydney Airport, some two-thirds of our revenue comes from non-aeronautical sources. The anti-competitive regime under the Trade Practices Act also provides and effective and appropriate disincentive to the misuse of market power and a potential remedy. The deregulated environment should be characterised by commercial agreements between airports and their key customers. Commercial agreements have of course been reached under the existing regulatory framework such as with Virgin Blue and Impulse on their start-up arrangements, and with major airlines on conditions of use and the passenger service charge.

However under the existing regulatory structure, airlines and key airport users do not have an incentive to reach a compromised position during negotiations. The ACCC's price notification assessment process may achieve a better outcome for them than commercial agreement because of the apparent conflict between the ACCC's consumer advocacy role and its efficiency considerations. Indeed, section 192 of the Airports Act provides another such disincentive demonstrated, I think, recently with the case of the Melbourne Airport common user terminal where that access regime almost overturned an existing commercial agreement.

The Commission's less preferred modified status quo option would retain many of the undesirable features in its existing regime, and it would entrench economically inefficient prices. This would not address the non-location-specific nature of charges at major airports. For Sydney Airport it's difficult to see how the modified status quo regime would work to achieve aeronautical prices that reflect opportunity costs. Prices that reflect opportunity costs would be best achieved in an iterative manner and through negotiation, and that would require flexibility which is not consistent with price regulation.

The Commission suggests that at most the modified status quo should involve price notification for increases above CPI to allow for peak period demand and to accommodate investment. However, this arrangement would make little appreciable difference for Sydney Airport compared with current arrangements. It would provide the same constraints as the current regime to - efficient price responses over time to manage peak demand and to optimise capacity. In terms of assessment of good behaviour, the assessment of whether to reintroduce a more onerous regulation regime at the end of the probationary period should be based in our view on significant, demonstrable abuses of market power. Appropriate considerations might include the number of complaints by airport users, the extent to which commercial agreements have been developed with airlines and other airport users, the numbers of applications for access declarations, and other indicators of behaviour such as action taken to restrict the capacity and quality of service of course.

Guidelines for good behaviour can be beneficial, but they are not essential to the success of the preferred light-handed regime, and they certainly shouldn't be prescriptive. While price efficiency is clearly a primary indicator of whether charges are excessive, caution needs to be exercised in relying too heavily on a technical assessment of individual prices with all the accompanying debate about the appropriate assumptions, and the risks that that type of regime would appear to be regulation by formula.

Turning lastly to access. Section 192 of the Airports Act needlessly extends the access regime beyond services and facilities that are uneconomic to duplicate and are of national significance. Application of Part IIIA of the Trade Practices Act provides a suitable and adequate means for resolving intractable disputes about pricing or other terms and conditions of access. There are however a number of procedural changes to Part IIIA that Sydney Airport would endorse. These are generally based on Part 11C of the Trade Practices Act, and they would include a statement of objectives to provide a better balance between price setting and a need to promote adequate investment in infrastructure and adequate returns for infrastructure providers; better facilitating the development and acceptance of access undertakings, and that could be done by requiring statement of reasons for rejected undertakings and providing appeal provisions.

Another change we would endorse would be to improve the incentives for parties to reach commercial agreement by giving the regulator power to issue enforceable directions to negotiate and to mediate at the request of the parties.

Just in summary, airlines and passengers expect a certain quality of service at airports. Airport owners require a reasonable return on their investment, and the economy relies heavily on an efficient airport system. The Productivity Commission's preferred option B provides an appropriate regime for this to be achieved.

PROF SNAPE: Thanks very much, Mr Schuster, for that, and I wonder if you might just tell us about congestion at the moment in Sydney. How have the events of the last month or so affected the congestion at Sydney?

MR SCHUSTER: As you would appreciate, slot allocation and slot usage are slightly slower to respond than passenger loads. So at the moment what we are seeing is lower passenger loads coming in - particularly internationally - with less response at the moment through slot usage. So our allocated slots are still full in four of the peak hours, and quite full in four shoulder periods, and we're obviously keeping a close eye on the way slots are being used in the slightly longer term to assess the longer term effects of that.

PROF SNAPE: So even with Ansett which probably had about a third of your peak hour slots - - -

MR SCHUSTER: Sorry, yes, domestically you are right. A lot of slots have been notionally freed up by Ansett. They are not being used - not all of them are being used. Some of them are being used by Air Pelican and Kendell, and some are being allocated to other carriers in the short term, but the government has put in place protections. Those slots aren't lost by not being used in the current season. So at the moment, yes, we have fewer landings, but those slots haven't been completely freed up as such.

PROF SNAPE: How do you see that working out into the future? You must have been taking a view as to how the congestion in slots would be affected into the future?

MR SCHUSTER: It clearly places a slightly different perspective than we may have had six months ago on the imminent congestion of Sydney Airport. We're clearly developing traffic forecasts for the type of usage we would expect to see. That obviously involves a lot of assumptions about the rate at which the economy will recover and the way those slots may be picked up by other users. So I guess it's fair to say we're reserving our position at the moment on that. But you're right, it should in theory mean there are more slots available that we would otherwise have thought in the longer term.

PROF SNAPE: Slot management scheme sets out criteria for allocation of - reallocation of slots, rather. How do you see the likely outcome of the redistribution of slots if Ansett doesn't recommence?

MR SCHUSTER: It's probably not - we probably don't know enough about the regime that will be used to make a good prediction of reallocation. I know the government is actively considering the way the slot regime should be used in the medium term to reallocate slots. Indeed, they've reacted initially by acting to protect some of the slots that Ansett held. If there were no changes whatsoever, I think it would be apparent that dominant airlines such as Qantas would take up a lot of slots, and there's risks about slot availability based on that, but you would have to consider that the government and the Minister for Transport may make amendments to the slot regime to keep that more competitive.

PROF SNAPE: The ACCC pricing decision for Sydney Airport, does it provide a framework for efficient operations and investment, as it were?

MR SCHUSTER: I think it provides a substantially efficient framework. You would be aware, of course, we had some differences of opinion about the basis of land valuation and other matters, but on the whole, I think we've moved much more closely to an efficient pricing structure on average than many of our other Australian airport counterparts. We try to take one challenge at a time, and having achieved that, we would now look to a system of reportioning costs to better manage the peak and the off-peak period. So it would be hard to say that were completely efficient now, for they don't have that peak consideration. That would be our next challenge.

PROF SNAPE: So your next challenge is to increase the fees for peak. Is that - - -

MR SCHUSTER: Well, to first look at reallocating fees between peak and off-peak, yes.

PROF SNAPE: You mean decreasing them off-peak and increasing them on-peak? Is that what that word means?

MR SCHUSTER: That would be the first approach you would take, yes.

PROF SNAPE: Yes, okay. So peak load pricing would in fact be on your agenda?

MR SCHUSTER: Yes.

PROF SNAPE: Now, what sort of price do you think would you be able to go to that would equilibrate the supply and demand in the peak periods?

MR SCHUSTER: It's fair to say we haven't done the sort of modelling required to present views here about the sort of price you would need in a peak. Looking in the first instance to reallocate charges obviously places something of a restriction on how much you could increase them, but it's far too early days to make a view about that.

PROF SNAPE: Mr Krolke has got a future for the time being, has he?

MR SCHUSTER: It would appear that way.

PROF SNAPE: Yes. You're not putting him out of business by your pricing policy?

MR SCHUSTER: No. No, I don't think the pricing policy would replace the slot allocation regime - not imminently, certainly.

PROF SNAPE: That's not an ambition?

MR SCHUSTER: No.

PROF SNAPE: Why not?

MR SCHUSTER: I guess you'd need to be looking at - even at an outcome where peak and off-peak prices equalise the value of the slot, at the very least, you would probably need an administrator to manage the allocation of those slots, if there was some form of trading system eventually introduced.

PROF SNAPE: An auctioneer, you mean?

MR SCHUSTER: Not an auctioneer, an administrator.

PROF SNAPE: Yes, but - well, you're not - - -

MR SCHUSTER: I don't think that a slot auctioning system provides all the answers necessarily. They can be more complex than simply peak period pricing.

PROF SNAPE: Yes, but slot trading could, could it not?

MR SCHUSTER: Wherever slot trading - that's slot trading with differences in value of slots?

PROF SNAPE: Yes, with the buyer and seller negotiating the price at which they would trade, just like in any other market where there is scarce resources.

MR SCHUSTER: It's certainly one of a number of options, and I wouldn't advocate one over the other necessarily. Where you're looking at incentives for new investment, I think slot trading can obscure the signals to an airport operator and it can lead to - not confusion, but a more difficult regime where new slots become available and how you value those compared with the existing slots.

PROF SNAPE: Presumably if there are new slots that are available, you simply just sell them in one way or another, just as when rezoning of land in the community - you get some new blocks of land, you put them up for sale.

MR SCHUSTER: That in itself makes sense, I agree. The shortcoming would probably still be where the signal is provided to the airport operator about the ability to recover new investment. I mean, there's some dichotomy there between the slot, who managed the slot trading system, and the airport operator.

PROF SNAPE: Yes. Well, there has to be a decision as to whose slots they are in order to sell them.

MR SCHUSTER: Yes.

PROF SNAPE: Who has the right, who has the property rights in them - but wouldn't a clearer definition of the property rights facilitate commercial relationships?

MR SCHUSTER: It wouldn't facilitate commercial relationships in - I mean, on the whole it may, if - it would depend on who you decided owned the property rights, really. If you decided they were owned - - -

PROF SNAPE: Well, it's a general proposition. It's where property rights are poorly defined that your market fails, and so you get over-fishing, because the property rights to fish aren't well defined, or you get salination, because the property rights to salt-free environment isn't well defined, and so on and so on and so on. It would seem to me that if property rights to the slots were defined, and it's a second consideration as to who actually owns them, but who has those property rights, then you would in fact tend to ensure a better - a more efficient allocation of those slots.

MR SCHUSTER: Well, there's no question it would provide a better indication of the value between owners and people who wanted to own the slot. Where it still falls over against, I think, against a peak pricing type model, is the way those values are indicated to the airport operator.

PROF SNAPE: Well, I mean, if you're selling slots for different types of day, you have an inbuilt peak pricing model. You don't have to - the regulator or administrator doesn't have to - or the airport doesn't have to say, to make a judgment of what price would clear that market. They just let the market clear itself.

MR SCHUSTER: But they don't get a clear idea of how much parties would be willing to pay for additional capacity.

PROF SNAPE: Well, that's what the markets generally determine. If I've got an antique piece of furniture, the market tells me what it's worth.

MR SCHUSTER: If you have information, full information about the antique market - - -

PROF SNAPE: Well, the price reflects the degree of information that is available.

MR SCHUSTER: I mean, I couldn't form a definitive view on the superiority of one to the other.

PROF SNAPE: I've probably teased you enough on that. I'll let Neil ask you something easier.

DR BYRON: Thank you. Coming back to the comment you made about having moved much closer to what you see as efficient price levels, you've also had the restructuring of charges from tonnage-based to passenger - - -

MR SCHUSTER: From 1 November.

DR BYRON: Yes. We had some discussion earlier this morning about the restructuring of charges, especially insofar as the consequences relating to the distribution of risk, the downside risk in these uncertain times and the upside potential in hopefully much better times. So have you got any indication so far on the impact of change to passenger-based charges, or even if you don't have evidence yet, can you tell us more about your expectations of what it will mean?

MR SCHUSTER: Well, I guess, by way of background to our move to passenger-based charging, that was something that emerged through commercial agreement with the airlines in the context of our commercial resolution of our dispute.

PROF SNAPE: Does that mean they proposed it to you?

MR SCHUSTER: It means we agreed with them, in the context of resolving the dispute. I think it's fair to say both parties were attracted to it. Not all airports, of course, would be as prepared to share risk, perhaps, as we are on this issue. The passenger charge level was set to provide a revenue neutral outcome for the airport, recognising that there were risks arising from that. On the face of it, if, as passenger loads decrease, there is the potential for us to burden some downside - the burden of downside risk, but that may only be in the short-term. So we've certainly looked at it, and I wouldn't want to take a short-term view about it, I think is the answer. It wouldn't be - we've only just implemented it. Clearly that was before the recent downturn, but you'd want to take a longer-term view about the affects.

DR BYRON: So you're not at all put off by the very short-term crisis aspect?

MR SCHUSTER: No. One thing - - -

DR BYRON: Presumably the passenger-based charges are long-term, in there for the future?

MR SCHUSTER: Yes, that's the way we've moved. Our risk is mitigated, to some extent, by domestic charges still being on a take-off aircraft rate base charge, and we've really yet to test how the passenger charge works out. So it's probably too early to form a view about the effects of the downturn.

PROF SNAPE: It has been reported that Sydney Airport has negotiated conditions of use agreements with major airlines.

MR SCHUSTER: Fairly reported, yes. We have executed conditions of use agreements with 20 of our airline customers.

PROF SNAPE: Can you tell us what the main features are of those agreements, and how did the negotiating process work?

MR SCHUSTER: The agreements don't go to the extent of a service/price/quality type undertaking, that I think some people perceive they might. They are your more generic conditions of use document. What Sydney Airport was seeking to do was to secure commercial agreement and certainty from its airline customers about the application, and acceptance of those terms. So they don't differ markedly from our pre-existing conditions of use, other than they have different charge schedules. The real benefit for us was commercial certainty about their application.

PROF SNAPE: Okay. Can you fill out some of the main features of it?

MR SCHUSTER: Well, the main features are we provide runway and taxiway services and we provide passenger processing facilities. Aircraft pay a certain price, depending on the number of passengers or the weight of the aircraft. They provide us with information about passenger numbers, to allow charging on a passenger basis.

PROF SNAPE: That's new, isn't it?

MR SCHUSTER: That's new, yes, but you wouldn't be able to implement a passenger-based charge really without that. There are provisions for interest penalties where fees are late. They're not revolutionary documents by any means.

PROF SNAPE: Okay. The obligations on you are obligations with respect to availability within a certain time of the scheduled time or anything like that, subject to weather, of course?

MR SCHUSTER: Yes. We certainly agree to make the airport available for allocated slots within curfew hours.

PROF SNAPE: Is there a penalty if it's more than, say, 10 minutes late?

MR SCHUSTER: I'd have to double-check that, if you'd like. I don't recall there being any penalties on service in that way.

PROF SNAPE: So this is a "best endeavours without penalty" type agreement?

MR SCHUSTER: That's my recollection.

PROF SNAPE: Yes, and what about the - - -

MR SCHUSTER: Just to clarify that they don't go that next step to, you know, quality and other - the next step to this sort of agreement would be issues such as quality and penalties. These really are your more generic - - -

PROF SNAPE: So you're not giving any guarantees about potholes on the runway or anything?

MR SCHUSTER: No.

PROF SNAPE: What about the - it doesn't seem to be a particularly dramatic change from the past, but was the negotiation smooth?

MR SCHUSTER: The negotiation was hurried - not hurried along, but there was a commercial imperative, I guess, for the airport. We certainly wanted clarity about the application of our new fee structure, and we had the spectre of privatisation hanging over us. That probably assisted things moving along. But as it was a good commercial outcome, I think both parties were happy with what happened. It wasn't a protracted and acrimonious - - -

PROF SNAPE: Okay. We suggest - a point we made in the draft report was that without specifying what the pricing policy was to be in the future, the bidders for Sydney Airport didn't really know what they were bidding for. Now the sale has been delayed a little bit, but it may or may not be that the pricing policy will have been determined by the time - or the available pricing policies would have been determined by the time the airport is due to be sold. Do you have any comments on our comments on that?

MR SCHUSTER: Certainty is always nice. I mean, it's difficult to argue with that. The effect on the sale process or the - I presume you're talking about the outcome for the taxpayer through the sale of the airport, of certainty. There's other considerations in the sale process. The intensity of bidding pressure will depend on how generous or restrictive a view buyers will take about the regime. If there is uncertainty, there's always the potential that the long-term regime will be more generous than what's anticipated at the time of sale. But through the sale structure itself, that effect can be less dramatic than it might otherwise appear.

DR BYRON: I had a question. Coming back to the point about congestion, I think in your opening statements and in the written notes, you say that, "As the airport becomes increasingly constrained, the airport will need to be price-responsive to cater for peak demand and undertake new investment to optimise capacity." It seems to me that there's already some externally-imposed constraints that restrict capacity significantly - - -

MR SCHUSTER: Clearly.

DR BYRON: - - - in the curfew, the movements limit and the regional ring fence, for example. I guess what I was wondering when I read that sentence the first time was, is it obvious that the airport would make substantial new investments to increase its physical capacity, when in fact many of the capacity constraints could be resolved by removing some of those restrictions?

MR SCHUSTER: The environment we're working in is certainly imperfect, based on that, but they are externally-imposed restrictions, and in an environment where you had to make a decision between capacity, expansion and changes at the margin to some of those regulatory impositions, I think it would be incumbent on the airport to discuss those with government. But they are the restrictions we operate under, so we have to assume that they are there to stay.

DR BYRON: But, for example, if there was a secondary slot market, coming back to this, it would reveal the shadow price of the capacity constraint very clearly.

MR SCHUSTER: Yes, it would.

DR BYRON: So the opportunity cost of having small regional aircraft on the runway, as opposed to another international 747, would become quite striking. I mean, the process would generate the information that would reveal the cost of those constraints, wouldn't it?

MR SCHUSTER: Indeed. I believe so, bearing in mind that there's a limited amount the airport itself could do with that information. They are a government - - -

DR BYRON: But is there scope, for example, having a minimum landing charge that might encourage some of the smaller regionals to voluntarily move somewhere else, such as Bankstown?

MR SCHUSTER: We would need to be careful in considering the way we treat aircraft within the regional ring fence. The previous government was very clear in its views on that.

DR BYRON: Yes.

MR SCHUSTER: Certainly, against our policy framework, we'd have to look first at perhaps a minimum charge that was more inclined to affect small aircraft outside of the ring fence.

DR BYRON: Yes.

MR SCHUSTER: That would be where you'd need to look first.

DR BYRON: Private Lear jets, for example?

MR SCHUSTER: Yes, and perhaps even frequent turbo-prop operations, because we need to be very cautious about the way we treat aircraft within the regional ring fence.

DR BYRON: Okay. Thank you very much.

PROF SNAPE: Go ahead, Neil.

DR BYRON: I was just wondering whether you've had an opportunity see the submission that we've had from the ACCC.

MR SCHUSTER: I've had a very brief look at it, yes.

DR BYRON: Did you happen to notice that they have an estimate there of what they think that the unconstrained profit-maximising charges would be?

MR SCHUSTER: I did.

DR BYRON: Any comment?

MR SCHUSTER: I had a few initial views about that. It doesn't seem entirely fair to me that the ACCC is putting forward its judgments about how we would behave, that way Sydney Airport would behave in an unconstrained environment. I haven't seen the assumptions underlying that figure, but I fail to see how it could take into account the other commercial constraints we operate within. The way it was put forward in the ACCC submission was curious, because it seemed to be saying, "Well, look at the horror of this. If they were allowed to, here's how much you would pay per passenger. We've worked this out on an efficiency basis, and look at it," and that says to me that the ACCC's concern is frequently a magnitude of price rather than efficiency of price. But without having a look through the assumptions, I couldn't form a view about the dollar figure, other than say I don't know if it takes into account all the pressures we operate within.

PROF SNAPE: I take your point that you mentioned about good behaviour and guidelines that are not essential to the success of a preferred light-handed regulatory model. So I wondered if you - are you really saying that if we were to go in the option B, that you don't really think that there should be much specified in terms of good behaviour, because that would lead the regulator to be giving you ticks and crosses against a whole menu of behaviour?

MR SCHUSTER: That's certainly my view.

PROF SNAPE: Yes. You mentioned one or two points. Would you like to suggest any other criteria, overriding criteria that could be used to assess good behaviour?

MR SCHUSTER: I'm hesitant to put forward an overriding criteria. I don't know - - -

PROF SNAPE: A few of them, not just a single one.

MR SCHUSTER: Just generally about the way good behaviour is assessed, I guess it comes down to your view about the way the review were being undertaken. It appears to me that a probationary regime, at the end of that time, it wouldn't be purely binary as to whether you remained with that or you moved back to a regulatory model. So I've just got some concerns about a good behaviour criteria that says, "Okay, we're at five years. Which way do we go, ticks and crosses?" I'd rather look at it in terms of a regime that was here unless there were demonstrable problems with it.

PROF SNAPE: I might say that our intention here was in fact, in this probationary period, to get away from the binary scheme.

MR SCHUSTER: Yes, and that's my reading of it, indeed.

PROF SNAPE: Yes, and so a possibility after five years, of course, could be a continuation of monitoring, rather than to go to one or the other and - - -

MR SCHUSTER: Indeed, yes. In terms of the more important indicators, the sort of ones I've reflected in there - or are they not in there? They're only in one of the other - the ones that I've mentioned - were the main types of items that I think you'd want to consider, and I think it's reasonable to have regard to the efficiency of prices. But I just - - -

PROF SNAPE: How would that be judged?

MR SCHUSTER: It's difficult to get away from an examination of your cost base and your revenues, but I would caution against using it as a strict indicator rather than a general test.

PROF SNAPE: But if you're using price to - if you've got a constrained airport or constrained at certain times, so you've got essentially a vertical supply curve at a fixed amount, then the efficient prices hasn't got anything to do with costs, has it?

MR SCHUSTER: In that environment, come the end of five years, I'd like to see that we would have agreements with airline customers in place about the way we charged and dealt with that, and against the sort of framework I've put forward, I think that would be of more importance than the technical efficiency of the number.

DR BYRON: About two weeks ago, was it 5 October, when Minister Hockey made the changes in the policy relating to airports, Brisbane, Melbourne and Perth have been given approval for some increase in charges, whether or not they actually make those increases. Does that have any implications for Sydney's pricing policies or behaviour?

MR SCHUSTER: I think the pricing structures of the airports are so different from

Sydney that it doesn't have direct implications, in my view. Sydney Airport has moved recently to what we believe is a more efficient structure, and the other airports are operating under something derived from the network charge that the FAC levied. Further to that, the other airports have seen real decreases in charges since privatisation. Sydney Airport hasn't been subject to a CPI minus X, so the differences are so enormous there that I don't think there's a direct affect on us.

DR BYRON: They're in a very different situation.

MR SCHUSTER: Indeed. Sydney Airport also has a more diverse base of airline traffic, and while it's derived from passenger numbers, we have a more diverse non-aeronautical income that helps protect it. So certainly for Sydney Airport, we would look much more towards cost-cutting than trying to take a direct implication from the minister's decision about the other airports.

DR BYRON: Would you expect that there would be any changes in the margin in the airlines' route schedules if Brisbane and Melbourne, for example - prices were to jump up by the approved amount of 6 per cent or whatever, or is that too small to actually influence decisions of where to route their aircraft?

MR SCHUSTER: Well, you'd be looking at changes in the margin in international traffic, which I think it's fair to say is less elastic than smaller, domestic traffic. I would have thought change of that magnitude wouldn't be dramatic.

DR BYRON: Thanks.

PROF SNAPE: Okay. Well, we do look forward to the fuller version of your submission, including some of the points that you made orally today and, of course, as I was saying this morning, the sooner the better, from our perspective. It makes it difficult for you, of course, but the earlier we get it, the more we can take things into consideration.

MR SCHUSTER: It's very, very close, I can assure you.

PROF SNAPE: Yes. Dr Byron referred to the ACCC and its comments in relation to Sydney, that you may wish to give some consideration to in that submission.

MR SCHUSTER: Yes, indeed. Okay, thank you.

PROF SNAPE: Thank you very much. In just a couple of moments, we will have the Capital Airport Group, if it is with us. I think it is? Is it? No, they're not, not at the moment. In that case, we will pause for a few moments.

PROF SNAPE: Okay. Let's resume. We welcome now Canberra Airport and we have a few dot points from you. We understand the problems of getting the submissions written in view of recent events. We would now invite you to elaborate on those dot points and also anything else that you may wish. First of all if you could both introduce yourselves and your positions and then go into your presentation please.

MR S. BYRON: Thank you both. Stephen Byron, I'm the managing director of Canberra International Airport.

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

MR S. BYRON: We'll just go through each item on the agenda and, if you like, take questions on each one as we go and just tick-tack between the two of us if you're happy with that; keep it as an informal discussion.

PROF SNAPE: Okay.

MR BROWN: The purpose of our appearance today is to generally have a general discussion about the events that have taken place since the release of the draft report rather than, I guess, respond to the report itself which we'll do in a more formal response to the Productivity Commission. Essentially it's the impact of the Ansett collapse which has taken up the vast amount of our time since the release of the draft report. To pick up on the first point there, it's the impact that the Ansett collapse has had on aeronautical revenues and prices, for that matter.

The Productivity Commission in its draft report recognised that airport charges were amongst the lowest in the world in Australia and well below the international average. In the case of Canberra Airport, charges for aero services are well below the cost of providing those services, so much so that we've consistently reported losses on the provision of those services. That has been a result of the FAC prices being adopted into the price cap. We've had many criticisms of the price cap, primarily the impact that it's had on our investment activities and the incentives that are provided to maintain the airport in an economic state.

Left unchecked, the impact of these low charges may not have been felt for some time and it may have been the impact that we would have seen in the capital bases of airports and we would have seen that in future new investment and reinvestment in aeronautical facilities. The collapse of the Ansett group merely highlighted the fact that many airports were operating on the brink of commercial failure in the provision of aero services and hence the need for many airports to move to more commercial footing in the charging for aero services, and we've seen that take place over the last week or so.

Allowing airports to move to a more commercial footing in the provision of these aero services will enable airports to better withstand future shocks. We've seen many shocks in the last few years. Brisbane Airport has made people aware of the impact of the Asian crisis on them. We're in the process of seeing a shock resulting from the events on 11 September and also there's the shock of the Ansett collapse. While there will always be shocks in the airport business, we acknowledge that, if airport charges were allowed to move to a more commercial footing, airports would be better placed to manage these shocks without having to seek increases in airport charges.

MR S. BYRON: When we look at what happened with the Ansett and Kendell group we lost 28,000 seats a week out of Canberra out of 59,000 seats a week. That was pretty devastating to us. It demolished about 40 per cent of our revenue immediately. Aside from the direct credit exposure and the losses that we've suffered over the four and a half weeks since that, we estimate that our losses are in excess of $5 million a year annually given what's happened, on the basis that we see a substantial recovery in the business commencing with - it will take until February to see a substantial recovery.

At the moment - and when I say "substantial recovery" we think that will still be substantially down on where we were travelling before Ansett collapsed. We've worked immediately quickly to try and introduce new services. We've worked with the administrators of Hazelton and Kendell to get services back, and with Hazelton we got back 2000 seats a week to Sydney with the Saab operation and we got back with Kendell 2000 seats a week to Sydney and 2000 seats a week to Melbourne. So we've got back 6000 out of the 28,000 seats we lost. We did that by offering substantial incentives to these businesses. We assisted with their marketing, we worked with the governments to provide them with assistance. We worked with hotel groups to provide them with accommodation, the taxi industry. It's a sign of the desperation right through. They said, "We'll provide free travel for your staff in the taxi system." Basically everyone in Canberra has pitched in to try and get these skeletons of airlines back up and providing some sort of service.

PROF SNAPE: For whose staff - the airport staff or the airline staff?

MR BROWN: The airline staff - the free travel and free accommodation.

MR S. BYRON: Yes, Hazelton and Kendell.

MR BROWN: For both their crew and their staff that operate at the check-in desks.

MR S. BYRON: That all happened very quickly and we were pleased to see that. We're in a situation now where we've not had one additional seat put on by Qantas. They've not put on one larger plane, not one additional service in all of this time. On Friday afternoon I was advised - and I've had discussions every two to three days about this - that they are increasing some capacity from the beginning of November and they will be putting 800 seats a week into the Melbourne market and just to give some context to that, we lost about 10,000 seats a week to Melbourne, so they're going to give us back 800 seats. They're going to put in around about 1500 seats a week to Brisbane where we lost about 3 and a half thousand seats.

Brisbane is the one route where we do have some level of competition through the presence of Virgin with a single service in the middle of the day between Canberra and Brisbane. We've been also in discussions with Virgin and we've tried to encourage them. We've offered them incentives. We've done everything we can to help them. But at the end of the day they are challenged by a lack of aircraft and by wanting to consolidate on their existing routes and I think by some timidity about starting on a new route. So we're in a situation where we've had very little of this business lost come back to us and really no major prospect of any improvement on that until at least February or March next year. One of the things that means for us is that in terms of market share, Qantas has around about 97 per cent of the market share. When we look forward we, on a rosy view of Ansett mark II, could say that Ansett mark II might operate two to four services a day into and out of Canberra; Virgin might operate two to four services a day to Canberra, rather than our existing one.

PROF SNAPE: Which route is this - all routes?

MR S. BYRON: No, in total - probably Melbourne and Sydney.

PROF SNAPE: Go through those numbers again.

MR S. BYRON: I would say that Ansett mark II might at best have one morning and one evening service to Melbourne, similarly to Sydney, and Virgin might or might not do that as well. It would be very rosy to see them both doing it. On a rosy view, Kendell and Hazelton will survive. I don't think they will both necessarily survive. I think we will end up with a Saab operation between Canberra and Sydney. When all that comes together I think we'll see Qantas's market share eroded from the present 97 to somewhere between 85 and 90 per cent of the market.

What that means - just putting aside what it means for our business - is it has a very severe impact on the airport-related business and indeed the whole town. When you think about Qantas's market power, it is not just their market power with us, it is their market power with the whole of the national capital because they will choose where they want to be on the supply demand curve to maximise profit. They will choose where to be, and that will mean, in our view, limits on the extent of capacity that's provided and that means that essentially Qantas decide how many people stay in the hotels in Canberra, how many people go to the restaurants from out of town, how many people rent cars from our car rental businesses at the airport, how many people park in the carparks at the airport, and so on and so forth. They make that decision because they now wholly control the volume, almost exclusively. So that's a pretty substantial change, particularly given where we were at some 12 months ago, where we had Impulse and then subsequent to Impulse, where we had attracted

Virgin.

We've offered incentives to encourage Qantas to provide additional capacity to Canberra. We've offered them free landing fees for October and 50 per cent off for November, and we hope that might trigger some more, but probably not. As well as ourselves as creditors, there are a large number of businesses at the airport that have been affected as direct creditors, and I've got a summary of that, together with a list of those businesses that are at some risk of either going under or closing, and I might hand that up at the end of this, if that's appropriate.

PROF SNAPE: Is that confidential?

MR S. BYRON: It's probably okay.

PROF SNAPE: Okay. So we can treat that as a submission?

MR S. BYRON: Yes, you could.

PROF SNAPE: Thank you.

MR S. BYRON: It also identifies a range of construction projects that have ended, as well as discussing the detail surrounding - one of the reasons the impact on Canberra has been particularly severe has been the demise of Kendell Airlines, because Ansett operated very, very few flights out of Canberra at the end of the day, and they operated four services a day to Melbourne and two services a day to Sydney. The rest were all Kendell services. That's one of my reasons for believing that we will see, at best, a limited Ansett Mark II operation through Canberra. The other issue that we've had is there has been a substantial shift in people travelling. In many ways, the airport business has substantially diminished. A lot of people are choosing to fly, where they can, on Canberra-Sydney, and Matt might take us through some of the numbers, but essentially what's happening is that people are finding it too difficult to book a flight.

There's a perception that it's just about impossible. There is a perception, which is real, that you can only get them at full economy airfares, and all in all, people who would very regularly travel on business are automatically shifting to the car. We're not seeing the same on the Melbourne route and the Brisbane route, where people who need to travel are, but wherever people don't have to travel, they are putting it off, or instead of having a meeting in two days, they're having it in eight days when they can get a flight, so that has a cumulative effect of reducing the amount of travel in terms of Sydney.

MR BROWN: Basically, to pick up on the point that the Commission made in its draft report on the potential for modal substitution, we've looked at both Sydney and Melbourne routes out of Canberra. Sydney is obviously our primary route.
50 per cent of our market is on the Canberra to Sydney route. Before the collapse of

Ansett, we did about 80,000 passengers Canberra to Sydney per month, and about 70,000 Canberra to Melbourne per month. Following the demise of Ansett, we saw about 50 per cent of that capacity taken out of the market, leaving us with basically Qantas as the sole provider for a period of time, until Kendell and Hazelton could recommence their operations. What that saw was that on the Canberra to Sydney route, we had a demand of approximately 80,000 passengers per month, and Qantas provided seats of 52,000 seats per month. So there was a shortfall in demand for about 28,000 seats, and that shortfall in demand for the Canberra-Melbourne route was just above 30,000 seats per month.

Upon the recommencement of Kendell, they started services Canberra to Melbourne and Canberra to Sydney, keeping in mind that they were only putting about 5000 seats per month into each market, and the unmet demand was up around 30,000 seats. Now, Canberra to Melbourne, they've been able to achieve load factors of around 70 per cent, whereas Canberra to Sydney, those loads have been around 30 per cent. So that differential in load of some 40 per cent we believe has been lost to road traffic.

PROF SNAPE: I'm not quite clear on that. You're saying that, Canberra-Melbourne, they're only operating at 70 per cent?

MR BROWN: 70 per cent loads.

MR S. BYRON: Yes, that's Kendell.

PROF SNAPE: Of Kendell, and yet you can't get a seat?

MR S. BYRON: No, you can get a seat with Kendell.

MR BROWN: But until Kendell commenced, you couldn't get a seat on Qantas.

PROF SNAPE: Canberra-Sydney, it was only 30 per cent?

MR BROWN: They're only getting a 30 per cent uptake of seats, that's right.

PROF SNAPE: That doesn't sound like very much excess demand.

MR BROWN: Well, I think a lot of that problem has been with both Hazelton and Kendell recommencing their operations, they've come into the market very quietly. They've been now operating for two weeks and we've only just started to see advertising take place. In terms of assistance to help Hazelton, our executive chairman himself put in the first advertisement for Hazelton Airlines, and that has been the only advertisement until last Sunday night.

MR S. BYRON: I think the other thing too, just to make the point, is - what we're saying is that Canberra-Sydney, where there is modal substitution, there has been a massive modal substitution in the order of, instead of 80,000 passengers per month, there's 50,000 flying with Qantas in round numbers. 30,000 have either disappeared or, in our view, are using the road. Now, it's not only Kendell and Hazelton that are struggling with their load factors Canberra-Sydney. Qantas in fact does have spare seats Canberra-Sydney. They don't have spare seats to Melbourne or Brisbane for the next couple of days, but they do have it to Sydney on the odd flight. So where there's a modal substitution opportunity, people are readily making availability of it, and that is a combination, as I said, of the perception of the difficulty of getting a ticket, the struggling with the marketing of the new entrant under administration airlines, and also it is a function of the cost, and clearly the increase in airfares is changing the demand from the 80,000 that it was to a lower number.

PROF SNAPE: I would have thought that if - in the picture that you described earlier, where people were not travelling or putting things off or anything like that, I would have thought that they would have immediately snapped up all the seats, even if they weren't advertised.

MR S. BYRON: That's what you would have thought, but I think that's part of - what we're saying the effect is is that people have moved to either not travel or to travel by car because, of course, you have to remember that business people, which is the bulk of the market in and out of Canberra, they are relatively time-sensitive and they need to be at their destination at a time and they want to return at a time. Now, that means that whilst they might be able to book a seat in one direction, if they can't book a seat back, then they just put off the whole trip to a different day, and we're seeing lots of people do that sort of thing.

MR BROWN: I think it's something that Kendell are seeing throughout the network. We've spoken to senior management within Ansett/Kendell and they've acknowledged that, even in markets where they've had a monopoly position, such as Belmont in Newcastle to Sydney, they're seeing basically their entire market wiped out, where passengers are taking the option to drive, catch a bus or train, rather than take the Aeropelican service or the Kendell service from Belmont to Sydney.

DR BYRON: Are Hazelton and Kendell covered by any sort of guarantee of the kind that Ansett Mark II has? I'm just wondering if there's a perception of people not wanting to buy tickets from an airline that's managed by an administrator.

MR S. BYRON: I think that's the case in terms of Ansett as well, that perception. The reality is that they are both covered by the same guarantee, and the second reality is that the administrators are personally liable. So in fact people who are well informed would know that before they lose their money for having prepaid on a ticket, not only does the entity have to fold, but the company, be it Arthur Andersen in this case - you know, you've got access to all of that money, and then when you finish with them, you've got access to Mark Korda and Mark Mentha's personal assets themselves. So there's a substantial level of guarantee in there, as well as the Commonwealth putting its guarantee in place. But you're right, the perception is with these airlines - there's a question as to how long they will be around.

Out of all of that, we took the decision following our - really, discussions with all of the airlines, and particularly Qantas outlining the extent to which it would increase capacity, that we were in a position that this was a sustained downturn and in discussions with our bankers, we then sort of worked through some issues and we resolved that our position needed to be protected by the imposition - by the increase in our landing charge of $2.60 per passenger. This was not a decision we took lightly. It's a decision that in our view, if the aeronautical charges were already at a sustainable level, we could have, with difficulty, admittedly, sustained this sort of an impact, but with the aeronautical charges as low as they were, we could not.

What I'd like to hand up to you to have a look at is - what that means is on a 737 trip to Sydney and to Melbourne, an increase in the landing charge on the airlines in the order of about $350. What this analysis indicates is it looks at the revenue that a 737 would have earnt before Ansett fell over and the revenue would have earnt afterwards and indicates that to Sydney they would have earnt about $10,000 more revenue and to Melbourne $16,000 more revenue.

PROF SNAPE: That can be treated as part of your submission too?

MR S. BYRON: Yes, it can.

PROF SNAPE: How did you hit upon the amount of price increase?

MR S. BYRON: All of the assumptions about the yield are completely assumptions of our own but they have been checked with some industry sources, including people who used to work with Ansett before and are familiar with these things. Some people have suggested to us that our forecast of the number of business class seats post-Ansett is conservative, but we've left it as such. The fares are accurate, so the assumptions are in the number of different types of fares sold.

PROF SNAPE: But for the 2.60 per passenger, is that a cost based charge? You're saying that your average costs have gone up by that amount because it reduced passenger throughput or what? How did you arrive at 2.60?

MR S. BYRON: It wasn't because our costs had gone up. In effect our costs were broadly the same.

PROF SNAPE: As per passenger, I mean.

MR S. BYRON: Yes, that's right. Yes, it was. It looked at the revenue we had lost as a consequence of the Ansett collapse and that number came out to be substantially in excess of the number that we'll recover on the basis of that $2.60 charge. To recapture that revenue would have been a charge around about $3.15 per passenger.

PROF SNAPE: So it was looking at basing the revenue but not quite, sort of thing. Is that right?

MR S. BYRON: That's correct.

MR BROWN: Just to restore the viability of the business and to take the pressure off us from our lenders.

PROF SNAPE: At the moment you don't have any pricing constraints upon you.

MR S. BYRON: We took that decision prior to the Commonwealth's decision. I mean, our simple view is this: we spent the first couple of weeks working desperately to get air services back; that was the first two. We then spent the next few weeks talking to our bankers and analysing how much more of the business would come back and it became clear that this was worse than we had thought, that the indication that Qantas would immediately deliver capacity to cover 80 per cent of the Ansett passengers wasn't happening; certainly wasn't happening in Canberra. We then worked and said, "Listen, we've got to fix this liquidity problem," and we were not interested in whether it was in or out of the price cap. At the time when we decided to increase the charge there was a price cap in place and this would have been within the price cap. It may have meant that we would have over-recovered.

Our position was we had no time to consider the issues for lobbying for this dollar amount to be in or out of the price cap. We had no time to lobby for the price cap to be in existence or not in existence or for its removal to be brought forward. We had no time for those things. We had to re-establish the viability of the business and get the cash flow back there. We took the position in our discussions with the ACCC and the Department of Transport that we should work through the issue of the $2.60 and sort out the rest of the stuff next year once the business stabilised.

PROF SNAPE: So this is an interim sort of stopgap increase.

MR S. BYRON: Yes.

PROF SNAPE: It's not as if you're saying, "Okay, now we don't have any constraints upon us in pricing. Let's see what we can do." You're not up to that stage yet?

MR S. BYRON: Not at all. As I said, we had these meetings well under way before the price cap was removed and - yes.

PROF SNAPE: Have you started to think ahead, now that you don't have the constraints upon you? It looks as if Qantas will just leave that amount of capacity into Canberra no matter what, so you'd be in a position, wouldn't you, to really put your landing charges up 20 or 30 dollars?

MR S. BYRON: I don't think that would be real or possible. I think an analysis of the models - and we haven't done much work on that - indicates that a fair price based on proper rates of return on an aeronautical cost base covering your cost might be around - anywhere from $6.50 to $8, depending on your analysis. This charge takes it to $4.91.

PROF SNAPE: But you're a privatised business and you don't have to look at fair prices, you can look at - - -

MR S. BYRON: No, no, I am answering the question - - -

PROF SNAPE: Thank you.

MR S. BYRON: So we've got to analyse what we do. I think the fundamental proposition is Qantas aren't going to let us increase our charges very easily. I think there is no question that Qantas would not accept a charge in excess of a fair price, no way whatsoever. They just wouldn't pay it. What we know is that for our airport we are still subject to prices monitoring and it is absolutely imperative for us to ensure that as our prices are monitored, as our costs are monitored and our profits are monitored, we make sure our costs are in line - and better than in line if we can - and that our profits are in no way near being excessive. So that will be a benchmark for us all the time.

MR BROWN: We always took the view that at the end of the initial five-year regulatory period that we would sit down with our users, the major airlines at the time, and put together a forward-looking plan, something in the order of three years that looked at what our pricing and what our new investment would be and have that embraced by the airlines as well and put that down as a commitment. "This will be our charges for the three years. This will be the investment that we undertake over these three years," and set that out.

PROF SNAPE: Are you still thinking in those terms?

MR BROWN: Yes, we are. When we initially saw the draft report from the Productivity Commission we had a view that that might take place in the first half of next year. Obviously we're not in the position to do it any earlier. In the absence of the price cap we'll probably still pursue that in the first half of next year.

MR S. BYRON: I've talked to Qantas specifically about it starting - because we're all pretty flat out for now - in February and March talking about the long term and where we go in the longer term with that sort of framework. I think the other thing I'd like to say is we'd also like to make sure that our business is dynamic and that it prices towards incentive - it's an incentive based pricing regime. One of the things I would be attracted to discussing with the airlines is to have some relationship between the price we charge and the revenue they earn. For example, it doesn't appear entirely fair necessarily that I charge the same price for an airline that sells a ticket for $70 and I charge the same charge for someone who sells a ticket for $400. That's where I am at the moment, and it would require immense cooperation between all airlines to have a price that was much more linked to theirs.

But it's another way of looking at it and if that's not something that can be done in the first 12 months, it's something we'll always think about. We're quite keen to make sure our prices are linked to their successes and fortunes. One of the things we are very concerned about in terms of the current environment and this increase is that it's not passed on to passengers. There has been some suggestion that the airlines might add it on as a passenger tax on top of the ticket price because it's an increase. I think our view is that if they don't reduce their ticket price - which they don't - then that's just another way of moving something out of their cost base and increasing the charge.

The evidence that's there before you says that the airlines, if they're making $16,000 extra per flight, can in the current environment afford to pay the additional $350 charge.

PROF SNAPE: What you were saying before is a link to their fares. Were you thinking of a charge that might be, say, 3 per cent or 4 per cent of the price of the ticket?

MR S. BYRON: That would be the concept, yes. I hadn't run to the numbers.

PROF SNAPE: Then you would in fact be levying it upon each passenger and in that formula the airline wouldn't have the same discretion or may not see the same discretion in allocating the charges to one category of passenger rather than another?

MR S. BYRON: That's certainly true, yes.

MR BROWN: Move on?

PROF SNAPE: Yes.

MR BROWN: We've discussed the problems that we faced in the past few weeks and we're now trying to get our head around how things will operate under a regime of prices monitoring. As I said before, we're readying ourselves for entering an arrangement with airlines where we will consult on our future charges, our future new investment, but the thing that we need to cement down first is how the prices monitoring regime would work. We understand from our discussions with the ACCC that they see it working in much the same way as operated on your aeronautical related services that you provide at airports and we agree that that is an incentive based framework and it is light handed.

The thing that we are concerned about is that the rules for prices monitoring are set down very early on in the piece so that the framework is not allowed to develop, much like the necessary new investment provisions which became unworkable, were very difficult and in the very end didn't provide the right incentives for investment. So I think it would be very important to sort out how the prices monitoring regime is going to work from the very start and make all parties aware of how that's going to work and how our proceedings will be assessed against the criteria that are adopted. At this stage we see something like a benchmarking exercise across airports both in Australia and overseas as a good way to assess an airport's performance under a price monitoring regime, but we await the decision of the regulators in that regard.

MR S. BYRON: I think I'll just reiterate the wording of the declaration for prices monitoring of aeronautical services is exactly the same as it was for the monitoring of aeronautical related services, so one wouldn't see why anyone would need to go on a much more detailed forensic journey beyond what they have been doing, which has been an analysis that clearly exposes the costs, revenues and profits of the aeronautical related businesses and lays it on the table, and we think that is entirely appropriate and we think that is something that the airlines will have regard to in terms of monitoring the fairness or otherwise of our charges.

But I think where that then leads to is that fundamentally there have got to be commercial relationships, and I think as we've said before, we were able to have a fully agreed, signed, executed conditions of use with Impulse Airlines and a charging framework fully agreed. Likewise, we achieved that with Virgin and the commercial deal was struck over four hours one morning when they were looking at coming to Canberra and they brought forward their entry of service to Canberra and the conditions of use was then sorted out over the next six days.

MR BROWN: I think it's important to note too that, while we have the problem with Qantas and Ansett in that they've flat-out rejected our conditions of use, Impulse and Virgin Blue didn't embrace those conditions of use initially. They did have issues with particular clauses but, given that they were actually around the table, we could negotiate with both airlines and come up with a mutually acceptable outcome for a signed conditions of use.

MR S. BYRON: Similarly, notwithstanding that Hazelton and Kendell have been in administration and under massive pressure - there are just so many issues for them - we were able to negotiate commercial arrangements for them. That facilitated their re-entry into the market. I understand we're one of, perhaps the only, airport that has offered incentives to help these new carriers get up. We did that and we agreed conditions of use and those matters are all signed off as well. With Qantas we're very confident that we'll be able to do that. We've had some very good dealings with Qantas in recent times on property-related matters. For example, the terminal dispute that we had we've come to a resolution of more or less, and in relation to the Impulse hangar that Qantas now is involved with, they wanted some amendments to the lease and, whilst we think a lot of them were a little unreasonable and a little aggressive commercially in demanding we put further incentives on the table to the tune of $400,000, we were able to come through and make agreements, and they're not at a level where they're putting us out of business or at a level where we're prohibiting them doing their business. So it's a lot more cooperative, and I think we'll sort out this conditions of use issue pretty quickly too.

PROF SNAPE: Why is it more cooperative now?

MR S. BYRON: Why?

PROF SNAPE: Why? Your relations with Qantas as you described them in the past were not exactly cooperative.

MR S. BYRON: To be quite frank, I think it's part of the way in which they've analysed how the debate on the economic regulation of airports has gone. They've realised that they were not getting many successes in just interminably trying to block processes, and I think they realise that the process is moving towards a more commercial relationship based process and they've changed the way they're dealing.

PROF SNAPE: In this conditions of use, how detailed are these conditions of use? Guarantee the state of the runway, for example?

MR S. BYRON: We've got an obligation under our crown lease to maintain the runway at the level it was when we took over the airport. We have obligations to CASA and the like. It's not a huge service charter, but nor at Canberra Airport have we been asked for one. It is a difficult thing to set out a full service charter when really the main areas that internationally they have service charter is in relation to the operation of terminals and particularly check-in and baggage. We don't do that for the airlines, and the other issue in terms of service charter to do with runways and aprons is more demand management issues, and we don't have demand management problems at Canberra in terms of the runway system. So none of the airlines that we've reached conditions of use with have requested that, nor has Qantas sat down in any way and sought that either.

PROF SNAPE: Okay. What about landing systems for in the fog?

MR S. BYRON: That starts to verge on the issues of quality of service. I think the airlines seek lower levels of investment and lower qualities of service than an airport might, and say for instance when it comes to landing systems to assist fog, airlines are broadly reluctant to support any investment to improve the quality. So they're not looking at guarantees from us; it's working the other way round.

PROF SNAPE: So they're not so concerned that their schedules are disrupted as you are?

MR S. BYRON: That would be correct. Essentially it's a very expensive process for an airline because there's no aircraft in this country that has the equipment in place to enable it to use an improved landing guidance system. So it would be 4 to

5 million-odd for us but X million dollars for them.

DR BYRON: Just going back to the increase in charges, one of the press reports that I read said that you had negotiated the increase, the $2.60, and I think the exact words in the newspaper were that Qantas had been understanding about that. Does that mean - obviously they understood. Can you elaborate on the relationship there?

MR S. BYRON: Qantas in a general sense are very understanding of the need to increase prices at smaller regional airports and in our first discussions with them that was their proposition, and their proposition was also that they are concerned to ensure the financial viability of their major suppliers and I think they're the words quoted in the press article. Aside from that, that doesn't mean that Qantas have said, "Yes, we embrace this charge." They are having some degree of resistance to it which has surfaced during the last couple of days, notwithstanding we've had an ongoing dialogue over the last two weeks on the matter. There's some resistance to it.

DR BYRON: Without wanting to be overly brutal or melodramatic about it, it's really not Qantas's problem if a particular airport falls over, or the ownership of it, in that the airport is still there physically; somebody else comes along and buys the assets at a fraction of the previous price and the initial shareholders take a bath. In a sense one could argue that Qantas doesn't need to incur any extra costs to keep the current owners of the facilities that it uses in good shape.

MR S. BYRON: I don't think Qantas take that view. Theoretically an airport could - before it got to that position of the equity owner surrendering to the bankers and putting it into administration and leaving it for someone else, having suffered massive capital losses, I think an airport would look to reduce its coverage of service. It might not open at night, with darkness - it might not have lights on. It might not open on weekends. I think they're the issues that Qantas without having thought about them in detail would be cautious and conscious of avoiding.

DR BYRON: That's exactly the sort of thing I was trying to get at, I guess, that there are reasons why it's not in Qantas' best interest to drive down the absolute lowest price and to push you to the wall, so to speak.

MR S. BYRON: I think that's right, and I think that comes back to this issue of mutual dependence, you know, between an airport and an airline and the fact that whilst they have substantial market power and they will use it brutally at times, they don't want to see all the blood run out of the body.

DR BYRON: Just on the subject of Qantas again, I was always of the understanding that the flights into and out of Canberra were fairly profitable routes in that you've got lots of business and full fare and public servants and so on. I guess I'm still trying to understand why Qantas would decide not to put more capacity onto what would seem to be one of the more attractive routes in the country.

MR S. BYRON: I thought the same thing, and I think your issue about the yield and the profitability of the services is correct. I suppose the fact of the matter is, and as the analysis indicates, in the current capacity structure they're making much, much higher profits and there's not a problem with that. Certainly they have a limited capacity available to them as a whole across Australia and indeed the world immediately and certainly they need to be cautious about the way in which that is deployed. I mean, no-one knows if Ansett mark II will completely fold and have zero capacity or whether it might have 20 per cent of the market with Virgin at sort of 10-ish. I think that's a little ambitious but that's part of the dilemma they're put in. But I think it would be also interesting to study where they put that capacity. They have put it on markets where Ansett is flying now from Ansett mark II and where Virgin is flying, and on some of those routes they're selling services well below, for example, the ticket prices that you'd get in and out of Canberra.

So they've got their business decisions. I think all it says is that they will pick the point of profit maximisation, not volume maximisation, particularly into Canberra from now on, even if this all grows in two or three years' time and Qantas are down to 75, 80 per cent of the market. They will not pick the point where they go for market share and they get the extra customer. They will put the profit maximisation point and that will not forever but for five to eight years change the dynamics of not only my business but a lot of businesses in Canberra.

PROF SNAPE: What happens to taxi charges now that the cap has gone?

MR S. BYRON: They are still determined, incorrectly in our view, as you would know - they are still presently determined to be aeronautical services and accordingly they would be part of the aeronautical revenues that are price monitored. I think we don't need to go into our submissions as to why we wouldn't necessarily agree with that but that's where it is.

PROF SNAPE: You may like to continue with your dot points.

MR BROWN: Just briefly on the implications for new investment, we previously talked about a forward-looking three-year investment program obviously with pricing of investment projects incorporated into that and we'd seek to maintain the consultative processes that we've implemented over the past two years or so on our new investment projects in terms of user group meetings and project control group meetings with airlines. Our user group meetings generally look at projects on the longer-term horizon between three months to three years, whereas our project control group meetings generally deal with projects that are under construction or in the immediate future.

The benefits of the price-monitoring regime for new investment we see as eliminating a lot of the delays that we've experienced in bringing new investment projects on line. Previously our experience is that airlines will only tell you that they need a project or an investment a week before they need it. Quite realistically there are lead times or construction lead times of up to six months and then you've got the planning and design - whether it be a terminal or a runway. So there are quite long lead times in these projects and we can get on and get involved in the process of planning and bringing a project on line without having to worry about the necessary new investment provisions.

At the same time we expect to be able to pass on savings to our airline users under a price monitoring regime. In the past we've incurred costs in seeking approval for new investment projects and they are costs that we have passed on to airlines as part of the recovery charge. Those costs in the past have been between 12 and 15 thousand dollars per project. We now see no need for a continuation of those costs and we'd seek to pass any savings on for future new investment projects onto the airlines.

Similarly, when we look at price monitoring and the removal of the price cap there are a lot of resources within the airport that have been devoted to price cap compliance, preparation of necessary new investment proposals, discussions with airlines, trips down to Melbourne to speak with the ACCC, conducting surveys to gauge ultimate user support, as we refer to it. Where we haven't received good levels of user support from the airlines we've sought that from the ultimate users, that being the passengers. Passenger surveys have cost us up to $5000. So there are quite a number of savings to be found. In addition, we expect that there would be savings equivalent of one and a half full-time staff members. The time that is currently allocated to regulatory compliance, we see a lot of that staff time diminishing under a price monitoring regime, and we look to pass on all these savings to the airlines and our users.

MR S. BYRON: The other issue that I think is important, looking forward, is that as an airport we're still subject to the access provisions. We're a volume based business. Volume is good for us. I can't see any situation where we would have any problems with access. If we do, we're pleased that those protections are there, but we would be concerned to ensure that they weren't abused and that we didn't end up with a de facto situation of reverting back to the ACCC for full hearings on the basis of anything we did in future and that's really going to have to be tested but is going to be a critical issue because otherwise the removal of this level of regulation will be completely undone by that. That's certainly a risk in the current environment. I don't know how we'd deal with it but that's a reality.

One final comment I would make is that as we look forward to how this business will evolve, I think there will be much greater efficiencies in the aviation industry where the levels of vertical integration are diminished and we have more smaller companies involved in the provision of services to the ultimate airline. In particular, we're looking to facilitate models which encourage independent ground handling companies; being based at the airport, they might be companies that come out of the shell of what was Ansett and Kendell, they might be other companies.

They will help - Qantas managed its costs as well and its flexibilities as it goes forward over the next five years because there's no question that Virgin are operating at a much smaller cost base than certainly Ansett was and Qantas is. So we've got to do what we can at our level to facilitate that and we see that as an important part of the competitive regime and always have.

I did think of one other comment in relation to the taxis and that was, interestingly enough, after our Full Federal Court appeal was handed down where it was firmly determined to be an aeronautical service, we had detailed discussions with one of the major airlines in terms of how to handle the taxi recovery and for the airline to agree jointly with the other major airline, if they could, that it was not in the price cap because they had never saw it as being in the price cap and to waive that because that particular major airline had a clear view that it should never have been in the price cap. So isn't that interesting.

PROF SNAPE: They hadn't said that earlier.

MR S. BYRON: They had said that earlier but it wasn't appropriate for them to get involved in the litigation and sadly that airline doesn't exist as we knew it.

PROF SNAPE: I wonder. Ansett's lease on its facilities, it's just lying idle at the moment?

MR S. BYRON: All of this shows that Canberra is a pretty small regional town. As a national capital we have a nice quality of living and sometimes we think we get up there a bit. But I think the issue of how far down the totem pole we are in terms of Qantas, in terms of even Kendell and Hazelton in getting services restarted, we were right at the bottom of the pile. The same was true when the administrators marched in and took over everything. Little old Canberra sat there and the terminal was just abandoned. We had some broad control over it and we ensured that the Virgin flight that had been handled by Ansett through the Ansett terminal got off at 11.30 that first Friday morning and Virgin continued to operate out of that terminal and have tried commercially to come to arrangements with Ansett through the administrator. But of course that's difficult when it's a tiny amount of money and people are too busy to talk to. So it sat there with that; Kendell are now operating in it. When Hazelton came they chose to operate through our central terminal through the old Impulse desks and that has worked well for them.

PROF SNAPE: That's a common user terminal essentially, is it?

MR S. BYRON: Correct, yes.

PROF SNAPE: One desk?

MR S. BYRON: Two. In terms of what happens with the Ansett lease, it's my view that Ansett mark II or Kendell or both together, assuming they are together, which is not necessarily the case, will not be a big enough airline enterprise to sustain the costs of running that terminal and they will want that to lapse and it will fall back to us. I don't know that for sure but that's our view and I think that then is an opportunity for us to make it in the future a common user and it might be a facility that Qantas could use as well because with the massive growth in their market share they will need to do something at some time in the future.

PROF SNAPE: So that's a development that you would probably embrace in a sense, getting a nice, big common user terminal.

MR S. BYRON: Yes, not that we think we'll have very many users for it for a long period of time, but more important to us than the volume and the revenue that might come in five years' time is the fact that we'll have control over it and be able to facilitate entrance and that's important from a philosophical point of view for us.

PROF SNAPE: So you wouldn't have to buy it back, the lease would just lapse.

MR S. BYRON: I think - but, you know, these things are never that simple, I don't think. Who knows.

PROF SNAPE: Okay.

DR BYRON: Just on the subject of new investment, going back a few steps. Has the turmoil of the last month or two changed the owners' attitude to risk and the required rate of return that you would want from new investments now, compared to what you would have expected from a new investment a year ago in pre-turmoil days, or are you not thinking very much of that new investment at the moment?

MR S. BYRON: It's fair to say we're pretty right for investment. I think the reality is that the first thing you look at is the risk side and you say, well, is it appropriate now that we provide what ends up being six to seven weeks' credit on aeronautical charges? Is that a fair thing? Is that a proper conduct of business? That's the way we do it. You end up getting stung pretty bad in a very severe way with short notice. Is it fair that we do that without any guarantees in place? Ansett and Qantas always said, "If you need to do that you should do it from the baby airlines, the country connections or something; but not us, we're so big we'll never fail." Is it appropriate to not have guarantees in place for subsidiary airlines like Eastern, Southern, say Kendell when it was with Ansett, when you realise that in the new global world, multinationals will ditch subsidiaries as big as Ansett.

So I think that's one of the risk indicators running through our mind is, should we have a Qantas guarantee in respect of some of the operations of, say, Eastern Airlines. We haven't talked about them, but it's a fair proposition. In terms of risk we will be much more cautious about risk and that will affect pricing to some degree but more so it will affect whether things will end up getting built, whether we just want to put the money in at all.

PROF SNAPE: Okay, good. That's been very helpful in elaborating those and we look forward to reading the transcript and contemplate. But even more we look forward to reading your submission and the sooner the better from our perspective, of course.

MR S. BYRON: We understand that.

PROF SNAPE: Thank you very much, Canberra Airport. We'll adjourn until 3.45 and at 3.45 we'll have Adelaide Airport, followed after that at approximately 4.30 by a videoconference to Canberra for the Taxi Industry Association.

PROF SNAPE: Let's resume hearings. We welcome Adelaide Airport and in the usual manner we would ask the representatives from Adelaide to identify themselves for the transcript and then to speak to their submission.

MR GOLDSMITH: I'm Robert Goldsmith. I'm the general manager business development for Adelaide Airport Ltd.

MR YOUNG: Mark Young, chief financial officer, Adelaide Airport Ltd.

MR GOLDSMITH: Thank you for the opportunity to present our position again today. We'd like to further address some of the key things that we developed in our first submission and highlight the implications of the dramatic recent events in the aviation industry which we think are particularly pertinent to our business in Adelaide. Generally speaking Adelaide Airport is in accord with the Productivity Commission's draft report for price monitoring at Adelaide Airport rather than the CPI minus X regime. We also note and are pleased to note that the ACCC also does not object to the Productivity Commission's recommendations for Adelaide in this context in their latest submission, but we still actually do disagree with the ACCC's conclusions regarding the limited modal substitution opportunities at Adelaide.

Just as a quick aside, an extra statistic which isn't in our latest submission: the majority of travellers to Adelaide Airport actually go for leisure and VFR reasons rather than the business opportunity, and over 66 per cent of visitors to Adelaide actually arrive by surface travel from Victoria and New South Wales, and those two states alone account for about 90 per cent of leisure and VFR visitors to the state. So given that the state's tourism authorities are actually putting a huge emphasis on extra marketing funding for surface transport in the light of recent capacity cuts by the aviation industry, I think that, as I say, does actually say that modal substitution is actually a threat to any perceived geographical monopoly position that Adelaide Airport was thought to enjoy.

PROF SNAPE: Do you have a fuller statement of those figures that you could supply to us?

MR GOLDSMITH: Yes, we can break those down. We can provide the detailed information from the South Australian Tourism Commission.

PROF SNAPE: Thank you.

MR GOLDSMITH: The recent failure of Ansett has huge implications for the whole industry, as we all know, and we believe that they will add considerably to the Productivity Commission's recommendations for price monitoring. For Adelaide this event has been perhaps more significant than most, given that 93 per cent of our business is actually regional or domestic airline traffic in terms of passengers. Within the domestic market at least, the failure of Ansett has redefined the nature and the intensity of both airline and airport competition in our view. Whilst airports generally face increased competition amongst themselves to regain lost traffic, airlines have greatly enhanced countervailing market power with greatly reduced competition, a theme I'll come back to later. The domestic airlines can now more or less dictate the pace and location of replacement or new domestic and regional seat capacity, and this has important implications for regaining lost revenues associated with Ansett's failure and it's a major concern to our shareholders.

If aeronautical charges are to be increased in the future, we believe any increase must be set in context with other more significant contributors to the end cost of the air ticket to the consumer, most significantly increases in price by the airlines themselves but also new government taxes and such elements as the high Air Services Australia charges that we continually endure in Adelaide. In the foreseeable future airlines domestically within Australia have considerably to reduce exposure to some costs associated with new route development and particularly frequency build, we believe.

At the first hearing the airlines made a big play of their sunk costs issue when disputing the airport view about the strength of their market power. So we actually, as I say, believe that the airlines are now in a position where this exposure to setting up new routes and certainly frequency build is much, much reduced. Adelaide Airport regards excessive aeronautical price increases as being counterproductive to delivering traffic growth, particularly in the longer term, and the total revenue growth associated with it would be reduced if we were to behave as an airport monopolist, as certainly is the way the airlines allege. Meanwhile airlines have increased average air fares dramatically on Adelaide's routes, and I'll come back to illustrating that a little bit later on.

I'd like to say a few words on the impact of the Ansett collapse on Adelaide Airport. In basic terms we've lost 43 per cent of our landed tonnes per week in the current time. A major impact on us locally in Adelaide has been the loss of Kendell Airlines, which handled around 70 per cent of the regional passengers in South Australia all hubbing into Adelaide. Although Kendell has recommenced operations, I think generally speaking the load factors have been fairly low as there is a degree of uncertainty about the airline's future, and obviously we're hoping that the airline survives in its current operational state.

The failure of Ansett as one of the airport's core tenants has had a major potential impact for property revenue, particularly through placing in jeopardy the lease rentals we get through the DTL rents. Under the current market conditions it's unlikely that new or existing competition to Qantas will reach the former size of Ansett within the foreseeable future, and in this context we certainly think it's going to be difficult to recoup that level of rental or lease payment in the future. In total the collapse of Ansett puts nearly 18 per cent of the airport's revenue at risk.

Another key reason for the airport's exposure to the Ansett crisis has been, as I said before, the dominance of the domestic market at Adelaide which, as I said, accounts for 93 per cent of our traffic. We're not in the same position as say Melbourne or Sydney in terms of the relative proportion of international traffic, property and commercial income that can to some extent offset the impact of the lost revenue directly from Ansett.

We've been keen to evaluate how replacement services might actually come into our marketplace in Adelaide. The picture is pretty unclear at the current time. Qantas is gradually increasing their level of service, but certainly at the moment they're nowhere near the 80 per cent of former Ansett capacity that - they were saying they would try to increase as quickly as possible after the immediate failure of Ansett. Virgin Blue are increasing by one flight, we've just heard, from 1 November, one flight a day, but up to this point haven't increased their flights, probably mainly because of aircraft shortages. Meanwhile Adelaide is the only major capital city not served by Ansett II's new operations under direction from the administrator. On this basis Adelaide remains a low priority for most carriers, indicating that, despite the sizeable flow of business traffic on some of the core routes, airline yields are apparently lower than for other major centres. The slow pace of replacement of Ansett's capacity at Adelaide provides further evidence, in our view, that Adelaide Airport does not enjoy the large degree of potential monopolistic power that the airlines or the ACCC have argued is common to all of the major airports.

Moving on to the issue of countervailing airline market power, we have a number of comments on this and we actually feel that the situation has markedly changed since the fall-over of Ansett. We felt that the draft report from the Productivity Commission was a little bit inconclusive regarding the strength of airline countervailing market power but, as I say, we believe the Ansett failure has fundamentally changed this whole perspective. The intensity of competition in the domestic Australian market has undoubtedly been dramatically reduced. Adelaide Airport is faced with the potential for one customer to control around 85 to 90 per cent of its domestic seat availability, especially in the short term.

It's likely that a number of Adelaide's domestic markets will now only be served by one airline for some time to come, thus reducing the benefits of competition for consumers and potentially suppressing demand. These emerging, new market dynamics are likely to have a profound impact on the ability of airports to abuse any perceived market monopolistic power in the future. Adelaide Airport's economic wealth will be inextricably linked to decisions made by one key customer and Adelaide is more sensitive to this fact than many of the other large capital cities because of the dominance of the domestic market and the small size of the international market.

There is now such a large imbalance between the supply of airline seats and demand that airlines can retain their existing or slightly enhanced levels of operation and simply optimise yield management accordingly. A similar point has been made by other airports. The airlines can dictate the rate and location of replacement seat capacity for the Ansett shortfall across the country as they choose, according to either perceived additional profitability or competitive pressures, if they exist at all. So in our view, airlines have a completely enhanced position of countervailing market power versus the pre-Ansett failure scenario where such options as limiting seat capacity were tactically dangerous, and a competitor with national network coverage would quickly capitalise on such behaviour.

Also in our view, potentially profitable domestic market development opportunities for the airlines have never been more plentiful whilst the ability to airports to influence these choices has rarely been weaker. Airports now have limited scope, given the large fall in aeronautical revenues to offer large incentives to airlines, and the level of airport charges is likely to be an even smaller contributor to the route development profit-loss equation in the post-Ansett market. Airports such as Adelaide will have to compete in future, both to gain and keep new or replacement air services with all the other major airports around the country in a way that wasn't necessary, or not necessary to the same extent prior to the fall of Ansett. So as I say in this context, airport competition is truly national now, rather than maybe localised within regions of Australia previously.

I'd like to move on now to consumer issues because following the fall of Ansett we believe it's vitally important to keep the materiality of airport charges in context. So, for example, any future increases by any airport can be set in that context. We can't talk about the implications of so-called monopoly pricing by airports without actually thinking about the actual, shall we say, absolute impact of price rises by airlines on the end consumer. For example in Adelaide, the cost of landing charges domestically currently work out at around \$1.60 to \$1.70 per head. We don't actually charge on a per head basis, we actually charge on a landed tonne basis. But that's basically what they work out per passenger.

With the increase in domestic seat factors associated with the Ansett fall-over, we anticipate that our charges on a per head basis have come down by around 15 to 20 per cent to the airlines because of the increase in seat factors, because obviously on a landed tonne basis we were charging a fixed cost. At the same time we've pointed out that, in our analysis anyway, average air fares are increasing domestically in the post-Ansett world. In our first submission we made the point that the introduction of new competition had seemingly reduced the cheapest 21-day advance fare by around 44 per cent on typical Adelaide routes. Since the collapse of Ansett we've seen a marked increase in the 21-day advance fares. For example, Qantas 21-day advance purchase fare is now thought to be over 150 per cent higher than the equivalent fare when Ansett and Virgin Blue were competing in the same markets.

It's easy to be spectacular with percentages but the point being at the end of the day, if you take an across-the-spectrum look at air fares I think you'll find that average yields and average prices for the airlines have increased markedly. Whilst there still are some special fares available in the market they're dramatically reduced in number. I should also say that in our analysis, Virgin Blue have also increased their lowest available fares by around 20 per cent on the key routes but generally their prices are much lower than the flexible fares from Qantas. The scale of the increase in some fare types is relevant given that it's the key driver of the end cost to consumers. Whilst some new costs and taxes account for a small part of the rise in air fares, they cannot possibly account for the huge differences between the pre and post-Ansett fare levels seen in most fare type categories.

Given that airport charges constituted only around 3 per cent of the domestic airline ticket purchase price prior to the failure of Ansett, there would have to be a massive increase in airport charges to retain the same proportion or contribution towards the average consumer air ticket cost. There has also been new charges introduced by government as well. As I'm sure most people are aware, obviously there's the Ansett entitlement tax, if you like, on air travellers and that charge alone is greater than Adelaide Airport's proposed new terminal passenger facility charge which was painstakingly negotiated over a number of years under commercial conditions.

A new government passenger tax for Ansett which was introduced almost overnight, I have to say, with some of the fastest legislation ever seen, is in itself three times higher than Adelaide Airport's typical domestic aeronautical charges per passenger. So again I think that sets our current level of charges in some sort of perspective in terms of the end consumer impact. I think this also illustrates too the key drivers of cost to the consumer in this aviation market at the moment. We feel that average prices rarely fall back to some extent when true airline competition is reintroduced. The post-Ansett market in general and in many parts of Australia, it's the potential monopoly power of airlines and not airports that should be the key concern of the public and the ACCC in our view.

Moving on quickly to airport development issues. Adelaide Airport gained agreement to collect a common passenger facilities charge to finance its proposed multi-user integrated terminal at the end of August this year. It's obviously been a huge disappointment to us and our shareholders that this terminal is now unlikely to go ahead in its current form because of the Ansett fall-over. Obviously this has been a painful process given the long-winded nature of a negotiation to get to where we had.

PROF SNAPE: I suppose it's just as well it took a long time.

MR GOLDSMITH: Yes, there is that. Under foreseeable market conditions, it's virtually impossible for it to be built, as I said. We have already come up with a new concept called Project Phoenix, interestingly, that will provide a high standard of terminal facilities on a common user basis for an overall reduced cost to the customer base. But under a scenario where Qantas retains around 65 to 75 per cent of the domestic market at a conservative estimate, and thereby the vast majority of traffic at our airport, it's extremely difficult for us as a company to move forward with this hugely needed upgrade of our facilities without the full cooperation and participation of Qantas and whilst the initial reaction following the Ansett fall-over by Qantas was positive about moving forward as quickly as possible, we've more recently been told that we are a lower priority in terms of going forward. Basically you can't expect any immediate progress on this issue under current market conditions.

Adelaide Airport could pursue an alternative terminal, build and upgrade options with other airlines but the scope for an integrated world-class facility with similar direct and indirect revenue-generating potential as our former concept is severely limited. Therefore, Qantas is not only able to dictate the pace and location of new replacement aircraft seat capacity but also enjoys greatly enhanced power of influence over the airport's timing and scale of future development. By default, the major airlines operating in Adelaide now have a marked - a much higher degree of direct and indirect control over the entire revenue-generating potential for the airport business over its longer-term future through either their action, inaction or the chosen level and timing of participative engagement with our management team.

We also looked at the issue of good practice for airports regarding future aeronautical charging and Adelaide Airport supports a basic principle of airport charges being, as far as possible, transparent, cost-related and non-discriminatory between customers. To this end we're keen to establish some form of formal process of consultation with our airline customers under a price monitoring environment regarding our aeronautical and any other charges that are relevant to that discussion. We've highlighted a few more details in the proposal about how this could work. But at this stage we only have a preliminary view. But we are keen to ensure that customer views are received, given appropriate attention and officially noted under any monitoring process.

We have observed that this type of process has worked well in other countries like the UK, although that is, as we all know, a regulated environment. But the benefits can be transferred to, shall we say, a less stringently regulated environment. We're also keen or willing for the Productivity Commission to invite a representative from whatever the price monitoring authority may be in the future. I think those are the key points of our submission.

PROF SNAPE: Good, thank you very much for that, Mr Goldsmith, and I should also have thanked you for your efforts in getting a written submission into us in the current climate in time for us to read it beforehand, so thank you very much. We realise how difficult it is at the moment. If subsequently with more time to reflect you wish to supplement it, then of course you're free to do so. I wonder if I could start by asking about the nature of the leases to the extent that you're able to talk about them - the lease that Ansett had with you and what you think is to be the future of that arrangement.

MR YOUNG: We have the domestic terminal lease and Ansett has three main facilities at the airport, domestic terminal building, cargo building and a maintenance facility. The administrator has not adopted those leases and the administrator continues to deal with us on essentially a month-by-month arrangement. Having said that, it is by notice, so presumably we can be given a notice that they don't wish to continue with that and that can finish basically at the time they give us the notice. So it's a day-by-day affair really.

PROF SNAPE: That would then revert to you.

MR YOUNG: The buildings, the facilities, bar one of them were always owned by the shareholders of Adelaide Airport Ltd, so it's not a ground lease. We own the building and we act as the landlord and the airline is a tenant.

PROF SNAPE: Therefore you would have a common user terminal - you would be able to use it as a common user terminal.

MR YOUNG: It would be vacant and we could then turn our minds to what it could be used for, I guess.

PROF SNAPE: A couple of other facilities as well as the terminal, however, yes. You said at 2.4 that it puts nearly 18 per cent of the airport's revenue at risk. That's elaborated in table 2. Yes, there we are - which I did look at before. But could you just remind me why it's only 18 per cent when Ansett's share of the market was substantially greater - 43 per cent.

MR YOUNG: The aeronautical charges at Adelaide Airport constitute approximately 30, 35 per cent of the total revenue stream of the airport. There are other income streams. So whilst Ansett represents about 30 per cent of our total aeronautical revenue we have income or revenue from other sources as well. So the combined effect of Ansett aeronautical and property charges, when compared to the total income stream of the airport from other aero charges, other property charges and miscellaneous sources of revenue, is 18 per cent.

PROF SNAPE: Yes, but are not a lot of those other revenue streams related to the Ansett passengers?

MR YOUNG: Certainly. We've only looked at the direct in that calculation, we haven't really looked at knock-on effects in terms of carpark or potential - - -

PROF SNAPE: So essentially you're assuming that the passengers would turn up on some other airline and it was only the landing of the planes that you were missing. Is that right?

MR YOUNG: In terms of assuming - on the basis of going forward, we've got, I guess, a different set of assumptions about the likely knock-on effect but in terms of Ansett's direct contribution to our revenue base, that's the number.

PROF SNAPE: Yes, good.

DR BYRON: We had some discussions, you probably heard this morning, about per passenger charges rather than maximum take-off weight charges. Currently you're on MTOW. The proposed new terminal was going to be on per passenger. My understanding is that the Ansett collapse means fewer flights with a greater seat occupancy. So in hindsight now do you think you would have been better off if you'd moved to per passenger charges earlier?

MR GOLDSMITH: I suppose, strictly speaking, yes, we would be undoubtedly in terms of short-term revenue flow, yes. I should say though with the new terminal concept we weren't actually dispensing with the runway charge. We hadn't made any decisions about the future status of the runway charges. Those were to remain intact. The passenger charge was on top of the - - -

DR BYRON: That was the terminal charge.

MR GOLDSMITH: Yes, it was the terminal facilitation charge.

DR BYRON: Mark, can I ask you the same question that I asked Canberra about whether the turmoil in international and domestic aviation has changed the required rate of return for new investment of the airport? If you want to elaborate on - is there new investment in the airport at present and how much has the environment altered your risk premium?

MR YOUNG: Can I say, firstly, we endorse Canberra's comments in terms of the credit risk. The Ansett demise has highlighted, I guess, a commercial risk that airports take and I didn't appreciate that Canberra's position was the same as ours and that is that we have no really normal commercial back-up in the face of a failure of a major customer like that, so there is a credit risk. In terms of the longer-term attitude, I guess, of our shareholders in relation to their need or desire for a normal commercial return are based on the risk that they're taking, we're still formulating our views on that and we really need further direction from our shareholders to be able to answer the question fully. But it seems to us - and we were discussing it earlier - that given that currently airports seem to be bearing the consequence, the major consequence or the brunt of the risk associated with the demise of Ansett, that perhaps there's an arguable case for shareholders to expect to achieve higher rates of return given that there would seem to be a higher risk profile attached to that now.

DR BYRON: The question of the distribution of risk between the airports and the airlines in terms of downturn, I guess I've been reading a lot of international reports of how the international aviation business is down and airlines - even fairly famous ones like Swissair - that some European and North American airports are having to actually share some of the pain with the airlines. I imagine the domestic situation is a bit different because at least domestically our surviving airlines seem to be doing reasonably well in terms of load and yield management, given Ansett's demise.

MR GOLDSMITH: I think that's possibly an understatement. I think they have never had it so good. It's unprecedented territory at the moment for the surviving incumbents. Whether that situation will continue to be as beneficial to them obviously remains to be seen as the Ansett II situation develops and market conditions generally develop. But again specifically with regard to Adelaide where we are so, so dependent on the domestic market, the profile of risk I would say for the domestic carriers is very low in terms of profitable market development opportunities, in terms of yield management on existing services.

As I said before, I made the point that we were in the position of only having one carrier on a great number of routes and greatly reduced competition on all of our key routes. So I would actually say that the risk burden for the airlines at this particular time, Adelaide Airport specifically, is low.

DR BYRON: Just on that point, you made the statement that airport charges constituted only around 3 or 4 per cent of domestic airline ticket purchase prior to the failure of Ansett. Given the increased seat occupancy and the much higher average fares paid with the reduction in discounts and so on, have you any idea what proportion of the cost aero charges would represent now? I mean, has it come down from 3 or 4 per cent to 2, 1 - - -

MR GOLDSMITH: No, I mean, I can't give you empirical evidence to say what the average increase in air fares has been since the Ansett failure or the average increase in yields would be. Our only mechanism to look at this from a snapshot point of view was to take a selection of different fare types at different points in time. We've provided that in appendix A. But there's no doubt that the more price sensitive end of the market, there was significant scope to increase prices, particularly in the middle range band of fare types and that seems to be borne out by the fares currently in the marketplace now.

DR BYRON: Thanks.

MR GOLDSMITH: I would just say in that context under the current situation, I would assume that our prices are at least probably half what they were in relative terms before. But if you actually look, as I said before, in terms of the absolute quantum of end consumer price of the air ticket, you'd probably be looking at anywhere between 15 and 30 times the magnitude of the airport cost per passenger in terms of what the additional airline charges are adding to the ticket. In fact it's probably a lot more than that. So that's why we advocate sort of setting any airport increase in charges, even if it seemingly is - what would have formerly been regarded as a significant price increase in terms of percentage in some sort of context.

DR BYRON: So the reduction in airline competition has increased lower end fares by, say, a couple of hundred dollars and an increase from 3 to 6 or 4 to 8 or something like that is - although percentage wise is a 100 per cent increase - compared to the $200 in the ticket price it's pretty trivial.

MR GOLDSMITH: Yes.

DR BYRON: Okay, thanks.

PROF SNAPE: Are you negotiating air service agreements now?

MR GOLDSMITH: We were with - what, do you mean in terms of service level agreements?

PROF SNAPE: Conditions, yes.

MR GOLDSMITH: Okay, yes. We were addressing that issue through the MUIT negotiations and actually had a whole series of documents which addressed all of the conditions of use-type issues. They were about to be signed off or more or less at the point of signature when Ansett fell over, unfortunately. But largely all the substantive issues associated with those agreements were fully negotiated.

PROF SNAPE: So what happens to that now?

MR GOLDSMITH: This yet remains to be seen. As I seen, our current powers of influence are rather limited.

MR YOUNG: Like other airports we have a conditions of use document which hasn't been accepted or adopted by the airlines. We maintain, of course, that their continued use of our facilities signals their de facto acceptance of it but that's never really been tested. But as Rob said we were a substantial way down the track towards getting service level agreements and other access agreements negotiated with the airlines to the new terminal and it remains our objective to still achieve that, at least with Qantas, and it's our strong preference to include Virgin.

MR GOLDSMITH: The process itself remains the same; the same principles of our commitment to undertaking that sort of arrangement remain the same, going forward as they have done with the previous MUIT terminal.

PROF SNAPE: Okay. How does Project Phoenix differ from MUIT? Can you give us a feeling of the difference between the two?

MR GOLDSMITH: In terms of its design we're looking now to actually try to integrate more of the existing shell of the existing facilities, particularly the international building and incorporate that, or at least the shell of the building, with upgrades into a combined common user facility which is obviously much larger than the current international building. Obviously this Project Phoenix can only go ahead with the commitment of Qantas as its primary perceived user at this point in time. But it would be similar in concept of having a flexible international facility with probably swing-gate concepts where they can - particularly gates can be used either as international or domestic gates for efficient use of the terminal building. But it would be basically a common user facility where the airport operates and owns the facility.

MR YOUNG: It would be our intention to have it designed in such a way that, firstly, our strong preference is to include Virgin in that and also designed in such a way to facilitate other new entrants.

PROF SNAPE: But Virgin was, I thought, previously going to continue to take over the use of the old Qantas - - -

MR YOUNG: That's correct and that remains the case at the moment. But of course the situation has now changed.

PROF SNAPE: So you describe it, it's essentially a scaled-down version of the MUIT with essentially the same location or near - - -

MR YOUNG: More or less.

MR GOLDSMITH: But as Mark was saying, we would envisage or we would hope that Virgin could play a strong part in the development of that facility, going forward.

PROF SNAPE: The state government was pretty active in that before. Where are they standing now?

MR YOUNG: I think they have the same view that we do. This is a very much needed facility for the state of South Australia, and it's the intention of the shareholders of Adelaide Airport, in conjunction with all interests of the stakeholders, to deliver that facility.

PROF SNAPE: Your major shareholders are not all just South Australia based though.

MR YOUNG: No, but they have their interests there.

PROF SNAPE: Uni Super, I think, is a major shareholder.

MR YOUNG: And their interests, as shareholders of Adelaide Airport, is to deliver a facility that is very much needed.

PROF SNAPE: Yes. Have you - I don't think you asked this, Neil. Stop me if you did. Have you considered switching to a per-passenger landing charge? You did? You did ask that, yes, okay.

DR BYRON: The answer was "not really".

PROF SNAPE: Yes.

MR GOLDSMITH: But, I mean, the exact answer - I was going to say, the exact answer on that really was because we were in the throes of negotiating the PFC for the new terminal. We didn't want to complicate by charging mechanisms unnecessarily whilst that was still going through. Now, obviously, we're in a completely new situation now and we have to re-evaluate many things and that will just be one of them, but we have no imminent plans to change at this point in time, and as I say, it certainly hasn't been discussed with the shareholders at this point.

PROF SNAPE: Okay. How are you going, Neil? Getting close to the end of mine, I think.

DR BYRON: Yes.

PROF SNAPE: Once I start asking the same question twice, it's obvious I've got close to the end of the list. I apologise for that.

DR BYRON: I guess the last very general one is, as I asked Malcolm this morning, where would you think we should concentrate our attentions and major outstanding issues in finalising the report? Do you think the government decision of two weeks ago basically answers most of the problems for the phase 2 airports?

MR GOLDSMITH: I think in broad terms, it was a very welcome move, from our perspective. It does bring forward a view that we'd advocated ourselves, and I believe that you have put forward in the draft proposal - as I say, moving forward, we would like to implement the process of constructive consultation with airlines moving forward within a responsible environment of price monitoring, and we would hope that we're able to broker sensible relationships of our customer base along those lines.

DR BYRON: So the main unfinished business for us is clarification of what's in price monitoring?

MR GOLDSMITH: Yes. Yes, but we are of the view, I think, that - I think similar to the Sydney perspective, that we wouldn't want to see too many sort of check list items that we have to adhere to at this point in time. I think you have to have a relatively flexible environment for individual airports, and potentially the way that airports act in dealing with their future customers is an important aspect of monitoring itself, rather than actually prescribing that process from the outset in absolute detail. We believe we can be responsible in that regard and we believe that we can broker sensible commercial relationships, based on the type of negotiations we've had with our terminals or terminal development.

DR BYRON: Thanks.

PROF SNAPE: Good. Well, thank you very much, and again, thank you for giving us the written submission in time for us to be able to read and consider it - it was very good of you, in the circumstances - and for your comments today, thank you. We will be now moving in a couple of moments, when we can get it organised, to a videoconference to Canberra with the Australian Taxi Industry Association.

MR EVANS: Good afternoon.

PROF SNAPE: Good. It's Mr Jack Evans, I think, up there. Is that correct?

MR EVANS: That's correct.

PROF SNAPE: Good, okay. Down here, as you might recall, I'm Richard Snape and on my right here is Dr Neil Byron. Thank you very much for appearing with us in this way. The picture looks pretty good from this end and I hope it looks okay from your end too.

MR EVANS: It looks fine. How is the weather?

PROF SNAPE: Well, as you would say up there, it's typical Melbourne weather - it's raining. Thank you, Mr Evans. Perhaps you would just like to identify yourself and your position for the benefit of the transcript please.

MR EVANS: Certainly. Jack Evans, adviser to the Australian Taxi Industry Association.

PROF SNAPE: Thank you very much. As you know, it's a public hearing. There is an audience, not huge I might say, but of very high quality down here so it is in public, just to mention that. Thank you for your submission. I wonder if you would like to speak to it now.

MR EVANS: Certainly. Thank you very much for the opportunity to respond to the draft report. As you would appreciate, I think our view differs from the conclusions in the draft report about the extent of market power of the airport corporations and really, I guess, it holds on a number of factors. Firstly, I think we very much support the view expressed by the Commission on page 135 that the extent of airport power is to a large extent a reflection of the degree to which the airports can exercise power, having regard to the proportion of the other industry - in this case the taxi industry's business is generated in relation to airports.

As we stated in our original submission, in the major cities and the locations where the airports that this inquiry is looking at are, the airport business represents the largest single market for the taxi industry. It is therefore in our view a situation where the airports do have a quite substantial degree of market power. We would suggest something more than the low to moderate ranking given by the Commission. In this regard we note the example quoted of Melbourne. The 790 carparking spaces that Melbourne Airport is providing will be the largest single taxi carparking facility anywhere in Melbourne and again reflects that importance of the airport market in terms of the overall taxi industry business.

We were also somewhat surprised, to put it mildly, about the extent to which you gave the taxi industry power in terms of its ability to organise and deal on a sort of cohesive basis with the airport organisations. You did acknowledge that the TWU for example does have a small base; that it is growing. The reality is that the taxi drivers themselves are set up as businesses in their own right and therefore the sort of degree to which union penetration can occur naturally within the industry is probably going to be very problematic. Whilst there will be small pockets, it's probably always only going to be at that smallish level.

Similarly, in terms of the taxi companies, whether say in Melbourne's case we're talking about Silver Top or one of the others, whilst you can say they've got several hundred taxis operating under their banner, it is really a marketing banner that operates primarily to provide the booking service through what has been traditionally described as a radio network. The Silver Top, say, to use that example, doesn't control what the individual taxi driver's business decisions are so that for example if I was driving a Silver Top cab in Melbourne, Silver Top wouldn't say to me, "Go to the airport." They can say, "There's work available at the airport," and I can choose whether I want to go out there to try and get that work or not. Alternatively, they don't say, "Don't go to the airport."

So from our perspective, in terms of the sort of nuts and bolts of the industry, we very much see ourselves in a situation where the role of those taxi organisations, the large companies, is to provide certain services to the taxi driving business and not effectively have the taxi driver as one branch office in terms of a large organisation. The taxi drivers themselves, if you do talk to them, would see themselves very much as being in competition with one another for business both between the various brands and even within those brands. So if I can organise myself so that I'm in a better position to get a better job than somebody else working for the same organisation I will do that in competition. So I think you pay us too much credit, to put it that way, in terms of the influence and the power and the cohesion within the industry in regard to that situation.

I would also note that in regard to the example quoted of what happened in terms of the charge to be imposed on pick-ups at Melbourne Airport, the reality is that despite the fact that the timing was less than kind to anybody because it came so soon after the introduction of the GST and the tollway fees in Melbourne, it was really only in the end the power of the ACCC to be able to say, "Hey, this pricing is subject to the general agreement about price increases," that led to the final outcome of the charge only being 66 cents rather than the proposed $1.40. Although there was the other adjustment to take it up to a dollar, without really that ACCC power, I wonder in the end whether the original proposed charge of the airports corporation of the $1.40 wouldn't have gone ahead.

Given that situation, when we consider the recommendations in the draft report, as you would appreciate, we do have a problem in terms of option A with the proposal that taxi parking not be subject to the price regulation, primarily for the reason we just have outlined. However, looking at the Commission's preferred approach of option B, basically provided the four key elements are recognised and accepted by the airports, we would be comfortable with the Productivity Commission's recommendations and the four key elements as we see it are that the airports are prepared to negotiate with the taxi industry on the charges to be imposed and of course the facilities to be provided. They then are prepared to consult fully with the state and territory regulators that control taxi fares before the charges are increased. They undertake not to increase the charges until the regulators have allowed the charges to be passed on by the taxi operators to the public and that they take a responsibility to provide information to the passengers going through the airport about the airport taxi charge that is going to be introduced or is now applying.

In proposing that, we believe that that's a reasonable position from our perspective and a not unreasonable arrangement to have the airport operators accept. Thank you.

PROF SNAPE: Good. Thank you for that. I see that in large part your four conditions are really because you're being regulated on the one hand and you want to make sure that you're not unregulated on the other hand in a sense.

MR EVANS: We're sure the other party is not regulated in some way on the other hand, yes.

PROF SNAPE: Yes, that you're not involved in a squeeze that you can't pass on because of regulation is what I was meaning.

MR EVANS: Yes, precisely our concern. Yes, that's right. I mean, when you look at Brisbane, Perth, Canberra, for example, the charges there have largely been implemented without any great degree of difficulties or problems or angst even amongst the passengers. I think when we appeared in Sydney we talked about the relative level of the charges at this stage to the overall taxi cost. Obviously we would be concerned if that started to get a long way from where it is today and I think, you know, the airports would obviously want to exercise some judgments in that regard, given in some cases the range of options that are available if you don't use taxi services.

PROF SNAPE: I think that probably our comments on the strength of the taxi drivers' negotiating power might well have been affected by the timing of some industrial actions down here, which it seemed to us were organised very successfully and effectively and I think that I had to walk over a kilometre on one occasion because of it. It came right at the time when we were in full - writing things down. So it just might have - we were able to appreciate at first hand what did appear to be very effective negotiating power.

MR EVANS: I think certainly the personal experience obviously can have quite an influence, particularly if you ended up with a fair old hike that you obviously wouldn't have wanted to undertake but I would see that Melbourne example as - to use the old cliche - the exception that proves the rule because it happened at a time when the industry had gone through quite a traumatic set of circumstances with the GST because - I'm not sure how much you're aware of the particular legislation that relates to the taxi industry in terms of the GST but there is, unlike any other industry, a requirement that all taxi operations, all taxi drivers in this case, must be registered for the GST. So that was quite an impact on the industry that got people somewhat agitated. Then the situation of the tollways down in Melbourne coming on and this was really one that sort of effectively was the straw that broke the camel's back. If it had happened in different circumstances, Brisbane, Canberra, Perth, then I would suspect there wouldn't have been the same organisation and the same reaction at all.

DR BYRON: Just to follow that, is it correct that Melbourne is the only place where the taxi drivers actually get a collection fee or some percentage of the surcharge?

MR EVANS: Yes, that's correct.

DR BYRON: I don't think that in any way undermines the strength of the four conditions that you suggest in your submission there which I imagine that's pretty much the way it has happened in the places like Brisbane and Perth where it wasn't particularly controversial with the consultation and the taxi regulators' consent and I think the timing done properly, it's not an insurmountable problem for you.

MR EVANS: As long as those four provisions are met then normally yes, it wouldn't be an insurmountable problem. The only question is, you know, how high does it go and obviously as it went higher the problems would start to manifest themselves. You know, if people say in Brisbane, to take an extreme example, looking at say a $22 taxi fare into the city and a $20 charge from the airport, then obviously we'd have a pretty big problem. But whilst it's a dollar, $2, it hasn't been an issue. It hasn't been particularly a concern. There's always some passengers who do react to - what are you adding onto the fare? Even in places like Sydney where the Sydney Harbour Bridge toll has been an add-on to taxi fares for a long, long time, occasionally you still get situations where people object to say a $25 fare at the end, saying, "Sorry, but it's $27 now." So whilst yes, we would say the three examples other than Melbourne suggest that that's the situation that has happened, I guess we look for the comfort of having some sort of - we've had the advantage of the arrangements that exist at the moment and we would like something that incorporates those comfort provisions in anything that the airport does or the airports do commit to if they are allowed to adopt the light-handed regulatory approach recommended by the Commission.

PROF SNAPE: I think that's a very clear position and helpful to us. I don't think we need to pursue it any further and you would probably be amused to know that I had a taxi driver the other day down here who refused to add onto the fare the toll charge, the City Link charge. He wouldn't take it.

MR EVANS: Can you give me his name and number and I'll make sure I get him next time I'm down in Melbourne.

PROF SNAPE: Get him one way or another. So thank you very much for that submission and the very helpful comment and very clear statement of the position that you gave to us. Thank you very much.

MR EVANS: Thank you.

PROF SNAPE: So that concludes the scheduled hearings for today and I'll now issue the invitation that I foreshadowed at the beginning and that is that if anyone present wishes to make an unscheduled statement at this time then please let us know.

In that case, we will finish the hearings for today and we resume the hearings here in the same place tomorrow morning at quarter to 10. Thank you very much. So until 9.45 tomorrow morning, thank you.

AT 4.50 PM THE INQUIRY WAS ADJOURNED UNTIL
THURSDAY, 18 OCTOBER 2001

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