NON-CONFIDENTIAL VERSION

PRICE REGULATION OF AIRPORT SERVICES

SUBMISSION TO THE

PRODUCTIVITY COMMISSION

FROM VIRGIN BLUE AIRLINES

21 July 2006

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1. INTRODUCTION AND EXECUTIVE SUMMARY

Virgin Blue Airlines Pty Limited (**Virgin Blue**) welcomes the opportunity to make this submission to the Productivity Commission (**Commission**) in response to the Commission's inquiry into the price regulation of airport services.

Following the Commission's 2002 *Inquiry Report on Price Regulation of Airport Services* (**2002 Report**), the Commonwealth Government adopted many of the Commission's recommendations and removed price notification and price caps from all airports, to be replaced with mandatory price monitoring arrangements for a probationary 5 year period. Although the Government acknowledged that major airports had considerable market power, the Government's decision to move to price monitoring alone was based on the premise that commercial constraints on airports' market power meant that a heavy handed regulatory regime was not warranted.[1] Further, the Government announced that it would consider re-introducing price controls on an airport if it formed the view that it had acted inconsistently with certain review principles (**Review Principles**) and that it would evaluate the conduct of airports against these Review Principles at the end of the probationary period.

The Review Principles are set out in full in section 2.4 below, however they essentially require that:

(a) airports price their aeronautical services efficiently;

(b) quality of service outcomes at airports be consistent with users' reasonable expectations; and

(c) airports and airlines operate primarily under commercial agreements and in a commercial manner, and that airport operators and users negotiate arrangements for access to airport services.

In general, in the period since the removal of price notification and price caps, Virgin Blue does not believe that the conduct of airports has been consistent with the Review Principles, especially the principles relating to the efficient pricing of aeronautical services and the commercial negotiation of agreements.

In relation to efficient pricing, during the probationary period:

(a) airports have increased aeronautical charges (at a time when passenger numbers have been steadily increasing) to the extent where they are now recovering aeronautical

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[1] *Government Response to the Productivity Commission Report on Price Regulation of Airport Services*, 13 May 2002, Response to Recommendation 1

revenues significantly above efficient costs and well in excess of competitive levels. As set out in the Allen Consulting Group Report submitted to the Commission by Virgin Blue (**Allen Consulting Group Report**),[2] a "common theme across all of the airports is that, over the period since the removal of formal price controls on the airports, actual revenue has risen substantially above 'total cost'". By way of example only, in the short period since the removal of price regulation (4 years) many major airports have more than doubled their take off and landing fees. The Australian Competition and Consumer Commission (**ACCC**) has also noted that *"[s]ince price monitoring was introduced revenue from aeronautical services increased by between 37 per cent and 163 per cent".*[3] Further, the margins being earned by airports on aeronautical charges have been largely disguised through unwarranted asset revaluations and changes to the inputs to the costing models used to justify the increases; and

(b) airports have changed the basis on which they charge for certain aeronautical services. Many major airports (including Melbourne, Perth and Sydney Airports) now charge for take off and landing on a per passenger basis rather than on the basis of the weight of the aircraft. For the reasons that are explored in detail in section 6.3 below, charging on a per passenger basis:

(i) is inefficient and results in a loss in social welfare;

(ii) has a negative impact on competition in the airline industry and has a disproportionate impact on a low cost carrier (**LCC**) such as Virgin Blue compared to a full service airline (**FSA**) such as Qantas; and

(iii) results in additional over-recovery by airports for the provision of these aeronautical services, in circumstances where prices are already well above efficient levels.

Further, per passenger charging for take off and landing charges is not international best practice. A review of international airports (see Schedule A) shows that the only airports internationally that charge in this way are in Australia and New Zealand – nowhere else. The question of per passenger charging for take off and landing charges was considered by the Australian Competition Tribunal (**Tribunal**) in *Re Virgin Blue Airlines Pty Limited*[4] (***Re Virgin Blue Airlines***) and the Tribunal confirmed that per passenger charging for take off and landing could not be justified on an efficiency basis and had a detrimental impact

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2 The Allen Consulting Group, "Productivity Commission Review of Airport Pricing, Behaviour of the Airports Since Removal of Price Control and Compliance with Review Principles 1 and 3", July 2006 p 13

3 ACCC press release, "ACCC issues third airport price monitoring report", 14 February 2006

4 [2005] ACompT5

on competition in the dependent airline market. Further, the Tribunal found that the move to per passenger charging by the owner of Sydney Airport, Sydney Airports Corporation Limited (**SACL**) had been a misuse of market power.

In relation to airports acting in a commercial manner, according to commercial agreements, Virgin Blue has had a very mixed experience since the removal of price regulation. When there has been a sufficient incentive for airports to negotiate, negotiations have resulted in genuine commercial agreements between the parties. Examples of this include the negotiations for terminal agreements following the collapse of Ansett, and other instances where funding for new investment has required the airport to have binding agreements with airlines. However, outside of these rare (or unlikely to be repeated) circumstances, Virgin Blue does not consider that negotiations have been conducted by airports in a commercial manner. Clear examples of this can be found in the imposition of take off and landing charges. These charges have generally been presented to Virgin Blue on a take it or leave it basis, and any attempt to negotiate them has been unsuccessful. For example, Virgin Blue was told by one airport that if it didn't like the charges, it didn't have to fly to that airport. Further, agreements between airlines and airports do not contain meaningful dispute resolution procedures or other provisions that are common in agreements between parties operating in competitive environments.

Virgin Blue is particularly concerned by the actions of airports since the removal of price controls because airport charges are a very significant part of Virgin Blue's cost base. Aeronautical charges levied by airports can amount to over a quarter of the lead-in fare offered by Virgin Blue on popular routes. As an LCC, Virgin Blue's business model relies on keeping its cost base as low as possible to enable it to offer lower fares, thereby stimulating additional demand for air travel. Inefficient and anticompetitive charges prevent Virgin Blue from being able to do this, with consequential losses in social welfare.

One of the key assumptions in the Commission's 2002 Report and the Government's response was that commercial opportunities and pressures, especially the opportunity to earn non-aeronautical revenue, would constrain the exercise of market power by major airports. However, evidence presented by SACL during the hearing of *Re Virgin Blue Airlines* indicated that non-aeronautical revenue would not prevent SACL from increasing the take off and landing charge more than ten-fold. The Tribunal found that there was consensus between all economic experts that the constraining effect of non-aeronautical revenue was not significant.

Further, the threat of re-regulation has not been effective either. While this is due in part to the shortcomings in the price monitoring regime (discussed at length in section 7 below), even if that regime was improved it would not act as an effective constraint. As the Tribunal noted in *Re Virgin Blue Airlines*: "*any threat of re-regulation is, in reality, quite limited*".[5] Nor is the general

[5] *Re Virgin Blue Airlines* at [505]

access regime in Part IIIA of the *Trade Practices Act 1974* (**TPA**) an effective constraint on airports' market power due to the delay, cost and difficulty in obtaining any redress through these provisions as discussed in section 8 below.

With the probationary period of price monitoring now nearing an end, Virgin Blue considers that it is clear that the move to reliance on price monitoring alone has not been successful, as airports have not acted in a manner consistent with the Government's Review Principles. Virgin Blue notes that very few other jurisdictions in the world have embarked on a privatisation scheme for major airports while also removing price controls (in fact, other than Australia, only New Zealand has taken this course).

However, rather than a return to price controls, Virgin Blue recommends the introduction of an alternative, lighter handed, form of regulation that would encourage airports and airlines to negotiate commercially for access to aeronautical services. Virgin Blue believes that a negotiate-arbitrate model, if applied to all aeronautical services provided by major airports, would encourage parties to negotiate commercially whilst also providing for a "circuit-breaker" (through independent arbitration) if negotiations break down.

Under such a model, in the event that commercial negotiations fail, airlines and major airports would have the ability to refer to independent arbitration any dispute over the terms and conditions on which aeronautical services are provided by the airport. Virgin Blue considers that the ACCC would be well placed to perform the role of independent arbitrator, due to its general experience in conducting arbitrations in relation to disputes over access to monopoly infrastructure and its specific experience in relation to the pricing of aeronautical services.

Further, the regulatory model could incorporate features to improve the information available to parties and therefore reduce the likelihood that parties would need to resort to arbitration.

First, the ACCC could issue detailed pricing and costing guidelines for the airport sector. Virgin Blue considers that guidance on issues such as asset valuations, calculation of the WACC used in airport revenue models and the implications of particular airport charging structures for competition and efficiency would greatly assist parties in commercial negotiations.

Secondly, the price monitoring procedures could be improved so that price monitoring reports would assist airlines and airports to engage in fully informed commercial negotiations. Virgin Blue recommends that the price monitoring regime should be amended to provide for timely reporting of a thorough and detailed analysis of the prices, costs and profits associated with the provision of aeronautical services.

Virgin Blue sets out its detailed recommendations in relation to its recommended model in section 11 below.

2. BACKGROUND TO THE REGULATION OF AIRPORT CHARGES

2.1 The Privatisation of Airports

Prior to 1997, the main airports in Australia were owned and operated by the Federal Airports Corporation established under the *Federal Airports Corporation Act 1986* (Cth).

In 1997 and 1998 the Commonwealth Government effectively privatised most of Australia's large airports by leasing them to private operators for a term of 50 years, with an option to renew for a further 49 years.

Sydney Airport was an exception. While it was subject to a lease of the same duration as the other airports, it was leased to SACL, which was at that time wholly-owned by the Commonwealth Government. In 2002 all the shares in SACL were acquired by Southern Cross Airports Corporation, such that Sydney Airport is now privately operated.

2.2 Price Regulation of Aeronautical Charges

As part of the privatisation process, price regulation under the *Prices Surveillance Act 1983* (Cth) was introduced for airports designated as 'core regulated airports' under the *Airports Act 1996* (Cth) (**Airports Act**). The following airports were core-regulated airports at the time of sale of leases: Adelaide, Alice Springs, Brisbane, Canberra, Coolangatta, Darwin, Hobart, Launceston, Melbourne, Perth, Sydney and Townsville.

Of those airports, Melbourne, Brisbane, Perth, Adelaide, Alice Springs, Canberra, Coolangatta, Darwin, Hobart, Launceston and Townsville were subject to a 5 year, CPI-X annual cap on prices for aeronautical services. These price caps were removed in 2001 for all but Melbourne, Brisbane and Perth Airports (price caps for these airports were subsequently removed in 2002).

Melbourne, Brisbane, Perth and Sydney airports were also subject to price notification arrangements, which required the operators to submit proposals to increase prices for aeronautical services to the ACCC. The ACCC could object to the proposals. For example, in 2001 the ACCC issued a decision objecting to SACL's proposal to increase certain aeronautical charges by approximately 130%, although it approved a lower increase.[6]

At the time of privatisation, it was envisaged that the regulatory regime would be subject to a review after its first 5 years of operation. The Commission undertook that review in 2002 and that review is discussed in the next section.

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[6] ACCC, "Sydney Airports Corporation Ltd Aeronautical Pricing Proposal Decision", May 2001

2.3 Productivity Commission Report (2002)

On 13 May 2002, the Commonwealth Treasurer, the Hon. Peter Costello MP, and the Minister for Transport & Regional Services, the Hon. John Anderson MP, released the Commission's 2002 Report.[7]

The principal recommendations of the Commission in the 2002 Report were that price notification arrangements for Sydney, Melbourne, Brisbane and Perth airports (and the price caps for Melbourne, Brisbane and Perth airports) should be replaced by "mandatory price monitoring arrangements for a probationary five-year period" (Recommendation 1) with an independent public review (**the Airport Pricing Review**) at the end of that period "to ascertain the need for any future price regulation of airports (including price monitoring or more stringent price regulation)" (Recommendation 6). The Government also reserved the right to bring forward the Airport Pricing Review or conduct a separate review if it appeared that an airport operator had unjustifiably increased prices (Recommendation 6).

The Commission found that airports have natural monopoly characteristics.[8] That is, for a given level of demand for a good, service or facility, one firm can produce a given set of outputs at a lower cost than two or more firms can. In the case of airports, natural monopoly characteristics were found to arise from:

(a) investment requirements, economies of scale and economies of scope; and

(b) network benefits, which determine the extent to which airlines are willing to spread their services across more than one airport in any given location.

These natural monopoly characteristics, combined with regulatory constraints, created significant barriers to entry in the provision of airports.[9] The Commission concluded that, considered in isolation, this would appear to give airports in Australia significant market power.[10]

In particular, Brisbane, Melbourne, Perth and Sydney airports were found to possess a high degree of market power in domestic markets due to high proportions of business and "visiting friends and relatives" (**VFR**) travellers, and their status as the main international ports for arrival into, and departure from, Australia.[11]

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7 Productivity Commission *"Price Regulation of Airport Services,"* Inquiry Report No 19, 23 January 2002

8 2002 Report, p 97

9 2002 Report, p 105

10 2002 Report, p 106

11 2002 Report, p 144

Despite the finding that these airports had a high degree of market power, particularly in relation to aircraft movement facilities and passenger movement facilities, the Commission found that the incentive of these airports to increase aeronautical charges was likely to be dampened because airports could earn additional non-aeronautical revenue from encouraging additional passenger throughput.[12] The argument was that tempering increases in aeronautical charges would encourage more passengers to travel (because the cost of travel is lower than it would otherwise be). According to this argument, airports had an incentive to temper increases in aeronautical charges because of the potential gains from increased non-aeronautical revenue.

The Commission acknowledged that it was difficult to be precise about the magnitude of the constraining effect that this complementary non-aeronautical revenue would have on aeronautical charges and did not have quantitative analysis available to it.[13]

The key rationale for the Commission's recommendation of the removal of price notification and price caps and the introduction of price monitoring arrangements for core-regulated airports was the constraining effect of complementary non-aeronautical revenue. The Commission considered that addressing the market power of airports did not require the implementation of price caps:[14]

> *"Though the four largest airports have considerable market power, the prospect of them using that power in a way that would generate significant costs to the economy or community is supported neither by the evidence nor the analysis.* ***There are strong commercial incentives pulling in the other direction, including the scope for increased profits in non-aeronautical activities from increasing passenger volumes,*** *and incentives to discriminate and differentiate in pricing."* [emphasis added]

The extent to which non-aeronautical revenues in fact constrain prices for aeronautical services, including on the basis of quantitative analysis that has been prepared since the date of the 2002 Report, is discussed in section 9 below.

The Commission also found that:[15]

> "*Monitoring would promote more productive commercial relationships between airports and airlines, while providing the discipline of the possible reintroduction of stronger regulation after five years.*"

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12 2002 Report, p 188
13 2002 Report, p 184
14 2002 Report, p 355
15 2002 Report, p xvi

The extent to which the threat of re-regulation has constrained the exercise of market power by airports is discussed in detail in section 7 below, however it is worth noting that the Tribunal recently found that "*any threat of re-regulation is, in reality, quite limited*".[16]

2.4 Government Response and Current Regulatory Environment

Government response

On the same date that the 2002 Report was published, the Treasurer and the Minister for Transport & Regional Services also issued a joint press release[17] and the Government's response to the 2002 Report (**Government Response**).

The Government adopted the reasoning of the Commission in determining that a price monitoring regime was appropriate, and that the former price caps and price notification arrangements were no longer necessary. In its press release announcing the implementation of the new regime, the Government said:

> *"The [Productivity] Commission's review concluded that Sydney, Melbourne, Brisbane and Perth airports have considerable market power in some aeronautical services. However,* ***due to commercial constraints****, the potential for abusing that power does not warrant a heavy-handed regulatory regime.*
>
> *The Government considers that lighter-handed regulation of airports is now appropriate. In particular,* ***it appears that airport operators have strong commercial incentives to increase passenger throughput****, and have facilitated the entry of new airlines to the market."* [emphasis added]

When the Government announced the commencement of the price monitoring regime, it announced that there would be an independent review at the end of the 5 year regulatory period – the Airport Pricing Review that the Commission is currently undertaking. The Government noted that it would only consider re-introducing price controls on an airport if it formed the view that the airport had operated in a manner inconsistent with the Review Principles, being:

> *At airports without significant capacity constraints, efficient prices broadly should generate expected revenue that is not significantly above the long-run costs of efficiently providing aeronautical services (on 'dual-till' basis). Prices should allow a return on (appropriately defined and valued) assets (including land) commensurate with the regulatory and commercial risks involved.*

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16 *Re Virgin Blue Airlines* at [505]

17 Joint Press Release No 024, Minister for Transport and Regional Services and Treasurer, *"Productivity Commission Report on Airport Price Regulation,"* 13 May 2002

Price discrimination and multi-part pricing that promotes efficient use of the airport is permitted. This may mean that some users pay a price above the long-run average costs of pricing aeronautical services, whereas more price sensitive users pay a price closer to marginal cost.

At airports with significant capacity constraints, efficient peak/off-peak prices may generate revenues that exceed the production costs incurred by the airport. Such demand management pricing practices should be directed toward efficient use of airport infrastructure and, when not broadly revenue neutral, any additional funding that is generated should be applied to the creation of additional capacity or undertaking necessary infrastructure improvements.

Quality of service outcomes should be consistent with users' reasonable expectations, and consultation mechanisms should be established with stakeholders to facilitate the two way provision of information on airport operations and requirements.

It is expected that airlines and airports will primarily operate under commercial agreements and in a commercial manner, and that airport operators and users will negotiate arrangements for access to airport services.

Current regime

The ACCC is now responsible for monitoring airports under two pieces of legislation:

(a) under Part VIIA of the TPA, the ACCC is responsible for the monitoring of prices, costs and profits relating to the supply of aeronautical services and aeronautical-related services by the 7 major airports: Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra, Darwin; and

(b) under the Airports Act the ACCC is responsible for reporting on financial accounts under Part 7 and quality of service monitoring under Part 8 for all 12 core-regulated airports, being the above 7 airports and Alice Springs, Gold Coast, Hobart, Launceston and Townsville airports.

The price monitoring role has been given to the ACCC by direction under section 95ZF of the TPA (**Direction 27**) (originally made pursuant to section 27A of the *Prices Surveillance Act 1983* (Cth)).[18]

[18] Direction 27, *Prices Surveillance Act 1983* (Cth), made by Ian Campbell, Parliamentary Secretary to the Treasurer on 26 June 2002

The ACCC has published an Airport Reporting Guideline which sets out the information that airport operators are required to provide to allow the ACCC to fulfil its price monitoring and financial reporting obligations.[19]

Neither the price monitoring role of the ACCC nor its financial reporting responsibilities require the ACCC to carry out an analysis to determine whether or not any airport is complying with its minimum obligations under the Government's Review Principles. Importantly, even if the ACCC sees its role as being able to comment on compliance with the Government's Review Principles, the information that airport operators are required to provide to the ACCC pursuant to the ACCC's Airport Reporting Guideline is insufficient to conduct an analysis as to whether there has been compliance with the Review Principles.

The efficacy of the price monitoring regime is discussed in section 7 below.

3. VIRGIN BLUE'S ENTRY AND BUSINESS MODEL

Virgin Blue commenced operations in August 2000 as a low fare carrier. When Virgin Blue first entered, there were 3 other domestic airlines operating jet aircraft on the domestic trunk routes in Australia: Qantas Airways Limited, Ansett Airlines and Impulse Airlines as well as other regional airlines.

When Virgin Blue commenced operations it adopted a low fare carrier or LCC business model. The international aviation industry has seen the emergence of a number of successful LCCs over the last decade. Examples include Southwest and JetBlue in the United States and Ryanair in Europe. LCCs focus on keeping their costs to a minimum so as to be able to stimulate demand through lower fares. They do this by adopting highly efficient business practices and cutting back on various frills offered by traditional airlines, often referred to as full service airlines or FSAs.

The business practices that LCCs commonly adopt in order to minimise costs include:

(a) operating a single type of aircraft, which reduces training and fleet support costs;

(b) configuring the aircraft to maximise available seats, including by not having an area dedicated to business class in which there are wider seats set further apart or extensive galley space for catering purposes;

(c) not providing the same level of inflight amenities available on full service premium airlines;

(d) not providing complimentary meals and other items in flight;

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[19] ACCC, *"Airports Reporting Guideline: Information Requirements under Part 7 of the Airports Act 1996 and Section 95ZF of the Trade Practices Act 1974,"* revised March 2004

(e) adopting operating procedures which enable efficient and faster turn around of aircraft, for example:

(i) embarking and disembarking from the front and rear exits, rather than just using the front exit, which enables a quicker turn around time; and

(ii) utilisation of efficient non-ticket based passenger booking systems, which enable faster check-in, and more efficient boarding procedures, including bar coded boarding passes. Non-ticket based passenger booking systems are also highly automated, which reduces the costs incurred in employing revenue accounting personnel;

(f) where possible, operating on routes and flight schedules which maximise operating efficiency, for example, by focussing on short to medium haul point to point operations and avoiding hub and networked operations which can impose higher operating costs on an airline as these typically require aircraft to spend a longer time on the ground in order to connect with incoming flights;

(g) where possible, preferring to operate out of simple, low cost terminal facilities, that is, facilities which enhance the operational efficiency of the airline, for example, smaller terminals can be configured to facilitate rapid check in, baggage collection and loading and embarkation, including permitting access to front and rear stairs across the tarmac;

(h) implementing flexible labour arrangements, for example that allow staff to be trained and utilised in a number of operational roles for the airline; and

(i) having a relatively small management structure.

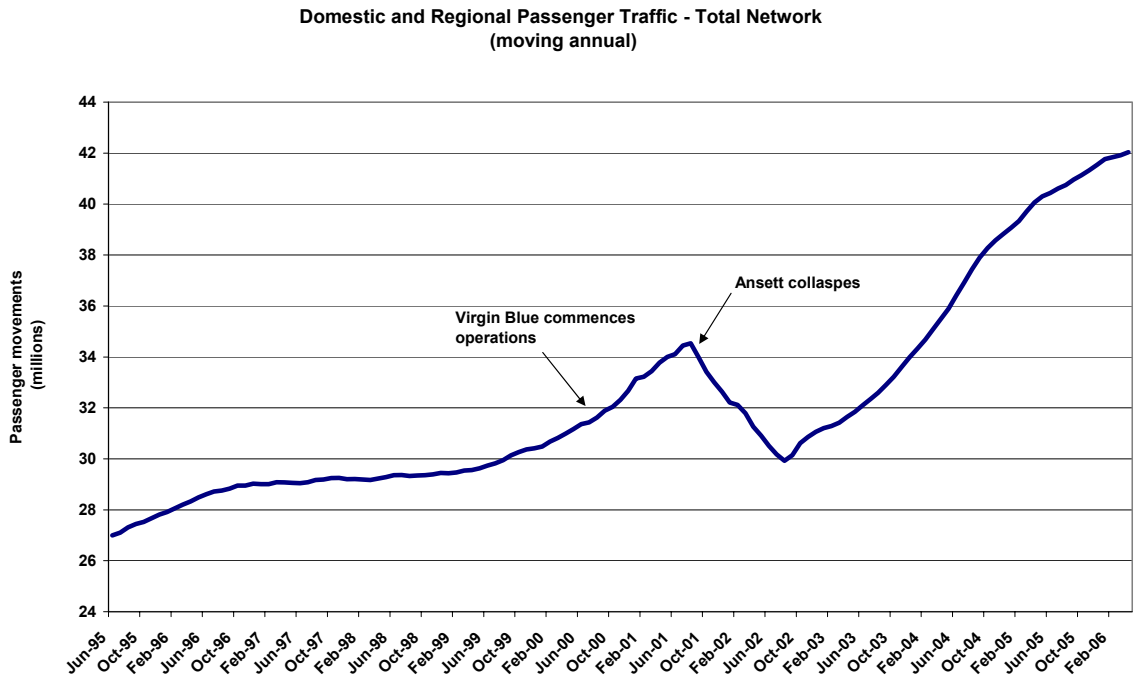
In contrast to LCCs, FSAs generally have higher cost structures and more extensive networks of routes and aim to capture a larger proportion of passengers that prefer higher levels of service, such as business passengers. Generally, FSAs offer a greater range of services built into the ticket price, such as complimentary meals, in flight entertainment, and subsidised business lounges. FSAs also offer business class (which incurs higher costs per passenger but also commands significantly higher fares) and may also have a larger seat pitch (the distance between rows of seats) elsewhere in the aircraft.

Importantly, LCCs analyse profitability on a route by route basis and not across networks as a whole. This means that LCCs are in general more prepared to reduce service on a route or exit a route altogether if that route's profitability is not acceptable. Given that airport aeronautical charges are quite significant when compared to route profitability, they could have a determinative effect on whether Virgin Blue operates on particular routes, and the number of services that Virgin Blue offers on those routes.

Another important difference between FSAs and LCCs is that LCCs aim to stimulate growth in passenger numbers through offering sharply discounted fares. When an LCC enters on a route where one or more FSAs are already operating, it will not rely merely on encouraging passengers to switch from the FSAs to it, but also on stimulating new business from those who would otherwise not fly on the route. An example of an important difference between LCCs and FSAs is their likely response to strong passenger demand on a route. Whereas an LCC will typically increase capacity on a route in response to strong demand, an FSA is more likely to increase fares to ration the existing capacity on the route and increase yield.

The impact of Virgin Blue's entry in 2000 and the introduction of the LCC model in Australia can be seen clearly in the following graph produced by the Bureau of Transport and Regional Economics (**BTRE**):

Growth in Domestic and Regional Traffic

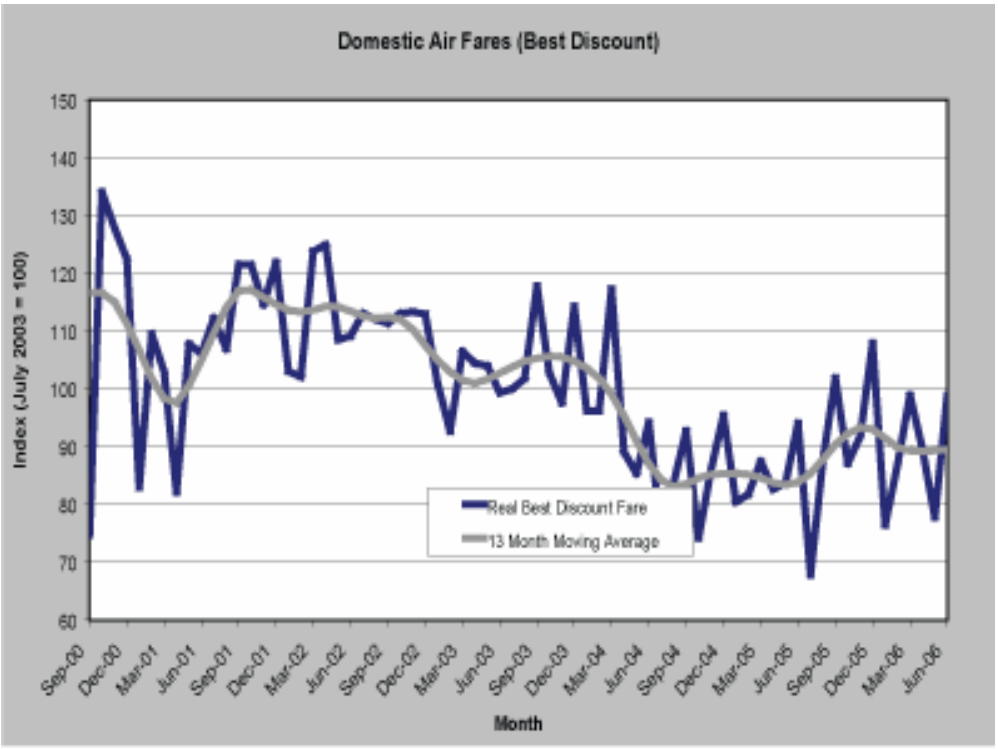


Source: BTRE statistics: http://www.btre.gov.au/statistics

Despite the collapse of Ansett and the acquisition of Impulse Airlines by Qantas, the graph above shows that there has been very substantial increase in domestic and regional passenger traffic since Virgin Blue's entry.

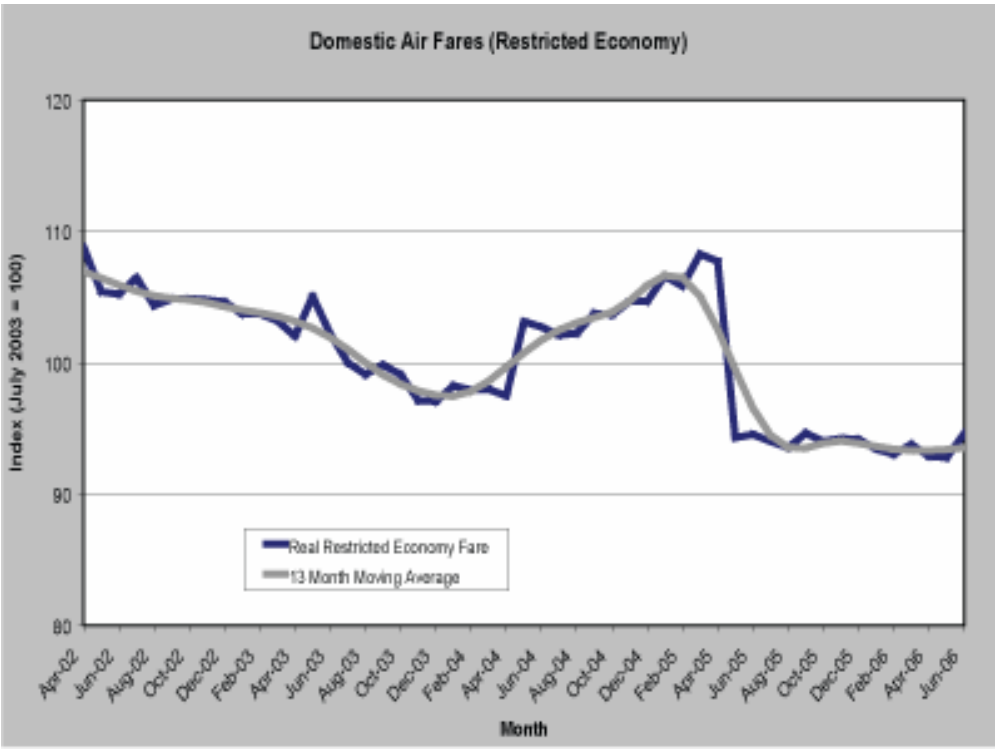
The reason for this increase in traffic is clear: there have been substantial reductions in the price of discounted and restricted economy airfares since Virgin Blue's entry in late 2000. Restricted and discount economy fares account for the majority of the fares sold by Virgin Blue. The graphs below were produced by BTRE and show the decrease in real fares in these two categories.

Domestic Airfares (Best Discount)



Source: BTRE statistics: http://www.btre.gov.au/statistics/aviation/air_fares.aspx

Domestic Airfares (Restricted Economy)



Source: BTRE statistics: http://www.btre.gov.au/statistics/aviation/air_fares.aspx

While there are currently only two airlines operating jet aircraft on major trunk routes (Qantas/Jetstar and Virgin Blue), discount and restricted economy fares are much lower in real terms than they were when Qantas and Ansett were the two airlines operating jet aircraft on major trunk routes.

Virgin Blue presented detailed evidence to the Tribunal in *Re Virgin Blue Airlines* about Virgin Blue's business model and LCCs and FSAs more generally.

Different types of LCCs exist throughout the world depending on the particular conditions that prevail in the regions where they operate. For example, from the outset Virgin Blue determined that it would offer allocated seating, good quality seats and some travel agent distribution. Since its entry in 2000, Virgin Blue has made, and continues to make, a number of changes to its business model in order to take account of changing conditions in the Australian aviation industry. Virgin Blue has never adopted the lowest cost business model typified by overseas operators such as Ryanair. Since entry, Virgin Blue has looked for opportunities to add incrementally to its profitability. However, in making changes to the model, Virgin Blue has remained true to the fundamental LCC principle of maintaining a low cost base, and any added offerings are priced so as to ensure they appeal to a greater proportion of the travelling public. Virgin Blue has introduced new services (such as "The Lounge", its lounge product for its passengers, and "Velocity", its loyalty program) to attract a higher proportion of business passengers and to be more relevant to those passengers. Virgin Blue has described itself as a "New World Carrier", however as such it remains much closer in approach and business drivers to the LCC model (especially in its cost containment and commitment to lower fares) than it does to the FSA model.

4. WHY AIRPORT CHARGES MATTER

4.1 Description of the relevant charges

There are 3 key categories of airport charges:

(a) aeronautical charges – essentially those charges that relate directly to the business of commercial aviation. These charges are defined differently in different instruments, but the key charges include those for take off and landing, screening and other security measures, terminal usage, the rentals charged by airports for the lease of space to airlines for operational purposes as well as the fees charged by Airservices Australia for air navigation and fire fighting services. The various definitions of aeronautical services are discussed in Schedule B, together with Virgin Blue's proposal for a new, consistent definition, following consultation with the Department of Transport and Regional Services (**DOTARS**);

(b) airport aeronautical charges – a subset of aeronautical charges. These are those aeronautical charges imposed by airports, and do not include charges imposed by Airservices Australia (for the sake of simplicity, in this submission we have excluded rents charged to airlines for operational purposes from this category); and

(c) non-aeronautical charges – other charges imposed by airports that do not directly relate to the business of commercial aviation, such as rents for retail space.

Schedule B to this submission sets out Virgin Blue's detailed recommendation in relation to the definition of aeronautical services. The definition of aeronautical services has been discussed with DOTARS and Virgin Blue understands that DOTARS is in broad agreement with Virgin Blue's proposed definition.

4.2 Why airport aeronautical charges are important

In order to properly analyse the appropriate framework for the regulation of airport charges, Virgin Blue considers that it is essential to understand the significance of airport aeronautical charges to airlines, and why increases in airport aeronautical charges can have important consequences for competition in the airline industry, and for the travelling public.

There is a tendency for airports to downplay the significance of airport aeronautical charges. If airport charges can be seen to be an insignificant part of the cost of an airline ticket or something that can just be added to the price of the ticket, then this would indicate that any increase in airport charges is unlikely to have any meaningful impact on ticket prices (and therefore only a negligible effect on consumer demand). In downplaying the significance of airport charges, airports will compare their charges with full economy or business fares offered by airlines. Virgin Blue considers that this approach is misleading in two key respects:

(a) full economy fares represent only a fraction of the tickets sold by an airline such as Virgin Blue, and thus this comparison will understate the importance of airport charges. Virgin Blue considers that it would be more instructive to use an airline's lead-in fare or average promotional fare as a comparison; and

(b) airport aeronautical charges are incurred at both ends of the flight – the origin and the destination, and it is important to take both of these into account as both must be paid for out of a one-way fare.

Contrary to the views of airports, Virgin Blue considers that airport aeronautical charges are a very important part of its cost base, and Virgin Blue is forced to try to pass on to its passengers at least part of any increases in aeronautical charges, resulting in reductions in demand and a loss in consumer welfare.

On this issue, the Commission's *Price Regulation of Airport Services Issues Paper*, dated May 2006, states on p 16 that:

> "*Charges for aeronautical services under the control of the price monitored airports are generally only a small component of the ticket price for airline passengers and much less than some other separately identified charges built into ticket prices. By way of illustration, per passenger charges for services provided to international airlines are of the order of 10 to 20 per cent of fuel surcharges applicable on flights to Europe, and are also considerably less than the passenger charges for border control processing.*"

Virgin Blue does not consider that the illustration chosen above assists in understanding the impact of airport charges on popular domestic routes in Australia. International airfares are generally far higher than domestic fares, especially those to Europe which is one of the most expensive destinations to travel to from Australia. Obviously, as a proportion of such an expensive airfare, airport charges are going to be low.

Rather than using international fares as a comparison, Virgin Blue considers that it would be better to compare the aeronautical charges imposed by airports on airlines on popular routes with the lead in fares and the average promotional fares offered by airlines on those routes.

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Virgin Blue notes that since it commenced operations in 2000 it has exited from a number routes where profitability was not adequate. These routes include Sydney-Alice Springs, Canberra-Sydney and Brisbane-Mount Isa.

In addition to airport aeronautical charges being a significant proportion of commonly offered fares and airlines' profits, any increase in aeronautical charges is likely to lead to an increase in at least some fares on routes to and from the relevant airport (or a reduction in the availability of discount fares). Given that demand for domestic air travel is relatively elastic,[22] this will result in a drop in the number of passengers, with a consequential deadweight loss for society.

For this reason, Virgin Blue considers that airport aeronautical charges above competitive levels will result not only in a wealth transfer from airlines to airports but will also result in significantly fewer people travelling than would otherwise be the case, and this is a cost to society as a whole.

[**CONFIDENTIAL**][23]

Further, Virgin Blue notes that in *Re Virgin Blue Airlines*, Sydney Airport Corporation Limited (**SACL**) argued that certain airport aeronautical services (the Airside Service) should not be declared because any small increases in the charges for these services would be unlikely to affect purchasing decisions of passengers or the business decisions of airlines. The Tribunal rejected these arguments (see paragraphs [540]-[541]).

The BTRE has also concluded that airport aeronautical charges are significant. In the first edition of *Avline*, under the heading "How significant are airport charges?" the BTRE concluded that:[24]

> "*Airport controlled charges can be a significant cost to airlines and, by extension, to passengers. ... Total airport charges as a proportion of the indicative air fare range from 2.5 per cent to over 9 per cent on these major routes.*"

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22 See *Application for Declaration of the Airside Service at Sydney Airport*, Frontier Economics, 12 August 2006 at paragraph [60]

23 See ACCC, "Airport price monitoring and financial reporting 2004-05", February 2006, Table B7, Appendix B

24 BTRE, *Avline*, January 2003 p 3

In fact, the BTRE figures underestimate the current significance of airport controlled charges for two reasons:

- first, BTRE excluded terminal charges from its calculations of airport controlled charges for domestic routes, and terminal charges can be as high as runway charges, if not higher; and

- since November 2002 when BTRE collected its information on airfares and charges, the best available discount fares have dropped by over 18% in real terms[25] whereas there has not been any significant decrease in airport charges in real terms (and in fact many have increased).

In *Re Virgin Blue Airlines* Virgin Blue presented detailed evidence to the Tribunal of the impact that increased take off and landing charges (a sub-set of airport aeronautical charges) would have on Virgin Blue's operations.

For the reasons explained further below, airport aeronautical charges are especially significant for LCCs such as Virgin Blue. This is because the LCC business model depends on being able to keep costs to a minimum so as to be able stimulate additional demand for air travel through offering lower fares.

5. NEGOTIATIONS WITH AIRPORTS UNDER THE CURRENT REGIME

In this section, Virgin Blue describes in general terms its experience in negotiating commercial agreements with airports since the removal of the price notification regime. Virgin Blue's experience in relation to increases in airport aeronautical charges, and to changes to the basis on which such charges are levied are discussed in the next section.

In the period since the removal of price notification, Virgin Blue has had a very mixed experience in negotiating with airports. Virgin Blue has found that major airports will generally just announce changes to take off and landing charges and any consultation that may be required under any agreement will be perfunctory. Such charges are essentially presented to Virgin Blue on a "take it or leave it" basis.

[**CONFIDENTIAL**]

[25] See section 4 which includes a graph of real domestic airfares produced by BTRE. Using an index where July 2003 = 100, that graph indicates that best discount airfares were approximately 110 in November 2002 and had dropped to approximately 90 in June 2006.

Another example of this conduct by an airport is the way in which SACL introduced per passenger charging for take off and landing charges for domestic airlines in July 2003.

In early 2003, SACL determined that a change to per passenger charging for take off and landing fees would be likely to generate increased revenue for SACL, and would also be supported by Qantas despite the increase in revenue for SACL because it would strengthen Qantas' commercial position with respect to Virgin Blue. Having made this decision, SACL notified Virgin Blue of the proposed change. Virgin Blue objected strenuously to this change in correspondence and meetings with SACL. Despite these objections, SACL introduced the change to the charging structure on 1 July 2003. An extract from *Re Virgin Blue Airlines* describing in detail the process through which SACL introduced per passenger charging is set out in Schedule C to this submission.

In contrast, where there have been incentives for airports to negotiate commercially with Virgin Blue, Virgin Blue has found that the commercial negotiation process can be very fruitful. For example, Virgin Blue was able to negotiate a number of terminal use agreements on a commercial basis following the collapse of Ansett. Prior to the collapse of Ansett, as a general rule Virgin Blue operated out of lower cost facilities at major airports, such as the Domestic Express Terminal at Sydney Airport or the Multi User Domestic Terminal at Melbourne Airport. Ansett itself operated out of leased terminals at major airports. When Ansett exited, many of the Ansett terminals were acquired by the airports for use as common user terminals. In such circumstances, Virgin Blue found that it was possible to conduct commercial negotiations because both parties had an incentive to negotiate: the airport wanted Virgin Blue to move into the empty Ansett terminal and begin paying higher terminal charges, and Virgin Blue had the opportunity to obtain access to a higher standard of terminal facilities.

However, outside of these situations where there was a commercial incentive for airports to reach agreement with Virgin Blue, Virgin Blue has often found negotiations with airports to be very difficult and airports have not agreed to provisions in agreements that are common in other competitive industries.

A good example of this is the absence of effective dispute resolution clauses in Virgin Blue's agreements with airports.

Virgin Blue has not been able to negotiate an agreement with any airport where a proposed increase in a charge would be subject to any meaningful dispute resolution process, such as a determination by an expert or a third party. Instead, in Virgin Blue's experience most dispute resolution clauses that are included in agreements with airports only require:

- consultation (as with the requirement for SACL to consult prior to the introduction of per passenger charging for take off and landing charges);
- non-binding mediation, where the dispute is only resolved through agreement between the parties; or
- if there is a procedure for a referral to an expert, it requires both parties' agreement before a matter can be referred.

There is one agreement that Virgin Blue has with an airport that provides for either party to refer a dispute to an independent expert. However, under that agreement this procedure would have limited application to a dispute about charges as charges are largely fixed for the duration of the agreement.

In conclusion, Virgin Blue considers that it is possible for airlines and airports to negotiate commercially in relation to a range of matters where there is a sufficient incentive for both parties to negotiate. However, given the market power that major airports have in relation to the provision of airport aeronautical charges, negotiations are unlikely to be commercial unless:

(a) unusual circumstances create an incentive to negotiate commercially (such as with the collapse of Ansett); or

(b) there is a an externally imposed "circuit breaker" of some description.

Since the removal of price regulation, the behaviour of airports in general has been inconsistent with the requirement in the Review Principles that airports should operate in a commercial manner, under commercial agreements.

6. ANALYSIS OF THE PRICING CONDUCT OF MAJOR AIRPORTS

6.1 Price Increases at Major Airports

The effect of the move to price monitoring has been that a number of major airports in Australia have been able to significantly increase the profits they obtain from providing aeronautical services, through increasing aeronautical charges and changing the basis on which these charges are levied.

Virgin Blue collated data in relation to increases in landing fees following deregulation for the proceedings in the Tribunal involving Virgin Blue and SACL. That data is set out in the table below. The table sets out the standard take off and landing charges levied for some of the major airports that Virgin Blue operates from as at:[26]

(a) the date just prior to the removal of airport price regulation (being either October 2001 or June 2002 depending on the airport); and

(b) 1 February 2004 (because the data was compiled for the purposes of the Tribunal proceedings).

[26] The one exception to this is Darwin Airport, where the date of the initial charge is 1 December 2001 (Virgin Blue commenced operations from Darwin Airport in December 2001).

Increases in Landing Fees from Deregulation to February 2004

Port	Removal of Price Regulation	Charges at 1 February 2004		Charges prior to removal of Airport Price Regulation		Increase ($)	Increase (%)
		Landing charge	Rate per Arr/Dep Pax	Landing charge	Rate per Arr/Dep Pax		
Adelaide	Oct 2001	$10.85 per MTOW	$2.99	$4.59 per MTOW	$1.27	$1.73	**136%**
Brisbane	June 2002	$8.40 per MTOW	$2.32	$5.79 per MTOW	$1.60	$0.72	**45%**
Canberra	Oct 2001	$5.52 per pax	$5.52	$2.27 per pax	$2.27	$3.25	**143%**
Melbourne	June 2002	$3.17 per pax	$3.17	$5.85 per MTOW	$1.61	$1.56	**96%**
Perth	June 2002	$3.70 per pax	$3.70	$5.81 per MTOW	$1.60	$2.10	**131%**
Sydney	June 2002	$2.88 per pax	$2.88	$6.872 per MTOW	$1.90	$0.98	**52% (+97% in 2001)**
Cool'gatta	Oct 2001	$5.50 per pax	$5.50	$5.18 per MTOW	$1.43	$4.07	**285%**
Darwin	Oct 2001	$5.50 per pax	$5.50	$4.48 per pax	$4.48	$1.02	**23%**

Airports in Australia generally charge on either of two bases: per arriving or departing passenger; or on the basis of the MTOW of the aircraft. In the table above, these charges have been converted to a charge per passenger arriving and departing at the airport to enable a comparison. To calculate this Virgin Blue has made several assumptions:

(a) we have assumed a load factor of 80% for aircraft on each route (ie that 80% of the seats on the aircraft are filled by passengers);

(b) an average number of passengers of 125 per aircraft; and

(c) an average MTOW for the aircraft of 69 tonnes.

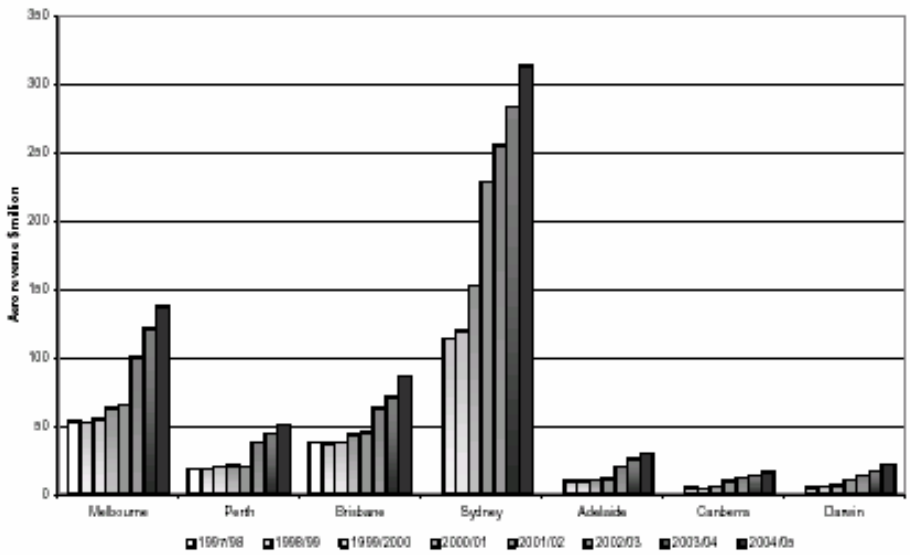
The charges are all exclusive of GST. In some circumstances the figures in the table have been rounded off to the nearest cent, although the calculations were performed using the exact figures. The above table only records price increases from deregulation up to February 2004.

Further, in October 2000, prior to deregulation, the ACCC allowed SACL to increase its aeronautical charges by an average of 97% (the average increase for domestic take off and landing charges was over 130%). The increase set out above for Sydney Airport was in addition to this 97% increase. The overall increase in the domestic take off and landing charge at Sydney Airport since October 2000, using the same assumptions set out above, is in excess of 250%.

The increases since deregulation can be observed from the ACCC's analysis of changes in aeronautical revenue and expenses over time.

The ACCC's table showing total aeronautical revenue from 1997-98 to 2004-05 at each of the 7 price monitored airports is reproduced below.[27]

Aeronautical revenue



Note: Relying on clause 3 in direction 27, reported revenues for Perth, Brisbane and Sydney exclude revenue from fuel throughput services. Brisbane advised that in 2004–05 fuel throughput revenues had been incorrectly reported as aeronautical revenues in previous years and that it is now relying on the clause 3 exemption to exclude this item from its aeronautical revenue. As a result, adjustments have been made to aeronautical revenues reported in 2002–03 and 2003–04 to exclude fuel throughput revenues.

Of course, revenue changes will be driven by other factors in addition to increased charges, such as increases in passenger numbers. However, not only have airports increased their revenues, they have also significantly increased their margins on a per passenger basis. This is due in large part to the fact that airports' aeronautical costs are largely fixed and therefore increasing passenger numbers result in lower per passenger costs. The ACCC's table measuring the changes in aeronautical operating margin per passenger is reproduced below.[28]

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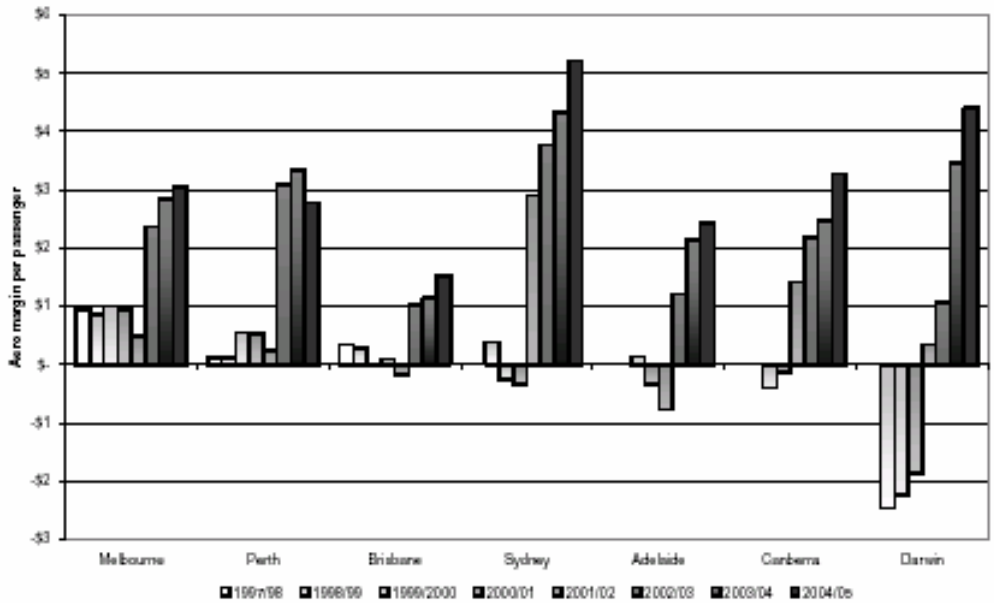
27 ACCC, "Airport price monitoring and financial reporting 2004-05", February 2006 p 22

28 ACCC, "Airport price monitoring and financial reporting 2004-05", February 2006 p 24

Aeronautical operating margin per passenger



Notes: Passenger numbers for Darwin for 1999–00 and 2000–01 are estimated based on the passenger-aircraft ratio from 2001–02 because Darwin did not provide actual figures.

This measure does not include an allowance for return on capital.

Relying on clause 3 in direction 27, reported revenues for Perth, Brisbane and Sydney exclude revenue from fuel throughput services. Brisbane advised that in 2004–05 fuel throughput revenues had been incorrectly reported as aeronautical revenues in previous years and that it is now relying on the clause 3 exemption to exclude this item from its aeronautical revenue. As a result, adjustments have been made to aeronautical revenues reported in 2002–03 and 2003–04 to exclude fuel throughput revenues.

We note that the ACCC's definition of operating margin includes the 'depreciation' of aeronautical assets that is declared by the airports in their financial accounts. This depreciation element is calculated on the basis of the value for aeronautical assets the airports have adopted. Accordingly, the airports' excessive upward revaluations of their assets would depress the operating margin as measured, which accounts for the low or negative margins recorded for some airports above.

In circumstances where airports are experiencing significant and sustained growth in passenger numbers, and very little increase in the overall cost of providing aeronautical services, then per passenger aeronautical charges should be decreasing to avoid over-recovery by airports. This is clearly not happening and to the contrary, a number of airports have recently introduced further increases in charges, which compound earlier increases.

In short, prices have increased dramatically since the introduction of price monitoring. By way of illustration, the ACCC has noted that:[29]

[29] ACCC press release, "ACCC issues third airport price monitoring report", 14 February 2006

> *"Since price monitoring was introduced revenue from aeronautical services increased by between 37 per cent and 163 per cent."*

Virgin Blue's strong concern is that since the removal of price notification and price caps airports have recovered aeronautical revenue from airport aeronautical services at levels significantly in excess of competitive levels.

The current regulatory regime (including the price monitoring) has not prevented this over-recovery which has had the effect of:

(a) reducing competition in the airline industry; and

(b) significant welfare loss through monopoly pricing.

As set out in the Allen Consulting Group Report:[30]

> *"A common theme across all of the airports is that, over the period since the removal of formal price controls on the airports, actual revenue has risen substantially above 'total cost'. This increase in revenue <u>is not</u> driven by an increase in costs incurred (including new investment requirements), a change to the level or structure of demand or from a revaluation of assets that would promote economic efficiency. Accordingly, we conclude that the airports' pricing decisions over the period since the removal of price control and the introduction of monitoring have not been consistent with the requirements of Review Principles 1 and 3".*

Further, since there is very little visibility about how airports allocate aeronautical costs, the over-recovery of aeronautical revenue could be even greater than indicated in the ACCC's price monitoring reports.

6.2 Asset Revaluations

The vast majority of airports justify their aeronautical charges on the basis of a building block methodology approach to calculate allowable revenue. There are a number of ways in which airports manipulate the inputs into building block calculations in order to justify higher prices, including altering asset betas and traffic forecasts.

However, one of the key methods that airports have employed to justify increased aeronautical charges in a static cost environment with steadily increasing passenger numbers is asset revaluations.

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[30] Allen Consulting Group Report p 13

Virgin Blue considers that, at present, there is insufficient guidance about the appropriate methodology for determining asset valuations for the purpose of the price monitoring reports. This has the result that the airports are able to use asset revaluations in order to manipulate or hide the excessive returns being earned from the sale of aeronautical and related services, effectively removing any 'moral suasion' effect on pricing that the monitoring may deliver. In addition, if the Minister's assessment of whether airport pricing is breaching the Review Principles is relying upon the same information, then the excessive freedom provided on asset valuation also implies that the threat of re-regulation as a means of disciplining pricing is also effectively removed.

This is discussed in more detail in section 7 in relation to the effectiveness of the price monitoring regime.

Virgin Blue notes that revaluation of assets and changes in asset classification can have a considerable impact on the asset base of an airport. Since the vast majority of airports purport to formulate aeronautical charges on a "building block" approach, this is very significant.

Asset revaluation is common in the airport industry. For example, the ACCC noted that the total value of tangible non-current assets for Canberra Airport increased by approximately 795% since 1998-99.[31] The significant increases in 2000-01 and 2001-02 were due to positive revaluations and, to a lesser extent, new investment. Revaluations of land over this time added approximately $63 million to the value of aeronautical land. Revaluation of aeronautical buildings increased by approximately $31 million.

SACL estimated the opportunity cost of the value of the land at Sydney Airport at $705m. However, the ACCC adopted an indexed historical cost of land and arrived at a value of $453m.[32] This approach involved an assessment of the cost of land when it was purchased, inflated according to CPI increases since purchase.

There are two significant issues:

(a) whether the opportunity cost valuation is appropriate in theory; and

(b) if so, whether SACL's application of the opportunity cost approach was appropriate.

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31 ACCC, *"Airports price monitoring and financial reporting 2003-04,"* February 2005, p 64-5

32 ACCC *"Sydney Airports Corporation Ltd: Aeronautical Pricing Proposal - Decision,"* May 2001, p 132

The ACCC noted that: *"while opportunity cost is in principle an appropriate approach to valuing land, its application is not straightforward"*.[33]

In relation to SACL's valuation, it said:

> *"As argued by BARA, the inclusion of holding costs and the exclusion of any demolition or site clean-up costs in the estimation of the land value suggests that SACL has overstated the opportunity costs of the Mascot site. ... It is not clear, however, that SACL's valuation is necessarily an opportunity cost approach. As BARA argues, it appears to be a replacement cost valuation"*.[34]

The ACCC accepted that if an opportunity cost approach were to be adopted, the relevant decision maker was the Commonwealth Government. However, given that the Commonwealth Government is concerned with a broader set of objectives than just profit maximisation, valuation of the land should be seen in the context of costs of relocation of the airport (rather than whether the site could be put to a higher value use). A complete assessment of all of the issues which would be taken into account by Government in making this assessment would be complex.

In its conclusion in relation to opportunity cost, the ACCC said:

> *"The above discussion highlights a number of difficulties in the application of an opportunity cost approach to land valuation. The Commission is not persuaded that SACL had adequately addressed these in its proposal and arrived at a reasonable measure of opportunity cost.*
>
> *Certain arguments support the view that the opportunity cost is zero, others that demolition costs should be incorporated. There are various possible ways to estimate the value of a vacant block at Mascot, but such valuations fail to recognise that the land has substantial specialised sunk assets constructed upon it. Furthermore, NECG argues that the opportunity cost of the land reflected in aeronautical charges is only one component of the airport location decision which, in any event, is not SACL's to make. The Commission considers that there is a strong case to suggest that SACL's approach overstates the opportunity cost of its land."*

The ACCC found that an indexed historical cost of land had 3 advantages:[35]

- the historic cost of the land is readily identifiable;

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[33] ACCC May 2001 Decision p 134
[34] ACCC May 2001 Decision p 136
[35] ACCC May 2001 Decision p 15

- it provides compensation to the owner for investments into land already undertaken by providing a rate of return on the investments; and
- it provides appropriate incentives for the airport operator to acquire additional land.

In arguing for an opportunity cost approach, SACL sought to rely on comments made by the Commission in relation to land valuation. However, the Commission stated in its report that:[36]

> *"The intention is not to recommend or suggest a detailed valuation methodology, which would be beyond the scope of this inquiry, but rather to explore the broad principles that can guide the valuation of aeronautical land."*

The Commission stated that an opportunity cost approach is appropriate in assessing whether an airport site should be moved as it gives the best approximation of the value of the airport if it were sold. However, such considerations are not relevant, for example, in the context of Sydney Airport which is subject to a long term lease from the Government which prohibits the land being used for alternative purposes. In any event, the decision about whether to move the airport is not a decision to be made by the airport operator. There is no opportunity for the airport operator to put the airport to an alternative use and as a result valuing the airport on an opportunity cost approach would achieve no purpose, other than to effect a large re-distribution of wealth from passengers to airport owners.

Elementary economic principles state that products should be priced (and hence, valued) at opportunity cost, but what is important is the **reason** for this. Economic principles advise that price should reflect (opportunity) cost so that buyers of services are informed (through the price) about the social cost of producing the item. The person purchases the product if he or she values it at more than the price, and if the price reflects the social cost of provision, then the person will only purchase the product where its value to the person is greater than the social cost of providing the product. Thus, the reason for cost-reflective pricing is that it provides signals to customers to buy products only where it is efficient to do so, and for products only to be produced where it is efficient for the item to be produced – cost-reflective pricing is not an end in itself.

Translating this to the airport context faces a number of obstacles. The same logic would imply that if passengers are faced with the opportunity cost of landing in Sydney, then they may choose to go elsewhere – and if enough make this decision, then Sydney Airport will be shut-down and it will revert to its alternative use. But using price (and observing demand response) is only one means of assessing whether Sydney Airport should remain open, and is probably a poor means of doing this assessment. The alternative – and better – approach is for a planner to assess the relative merits of different airport sites, taking account of all costs and benefits (not just those that

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[36] 2002 Report p 401

are borne by passengers and the airport). In the planning regime, opportunity cost pricing performs no role – the planner will decide whether the airport remains where it is or is shifted. And the planning regime is the world that we are in – SACL has no power to decide whether the land should be used as an airport or as a housing development, rather its lease states that it must be used as an airport.

This issue has been dealt with in the United States. The US Department of Transportation found that fees that sought to recover the opportunity costs of using the land on which Los Angeles Airport is located as an airport were unreasonable. The US DC Circuit Court of Appeals upheld that decision (see further section 10.4 below).

Moreover, even if an opportunity cost approach was considered appropriate, the same logic that would justify valuing land assets at opportunity cost would also require the non-land assets – such as the tarmac and reinforced concrete required for runways, taxiways and aprons – also to be valued at opportunity cost. However, in contrast to land, the tarmac and concrete do not even have a theoretical alternative use – rather, in order to use the land for its next best use, it would need to be torn up and disposed of for a cost. Used terminals, likewise, would likely have little value if the land use was changed to its theoretical alternative use. In addition, the non-land aeronautical assets typically make up a greater share of the cost of constructing an airport than the land assets, as borne out in the ACCC's 2001 review of the prices for Sydney Airport.

In addition, a significant part of the value of the airport derived under the Commission's analysis is based on the assumption that the airport is capacity constrained by regulation. Setting aside the fact that the efficient price for a constrained asset is short run marginal cost (which excludes fixed assets, including land) and that the third review principle precludes the airports from benefiting from congestion charging (by reducing off-peak prices or by quarantining the funds to augment or improve aeronautical services), even Sydney Airport is not capacity constrained.[37] Therefore it would be inappropriate to rely on the Commission's theoretical model in determining land value for airports.

In conclusion, there should be clear guidelines for determining land valuation.

These issues are considered further in Chapter 4 of the Allen Consulting Group Report. The Allen Consulting Group has concluded that there is no single correct approach for valuing airport assets (and consequently, no single correct level for prices). It noted that the approach for valuing assets that is most consistent with the Commission's terms of reference and the full context of the Government's Review Principles is to set the value of aeronautical asset at the start of the monitoring regime at their implied value under the pre-existing price levels. By setting the

[37] In the proceedings before the Tribunal in *Re Virgin Blue Airlines*, evidence was given on behalf of SACL that in July 2003 it did not expect to be capacity constrained at peak hour until somewhere between 2009 and 2014.

initial values using this approach, price changes would be considered justifiable where in response to an increase in expenditure requirements or a change in the level or structure of demand, but not for a revaluation of assets that had no justification on efficiency grounds.

6.3 Per Passenger vs Weight Based Charges

In addition to the substantial increase in headline rates for aeronautical services since the removal of price regulation, Virgin Blue is particularly concerned by the increasingly common practice in Australia to charge for take off and landing or runway charges on a per passenger basis rather than on the basis of the weight of the aircraft. This practice is unique to Australia and New Zealand (countries where there has been an unusual combination of privatisation of airports and lighter handed regulatory regimes) and has resulted in:

(a) airports recovering higher revenue for take off and landing charges than they would recover under weight based charges, thereby recovering revenue in excess of competitive levels (since previous weight based charges were set to allow the airport to recover all of the relevant allowable revenue); and

(b) significant damage to competition in the airline sector, with consequential costs to society in the form of inefficiencies, deadweight losses and sub-optimal consumption of airline services.

A Charging structures have a significant impact on competition

Charges for aeronautical services can be levied in a number of ways. Most commonly, charges for take off and landing are based on the maximum take off weight of the relevant aircraft, known as MTOW. However, aeronautical charges can also be levied on a per passenger basis.

The structure of take off and landing charges can have a significant impact on competition because:

(a) different methods of calculating charges can impact on airlines in different ways depending on the business model that they adopt; and

(b) changing charges from fixed costs per flight to variable costs per passenger changes patterns of competition and reduces incentives for airlines to offer discounted fares.

In particular, recent changes in take off and landing charges by a number of airports including Sydney Airport, Melbourne Airport, Perth Airport and Canberra Airport have had a differential impact on Virgin Blue (an LCC) compared with the impact on Qantas (an FSA). Further,

Brisbane Airport has recently informed Virgin Blue that it is considering moving to per passenger charging for take off and landing charges.

This effect was acknowledged by the ACCC in its 2002-03 price monitoring report where it stated:[38]

> *"changes in the price structure by an airport may affect users in different ways, even to the point of effectively lowering the costs to one user while raising them for another."*

A charge levied on an MTOW basis varies with the weight of the plane and means that airlines incur costs as the weight of the aircraft increases (through the use of larger aircraft). A change from MTOW to per passenger charging converts a cost that is fixed (with respect to the number of passengers on the aircraft) to a cost that varies in accordance with fluctuations in the number of passengers carried on the aircraft.

There are two immediate impacts of changing the basis of calculating aeronautical charges from an MTOW structure to a per passenger structure. First, it has a differential impact on FSAs compared to LCCs. LCCs, as a result of their business model, typically carry more passengers than FSAs on an aircraft of equivalent weight. This means that LCCs will incur greater landing charges than FSAs for comparable aircraft when charged on a per passenger basis. A recent example of the unjustifiable differential that can emerge when adopting per passenger charging for use of the runway is the position of OzJet when it operated. Both Virgin Blue and OzJet used Boeing 737 aircraft, yet OzJet's 737-300 aircraft were configured to business class only with 60 seats, while Virgin Blue's 737-800 aircraft have approximately 180 seats. Therefore, even though OzJet was charging higher fares and catering exclusively to business class passengers, if both aircraft had been full OzJet would only have paid one third of the landing charges that Virgin Blue would have been required to pay.

With per passenger charges, the total landing charges incurred by an FSA may even decline compared with the position under weight based charges. Therefore, following a change to per passenger charging, low cost airlines would need to increase their prices in order to try to recover their increased costs. This would in turn lead to a disproportionate impact on the profits of LCCs.

Low cost airlines are price leaders in offering discount fares. If LCCs are forced to increase their fares then FSAs are likely to also increase the price of their discount fares. Therefore, any increase in charges which has a greater proportional effect on low cost airlines will increase overall fares and decrease the availability of discount fares. Fewer discount fares will result in a reduction in the number of people travelling by air and an overall loss in consumer welfare.

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[38] ACCC, "Airport price monitoring and financial reporting 2002-03," February 2004, p 95

Secondly, a transfer of costs from costs that are invariant with respect to the number of passengers to costs that vary with the number of passengers carried can change patterns of competition. The greater the extent to which costs vary with the number of passengers, the lower the incentive for an airline to chase the marginal passenger.

The move by some Australian airports to per passenger charges has had the effect of competitively disadvantaging Virgin Blue with respect to Qantas and reducing Virgin Blue's ability to offer discounted fares. Virgin Blue also notes that this shift to per passenger charges is at odds with general international practice.

B MTOW charging is international best practice

Traditionally, airports have charged for the use of runways, taxiways and aprons on the basis of the weight of the aircraft. The International Civil Aviation Organisation (**ICAO**) has published policies on charges for airports and air navigation services.

ICAO recommends that:[39]

> *"Landing charges should be based on the weight formula, using the maximum permissible take-off weight as indicated in the certificate of air worthiness (or other prescribed document) as the basis for assessment. However, allowance should be made for the use of a fixed charge per aircraft or a combination of a fixed charge with a weight-related element, in certain circumstances, such as at congested airports and during peak periods."*

The table that appears at Schedule A sets out the basis upon which international airports set their take off and landing fees.[40] With the exception of Wellington airport in New Zealand, all airports outside of Australia use some form of weight based calculation to determine the appropriate level of take off and landing fees. In over 95% of cases, this is a weight-based measure. Virgin Blue considers that this is strong evidence that the major airports in Australia that have shifted to per passenger charges since the removal of price notification are not acting in accordance with international best practice.

Prior to the removal of price regulation, charges for take off and landing by domestic airlines at all major airports were levied on the basis of MTOW.

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39 ICAO's Policies on Charges for Airports and Air Navigation Services, 6th edition 2001, 7th edition 2004 at p 9

40 This table has been prepared on the basis of information in the IATA *Airport and Air Navigation Charges Manual*.

In addition to weight based charges being consistent with international best practice, Virgin Blue considers that a weight based charging structure for take off and landing fees is more appropriate than a per passenger structure for the following reasons:

(a) it is the aircraft that directly uses the runway, not the passengers who are inside the aircraft;

(b) it is very unusual to charge per passenger for a transport vehicle, for example car park stations and bridge and road tolls charge per vehicle not according to the number of passengers inside the vehicle;

(c) charging on a per passenger basis encourages inefficient use of airports, as larger aircraft are often less efficient than smaller aircraft. Other factors such as the turn around times of aircraft, the necessary airport expenditure in upgrading facilities for larger aircraft and the greater impact on the airside facilities per passenger compared to smaller aircraft are all important considerations that impact on aircraft efficiency. Virgin Blue, like many other LCCs uses a fleet of Boeing 737 aircraft. These aircraft are recognised as highly efficient aircraft from the perspective of both airlines and airports, yet, at average load factors, the move to per passenger charges has increased the landing charges for Virgin Blue's 737 aircraft;

(d) charging on a per passenger basis does not reflect the costs of providing the service. Larger aircraft with a greater MTOW cause greater wear and tear on the runways and parking aprons than smaller aircraft. Any charge for take off and landing should correspond to the costs of maintaining the facilities to provide the service and the incremental cost incurred by the aircraft, for example the cost of maintaining runways. This is more closely aligned to the weight of the aircraft than the number of passengers on the aircraft.

C ACCC objects to domestic passenger based charging

During the price notification period, the ACCC objected to a SACL proposal to move to per passenger charging for domestic airlines for take off and landing. On 3 August 2001, SACL submitted a notification under s 22 of the *Prices Surveillance Act* to the ACCC seeking approval to change the existing MTOW based fees that it charged to both international and domestic airlines for the use of runways, taxiways and airside facilities to per passenger charges.

Both Qantas and Ansett supported SACL's proposal to move from an MTOW charge to a per passenger charge for domestic airlines. Virgin Blue, however, opposed the proposed change. Virgin Blue notified its concerns to the ACCC pursuant to a letter dated 13 August 2001. In

substance, Virgin Blue submitted that per passenger charges did not reflect underlying costs, would promote inefficiency and were anti-competitive.

The ACCC objected to the proposed domestic passenger charge but did not object to the proposed international passenger charge. In its decision dated 28 August 2001, the ACCC concluded, after noting Virgin Blue's arguments:

> *"The Commission considers that Virgin Blue's submission raises important concerns about the impact the domestic passenger charge may have on competition in the domestic aviation market. It appears that the proposed restructure may disadvantage new entrants who carry more passengers per aircraft. However, these complex issues require greater analysis that what has been possible than in the PS Act's 21 day statutory period.*
>
> *The Commission considers that it has not had sufficient time under the PS Act's 21 day statutory period to fully consider and analyse the effects of the proposed domestic charge restructure. As such, the Commission objects to the proposed passenger service charge for domestic passengers."*

Despite an industry policy of charging for the use of runways, taxiways and aprons on the basis of weight in the absence of congestion, SACL pursued a policy of implementing per passenger charges for take off and landing charges, culminating in the imposition of a domestic passenger service charge in July 2003. At the time of introduction, SACL was not capacity constrained and did not anticipate that it would be so constrained for a number of years. In any event, were SACL capacity constrained, this would be most efficiently addressed through peak and off-peak pricing, as recognised in the Review Principles.

D SACL's rationale for moving to per passenger charging

Many airports argue that per passenger charging is efficient and equitable. While Virgin Blue does not have all relevant information relating to all of the airports that have moved to per passenger charging, the issue of SACL's motivation for moving to a per passenger charge is set out in the Tribunal's decision in *Re Virgin Blue Airlines*:

- In February 2000 a group of 27 airlines, including Qantas, commenced proceedings against SACL in the Federal Court of Australia in relation to, *inter alia*, whether SACL

was entitled to increase its aeronautical charges in order to recover amounts that SACL had spent on airport upgrades in preparation for the Olympic Games in Sydney.[41]

- From April to July 2001, there were intensive negotiations between SACL and the various airlines in relation to settlement of the Federal Court proceedings, during which time SACL and Qantas discussed replacing various airport charges with a single passenger-based charge.[42]

- In August 2001, SACL entered into a Deed of Settlement and Mutual Release with Qantas in relation to the legal action taken by the airlines. As part of the settlement, SACL agreed to prepare a Passenger Services Charge Notification to the ACCC to replace various airport charges with a single passenger based charge.[43]

- SACL lodged such a notification with the ACCC in August 2001. However, as noted above, the ACCC objected to this change for domestic airlines (on the basis of submissions from Virgin Blue). The ACCC did not object to the change for international airlines. Shortly afterwards, SACL changed to a per passenger charge for international airlines[44] but left the domestic charge as a weight-based charge.[45]

- Following SACL's change to per passenger charges for international airlines, but prior to the actual introduction of a per passenger charge for domestic airlines in July 2003, a representative of SACL had regular discussions with the head of airport charges and billing at Qantas. In the course of these discussions, Qantas informally recognised that SACL could derive more revenue overall by changing the basis on which take off and landing fees were charged from an MTOW based charge to a per passenger charge but indicated that Qantas had no difficulties with that.[46]

- SACL had offered Qantas the prospect of moving to a domestic PFC (being a per passenger charge) prior to SACL negotiating with Virgin Blue about moving to a domestic PFC. Qantas indicated to SACL that it was not attracted to the option of moving to a domestic PFC prior to SACL reaching agreement with Virgin Blue about

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41 at [170]

42 at [173]

43 at [173]

44 As noted by the Tribunal at [177], it is important to note that the international charge is a combined take off and landing charge as well as a terminal charge. Virgin Blue accepts that charging on a per passenger basis is appropriate for terminal charges. Further, one of the reasons why the ACCC approved per passenger charges for international airlines was because there were no objections from international airlines. At the relevant time, August 2001, Pacific Blue was not operating internationally and there were no other international low cost carriers operating from Sydney Airport.

45 at [176]-[178]

46 *Re Virgin Blue Airlines* at [183], [216]

moving to a domestic PFC. However, Qantas supported the PFC if it applied to both Qantas and Virgin Blue.[47]

- In about December 2002, SACL surmised from discussions with the head of airport charges and billing at Qantas that one of the main reasons for Qantas's enthusiasm for the PFC was that it could strengthen Qantas's commercial position relative to Virgin Blue.[48]

- SACL had also formed the conclusion that moving to the passenger charge could strengthen Qantas's commercial position relative to Virgin Blue.[49]

- The General Manager, Aviation Business Development, at SACL understood that Qantas was happy to pay on a per passenger basis even if it involved Qantas paying more because Qantas knew that the per passenger charge would hurt Virgin Blue much more than it would hurt Qantas.[50]

- SACL recognised that Virgin Blue would be materially disadvantaged in terms of costs per passenger if an MTOW regime was replaced with a per passenger regime.[51]

- A representative of SACL recognised that as a result of the move to per passenger charges, the total amount payable by Virgin Blue for take off and landing fees at Sydney Airport would increase by 50%-53% while Qantas's total fees would increase by 4% or even less.[52]

- SACL moved to a per passenger charge for domestic airlines in July 2003 for reasons including that SACL would derive higher revenue and because Qantas preferred it.[53]

E SACL's move to per passenger charges was an exercise of monopoly power

The Tribunal went on to consider whether SACL's change to a per passenger charge was an example of an exercise of monopoly power which could not be sustained in a competitive market.

The Tribunal accepted that the change in tariff structure had a differential impact on the airlines as submitted by Virgin Blue, that is, that it resulted in a cost increase of approximately 52% for Virgin Blue (based on the assumption of an 80% load factor, 125 passengers per aircraft and an

47 *Re Virgin Blue Airlines* at [181]-[182]
48 *Re Virgin Blue Airlines* at [183]
49 *Re Virgin Blue Airlines* at [183]
50 *Re Virgin Blue Airlines* at [214]
51 *Re Virgin Blue Airlines* at [186], [217]
52 *Re Virgin Blue Airlines* at [190]
53 *Re Virgin Blue Airlines* at [215]-[216]

average MTOW of 69 tonnes) compared to an estimated increase for Qantas of approximately 4%.[54]

That Virgin Blue, as an LCC, was more affected by the domestic PSC than Qantas, as an FSA, was supported by Professor Tae Hoon Oum, UPS Professor of Transport and Logistics at the University of British Columbia, who was called as an expert witness by Virgin Blue. Professor Oum stated:[55]

> *"All of the empirical findings via the duopoly competition models indicate that a 100% increase in SACL's Airside Services charges (from A$3 to A$6 per passenger) has a significantly larger negative percentage impact on Virgin Blue's traffic volumes than those of Qantas in all of the duopoly routes to/from Sydney Airport. This result is supported by a clear intuition: because a low cost carrier, such as Virgin Blue, carries a larger share of fare sensitive passengers and has a lower cost per passenger, an identical cost increase per passenger will surely have a larger impact on it than a full service airline, such as Qantas".*

That evidence was accepted by the Tribunal, which stated that:[56]

> *"SACL's change from an MTOW-based charge to a Domestic PSC thus puts LCCs such as Virgin Blue at a disadvantage vis-à-vis FSAs such as Qantas due to the higher load factors and lighter, single class configuration aircraft used by LCCs".*

The history of the per passenger charge and SACL's motives for introducing the charge are discussed above. In short, the Tribunal was satisfied that SACL was aware that Qantas particularly wanted the domestic PSC introduced to give it a competitive disadvantage over Virgin Blue. The Tribunal stated:[57]

> *"In such a situation it was incumbent upon SACL to be even more cautious about its reasons for changing the nature and methodology of its airside charges. To change from an MTOW-based charge to a Domestic PSC because Qantas preferred it was a misuse of monopoly power…"*

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54 *Re Virgin Blue Airlines* at [202]
55 *Re Virgin Blue Airlines* at [203]
56 *Re Virgin Blue Airlines* at [206]
57 *Re Virgin Blue Airlines* at [218]

The Tribunal accepted the evidence of Dr Phillip Williams, an expert economist called by Virgin Blue, about the impact of the change from MTOW to per passenger charges.[58] In summary, Dr Williams explained that:

- the change from an MTOW-based charge to the PSC had the effect of changing the ratio of fixed costs to variable costs for the airlines;

- when SACL changed the tariff structure, the cost that was formerly fixed (with respect to the number of passenger on the aircraft) was converted to a cost that varied according to the number of passenger on the aircraft;

- that conversion of a fixed cost to a variable cost has two significant consequences for competition. First, FSAs are favoured over LCCs as the tariff structure has a differential impact on LCCs as compared to FSAs. Secondly, airlines are less likely to chase incremental or marginal passengers and less likely to be concerned about losing marginal passengers to their rivals. The higher the costs that the airline will save by losing those marginal passengers to its competitor, the less its incentive to respond to the competitor's activities, leading to a 'softening' of competition.

The Tribunal gave the following example:[59]

> *"FSAs typically offer passengers a probability that seats will be available on alternative flights if they wish to change their time of travel. It is costly for an airline to provide this service. The cost of providing this service equates to the net revenue that has to be foregone if some seats on planes are left unsold in order to provide flexibility to passengers. Put another way, the revenue foregone is the lost revenue less the marginal cost to fill the seat. Dr Williams said that the lower the marginal cost of filling a seat, the greater the net revenue that is foregone by leaving a seat vacant. When SACL imposed an Airside Service charge that varied with the weight of the plane – the MTOW-based charge – the airlines incurred costs as the weight of aircraft increased, whilst the cost of carrying additional passengers on any given aircraft was very low. Under the Domestic PSC, it has become less costly for FSAs to leave a seat empty and therefore less costly to provide the service to their passengers of ticket flexibility. For an LCC, the same mechanism applies. The net cost of failing to fill a seat is reduced by any increase in the marginal cost per passenger. However, the reduction in the net cost of failing to fill a seat is proportionately larger for an LCC so that the blunting of the incentive to chase the incremental passenger is proportionately greater for an LCC."*

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58 *Re Virgin Blue Airlines* at [523]-[527]

59 *Re Virgin Blue Airlines* at [562]

However, the Tribunal recognised that any tariff structure SACL adopted could be said to discriminate against the business model of any given airline,[60] and went on to examine the context in which SACL made the decision to change its tariff structure and whether such a tariff structure is supported by a legitimate rationale that would survive in a competitive market.

SACL advanced a number of submissions that it contended justified the change in methodology.[61] A summary of those arguments, and the Tribunal's response, is set out below.

- SACL argument: The Domestic PSC encouraged a more efficient use of Sydney Airport than the MTOW based charge.

  Tribunal finding: *"…we reject SACL's submission that the Domestic PSC encourages a more efficient use of Sydney airport than does an MTOW-based charge. Efficient pricing of the charges for the Airside Service would require consideration of the cost drivers underlying the provision of those services by reference to the number of aircraft using those facilities, rather than by reference to the number of passengers travelling in such aircraft."*[62]

- SACL argument: The Domestic PSC encouraged airlines to use large rather than small aircraft thereby encouraging the efficient use of airport facilities.

  Tribunal finding: "*…the contention that a passenger-based charges encourages airlines to use large rather than small aircraft, thereby encouraging the efficient use of airport facilities by encouraging more passengers per aircraft, does not survive critical analysis."*[63]

- SACL argument: The Domestic PSC reduced barriers to entry in the domestic aviation market.

  Tribunal finding: *"[the] proposition that the Domestic PSC reduced barriers to entry in the domestic aviation market does not appear to us to be warranted…if there is any benefit to LCCs of passenger-based charging, it is only for a short period, and is unlikely to be sufficient to outweigh the concerns of an aspiring entrant as to the long-term cost…on one view it could be seen as raising barriers to entry rather than lowering them*

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60 *Re Virgin Blue Airlines* at [207]
61 *Re Virgin Blue Airlines* at [223]
62 *Re Virgin Blue Airlines* at [245]
63 *Re Virgin Blue Airlines* at [253]

for new LCC entrants in the medium to long term, as their business models dictate that smaller aircraft and higher load factors be used."[64]

- SACL argument: The Domestic PSC provided a more sustainable basis of charging in terms of revenue to SACL.

  Tribunal finding: *"The proposition that SACL needed to change to a Domestic PSC in order to increase its revenue is not warranted, unless SACL believed that other airlines were going to cease operating, or there was some other explanation as to why passenger numbers would be more constant than airline numbers….we pause to note that SACL has acknowledged that it chose a passenger-based charge "because Qantas preferred it" to an MTOW-based charge, and because it moved close to its allowable revenue. The charge on a per passenger basis was not satisfactorily justified upon recovery of cost principles."*[65]

- SACL argument: The Domestic PSC provided for greater equity in the application of airport charges, enabled transparency and facilitated risk sharing between SACL and the airlines.

  Tribunal finding: *"...SACL's concern should be with the efficient use of the Airside Service rather than with equity as between passengers….By purporting to address equity between airline passengers rather than the efficiency of the use of its services by airlines, SACL is, in effect, discouraging efficiency and innovation by airlines. The Domestic PSC is, in effect, a tax on efficiency….Further, we see no merit in SACL's transparency submission."*[66]

- SACL argument: The passenger based charges were supported by aviation authorities and had been adopted by a number of other airports and accepted by Virgin Blue in a number of other airports.

  Tribunal finding: *"Standardisation of charges, even if it supported SACL's position (which in our view it does not), would not be determinative without further explanation of the benefits it would bring."*[67]

- SACL argument: The Domestic PSC produced a revenue which fell within the ceiling of allowable revenue provided for in the ACCC's building block methodology.

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64 *Re Virgin Blue Airlines* at [261]-[263]
65 *Re Virgin Blue Airlines* at [271]
66 *Re Virgin Blue Airlines* at [277]-[280]
67 *Re Virgin Blue Airlines* at [288]

> Tribunal finding: *"The fact that overall revenue raised may be within the ceiling of revenue allowed by the ACCC provides no justification for a monopolist determining a tariff charge structure which is discriminatory or which is not determined by reference to principles which would apply to the fixing of prices in a competitive environment."*[68]

The Tribunal found that SACL had misused its monopoly power.[69]

F Conclusion

In short, there is publicly available material to the effect that SACL considered it could obtain more revenue from a move to per passenger charges for take off and landing fees. This runs counter to public statements made by SACL that the change to per passenger charging would be revenue neutral.[70] In its latest monitoring report, the ACCC confirmed that the effect of a change to per passenger charging is to increase airports' revenue:[71]

> "*The effect of airports charging on a largely per passenger basis has been an increase in revenues. Costs have increased to a lesser extent, as they are largely fixed and are less influenced by passenger volumes.*"

There is also evidence that SACL understood that Qantas was happy for this change to occur, even if it paid more overall, because Virgin Blue would be financially disadvantaged more than Qantas would, and the change would therefore aid Qantas's competitive advantage. In July 2003, SACL moved to a per passenger charge, and this had the effect of increasing the total amount payable by Virgin Blue for take off and landing fees by approximately 50% while not significantly increasing the total fees payable by Qantas (and perhaps even reducing its total fees). It is clear from this information that the structure of fees charged by airports can have a significant detrimental impact on competition and efficiency in the aviation industry.

6.4 Conclusion re Pricing Conduct of Major Airports

As noted above, since the removal of price notification and price caps airports have recovered aeronautical revenue from airport aeronautical services at levels significantly above competitive levels.

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68 *Re Virgin Blue Airlines* at [292]

69 *Re Virgin Blue Airlines* at [14]

70 For example, see the letter dated 30 April 2003 from Max Moore-Wilton to Graeme Samuel (then President of the NCC) which states on page 7:

> ".. the proposed introduction of the passenger based charge is not intended to achieve an increase in overall SACL revenue, but simply to bring about a conversion from the current weight-based charges with reference to the set of passenger and tonnage forecasts that underpin existing aeronautical charges."

A copy of this letter appears at the NCC's website at: http://www.ncc.gov.au/pdf/DEAiViSu-014.pdf.

71 Source: ACCC, *Airports price monitoring and financial reporting 2004-05*, February 2006, p 22

The current regulatory regime (including the price monitoring) has not prevented this over-recovery which has had the effect of:

(a) reducing competition in the airline industry; and

(b) significant welfare loss through monopoly pricing.

This has been achieved in part through the inappropriate revaluation of assets as discussed above.

Further, in addition to the over-recovery of aeronautical revenue through increased aeronautical charges, many major airports (including Sydney Airport, Melbourne Airport, Perth Airport and potentially Brisbane Airport) have moved from weight based to per passenger charges. Such a method of charging is inconsistent with international practice and cannot be justified on efficiency grounds. Further, per passenger charges:

(a) result over time in even greater over-recovery of aeronautical revenue above competitive levels than would be the case under weight based charges (because passenger numbers are increasing at a faster rate than landed tonnes) leading to even greater adverse consequences for competition and social welfare; and

(b) have a significant negative impact on competition in the aviation industry.

In *Re Virgin Blue Airlines*, the Tribunal found that SACL's conduct, in changing its pricing structure in order to increase revenues (and advantage Qantas at the expense of Virgin Blue), went so far as to amount to a misuse of monopoly power.[72]

In conclusion, the pricing conduct of a large number of airports is clearly inconsistent with the Government's Review Principles as their airport aeronautical charges:

(a) generate expected revenue that is significantly above the long-run costs of efficiently providing aeronautical services on a dual-till basis;

(b) are not based on appropriately defined and valued assets; and

(c) are inefficiently structured.

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[72] *Re Virgin Blue Airlines* at [14]

7. HOW EFFECTIVE IS THE CURRENT PRICE MONITORING REGIME?

The key goals of the price monitoring regime are:

(a) determining whether airports are operating consistently with the Review Principles;[73] and

(b) enhancing commercial negotiations.

This section of Virgin Blue's submission will cover why the price monitoring regime is insufficient as a complete basis on which to review compliance with the Review Principles or to enhance commercial negotiations. This section will also cover why the ACCC's current powers are insufficient for it to carry out even its limited role under Direction 27. Virgin Blue's recommended model is discussed in section 11, including suggestions to improve the current price monitoring regime.

When the Government announced the commencement of the price monitoring regime, it announced that there would be an independent review at the end of the 5 year regulatory period, which the Commission is now undertaking.

The Government noted that it would only consider re-introducing price controls on an airport if it formed the view that the airport had operated in a manner inconsistent with the 5 Review Principles set out in section 2.4.

There are significant differences between the information provided to the ACCC in its price monitoring role and financial reporting role on the one hand, and the information that would be required in order for it to be able to consider airport pricing under the Government's Review Principles on the other.

Currently, the ACCC views its role as merely compiling information rather than forming any conclusions as to airports' prices, costs and profits. The ACCC's approach is very limited and does not include:

(a) expressing any views on price, cost and profit levels for airports, but merely reporting on them;

(b) actively investigating reported costs, revenues or cost and revenue allocation methodologies used by airports, or prescribing a value to be used for the initial asset value for aeronautical and related services;

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[73] See eg the Government Response to the Productivity Commission, 13 May 2002

(c) providing guidance as to appropriate principles and methodologies for setting aeronautical and related charges.

Further, the ACCC is not given sufficient information to undertake even its limited task under Direction 27 effectively. One of the most significant items to be taken into account in determining costs and therefore profits is the airport's asset valuations. The ACCC, however, concluded in Appendix A to its initial Airport Price Monitoring and Financial Reporting report released in February 2004 that:[74]

> *"In preparing this monitoring report, the ACCC has not been in a position to thoroughly evaluate the appropriateness of airport asset valuations as a basis for evaluating prices. As such, it has not drawn firm conclusions regarding the relationship between current airport charges and profitability. In certain cases, however, the report highlights changes in the valuation of assets at particular airports."*

A similar disclaimer is contained in the price monitoring report released in 2005.[75] Without being able to form a view on asset valuations, the ACCC is unable to determine the costs of an airport. Moreover, the 'correct' valuation is not something that simply can be observed – rather a decision is required on the most appropriate method for valuing assets, and then the information relevant to that method must be collected. The ACCC is therefore unable to judge whether the revenue is significantly above the long-run costs of efficiently providing aeronautical services, which is one of the key Review Principles.

As discussed in section 6.2 above, revaluation of assets and changes in asset classification can have a significant impact on the asset base of an airport.

One problem encountered by the ACCC was that it was forced to rely on the valuation of assets provided by airports and did not undertake an evaluation of whether these valuations were appropriate. The ACCC noted:[76]

> *"... notwithstanding the advantages of this measure of profitability [examining tangible non-current assets], it has the disadvantage of being reliant on the airport operator's valuation of its assets. As detailed in sections 2 and 3 of the report, a number of airports have effected upward revaluations of their assets, which has the effect of lowering the return on assets. While such revaluations may be in accordance with relevant accounting standards, such standards allow a variety of accounting treatments and the approach taken by an individual airport operator may not reflect an economic approach to valuing assets.*

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74 ACCC, *"Airport price monitoring and financial reporting 2002-03,"* February 2004, pp 99-100
75 ACCC, *"Airports price monitoring and financial reporting 2003-04,"* February 2005, p 15
76 ACCC, *"Airports price monitoring and financial reporting 2003-04,"* February 2005, p 17

In preparing this monitoring report, the ACCC has not attempted to evaluate the appropriateness of airport asset valuations. Asset valuation is often complex and contentious. This report does, however, provide details of asset values over time."

Many difficulties confront the ACCC in attempting to monitor the prices that are charged for a particular service. The ACCC needs to determine the appropriateness of the rate of price increases, the allocation of revenue between aeronautical and non aeronautical services, the allocation of revenue between domestic and international travel and the changes in the valuations of assets. Even measuring aggregate expenditure levels may not be straightforward, as devices such as related party arrangements can be used to inflate the costs actually incurred (which is a practice that is common within other regulated sectors). These difficulties are compounded by the fact that the ACCC does not have access to sufficient information to be able to draw its own conclusions about these matters, and instead has to rely on the assertions of the airport operators.

Further, airport operators may be able to structure some charges in such a way as to avoid the operation of the monitoring regime. For example, the Tribunal stated:

> *"There is support for the airlines' submission that an inference should be drawn that SACL will seek to introduce* [certain charges] *in such a way as to avoid the ACCC's price monitoring".*[77]

In order to properly perform the role of assessing whether the Review Principles may have been breached (which would not be necessary under Virgin Blue's proposed model, discussed further in section 11 below), the ACCC would have to decide how the assets in place at the start of the regime should be valued, and how the values should be updated over time – the valuation of assets is central to determining 'long run economic cost' in an asset-intensive industry. In addition, for monitoring to provide any sort of 'moral suasion', there have to be rules for how profit should be measured, a central component of which is the asset valuation. If providers were able to establish whatever value they desire for the assets, and were also able to revalue assets at a whim, there need not be any link between the level of prices and the reported returns – indeed, asset values could always be selected in order to provide what appeared to provide a reasonable return, and the monitoring regime would have no effect on behaviour whatsoever.

In addition to the substantive problems with the current regime, there is significant delay (of up to 9 months) following the end of the financial year in which a charge is introduced before the ACCC monitoring report is released. Therefore, if the charge was introduced at the beginning of the financial year, it would not be reported publicly by the ACCC until approximately 21 months after its introduction. Virgin Blue considers that the effectiveness of price monitoring is

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[77] *Re Virgin Blue Airlines* at [363]

significantly reduced in circumstance where airport operators know that there will be a significant delay in the public reporting of their prices, costs and profits.

Virgin Blue notes that some parties may argue that the threat of re-regulation, when combined with the price monitoring regime, provides a constraint on airport operators' behaviour. However, that has not been Virgin Blue's experience. Nor was that argument accepted by the Tribunal in *Re Virgin Blue Airlines*. The Tribunal noted that concerns about re-regulation did not act as a constraint on SACL's pricing policies[78] and, specifically, did not inhibit SACL from changing from MTOW to a per passenger charge.[79]

Thr Tribunal concluded that "any threat of re-regulation is, in reality, quite limited".[80] The Tribunal noted that:[81]

> *"…even if Sydney Airport were to become regulated again, such re-regulation could not operate retrospectively and would therefore enable SACL to retain, and not have to disgorge, any excessive or inappropriate pricing proceeds which it had derived prior to the introduction of any future re-regulation. Re-regulation would not enable the airlines to redress the consequences of SACL's monopolistic conduct which had occurred prior to that date."*

In addition, the threat of the reintroduction of price controls has been ineffective in part because the only information available with which to measure airport pricing performance against the Review Principles has been the information collected by the ACCC, and while this information can provide some indication of aggregate prices exceeding efficient long run costs (see Chapter 5 of the Allen Consulting Group Report) it is manifestly inadequate to conduct a detailed review of airports' behaviour against the Review Principles for the reasons discussed above.

8. HOW EFFECTIVE IS PART IIIA OF THE TPA?

Part IIIA of the TPA provides a general (as opposed to industry specific) access regime for access to what might be broadly described as monopoly infrastructure. Part IIIA applies to a potentially very wide range of infrastructure, from water and waste water infrastructure, to rail infrastructure as well as airports.

Part IIIA provides for a variety of different access mechanisms, including (relevantly) a negotiate-arbitrate model for access to "declared" services.[82] A negotiate-arbitrate model is a

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78 *Re Virgin Blue Airlines* at [505]

79 *Re Virgin Blue Airlines* at [504]

80 *Re Virgin Blue Airlines* at [505]

81 *Re Virgin Blue Airlines* at [506]

82 Part IIIA also provides a mechanism under which an owner or operator of infrastructure can lodge an access undertaking with the ACCC which, if accepted by the ACCC, will prevent the relevant service

light handed form of regulation that seeks to ensure that the primary method for determining the terms and conditions of access to the service is commercial negotiation between the access seeker and the access provider. Under a negotiate-arbitrate model, it is only if this commercial negotiation breaks down that parties have the right to have any dispute arbitrated, and even then the subject matter of the arbitration is limited to the terms and conditions over which the parties cannot reach commercial agreement.

In order to be declared, the service must meet certain criteria set out in Part IIIA of the TPA. These criteria are:

(a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;

(b) that it would be uneconomical for anyone to develop another facility to provide the service;

(c) that the facility is of national significance, having regard to:

    (i) the size of the facility; or

    (ii) the importance of the facility to constitutional trade or commerce; or

    (iii) the importance of the facility to the national economy;

(d) that access to the service can be provided without undue risk to human health or safety;

(e) that access to the service is not already the subject of an effective access regime;

(f) that access (or increased access) to the service would not be contrary to the public interest.

Further, in order to have a service declared, an access seeker must first apply to the National Competition Council (**NCC**) for a recommendation that the service be declared (s 44F). The NCC will then make its recommendation to the relevant Minister on the basis of the criteria set out above (s 44G), who will then make a decision whether or not to declare the service on the basis of the same criteria (s 44H).

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from being declared. No airport has lodged any access undertaking with the ACCC under Part IIIA of the TPA.

Both the access provider and the access seeker may apply to the Tribunal for a review of a decision by the relevant Minister to declare or not declare the service (s 44K). The Tribunal is then required to reconsider the Minister's decision (s 44K(4)) and the Tribunal may decide to affirm the Minister's decision or set it aside and decide the matter differently. While Part IIIA of the TPA does not provide for any statutory right of appeal from the Tribunal's decision, persons dissatisfied with the Tribunal's decision may seek judicial review of the Tribunal's decision under:

(a) s 39B of the *Judiciary Act 1903* (Cth);

(b) the *Administrative Decisions (Judicial Review) Act 1977* (Cth); and

(c) s 163A of the TPA.

The Government, in its response to the 2002 Report, acknowledged that airports were subject to the generic access provisions in Part IIIA of the TPA. Indeed, there have been two instances in which services provided by airports have been declared under Part IIIA of the TPA, and Sydney Airport was the relevant airport in both instances.

First, in *Sydney International Airport* [2000] ACompT 1 (1 March 2000) (*Sydney Airport*) the Tribunal declared the following services provided by SACL:

(a) the service provided by the use of the freight and passenger aprons and the hard stands at Sydney International Airport for the purpose of enabling ramp handlers to load freight from loading equipment onto international aircraft and to unload freight from international aircraft onto unloading equipment.

(b) the service provided by the use of an area at Sydney International Airport for the purpose of enabling ramp handlers:

    (i) to store equipment used to load and unload international aircraft; and

    (ii) to transfer freight from trucks to unloading equipment and to transfer freight from unloading equipment to trucks, at the airport.

Secondly, in *Re Virgin Blue Airlines*, the Tribunal declared the Airside Service, being:

> "*a service for the use of runways, taxiways, parking aprons and other associated facilities (**Airside Facilities**) necessary to allow aircraft carrying domestic passengers to:*
>
> *(i) take off and land using the runways at Sydney Airport; and*

(ii) *move between the runways and the passenger terminals at Sydney Airport.*"

Virgin Blue believes that *Re Virgin Blue Airlines* is an important decision because it demonstrates both:

(a) that without an effective constraint on their market power, major airports will tend to exercise their power to the detriment of competition and the travelling public; and

(b) that Part IIIA is not well suited to the task of constraining the market power of major airports.

The problems with relying on Part IIIA of the TPA to constrain the market power of major airports stem from 3 sources:

(a) the time involved in an access seeker having relevant services declared under Part IIIA and then obtaining a determination from the ACCC in the event that commercial negotiations fail;

(b) the cost and expense in seeking declaration under Part IIIA, especially the cost that would be involved in seeking declaration of all airport services provided by all major airports where those airports have substantial market power; and

(c) the uncertainty attendant upon declaration given that some doubt exists currently in relation to the interpretation of the declaration criteria under Part IIIA.

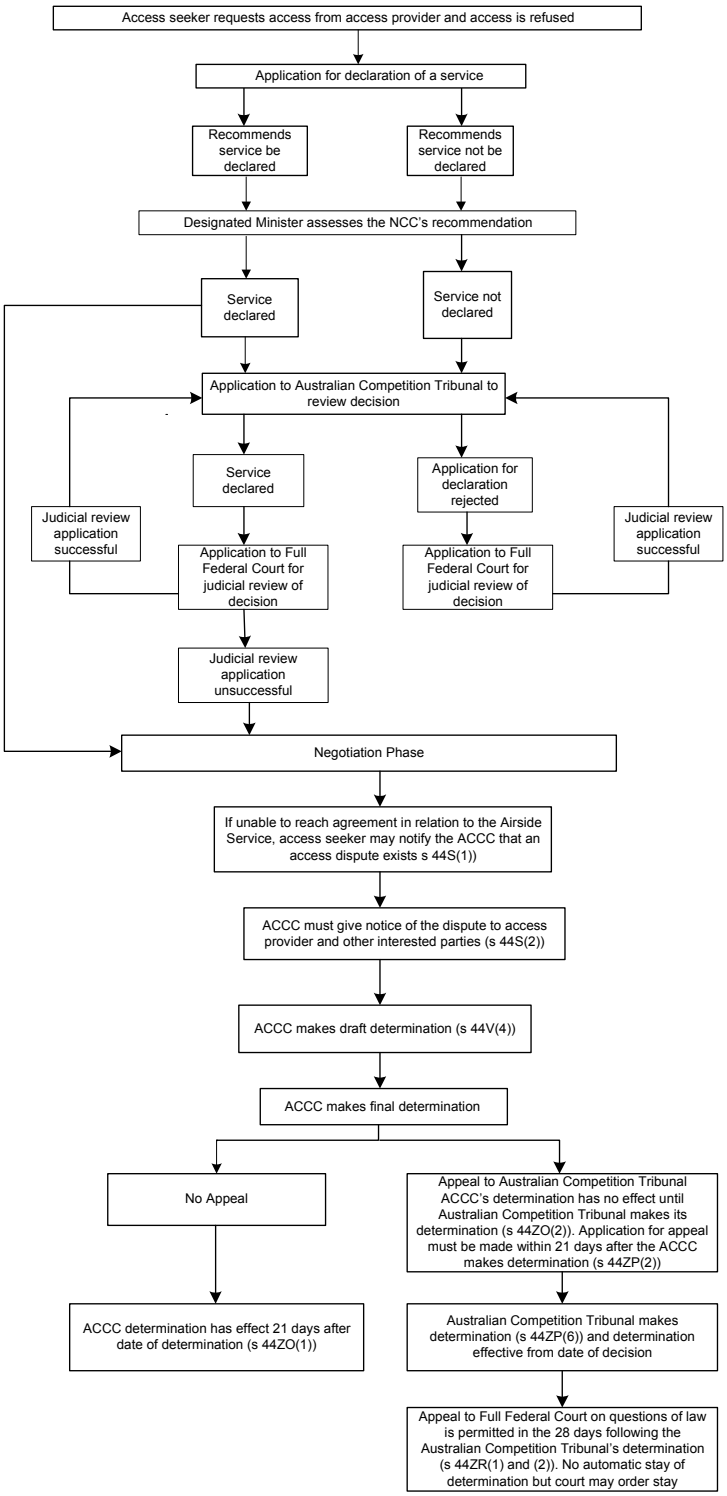
We discuss each of these problems in detail below.

8.1 Time and Cost Involved in Obtaining Access under Part IIIA

The processes that an access seeker is required to follow in order to have a service declared are complex and lengthy. In relation to declaration alone there are potentially 4 separate decision makers to consider the matter: the NCC, the relevant Minister, the Tribunal and the Federal Court. Of course, declaration itself does not result in any automatic right to access nor does it automatically alter the terms and conditions on which access to the service is provided. If an access seeker and an access provider cannot agree on the terms and conditions for access following declaration then either can seek to have the ACCC arbitrate the dispute. Following the ACCC's determination, there is a further prospect of an application to the Tribunal for it to review the determination and a further appeal (on a question of law) to the Federal Court.

The diagram below sets out a flow chart of the processes that could be involved from an initial application to the NCC for a recommendation that a service be declared through to a binding determination of an access arbitration.

Process for Declaration and Arbitration under Part IIIA of the TPA



The time taken for Virgin Blue to have the Airside Service declared clearly demonstrates the problem with relying on Part IIIA more broadly as a constraint on the exercise of market power by major airports.

Virgin Blue applied to the NCC for a recommendation that the Airside Service be declared in October 2002. The NCC issued an issues paper in response to Virgin Blue's application in November 2002. Following submission from interested parties, the NCC issued a draft recommendation in favour of declaration in June 2003. Following further submissions from interested parties, the NCC delivered its final recommendation (which was not to declare the service) to the relevant Minister, the Parliamentary Secretary to the Treasurer, in December 2003. The Parliamentary Secretary to the Treasurer made his decision not to declare the service in January 2004.

In February 2004 Virgin Blue applied to the Tribunal for a review of the decision of the Parliamentary Secretary to the Treasurer. The Tribunal heard the application over two and a half weeks in October 2004. The Tribunal's decision was handed down in on 9 December 2005. Shortly afterwards, SACL sought judicial review of the Tribunal's decision in the Federal Court. Those proceedings were heard by the Full Federal Court in early May 2006 and the parties are currently still awaiting judgment.

In summary, it took over 3 years from the time when Virgin Blue commenced its application for declaration of the Airside Service to the time when the Tribunal made its decision to declare the service. Further, that decision is the subject of incomplete judicial review proceedings so that there is still uncertainty as to the final outcome of Virgin Blue's application almost 4 years after it was lodged with the NCC.

Further, the process for declaration under Part IIIA of the TPA is very costly for access seekers and for access providers. In relation to the Airside Service at Sydney Airport, Virgin Blue has had to be represented at two separate hearings (one before the Tribunal and one before the Full Federal Court) as well as provide lengthy submissions to the NCC (including expert economic reports).

Of course, declaration does not of itself result in access being granted on terms and conditions acceptable to both the access seeker and the access provider. However, if commercial negotiations fail in relation to a declared service, then either party may seek to have the matter arbitrated by the ACCC. An arbitration before the ACCC can also be a significant procedural and substantive exercise for the parties. In its publication *Arbitrations – A guide to resolution of access disputes under Part IIIA of the Trade Practices Act 1974*, the ACCC breaks the arbitration down into the following steps:

(a) Pre notification stage;

(b) Preliminary phase of the arbitration (notification);

(c) Substantive phase of the arbitration (procedure and submissions);

(d) Determination phase of the arbitration (arbitration and determination).

The arbitration process could take a number of weeks.

Following a final determination by the ACCC, any party dissatisfied with the determination has a right to apply to the Tribunal for a full rehearing of the dispute (s 44ZP). Finally, under s 44ZR of the TPA, either party is entitled to appeal to the Federal Court from a decision of the Tribunal, but only on a question of law.

Therefore, even once a service is (finally) declared under Part IIIA of the TPA, if parties cannot agree on the terms and conditions for access (which is a particular problem in negotiations where one party has a substantial degree of market power), then there can be substantial additional delays before access is provided on terms other than those imposed unilaterally by the service provider.

Amendments have been proposed to Part IIIA of the TPA in order to address criticisms about its operation, including in relation to the timing of the declaration process. These amendments are contained in the *Trade Practices Amendment (National Access Regime) Bill 2006* (**TPA Amendment Bill**), which at the date of writing has passed the House of Representatives but which is yet to be introduced to the Senate. Under the TPA Amendment Bill there would be a number of target time limits introduced for the various steps involved in declaration. In particular, the following bodies must use their best endeavours to make decisions within the following timeframes (called standard periods):

(a) 4 months for the NCC to make a final declaration following an application (proposed s 44GA);

(b) 4 months for the Tribunal to make a decision under any application for a review under Part IIIA (this would include reviews of declaration decisions and reviews of arbitrations) (proposed s 44ZZOA); and

(c) 6 months for the ACCC to make a final determination on an arbitration (proposed s 44XA).

However each of the NCC, the ACCC and the Tribunal is permitted under the proposed amendments to extend the standard period if it cannot make a decision within the standard period. Virgin Blue notes that the standard periods are far shorter than the timeframes experienced by

Virgin Blue in its application for declaration of the Airside Service. In that matter, the NCC process took 14 months rather than the proposed standard period of 4 months and the Tribunal process took 22 months compared with the proposed standard period of 4 months.

Therefore, while Virgin Blue welcomes the introduction of the target time limits, and believes that they should assist in reducing the time taken for each of the steps in the declaration process, given that:

- the timeframes are not mandatory and can be extended; and
- it is quite likely that decision makers will be presented with a wealth of material in connection with an application for declaration of airport services,

Virgin Blue is concerned that any future application for declaration of a service provided by an airport is still likely to take a very significant amount of time to progress through the required stages.

8.2 Uncertainty Attendant on Declaration

In addition to the time and cost involved in obtaining declaration under Part IIIA of the TPA, there may also be some doubt about whether all airport aeronautical services provided at major airports in Australia (being those services in relation to which the airports have substantial market power) would meet the criteria for declaration under Part IIIA of the TPA. Very few applicants to have services declared have been successful,[83] and as yet there has not been a single arbitration conducted under Part IIIA of the TPA.

In relation to Sydney Airport, the Tribunal found in *Re Virgin Blue Airlines* that the Airside Service should be declared, for the reasons discussed in detail above. However, at the time of writing this decision is the subject to an application for judicial review and a final decision from the Full Federal Court is still pending.

Even if the application for judicial review is unsuccessful, this does not mean that other aeronautical services provided by major airports will meet the criteria for declaration under Part IIIA of the TPA. This is due in part to the fact that the declaration of services must be considered on a case by case basis, looking at the particular features of the relevant service, the

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83 Of a total of 20 applications to the NCC for declaration, only the November 1996 applications by Australian Cargo Terminal Operators, the October 2002 application by Virgin Blue and the March 2004 application by Services Sydney have ultimately been successful. In the case of the Virgin Blue and Services Sydney applications, the Minister did not decide to declare the services. Rather, the Tribunal determined that the relevant services should be declared.

service provider and the relevant dependent market (which may alter from service to service and from airport to airport).

The most contentious declaration criteria for airport services is criterion (a), which currently requires that a service only be declared where:

> "*access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.*" (s 44H(4)(a))

On the approach adopted by the Tribunal for criterion (a) (which is not the approach that Virgin Blue contends for) the relevant question is whether, absent declaration, the service provider would use its market power in providing the service so as to have an adverse impact on competition in the dependent market.[84]

In *Re Virgin Blue Airlines* the Tribunal was able to come to the conclusion that, absent declaration, SACL would use its market power so as to have an adverse impact on competition because SACL had in fact already done so in the past in moving from weight based charges for the Airside Service to per passenger charges.[85] There was a wealth of material that was extracted from SACL in the Tribunal proceedings to demonstrate the adverse impact that SACL's conduct would have on competition in the dependent airline market, and to indicate that SACL knew that this would be the case.

However, in relation to other services provided at other airports, the picture may not be as clear in relation to whether declaration would be likely to prevent the airport from misusing its market power. This may be because the airport has not yet misused its market power, or because evidence of its conduct (and its motivating purpose) will not be as readily available as was the case before the Tribunal in *Re Virgin Blue Airlines*.

This uncertainty is increased due to the proposed change to the test in criterion (a) under the Trade Practices Amendment Bill, which will require that access (or increased access) would promote a material increase in competition in the dependent market. While there are good arguments that this amendment should not have any significant impact on the way in which criterion (a) is applied, the amendment is yet to be considered by the Tribunal or a court.

8.3 Conclusion in Relation to Part IIIA

In conclusion, Part IIIA is a very slow, costly, inefficient and difficult process by which to constrain the exercise of market power by airports.

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84 See *Re Virgin Blue Airlines* at [516]

85 Ibid

The delay involved in obtaining declaration is itself a sufficient reason to discount its application, even with the proposed target time frames. This is in part because even under the proposed amendments, the earliest time for backdating any determination in relation to the terms and conditions for access is the date of declaration. It is quite likely that an airline will not want to go through the costly process of having services provided at a particular airport declared if it considers that it can obtain acceptable terms and conditions through commercial negotiation. However, if the airport subsequently refuses to offer acceptable terms and conditions, then the airline is in a very poor position because it could be a matter of years before the service is declared, and Part IIIA offers no remedy or compensation for any loss incurred by the airline in the interim as a result of the airport's exercise of market power. Therefore, if an airline waits until a problem arises in negotiations with an airport, it is already too late as any redress is years away (even if the service is successfully declared). Further, because of the legal doubt attendant on whether a particular service will be declared under Part IIIA, there is a barrier to such disputes being settled commercially.

Given that it is not possible to predict years in advance when a dispute with an airport may arise (and with which airport in relation to which service), it is not possible to proactively apply to have just those services declared under Part IIIA. Further, on the current approach adopted by the Tribunal under criterion (a), the relevant Minister and the Tribunal may decline to declare a service at an airport if that airport had not yet misused it market power and there was insufficient evidence available that it intended to do so.

Thus one of Virgin Blue's major concerns with the operation of Part IIIA in the way in which it has been interpreted by the Tribunal is that it is very difficult to have a service declared until a service provider has misused its market power, and once a service provider has misused its market power there can be a delay of a number of years before the access seeker can obtain redress.

9. DOES NON-AERONAUTICAL REVENUE CONSTRAIN AIRPORTS?

In the 2002 Report, the Commission found that a number of major Australian airports had substantial market power, and that the airport services where market power was strongest included facilities for aircraft movements (runways, taxiways, aprons) and "front door" vehicle access.[86]

However, the Commission also found that:

[86] 2002 Report, p xvi

> "*The scope for airports with market power to use (or abuse) that power is constrained by commercial pressures and opportunities, particularly the substantial 'non-aeronautical' income to be had from promoting airline passenger traffic.*"[87]

However, Virgin Blue does not consider that complementary non-aeronautical revenue will constrain airports from charging amounts far in excess of the competitive price for aeronautical services. Events since the 2002 Report was released have confirmed this position.

It is accepted that airports earn revenue from both aeronautical services, such as take off and landing charges and terminal charges, as well as non-aeronautical services such as concession businesses and car parking. To the extent that airports' non-aeronautical revenues vary with passenger numbers, if the number of passengers flying decreases, then this will affect the airports' revenues not just from aeronautical services (which are largely currently charged on a per passenger basis) but also from non-aeronautical services. In *Re Virgin Blue Airlines* the economic experts accepted this as common ground, and agreed that the effect of these complementary non-aeronautical revenues would be to cause SACL to set charges for the Airside Service lower than would be the case in the absence of non-aeronautical revenues.

However, the relevant question for the Commission is the *extent* to which the existence of these non-aeronautical revenues would constrain airports from increasing the aeronautical charges above competitive levels. There was also agreement between the economic experts in *Re Virgin Blue Airlines* that the constraining effect of complementary non-aeronautical revenues was not strong. SACL's expert witness conceded that:[88]

> "*... the existence of non-aeronautical revenues alone is not sufficient to eliminate SACL's incentive to increase Airside Service charges above their current level.*"

Various modelling was conducted by the economic experts in that case in order to determine the extent of the constraint imposed by non-aeronautical revenue. Dr Williams in his first report for Virgin Blue found, on the basis of a number of assumptions, that if the charge for the Airside Service (essentially the take off and landing charge) was to increase by 100%, then SACL's revenue from the Airside Service would increase from $41.6 million to around $82 million, while revenues from non-aeronautical services would decline by only $6.9 million.[89] In other words the result of a 100% increase in the charge for the Airside Service would be a net gain of $33.5

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87 Ibid
88 Houston at [102]
89 Williams at [67]-[69]

million for SACL. Professor Oum found that an increase in the charge of 500% (that is, from approximately $3 to $15) would result in revenue from the Airside Service increasing from $43.9 million to $188.3 million, while revenue from non-aeronautical revenues would only fall from $113.2 million to $97.2 million.[90] Therefore, such an increase would result in a net revenue increase to SACL of approximately $128 million.

SACL's expert witness agreed with the theoretical models used by Dr Williams and Professor Oum to estimate the constraining effect of non-aeronautical revenues. However, he did not agree with certain assumptions adopted by the other economic experts and in Attachment C to his first report Mr Houston presented his own estimates of the effect of non-aeronautical revenues using different assumptions. In conducting his modelling, SACL's expert witness used 3 different assumptions for the demand elasticity for air travel: -0.5, -1 and -1.5. Professor Oum, giving expert evidence for Virgin Blue referred to numerous studies and reports in support of his use of a demand elasticity of -1.6 for non-business travellers and a demand elasticity of -0.7 for business travellers.[91]

We set out in a table below SACL's expert's findings in relation to the profit maximising charge for the Airside Service with and without taking into account the impact of non-aeronautical revenue as well as the revenue impacts of increasing the charge for the Airside Service by 100%.

Table 1: Effects of Non-Aeronautical Charges

	Elasticity of -0.5	Elasticity of -1	Elasticity of -1.5
Profit maximising price ignoring non-aeronautical revenue	$126.44	$63.94	$43.11
Profit maximising price taking into account non-aeronautical revenue	$120.50	$58.00	$37.17
Effect of increasing charge by 100%:			
Change in passengers	-1.2%	-2.3%	-3.5%
Change in Airside Service revenue	$40.64 m	$39.68 m	$38.72 m
Change in non-aeronautical revenue	-$1.98 m	-$3.95 m	-$5.93
Change in total revenue	$38.67 m	$35.73 m	$32.80 m

SACL's expert's modelling demonstrates two important propositions. First, the profit maximising price of the Airside Service is significantly above current levels and the effect of non-aeronautical revenue is only to reduce the profit maximising charge by a small amount. As

90 Oum at [36]-[37]
91 Oum at [63]-[67]

can be seen from Table 1, the effect of non-aeronautical charges is to reduce the profit maximising charge for the Airside Service, assuming a demand elasticity for air travel of -1, from $63.94 to $58.00. On the basis of a demand elasticity of -1.5, the effect would be to reduce the profit maximising charge from $43.11 to $37.17. Secondly, even at lower levels of charges, the revenue lost by reason of reduced non-aeronautical revenues is small compared with the gain in aeronautical revenue. As can be seen from Table 1, assuming a demand elasticity for air travel of -1, a doubling of the current charge for the Airside Service will bring additional Airside Service revenue of $39.68 million while only resulting in a decrease in non-aeronautical revenue of $3.95 million, resulting in a net increase of over $35 million in overall revenue.

In its decision in *Re Virgin Blue Airlines*, the Tribunal agreed that the constraining effect of complementary non-aeronautical revenue was weak. It found that:

> "*There was general agreement among the economic experts that the answer to this question was that the constraining effect of non-aeronautical revenues was not significant. For example, Mr Houston, who was called by SACL, accepted that the existence of non-aeronautical revenues alone was not sufficient to eliminate SACL's incentive to increase the charges for the Airside Service above their current level. It appeared that the existence of non-aeronautical revenues might be relevant if SACL sought to set its Airside Service charges at the profit-maximising price. However, it was apparent from the modelling carried out by the economic experts that this profit-maximising price was significantly above the current level of Airside Service charges.*
>
> *We are therefore mindful that the evidence of the economic experts did not disclose that the existence of non-aeronautical revenues alone was sufficient to constrain SACL in the sense that the existence of those revenues eliminated its incentive to increase Airside Service charges above their current levels. If there was to be any constraint as a result of non-aeronautical revenues, that would only occur if the Airside Service charges were raised to levels substantially higher than they are presently set at.*" (at [511] and [512])

10. AIRPORT PRICE REGULATION - INTERNATIONAL PRACTICE

10.1 Summary

The table below sets out a summary of airport ownership and regulation in the United Kingdom, the United States, Canada and the European Union.

Comparison of Airport Ownership and Regulation

Main airport ownership (including leasehold)	Price regulation?	Type of price regulation	Other key regulatory features
United Kingdom			
Private	Yes, for airports designated by Government	Price cap imposed by CAA, currently set as a cap on the annual yield per passenger departing with a small proportion of revenues at some airports tied to service and investment performance	Conditions to remedy adverse effects of conduct against the public interest
Canada			
Local airport authorities (not-for-profit) or territorial governments	No, but a bill has been introduced, which would apply regulation to certain airports, depending on type and size	Proposed legislation requires a pricing methodology for some airports, consistent with stated criteria, smaller airports would have to comply with different requirements	
United States			
Local governments or government authorities (one privatised airport as part of privatisation pilot program)	No		Under privatisation pilot program, each airport fee must not increase faster than the rate of inflation unless approved by 65% of the air carriers
European Union			
Varies by member state	Not at an EU level, but national regulation applies		
New Zealand			
Private	No		

10.2 United Kingdom

As in Australia, the United Kingdom has undertaken privatisation of airports. The United Kingdom has a wide-ranging regulatory regime, imposed under the *Airports Act* 1986 (**UK Airports Act**). Its core provisions relate to the ability of the Government to "designate" airports, which are then susceptible to price regulation.

Airports with an annual turnover in excess of £1 million may not levy airport charges unless they have permission to do so from the Civil Aviation Authority (**UK CAA**). Airport charges are, under

s 36 of the UK Airports Act, charges levied on operators of aircraft in connection with the landing, parking or taking off of aircraft at the airport (including charges that are to any extent determined by reference to the number of passengers on board the aircraft, but excluding certain charges payable pursuant to provisions of the *Transport Act* 2000) and charges levied on aircraft passengers in connection with their arrival at, or departure from, the airport by air.

Once permission to levy charges has been granted, the UK CAA may impose conditions to regulate the conduct of the airport in relation to its users.[92]

In addition, the UK CAA imposes price caps for a 5 year period on airports designated by the Secretary of State. Heathrow, Gatwick, Stansted and Manchester airports are currently designated. Although the Government did not give reasons for designating those airports in 1986, the Government has subsequently set out criteria it will consider, being:[93]

(a) the market position, including the extent of competition from other airports and other modes;

(b) prima facie evidence of excessive profitability or abuse of a monopoly position;

(c) the scale and timing of investment, and their implications for profitability; and

(d) efficiency and quality of service.

The process for the imposition of price controls is, in general terms:[94]

(a) the UK CAA formulates price control proposals and conducts public consultation;

(b) the UK CAA makes references to the Competition Commission, submitting price control proposals and specifying whether any courses of conduct by airport operators in relation to airport charges, operational activities carried out by the operator or the granting of rights by which others may carry out operational activities since the date of the previous reference operate or might be expected to operate against the public interest;

(c) the Competition Commission conducts an investigation into the appropriate price caps and whether any of the airports has pursued a course of conduct that is contrary to the public interest;

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92 The UK CAA had not imposed any such conditions as at December 2005: see CAA, "Airports review – policy issues, Consultation Paper", December 2005, p 21

93 See eg CAA, "EasyJet Application for Designation of Luton Airport", 31 July 2000

94 See eg CAA, "Airports Review – policy update", 15 May 2006, p 2-3, 11-12

(d) the Competition Commission reports to the UK CAA on the price caps and, where the Competition Commission finds that an airport operator has pursued a course of conduct which has operated or might be expected to operate against the public interest, the CAA must impose conditions that will remedy the adverse effects of the conduct;

(e) the UK CAA publishes the Competition Commission's report, the price cap and any public interest proposals and conducts public consultation;

(f) the UK CAA publishes its decision, following which the new price caps and any public interest conditions take effect.

The UK CAA has set the current price caps as caps on the average yield per passenger departing from the relevant airport, with a small proportion of revenues at Gatwick and Heathrow tied to specific service and investment performance. The UK CAA has also imposed a number of conditions where conduct has been found to be against the public interest.

The UK CAA is currently undertaking a review process before setting new price caps to commence in 2008 (and 2009 in the case of Manchester Airport).

10.3 Canada

In Canada, most airports are operated by private but not-for-profit local airport authorities and territorial governments as part of a policy known as the National Airports Policy.

Canada does not have price regulation in place, however, despite the not-for-profit nature of the airport authorities, concerns about pricing have arisen.[95] In June 2006, a Bill[96] was introduced into Parliament that, if passed, would implement a regulatory regime, the key relevant pricing requirements of which are:

(a) if an operator of certain airports, including specified Government-owned airports and airports not owned by airport authorities that meet a passenger threshold of 300,000, proposes to establish or increase a fee, it is required:

    (i) not to discriminate other than on the basis of consistently applied objective criteria (and not on the basis of nationality);

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95 See eg IATA press release, "New Charges at Toronto Airport Ignore Airline Community's Call for Cost Control", 31 October 2003

96 Bill C-20, An Act respecting airports, airport authorities and other airport operators and amending the Transportation Appeal Tribunal of Canada Act

(ii) to adhere to specified transparency requirements, including informing aircraft operators and the public how the fee has been determined and making available, on request and on its website if it has one, particular details about the fee, including the use of the revenues generated by each passenger fee (as defined); and

(iii) to undertake public consultation;

(b) if an airport authority proposes to establish or increase a fee in respect of a principal airport (as specified in the legislation) that does not meet a passenger threshold of two million, or in respect of certain other airports that meet a passenger threshold of 300,000, that airport authority will be required to meet the same obligations set out in paragraph (a) above;

(c) for principal airports that meet a passenger threshold of two million, an airport authority is required:

(i) to establish a methodology for determining fees, which must:

A. be consistent with the charging principles, including that:

- any differences in fees must be on the basis of consistently applied objective criteria (and not on the basis of nationality); and
- aeronautical fees (as defined) are not to be set at a level that would generate revenues exceeding the portion of the financial requirements that is to be met from those fees;

B. explain how the airport authority will determine its financial requirements, and how it will determine what portion of its financial requirements is to be met from passenger fees and what portion is to be met from aeronautical fees;

C. list fees;

D. describe the unit of measurement to be used for each fee and the rationale for its use;

E. explain how each fee is to be set; and

F. describe the rationale for the use of different fees, or for differences in a fee in respect of particular facilities and services;

(ii) to explain how it determines any charges other than fees that it imposes on air carriers;

(iii) to undertake public consultation, which is more prescriptive than that required for smaller airports;

(iv) to adhere to specified transparency requirements; and

(d) an airport authority may only impose passenger fees for specified purposes.

At the time of writing the Bill had not been passed as it was awaiting its second reading.

10.4 United States

Airports in the United States are not privatised.

In the mid 1990s an Airport Privatization Pilot Program was established and the Federal Aviation Authority (**FAA**) called for applications, intending that 5 airports would participate in the scheme. As part of the pilot program, airports were to be released from the obligation to use airport revenues solely for airport purposes. On pricing, the pilot program required that each airport fee imposed on an air carrier not increase faster than the rate of inflation, unless a higher fee is approved by 65% of the air carriers serving the airport.[97]

Interest was limited and ultimately only one airport, Stewart International Airport in the Hudson Valley, was approved for privatisation. It has since become the first privatised airport in the US, under a 99 year lease from the New York State Department of Transport, and is subject to the pricing restrictions required during the application process.

While there is no price regulation for US airports, the Department of Transportation has the authority to set aside "unreasonable" fees. When the City of Los Angeles, as the operator of Los Angeles Airport, sought to impose fees that would recover its opportunity cost of using the land on which the airport is located as an airport, various airlines challenged the fees on the basis that they was unreasonable, and the Department of Transportation found that they were. The City of Los Angeles challenged that finding.

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[97] US Department of Transportation and the FAA, "Report to Congress on the Status of the Airport Privatization Pilot Program", August 2004

The US DC Circuit Court of Appeals found that the City of Los Angeles was not entitled to recover the opportunity cost of using the land as an airport.[98] In rejecting an appeal by the City of Los Angeles Justice Silberman stated:

> *"…the issue might properly be described as whether LAX, having taken taxpayer money under the condition that it would continue to use LAX as an airport is legally entitled to charge a significant group of those taxpayers, airline passengers flying in and out of LAX, its opportunity cost based on a nonexistent opportunity".*

10.5 European Union

There is no EU legislation regulating airport charges; national regimes apply. The EU has recently conducted consultation on airport policy[99] and has indicated that it intends to undertake a review of air transport liberalisation measures, airport charges and capacity in 2006.[100]

Some examples of the positions in member states are set out below (see also discussion above regarding the UK):

(a) Germany – has undertaken privatisation, for example at Frankfurt Main. Charges for Frankfurt Main must be approved by the Government, which is straightforward where they are agreed between the airport operator and the airlines. Airport charges at Frankfurt Airport are governed by contractual arrangement between the operator and the airlines, which will expire on 31 December 2006.

(b) Italy – at least some airports have been privatised. Price controls are set according to a complex formula devised by the regulator and set by Ministerial decree.

(c) Belgium – most airports are operated by municipalities, but Brussels Airport is privately owned. Under licence conditions, charges must be set on a CPI-X basis.

10.6 New Zealand

New Zealand's major airports have been privatised. However, no price regulation was introduced at the time of regulation.

High charges raised concerns and in 1998 the Commerce Minister requested that the Commerce Commission investigate.

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98 *City of Los Angeles v US Department of Transportation* 165 F. 3d 972 (DC Cir 1999); petition for rehearing denied 179 F. 3d 937 (DC Cir 1999)

99 See eg EU Press Release, "Consultation on airport policy", 6 April 2006 (Ref: IP/06/467)

100 EU Press Release, "Keep Europe moving: a transport policy for sustainable mobility", 22 June 2006 (Ref: IP/06/818)

In 2002, the Commerce Commission completed its report and recommended that the airfield services supplied by Auckland International Airport be controlled under the New Zealand Commerce Act.[101] In that report, the Commerce Commission stated that:[102]

> *"The Commission's conclusion is that there are insufficient constraints on* [the airport operators of Auckland, Wellington and Christchurch airports] *ability to exercise market power in the supply of airfield activities compared to what would be found in a market where competition was workable or effective."*

However, the Commerce Minister ultimately decided not to impose controls at any New Zealand airports.

10.7 Conclusion in Relation to International Experience

Virgin Blue's research indicates that, with the exception of New Zealand, Australia is alone in its approach of privatising airports and then removing regulatory pricing controls.

11. VIRGIN BLUE'S RECOMMENDED MODEL

As discussed above in this submission, since the removal of price regulation, airports have not acted in a manner consistent with the Review Principles announced by the Government in relation to efficient pricing (be it pricing levels or the basis on which charges are levied) or with respect to the manner in which airports generally conduct negotiations, especially in relation to take off and landing charges. The current regime (price monitoring and the general access regime in Part IIIA) has not been able to prevent airports from acting in this way.

The Government's Response to the Commission's 2002 Report referred to the re-introduction of price controls[103] in the event that airports did not act consistently with the Review Principles. While there may be good arguments for this approach, Virgin Blue does not consider that such a response is necessary, and considers that greater benefits would flow from a lighter handed regulatory approach proposed below.

11.1 Overview of Virgin Blue's Proposed Model

Virgin Blue's preference is to commercially negotiate agreements with airports. Commercial negotiation is the most efficient and flexible method for setting the terms and conditions on which airports supply, and airlines acquire, airport services. However, as noted above in section 5,

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101 New Zealand Commerce Commission, "Final Report Part IV Inquiry into Airfield Activities at Auckland, Wellington and Christchurch International Airports", August 2002

102 at [25]

103 See the response to Recommendation 6

negotiations between (at least) major airports and airlines have rarely been conducted on a commercial basis. This is due in part to the market power that major airports possess in supplying aeronautical services.[104] Therefore, an incentive is needed to encourage airports to negotiate commercially in relation to the supply of aeronautical services. Virgin Blue believes that the best way to retain the efficiency and flexibility of commercial negotiation whilst providing an incentive for airports to negotiate is to provide for a "circuit breaker" where a party would have the option of referring a matter to independent arbitration if the parties could not agree commercially.

Such a light handed negotiate-arbitrate model would have the following features (which are explained in more detail below):

(a) in the event that commercial negotiations fail, airlines and major airports would have the ability to refer to independent arbitration any dispute over the terms and conditions on which aeronautical services are provided by the airport;

(b) the independent arbitrator would be the ACCC;

(c) in order to assist commercial negotiations and reduce the need for any arbitrations:

    (i) the ACCC would issue pricing and costing guidelines addressing key issues in negotiations over the provision of aeronautical services such as the valuation of major airport assets, the allocation of costs between aeronautical and non-aeronautical services and the basis for charging for particular aeronautical services; and

    (ii) the current shortcomings in the price monitoring regime would be addressed to ensure that airlines and airports have up to date, accurate and transparent information about airports' costs and prices.

Virgin Blue considers that such a light handed negotiate-arbitrate model could be introduced for aeronautical services at major airports with minimal need for additional legislation or regulation. Further, Virgin Blue considers that such a regulatory model would have significant benefits for the industry as it would lead to fully informed commercial negotiations between major airports and airlines and any resort to arbitration would be minimised through the provision of costing and pricing guidelines which would provide the parties with greater certainty as to the outcome of any arbitration. The arbitration process should also provide for interim determinations and

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[104] This market power has been found previously by the Commission in its 2002 Report (see page xvi) as well by the Tribunal in *Re Virgin Blue Airlines*: "The existence of SACL's monopoly power was not controversial and, indeed, was accepted by all the economic experts called by the parties." (at [164])

backdating of final determinations to ensure that there are no commercial benefits to any party from delaying the arbitration process.

Such a model would bring the aviation industry into line with other industries where the provision of services by monopoly infrastructure owners is a necessary input into downstream markets, eg the telecommunications and energy industries. It would also bring the industry into line with accepted international practice for airport regulation (nowhere apart from Australia and New Zealand have airports been privatised with nothing more than a price monitoring regime in place).

11.2 The Scope of the Negotiate-Arbitrate Model

The negotiate-arbitrate model should apply to **aeronautical services** provided at **major airports** in Australia.

For the purposes of the proposed negotiate-arbitrate model, the major airports are the airports in Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra, Darwin, Alice Springs, Gold Coast, Hobart, Launceston, Townsville and Cairns (ie the 12 core regulated airports plus Cairns).

Aeronautical services should be defined in accordance with the definition set out in Schedule B to this submission. Under this definition, aeronautical services are essentially all those services provided at airports that are necessary for the purposes of operating and/or maintaining civil aviation services at the airport. These are the services provided by airports in which airports have market power. Defining this set of services too narrowly would simply result in airports seeking to recover revenue that they can not obtain from the defined services from other services which are required by airlines in order to provide civil aviation services at the airport. For example, consider the position if take off and landing charges at an airport were regulated but the right to access the airside in order to carry out ground handling services was not regulated. If an airport was not permitted to earn excess returns from take off and landing charges then it would be likely to seek to extract this additional revenue from airlines through imposing additional charges for other services, such as introducing a charge for access to the airside to carry out ground handling services. Virgin Blue notes that the regulatory regime should also apply to services provided by airports to third party suppliers to airlines. Monopoly charges levied on such third party suppliers (eg fuel companies, caterers) are inevitably passed on to airlines through increased prices.

Virgin Blue understands that DOTARS has recently closely reviewed the definition of aeronautical charges in consultation with all interested parties and is in broad agreement with the approach proposed by Virgin Blue discussed above and detailed in Schedule B.

11.3 The ACCC as Arbitrator and the Arbitration Process

An independent arbitrator is required in order to be able to resolve disputes when commercial negotiation between the parties fails. Given the issues that are likely to be involved in any dispute over the provision of aeronautical services (eg asset valuations, the impact of charging structures, efficiency of pricing levels), Virgin Blue considers that the ACCC would be the entity best placed to conduct the independent arbitrations due to its:

(a) extensive general experience in conducting arbitrations in relation to disputes over access to monopoly infrastructure; and

(b) specialised experience in relation to the pricing of aeronautical services through the price monitoring work that it does and the work that it performed under the previous price notification and price cap regime.

A speedy arbitration process would be in the interests of all parties. While Virgin Blue considers that the arbitration process under Part IIIA of the TPA is overly cumbersome (as discussed in section 8.1 above), the Trade Practices Amendment Bill will improve the process through the introduction of:

(a) target time limits (of 6 month for an ACCC arbitration and 4 months for the Tribunal); and

(b) express provisions for interim determinations and the backdating of any final determination to the date on which a dispute was first notified to the ACCC.

Therefore, even though Virgin Blue would prefer that the final appeal avenue under the Part IIIA arbitration process was removed (being the appeal as of right to the Federal Court on a question of law), Virgin Blue considers that the proposed negotiate-arbitrate model should use this process because the legal mechanisms are already in place and it is, in general terms, an accepted arbitration process for disputes over access to monopoly infrastructure.

11.4 Pricing and Costing Guidelines and Improved Price Monitoring

A <u>Pricing and Costing Guidelines</u>

While the threat of arbitration may be a significant incentive for parties to negotiate commercially, if the ACCC were to issue guidelines addressing key costing and pricing issues then parties would be better informed about the likely outcome of any arbitration. This additional certainty would assist in negotiating commercial outcomes without the need for formal arbitration.

Such an approach is not uncommon in industries where there are disputes over access to monopoly infrastructure. For example, in the telecommunications industry the ACCC has the power to determine principles in relation to the price of access to a declared service, as well as the power to determine model terms and conditions for access to specified "core services".

In relation to airports, Virgin Blue considers that guidelines on the following issues would greatly assist parties in commercial negotiations:

(a) the ACCC should determine an initial regulatory value for the assets of each of the airports, and rules for updating these values over time. In so doing, the ACCC would need to provide guidance on the appropriate treatment of land valuations;

(b) the ACCC should provide guidance on the benchmark inputs for inclusion in formulating the WACC used in airport revenue models;

(c) the ACCC should provide guidance on the implications of particular airport charging structures for competition and efficiency. The price structures adopted by airports can have significant implications for competition. For example, any change from charging for take off and landing fees on a MTOW basis to a per passenger basis has disproportionate impacts on LCCs and reduces incentives for all airlines to offer discounted seats.

B <u>Improved Price Monitoring</u>

For the reasons set out in section 7 above, Virgin Blue does not consider that the current price monitoring regime is effective.

Virgin Blue considers that the ACCC price monitoring reports should provide a thorough and detailed analysis of prices, costs and profits, rather than merely comprising information provided to it by airports. In addition, those costs need to be measured and returns reported in a manner that is consistent with the purpose of monitoring, which would be to assist airlines and airports to engage in fully informed commercial negotiation. Therefore, the reports should involve more substantive analysis from the ACCC.

In order to improve the operation of the price monitoring regime, Virgin Blue recommends the following changes:

(a) the ACCC should adopt benchmarking measures for use in assessing airport operating costs and charges, so that trends can be monitored;

(b) the ACCC should distinguish between charges for domestic and international activities. This would allow an analysis of trends in domestic and international related charges, costs and profits;

(c) the ACCC should investigate (and comment on) the allocation of airports' costs to aeronautical and non-aeronautical services. Under a dual till regulatory structure there is a strong incentive for airports to over-allocate costs to aeronautical services so as to justify higher price levels for aeronautical services;

(d) the ACCC should monitor charges for particular aeronautical and related services. Currently, the ACCC only considers overall aeronautical charges, so that comparisons can be made between airports on a charge per passenger basis. However, many activities undertaken at airports are not passenger based, for example, take off and landing and refuelling; and

(e) the ACCC should complete its monitoring reports in a timely manner. At present, there can be a lag of up to 9 months following the end of the financial year in which a charge is introduced before the ACCC monitoring report is released.

11.5 Implementation of Proposed Regime

There are a number of ways in which Virgin Blue's proposed model could be implemented (or variants on the model involving the opportunity for independent arbitration of disputes concerning the provision of aeronautical services at major airports).

However, Virgin Blue considers that its proposed negotiate-arbitrate model could be implemented without the need for major legislative reform.

In relation to legislative amendments, the model could be introduced through the following amendments:

(a) an amendment to the TPA to deem aeronautical services provided at major airports to be declared services for the purposes of Part IIIA of the TPA. Suggested definitions of major airports and aeronautical services are provided in section 11.2 above and Schedule B below. Alternatively, such a deeming provision could be included in the Airports Act as was the case with the industry specific access regime created under s 192 of the Airports Act (now repealed); and

(b) an amendment to the TPA to require the ACCC to issue guidelines on important costing and pricing issues for aeronautical services at major airports; and

(c) a further amendment to the TPA to allow the ACCC to take such guidelines into account when making an arbitral determination under Part IIIA of the TPA.

In relation to the improved price monitoring, Virgin Blue's recommendations could be achieved through:

(a) revised directions from the relevant Minister under:

    (i) s 95ZE of the TPA. This is the core power under the TPA for the Minister to direct the ACCC to monitor the prices, costs and profits of an industry; and

    (ii) s 95ZH of the TPA, which permits the relevant Minister to direct the ACCC to give special consideration to a specified matter or matter in exercising its price monitoring powers; and

(b) the exercise by the ACCC of its powers under Part VIIA of the TPA to obtain information and documents relevant to its price monitoring powers under the TPA (see for example s 95ZK).

SCHEDULE A

International and Domestic Airport Landing Charges

Source: IATA Airport & Air Navigation Charges Manual

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Afghanistan	Class 1	MAW	Not specified	20.01.92	Not specified
Albania	Tirana (TIA)	MTOW	Not specified	25.11.04	Jan-05
Algeria	All International	MTOW	Yes	01.08.04	Sep-04
Angola	Luanda (LAD)	MTOW	Yes	01.01.99	Feb-99
Anguilla	Wallblake (AXA)	MTOW	Not specified	14.12.89	Aug-01
Antigua	St. John (ANU)	MTOW	Not specified	01.01.93	Aug-01
Argentina	Class 1 Airports	MTOW	Yes	Int'l: 01.06.88 Dom: 10.04.02	Jun-02
Armenia	Yerevan (EVN)	MTOW	Not specified	09.06.02	Jul-05
Aruba	Reina Beatrix (AUA)	MTOW	Not specified	31.03.04	Jul-04
Australia	Adelaide (ADL)	MTOW	Yes	01.07.04	Sep-04
Australia	Brisbane (BNE)	MTOW + Internationalpassenger landing fee incl. in Passenger Service Charge (PSC)	Yes	01.07.04	Sep-04
Australia	Cairns (CNS)	MTOW	Not specified	01.07.04	Sep-04
Australia	Darwin (DRW)	Passenger flights – incl. in PSC; all-cargo flights: MTOW	Yes	01.09.02	Dec-02
Australia	Melbourne (MEL)	Scheduled passenger flights – incl. in PSC; non-scheduled passenger flights and all-cargo flights: MTOW	Yes	01.07.02	Aug-02

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Australia	Perth (PER)	Domestic, International: arrival. and departure pax Cargo&Charter Fixed Wing: MTOW	Yes	01.07.05	Jul-05
Australia	Sydney (SYD)	Passenger flights: Included in PSC All-cargo flights: MTOW	Not specified	01.09.04	Dec-04
Austria	Graz (GRZ), Linz (LNZ)	MTOW-A/C over to 5 tonnes (Int'l) 85% of int'l charge – (Regional)	Int'l and Regional. Not specified whether applies to domestic.	01.04.04	Sep-04
Austria	Innsbruck (INN), Klagenfurt (KLU)	MTOW (Innsbruck – Int'l and Klagenfurt Int'l) 85% of int'l charges (Regional Flights – Innsbruck)	Int'l and Regional. Not specified whether applies to domestic.	01.04.04	Sep-04
Austria	Salzburg (SZG)	MTOW (Int'l) 85% of int'l charge (regional traffic)	Int'l and Regional. Not specified whether applies to domestic.	01.01.05	Jan-05
Austria	Vienna (VIE)	MTOW – A/C over 4 tonnes Discontinued for Regional Air Traffic)	Yes. Also applies to regional.	01.10.04	Sep-04
Azerbaijan	Baku (BAK)	MTOW	Not specified.	13.05.04 (AIC date)	Jan-05
Bahamas	Freeport Int'l (FPO), Nassau Int'l (NAS)	MTOW: including different sets of charges for (a) Piston and Turbo	Not specified.	Not specified	Aug-02

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
		Prop A/C; and (b) Jet Aircraft.			
Bahrain	Bahrain Int'l (BAH)	MTOW	Not specified.	19.02.81	Apr-04
Bangladesh	Dhaka (DAC)	MTOW	Yes	01.04.91	Nov-98
Barbados	Bridgetown (BGI)	AUW	Not specified	01.08.80	Nov-01
Belarus	Minsk-1(MHP), Minsk-2(MSQ)	MTOW	Not specified	MHP: Not specified MSQ: 15.08.01	Jul-04
Belgium	Brussels National (BRU)	MTOW: Calculation takes into account-(a) Unit Rate; (b) Weight factor; (c) Environment factor and (d) Day/Night factor	Not specified	01.04.04	Jul-05
Belgium	Antwerp (ANR), Ostend (OST)	MTOW	Not specified	19.02.04 (AIP date)	Apr-04
Belgium	Charleroi (CRL), Liege (LGG)	MTOW	Not specified	01.11.98	Apr-04
Belize	Philip S.W. Goldoson Int'l (BZE)	MAW (Int'l) 75% of int'l charges (Domestic)	Yes	Not specified	Dec-01
Benin	Contonou (COO)	MTOW – A/C over 2 tonnes	Yes	16.03.05 (AIP date)	Apr-05
Bermuda	Bermuda International Airport (BDA)	MTOW	Not specified	01.04.96	Jan-04
Bhutan	All Int'l	MTOW	Yes	17.12.02 (AIP date)	Jul-04
Bolivia	La Paz (LPB), Santa Cruz (VVI)	MTOW	Yes	14.09.01	Jan-02
Bolivia	Cochabamba (CBB)	MTOW	Yes	14.09.01	Jan-02
Bolivia	Class II Airports:	MTOW	Yes	01.01.99	Jan-01

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	(a) Potosi (POI), (b) Sucre (SRE); (c) Tarija (TJA); (d) Puerto Suarez (PSZ); (e) Trinidad (TDD); and (f) Santa Cruz (SRZ)				
Bosnia Herzegovina	Sarajevo (SJJ)	MTOW	Not specified	10.03.97	Dec-98
Bosnia Herzegovina	Banja Luka (BNX)	MTOW	Not specified	01.01.02	Jun-02
Botswana	Gaborone (GBE)	MAW	Not specified	30.09.04	Dec-04
Brazil	Class 1 & 2 (see list of Class 1 and Class 2 Airports in IATA Manual)	MTOW	Not specified	01.01.94	Jan-97
British Virgin Islands	Beef Island (EIS), Virgin Gorda (VIJ)	MTOW plus USD 3.00 per landing	Not specified	Not specified	Aug-01
Brunei	Darussalam – Brunei Int'l (BWN)	MAW	Not specified	29.07.86	Dec-02
Bulgaria	Sofia (SOF), Burgas (BOJ), Gorna Oryahovitsa (GOZ), Plovdiv (PDV), Varna (VAR)	MTOW	Yes	01.01.99	Jul-05
Burkina Faso	Ouagadougou (OUG), Bobo Dioulasso (BOY)	MTOW	Yes	16.02.05	Apr-05
Burundi	Bujumbura (BJM)	MTOW	Not specified	01.07.95	Dec-00
Cambodia	Phnom Penh (PNH)	MTOW	Not specified	01.02.96	Jan-04
Cameroon	Douala (DLA), Garoua (GOU),	MTOW	Yes	01.01.05	Jan-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	Yaounde (NSI)				
Canada	All Int'l	No landing charge specified	Not specified	01.08.04	Jul-04
Canada	Calgary (YYC)	GTOW	Yes	01.02.04	Apr-03
Canada	Edmonton (YEG)	MTOW	Yes	01.02.04	Sep-04
Canada	Gander (YQX)	MTOW	Yes	01.04.01	Sep-04
Canada	Halifax (YHZ)	MTOW	Yes	01.01.04	Jan-04
Canada	Montreal Truedeau (YUL)	MTOW	Yes	01.01.05	Apr-05
Canada	Montreal Mirabel (YMX)	MTOW	Yes	01.01.03	Dec-04
Canada	Ottawa (YOW)	MTOW	Yes	12.10.03	Jul-04
Canada	Quebec Jean Lesage (YQB)	MTOW	Yes	01.01.05	Apr-05
Canada	Toronto (YYZ)	MTOW	Not specified	01.01.05	Apr-05
Canada	Vancouver (YVR)	MTOW	Yes	01.01.05	Jan-05
Canada	Winnipeg (YWG)	MTOW	Yes	01.01.04	Jul-04
Cape Verde	Amilcar Cabral Int'l (SID)	MTOW	Not specified	01.03.03	Jun-03
Cayman Islands	Grand Cayman (GCM)	MTOW	Not specified	Not specified	Apr-94
Central African Republic	Bangui (BGF)	MTOW	Yes	01.01.05	Jan-05
Chad	N'Djamena (NDJ)	MTOW	Yes	01.01.05	Jan-05
Chile	Class 1 Airports	MTOW	Yes	01.01.02	Apr-04
China	All Int'l	MTOW	Not specified	01.10.95	Apr-05
Colombia	Barranquilla (BAQ)	MTOW	Yes	01.01.03	Feb-03
Colombia	Bogota (BOG)	MTOW	Yes	21.01.05	Apr-05
Colombia	Cali (CLO)	MTOW	Yes	15.01.03	Jan-03
Colombia	Cartagena (CTG)	MTOW	Yes	01.01.03	Feb-03
Colombia	Class A Airports	MTOW	Yes	16.02.01	May-01

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Comoro Islands	Moroni-Hahaya (HAH)	MTOW	Yes	01.01.05	Jan-05
Congo	Kinshasa (FIH)	MTOW	Yes	01.12.91	Dec-02
Congo	Brazzaville (BZV)	MTOW	Yes	01.01.05	Apr-05
Cook Islands	Rarotonga (RAR), Airutaki (AIT)	MGTOW	Not specified	01.04.90	Feb-02
Costa Rica	San Jose (SJO)	MTOW	Not specified	01.08.03	Sep-04
Cote D'Ivoire	Abidjan (ABJ)	MTOW	Yes	01.01.05	Jul-05
Croatia	Dubrovnik (DBV)	MTOW	Not specified	01.01.00	Apr-05
Croatia	Split (SPU)	MTOW	Not specified	01.01.03	Apr-05
Croatia	Zagreb (ZAG)	MTOW	Not specified	01.01.04	Apr-05
Cuba	Havana (HAV), Varadero (VRA)	MAW	Not specified	13.01.03	Jan-03
Cyprus	Larnaca (LCA), Paphos (PFO)	MTOW	Not specified	01.04.02	Apr-02
Czech Republic	Prague (PRG), Brno (BRQ), Ostrava (OSR), Karlovy Vary (KLV)	MTOW	Yes	Prague Ruzyne: Int'l and Domestic 01.01.05 Brno, Ostrava & Karlovy Vary 01.09.04	Apr-05 Sept-04
Denmark	Billund (BLL)	MTOW	Yes	01.01.01	Jan-03
Denmark	Copenhagen (CPH)	MTOW	Yes	01.01.05	Jan-05
Djibouti	Ambouli (JIB)	MTOW – A/C over 6 tonnes	Yes	01.01.02	Nov-02
Dominica	Melville Hall, Canefield	MTOW	Not specified	01.03.94	Apr-04
Dominican Republic	Punta Cana (PUJ)	MTOW	Not specified	01.11.01	Aug-02
Dominican Republic	Santo Domingo (SDQ), Puerto	MTOW – A/C over 12,500 lbs	Yes	2001	Aug-02

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	Plata (POP), Barahona (BRX), Samana				
Ecuador	Class 1 Airports	MTOW	Yes	15.06.02	Aug-02
Egypt	Cairo (CAI)	MTOW	Not specified	01.10.00	Dec-04
Egypt	Alexandria (ALY), Aswan (ASW), Hurghada (HRG), Luxor (LXR), Sharm El Sheikh (SSH)	MTOW	Not specified	01.10.00	Dec-04
El Salvador	El Salvador Int'l (SAL)	MTOW	Not specified	Not specified	May-95
Equatorial Guinea	Malabo (SSG), Bata (BSG)	MTOW	Yes	01.01.04	Jul-05
Eritrea	Asmara (ASM)	MTOW	Not specified	11.06.93	Apr-05
Estonia	Tallinn (TLL)	MTOW	Yes	01.03.01	Sep-04
Ethiopia	Addis Ababa (ADD)	MAW	Not specified	28.12.00 (AIP date)	Not specified
Fiji	Nadi Int'l (NAN)	MTOW	Yes	01.01.97	Aug-02
Finland	All CAA Airports – Incl. Helsinki (HEL)	MTOW	Yes	01.01.05	Jan-05
France	Ajaccio (AJA)	Aircraft over 6 tonnes – MTOW	Yes	01.01.04	Apr-04
France	Bordeaux (BOD)	Aircraft over 6 tonnes –MTOW	Yes. Also applies to EU flights.	01.04.04	Sep-04
France	Cannes-Mandelieu (CEQ)	MTOW	Yes. Also applies to EU flights.	01.04.05	Jul-05
France	Clermont-Ferrand Auvergne (CFE)	MTOW – Aircraft over 6 tonnes	Yes	20.06.05	Jul-05
France	Lille-Lesquin (LIL)	Aircraft over 6 tonnes – MTOW	Yes. Also applies to EU flights.	01.04.03	Apr-03
France	Lyon – Saint Exupery (LYS)	Aircraft over 6 tonnes – MTOW	Yes. Also applies to EU flights.	01.04.04	Apr-04

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
France	Marseille-Provence (MRS)	MTOW	Yes. Also applies to EU flights.	01.07.03	Apr-05
France	Montpellier (MPL)	MTOW	Yes	01.06.05	Jul-05
France	Nantes Atlantique (NTE)	MTOW	Yes	01.07.04	Sep-04
France	Nice – Cote D'Azur (NCE)	MTOW	Yes. Also applies to EU flights.	01.04.05	Apr-05
France	Paris – Charles de Gaulle (CDG), Orly (ORY)	MTOW	Yes.	01.02.05	Apr-05
France	Paris – Le Bourget (LBG), Pontoise (PHT)	MTOW	Yes	01.07.04	Jul-04
France	Strasbourg (SXB)	MTOW	Yes	01.01.05	Apr-05
France	Toulouse (TLS)	MTOW – A/C over 6 tonnes	Yes. Also applies to EU flights.	01.04.04	Jul-04
French Guiana	Cayenne-Rochambeau (CAY)	MTOW	Yes	01.01.04 (AIP date)	Dec-04
French Polynesia (Tahiti)	Papeete (PPT)	MTOW	Yes	01.07.99	Oct-02
Gabon	Libreville (LBV)	MTOW	Yes	16.02.05	Apr-05
Gambia	Banjul (BJL)	MTOW	Not specified	01.02.97	Jan-02
Georgia	Tbilisi (TBS)	MTOW	Not specified	09.08.01 (AIP date)	Dec-04
Germany	Berlin Schonefield (SXF)	A/C over 2 tonnes - MTOW	Not specified	01.05.04	Sep-04
Germany	Berlin – Tegel (TXL), Tempelhof (THF)	A/C over 2 tonnes - MTOW	Not specified	01.08.03	Aug-03
Germany	Bremen (BRE)	A/C over 2	Yes	01.01.05	Jan-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
		tonnes – MTOW			
Germany	Cologne/Bonn (CGN)	A/C over 2 tonnes –MTOW	Not specified	01.07.04	Jul-04
Germany	Dresden (DRS)	A/C over 2 tonnes – MTOW	Yes	01.10.03	Jul-05
Germany	Dusseldorf (DUS)	Aircraft over 5.7 tonnes – MTOW	Yes	01.06.05	Jul-05
Germany	Erfut (ERF)	A/C over 5.7 tonnes – MTOW	Yes	01.10.99	Aug-02
Germany	Frankfurt (FRA)	MTOW	Not specified	01.01.05	Jan-05
Germany	Hamburg (HAM)	A/C over 2 tonnes – MTOW	Not specified	01.10.01	Jul-05
Germany	Hanover (HAJ)	Aircraft over 2 tonnes – MTOW	Yes	01.01.05	Jan-05
Germany	Leipzig (LEJ)	A/C over 2 tonnes – MTOW	Yes	01.10.03	Jul-05
Germany	Munich (MUC)	A/C over 5.7 tonnes – MTOW	Not specified	01.10.04	Jan-05
Germany	Munster-Osnabruck (FMO)	A/C over 2 tonnes – MTOW	Yes	01.08.04	Sep-04
Germany	Nurnberg (NUE)	A/C over 2 tonnes – MTOW	Yes	01.10.02	Jul-05
Germany	Stuttgart (STR)	A/C over 2 tonnes – MTOW	Yes	01.01.05	Jul-05
Ghana	All, incl. Accra (ACC)	MAW	Int'l yes. Unsure re. domestic	01.12.03	Jan-05
Greece	Athens (Spata) Airport (ATH)	MTOW	Not specified	01.08.04	Jul-04
Greece	All state airports	MTOW	Not specified	10.06.04	Jul-04
Greenland	All Category C&D Airports	MTOW	Yes	01.01.01	Jun-02
Grenada	Point Salines Int'l (GND)	MTOW	Not specified	08.12.94 (AIP date)	Aug-01
Guadeloupe (French West Indies)	Pointe-a-Pitre (PTP)	Aircraft over 6 tonnes – MTOW	Yes	02.09.04 (AIP date)	Dec-04
Guam	Agana (GUM)	MTOW	Not specified	01.10.97	Nov-02

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Guatemala	Guatemala City (GUA)	MTOW	Not specified	18.11.94	Apr-99
Guinea	Conakry (CKY)	MTOW	Yes	22.11.99 (AIP date)	Jul-04
Guinea-Bissau	Bissau (BXO)	MTOW	Not specified	25.05.95	Apr-02
Guyana	Georgetown – Timerhi (GEO)	MTOW	Not specified	15.02.84	Nov-02
Haiti	Port au Prince (PAP)	MTOW	Yes	02.11.03 (AIP date)	Sep-04
Honduras	All International	MTOW – Aircraft over 2 tonnes	Yes	01.03.04	Jan-05
Hong Kong	Hong Kong Int'l (HKG)	MTOW (rounded to the nearest tonne)	Not specified	01.01.00	Sep-04
Hungary	Budapest-Ferihegy (BUD)	MTOW	Not specified	01.01.05	Jan-05
Iceland	Reykjavik (REK), Keflavik (KEF)	MTOW	Not specified	17.02.05 (AIP date)	Jul-05
India	Chennai (MAA), Delhi (DEL), Kolkata (CCU), Mumbai (BOM), Trivendrum (TRV)	MAW	Yes	01.04.01	Apr-04
India	Domestic Airports	MAW	Yes	01.04.01	Apr-04
Indonesia	Jakarta (CGK)	NTOW	Yes	01.07.96	Jul-04
Indonesia	Medan (MES)	NTOW	Yes	01.07.96	Jul-04
Iran	International Airports, incl. Tehran (THR)	MTOW	Yes	01.11.04 (AIP date)	Apr-05
Iraq	All International	MAW	Not specified	Not specified	Aug-02
Ireland	Dublin (DUB), Shannon (SNN), Cork (ORK)	MTOW	Not specified	01.01.05	Jul-05
Israel	Tel Aviv (TLV), Haifa (HFA)	MTOW	Not specified	01.09.91	Apr-03

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Israel	Eilat (ETH), Jerusalem (JRS), Ovda (VDA)	MTOW	Not specified	Not specified	Apr-03
Italy	All Major Airports	MTOW	Yes. Also EU flights	20.01.05	Apr-05
Jamaica	Kingston (KIN), Montego Bay (MBJ)	MTOW	Not specified	01.07.98	Aug-01
Japan	Chubu Centrair International Airport (NGO)	MTOW	Not specified	17.02.05	Jul-05
Japan	Kansai (KIX)	MTOW	Yes	Int'l: 01.07.95 Dom: 04.09.94	Jul-05
Japan	Narita (NRT)	MTOW	Yes	Int'l: 01.04.84 Min. Charge: 10.08.00 Domestic: 18.04.02	Jul-04
Japan	Int'l Airports (other than Narita and Kansai)	MTOW	Not specified	23.04.98	Jul-05
Jordan	All Jordanian Airports	MTOW	Yes (Int'l Commercial; and Domestic & Int'l Charter Flights)	16.11.98	Jul-04
Kazakhstan	Almaty (ALA)	MTOW	Not specified	01.02.00	Sep-01
Kenya	Nairobi (NBO), Mombasa (MBA)	MAW	Not specified	01.07.96	Apr-05
Dem. People's Rep. of Korea	All Int'l	taxi-weight of aircraft	Not specified	01.11.94 (AIP date)	Jan-05
Rep. of Korea	Seoul – Incheon Int'l Airport	MTOW	Not specified	01.04.04	Apr-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Rep. of Korea	All Int'l except Incheon Int'l	MTOW	Int'l. Not specified whether applies to domestic	10.03.00	Apr-05
Kuwait	Kuwait (KWI)	MTOW	Not specified	01.07.95	Jan-05
Kyrgyz Republic	All Civil Airports	MTOM	Not specified	01.01.94	Apr-05
Laos	Vietiane-Wattay (VTE)	MTOW	Not specified	01.04.89	Jun-93
Latvia	Riga (RIX), Liepaja (LPX)	MTOW	Not specified	10.01.05	Apr-05
Lebanon	Beirut Int'l (BEY)	MTOW	Not specified	01.08.99	Jan-04
Lesotho	Maseru (MSU)	MTOW	Yes	Not specified	Nov-02
Liberia	Monrovia (ROB)	MTOW	Not specified	10.07.03 (AIP date)	Jul-04
Libyan Arab Jamahiriya	Major International	MTOW	Int'l. Not specified whether applies to domestic	15.07.89	Aug-99
Lithuania	Vilnius (VNO), Kaunas (KUN), Palanga (PLQ), Siauliai (SQQ)	Aircraft over 2 tonnes MTOW	Yes	23.01.02	Jul-04
Luxembourg	Findel (LUX)	MTOW	Not specified	01.01.02	Jun-03
Macau	Macau Int'l (MFM)	MTOW	Not specified	16.11.96	Jan-05
Macedonia (Fyrom)	Skopje (SKP), Ohrid (OHD)	MTOW	Int'l. Not specified whether applies to domestic	15.06.01 (AIP date)	Jul-01
Madagascar	Antananarivo (TNR)	MTOW	Yes	20.10.04	Jan-05
Malawi	Liongwe (LLW)	MAW	Yes	01.01.97	Jul-05
Malaysia	Kuala Lumpur (KUL), Sabah (SBV), Sarawak	MAW	Not specified	01.05.92	Jul-00
Maldives	Male (MLE)	MTOW	Yes	01.08.99	Jul-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Mali	Bamako (BMK)	MTOW	Yes	01.01.05	Jan-05
Malta	Luqa (MLA)	MAW	Not specified	01.04.05 Night surcharge: 10.09.82	Jul-05
Martinique (French West Indies)	Fort de France (FDF)	MTOW	Yes	02.09.04 (AIP date)	Dec-04
Mauritiana	Nouakchott (NKC), Nuadhibou (NDB)	MTOW	Yes	16.02.05	Apr-05
Mauritius	Mauritius (MRU)	MAW	Not specified	01.11.98	Jul-04
Mexico	Mexico City (MEX)	MTOW	Yes	12.10.04	Jul-05
Mexico	Asur Group Airports: Cancun (CUN), Merida (MID)	MTOW	Yes	01.01.04	Sep-04
Mexico	Asur Group Airports: Cozumel (CZM), Huatulco (HUX), Minatitlan (MTT), Tapachula (TAP), Veracruz (VER)	MTOW	Yes	01.01.04	Dec-04
Mexico	Asur Group Airports: Villahermosa (VSA), Oaxaca (OAX)	MTOW	Yes	01.01.04	Dec-04
Mexico	GACN Group Airports: Acapulco (ACA), Monterrey (MTY)	MTOW	Yes	01.01.04	Sep-04
Mexico	GAP Group Airports: Guadalajara	MTOW	Yes	01.06.01	Dec-01

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	(GDL), Puerto Vallarta (PVR), Tijuana (TIJ)				
Moldova	All Civil Airports	MTOW	Not specified	Chisinau: 01.01.04 Other Moldovian Airports: 03.09.97	Apr-05 May-98
Mongolia	All International	MTOW	Yes	23.05.05 (AIP date)	Jul-05
Montserrat [Note: AERODROME CLOSED]	Blackburne Airport (MNI)	MTOW	Not specified		Dec-95
Morocco	Casablanca (CMN, CAS)	MTOW	Yes	01.04.97	Jun-02
Morocco	All Int'l except Casablanca	MTOW	Yes	01.04.97	Jun-02
Mozambique	Beira (BEW), Maputo (MPM), Nampula (APL), Vilanculos (VNX)	MTOW	Not specified	01.06.98	Sep-04
Myanmar	Yangon (RGN)	MTOW	Yes	01.12.98	Feb-01
Namibia	Windhoek Int'l (WDH)	MTOW	Yes	01.09.04	Apr-05
Nepal	Kathmandu (KTM)	MAW	Yes	05.02.96	Jul-05
Netherlands	Amsterdam (SPL)	MTOW	Not specified	01.04.05	Apr-05
Netherlands	Maastricht Aachen (MST)	MTOW	Not specified	09.05.03 (AIP Date)	Jun-03
Netherlands	Rotterdam (RTM)	MTOW	Not specified	09.05.03 (AIP Date)	Jun-03
Netherlands Antilles	Bonaire (BON), Curacao (CUR), St. Eustatius (EUX), St. Maarten (SXM)	MTOW	Not specified	01.11.98 (AIP date)	Dec-04

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
New Caledonia (French Territory)	Noumea (NOU)	MTOW – A/C over 6 tonnes	Yes	14.06.01	Oct-02
NZ	Auckland (AKL)	MTOW	Not specified	01.11.01	Aug-02
NZ	Christchurch (CHC)	MTOW	Yes	01.01.01	Jan-03
NZ	Wellington (WLG)	Incl. in Passenger Service Charge	Yes	05.02.03	Aug-03
Nicaragua	Managua (MGA)	MTOW	Not specified	01.01.00	Mar-00
Niger	Niamey (NIM)	MTOW	Yes	01.01.05	Jan-05
Nigeria	Lagos (LOS), Kano (KAN), Port Harcourt (PHC), Abuja (ABV)	MTOW	Yes	01.03.95	Oct-02
Northern Mariana Islands	Saipan (SPN)	MLW	Not specified	01.03.02	Dec-02
Norway	State Airports	Take Off Charge – MTOW – A/C over 8 tonnes	Not specified	01.01.05 Night surcharge: 01.01.03	Jan-05 Jan-03
Oman	All Int'l	MTOW	Not specified	11.08.82	Dec-04
Pakistan	Class 1 Airports	MTOW – A/C over 1 tonne	Not specified	Karachi Airport: 01.09.98 Other Class 1 Airports: 01.07.03	Jan-02 Aug-03
Panama	Panama City (PTY)	MTOW	Yes	01.01.88	Dec-02
PNG	Port Moresby (POM)	MTOW	Yes	01.01.01	Jan-01
Paraguay	Asuncion (ASU)	MTOW	Yes	1996	Oct-01
Paraguay	Cuidad del Este (AGT)	MTOW	Yes	Not specified	Oct-01
Peru	Category I Airports incl.	MTOW	Yes	12.06.04	Jul-04

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	Lima (LIM)				
Philippines	Manila Int'l (MNL)	MTOW	Not specified	01.01.00	May-99
Poland	Class I, II and III	A/C over 2 tonnes - MTOW	Yes	01.04.03	Jul-04
Portugal	Lisbon (LIS)	MTOW	Not specified	23.05.04	Jul-04
Portugal	Faro (FAO), Oporto (OPO)	MTOW	Not specified	23.05.04	Jul-04
Portugal	Santa Maria (SMA), Ponta Delgada (PDL), Horta (HOR), Flores	MTOW	Not specified	17.06.04	Jul-04
Portugal	Funchal (FNC), Porto Santo (PXO)	MTOW	Not specified	11.06.05	Jul-05
Puerto Rico	San Juan Int'l (SJU)	MAGTOW	Not specified	01.01.99	Aug-02
Qatar	Doha (DOH)	Based on Aircraft Type	Not specified	16.05.02	Jun-02
Reunion	Saint Denis/Gillot (RUN)	MTOW	Yes	01.05.04	Jul-04
Romania	Bucharest Henri Coanda (Otopeni)(OTP)	MTOW – Rate per Tonne	Yes	28.10.04	Apr-05
Romania	Cluj (CLJ), Tulcea (TCE), Timisoara (TSR)	MTOW	Not specified	17.03.05 (AIP date)	Apr-05
Russian Federation	Ekaterinburg (SVX)	MTOW	Not specified	25.04.99 (AIP date)	Jan-03
Russian Federation	Kalingrad (KGD)	MTOW	Not specified	01.07.99	Jul-05
Russian Federation	Khabarovsk (KVH)	MTOW	Not specified	01.07.99	Jul-05
Russian Federation	Krasnoyarsk (KJA)	MTOW	Not specified	25.04.99 (AIP date)	Jul-05
Russian Federation	Moscow: Sheremetievo (SV), Domodedovo	MTOW	Not specified	01.03.01	Jul-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	(DME), Vnukovo (VKO)				
Russian Federation	Novgorod (NVR)	MTOW	Not specified	25.04.99 (AIP date)	Jul-05
Russian Federation	Novosibirsk (OVB)	MTOW	Not specified	Not specified	Jul-05
Russian Federation	Omsk (OMS)	MTOW	Not specified	30.09.04	Jul-05
Russian Federation	Orenburg (REN)	MTOW	Not specified	25.04.99 (AIP date)	Jul-05
Russian Federation	Perm (PEE)	MTOW	Not specified	25.04.99 (AIP date)	Jul-05
Russian Federation	Rostov-on-Don (ROV)	MTOW	Not specified	25.04.99 (AIP Date)	Jul-05
Russian Federation	Samara (KUF)	MTOW	Not specified	07.07.05	Jul-05
Russian Federation	St. Petersburg (LED)	MTOW	Not specified	01.08.99	Jul-05
Russian Federation	Vladivostok (VVO)	MTOW	Not specified	01.07.99	Jun-03
Rwanda	Kigali (KGL)	MTOW	Not specified	01.08.04 (AIP date)	Apr-05
Sao Tome and Principe	Sao Tome Int'l (TMS)	MTOW	Not specified	Not specified	Nov-98
Saudi Arabia	Jeddah (JED), Riyadh (RIY), Dhahran (DHA)	MTOW	Not specified	07.07.83	Feb-98
Senegal	Dakar (DKR)	MTOW	Yes	01.01.05	Jul-05
Serbia & Montenegro	Belgrade (BEG)	MTOW	Not specified	01.03.05	Jul-05
Seychelles	Seychelles Int'l (SEZ)	MTOW – A/C over 2 tonnes	Int'l. Not specified whether applies to domestic	16.03.92	Nov-02
Sierra Leone	Freetown (FNA)	MTOW (Int'l). 50% surcharge domestic	Yes	23.12.04 (AIP date)	Apr-05
Singapore	Changi (SIN)	Taxi weight of aircraft	Not specified	01.08.95	Apr-03

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Slovak Republic	All Airports	MTOM	Yes	17.02.05	Jan-05
Slovenia	Ljubljana (LJU), Maribor (MBX)	MTOW	Not specified	04.08.04 (AIP date)	Apr-05
Solomon Islands	All Int'l	MTOW	Int'l. Not specified whether applies to domestic	01.01.97	Sep-97
Somala	Mogadishu (MGQ)	MAW	Not specified	31.08.86	Not specified
South Africa	Johannesbourg (JNB), Durban (DUR), Cape Town (CPT)	MTOW	Yes. Also regional	15.10.03	Oct-03
Spain	Class 1,2,3	MTOW	Yes. Also EU flights.	01.01.05	Jan-05
Sri Lanka	Colombo (CMB)	MTOW	Not specified	01.03.87	Jul-04
St. Kitts & Nevis	St Kitts (SKB)	MTOW	Not specified	20.02.03 (AIP date)	Jun-03
St. Lucia	Hewanorra (UVF), Vigie (SLU)	MTOW	Not specified	01.09.01	Aug-01
St. Vincent & Grenadines	ET Joshua (SVD)	MTOW	Not specified	1995	Mar-02
Sudan	Khartoum (KRT)	MAW	Yes	01.01.00	Jun-02
Suriname	Paramaribo (PBM)	MTOW	Yes	01.01.02	Apr-03
Swaziland	Manzini (MTS)	MAW	Not specified	28.01.04 (AIP date)	Dec-04
Sweden	Goteborg-Landvetter (GOT)	A/C over 2 tonnes – MTOW	Yes	01.03.04	Jan-05
Sweden	Malmo-Sturup (MMX)	A/C over 2 tonnes – MTOW	Yes	01.03.04	Jan-05
Sweden	Stockholm-Arlanda (ARN)	A/C over 2 tonnes – MTOW	Yes	01.03.04	Jan-05
Sweden	Stockholm-Bromma (BMA)	A/C over 2 tonnes – MTOW	Yes	01.03.04	Jan-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Switzerland/France	Basle/Mulhouse (BSL/MLH)	MTOW	Not specified	01.04.05	Apr-05
Switzerland	Geneva (GVA)	MTOW	Not specified	01.11.98	Apr-05
Switzerland	Zurich (ZRH)	MTOW	Not specified	01.09.97	Aug-05
Syrian Arab Republic	All, incl. Damascus (DAM)	MTOW	Yes	01.10.00	Jan-05
Taiwan	All Int'l incl. Taipei (TPE)	MTOW	Yes	01.01.96	Jul-04
Tajikistan	All Civil Airports	MTOW	Not specified	01.01.94	Apr-98
Tanzania	Dar es Salaam (DAR), Kilimanjaro (JRO)	MAW	Not specified	Foreign Registered Aircraft: 16.09.02 Tanzania Registered Aircraft: 01.09.04	Dec-04
Thailand	Bangkok (BKK), Chiang Mai (CNX), Chiang Rai (CEI), Hat Yai (HDY), Phuket (HKT), Samui (USM), Soukhothai (THS)	MTOW	Yes	01.01.05	Jul-05
Togo	Lome (LFW)	MTOW	Yes	01.01.05	Jan-05
Tonga	Tonga	MTOW	Yes	01.11.96	Jul-04
Trinidad & Tobago	Port of Spain – Piarco (POS), Tobago – Crown Point (TAB)	MTOW	Not specified	2001 Crown Pt. Int'l Airport – 01.01.96	Aug-01
Tunisia	All Int'l	MTOW	Yes	01.04.95	Jan-02
Turkey	Ankara (ESB), Istanbul (IST), Antalya (AYT), Bodrum (BJV),	MTOW	Int'l. Not specified whether applies to domestic	01/01/05	Jan-05

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
	Dalaman (DLM), Izmir (ADB)				
Turkey	Istanbul Sabiha Gokcen Int'l Airport (SAW)	MTOW	Yes	01.01.01	Jun-01
Turkmenistan	Major Int'l Airports	MTOW	Not specified	26.10.99	Jan-02
Turks and Caicos Islands	All Airports	MTOW	Not specified	Not specified	Oct-86
Uganda	All Civil Airports	MTOW	Int'l. Not specified whether applies to domestic	01.07.00	Jan-04
Ukraine	Dnipropetrovsk (DNK), Donetsk (DOK)	MTOW	Yes	01.01.01	Dec-04
Ukraine	Kiev Borispol (KPB)	MTOW	Yes	Int'l Flights: 01.11.01 Domestic Flights – Terminal A: 20.02.03 Terminal B,C: 01.11.01	Dec-04
Ukraine	Kharkiv (HRK), Lviv (LWO), Odessa (ODS), Simferopol (SIP)	MTOW	Yes	17.03.95	Dec-04
United Arab Emirates	Abu Dhabi (AUH), Al Ain Int'l (AAN)	MAW	Not specified	01.09.77	Mar-98
United Arab Emirates	Dubai (DXB)	MTOW	Not specified	01.05.94	Jan-04
United Arab Emirates	Fujairah (FJR)	MAW	Not specified	14.11.91	Dec-02
United Arab	Ras Al Khaimah (RKT)	MAW	Not specified	01.09.77	Jun-02

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
Emirates					
United Arab Emirates	Sharjah (SHJ)	MAW	Not specified	06.09.79	Oct-02
United Kingdom	Aberdeen (ABZ)	MTOW	Not specified	01.04.03	Apr-05
United Kingdom	Belfast (BFS)	MAW	Not specified	01.04.98	Apr-01
United Kingdom	Birmingham (BHX)	MTOW	Not specified	01.04.02	Apr-05
United Kingdom	Bournemouth (BOH)	MTOW	Not specified	01.04.03	Sep-04
United Kingdom	East Midlands (EMA)	MTOW	Not specified	01.03.04	Sep-04
United Kingdom	Edinburgh (EDI)	MTOW	Yes	01.04.05	Apr-05
United Kingdom	Glasgow (GLA)	MTOW	Not specified	01.04.05	Apr-05
United Kingdom	Jersey (JER)	MTOW	Not specified	01.01.04	Jan-05
United Kingdom	London City (LCY)	MTOW	Not specified	01.04.04	Jul-04
United Kingdom	London Gatwick (LGW)	MTOW – Fixed Charge	Yes	01.04.05	Apr-05
United Kingdom	London Heathrow (LHR)	MTOW – Fixed Charge	Not specified	01.04.05	Apr-05
United Kingdom	London-Luton (LTN)	MTOW	Not specified	01.04.05	Apr-05
United Kingdom	London Stansted (STN)	MTOW – Fixed Charge	Not specified	01.04.04	Apr-04
United Kingdom	Manchester (MAN)	MTOW	Not specified	01.04.05	Jul-05
United Kingdom	Newcastle (NCL)	MTOW	Not specified	01.04.01	Apr-04
United Kingdom	Prestwick (PIK)	MTOW	Not specified	01.05.03	Jul-04
USA	All Int'l	No specified landing charge	Not specified	Not specified	Not specified
USA	Anchorage (ANC)	MGTW	Not specified	01.07.04	Jul-04

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
USA	Atlanta (ATL)	MLW	Not specified	01.01.01	Aug-01
USA	Boston Logan (BOS)	MLW	Not specified	01.10.04	Dec-04
USA	Chicago O'Hare (ORD)	MLW	Not specified	01.01.04	Jul-04
USA	Dallas – Forth Worth (DFW)	MLW	Not specified	01.10.04	Jan-05
USA	Denver Int'l (DEN)	MLW	Not specified	01.01.05	Jan-05
USA	Detroit Metro (DTW)	MLW	Not specified	2004	Jul-04
USA	Fort Lauderdale (FLL)	MGLW	Not specified	01.10.03	Jul-04
USA	Honolulu (HNL)	MLW	Not specified	01.07.97	Aug-01
USA	Houston Intercontinental (IAH)	MLW	Not specified	01.07.03	Oct-03
USA	LA Int'l (LAX)	MLW – A/C over 12,500 lbs A/C over 25,000 lbs	Not specified	01.07.97 02.08.04	Sep-04 Sep-04
USA	Memphis (MEM)	MLW	Not specified	01.01.02	May-02
USA	Miami (MIA)	MLW	Not specified	01.10.04	Dec-04
USA	NY – JFK	MTOW	Not specified	Scheduled Carriers: 01.01.03 Itinerant/Commuter: 01.01.02	Sep-04 Jan-02
USA	Newark Int'l (EWR)	MTOW	Not specified	01.01.04	Sep-04
USA	Orlando (MCO)	MCGLW	Not specified	01.08.03	Sep-04
USA	Philadelphia Int'l (PHL)	MAGLW	Not specified	15.04.04	Dec-04
USA	San Francisco	MLW	Not specified	01.07.04	Sep-04
USA	Seattle – Tacoma	MGLW	Not specified	01.01.04	Jul-04

Country	Airport	Basis	Application to both Int'l and Dom Flights?	Date Effective	Date Verified
USA	Washington Dulles (IAD)	MLW	Not specified	01.06.04	Sep-04
Uruguay	Punta del Este (PDP)	MTOW	Yes	01.12.00	Aug-02
Uruguay	Category 1 (excl. Punta del Este)	MTOW	Not specified	01.08.99	Jan-05
US Virgin Islands	St. Thomas (STT), St. Croix (STX)	MALW	Not specified	01.04.01	Aug-02
Uzbekistan	Major Int'l Airports	MTOW	Not specified	01.01.91	Jul-05
Vanuatu	Port Vila/Bauerfield (VLI), Santo/Pekoa (SON)	MTOW	Yes	17.08.95 (AIP date)	Apr-96
Venezuela	Category I Airports	MTOW	Yes	International: 01.01.96 Dom: 01.07.95	Aug-95
Vietnam	Int'l Airports	MAW	Not specified	01.04.98	Dec-04
Yemen	San'a (SAH), Aden (ADE), Hodeidah (HOD)	MTOW	Not specified	01.07.02	Oct-02
Zambia	Category 1	Aircraft over 5 tonnes – MTOW Domestic flights – 80% of int'l rates	Yes	Int'l: 18.03.97	Sep-04 Domestic Flights: Jun-99
Zimbabwe	All Int'l Airports	MAUW (Charge per landing)	Yes	01.03.03	Sep-04

List of Abbreviations Used

AIP	Aeronautical Information Publication
AUW	All Upweight of Aircraft
CMG	Certified Maximum Gross Landing Weight
GLW	Gross Landing Weight
MAGTOW	Maximum Allowable Gross Take-Off Weight
MALW	Maximum Allowable Landing Weight
MAUW	Maximum Allowable Gross Take-Off
MAW	Maximum Allowable Weight
MGLW	Maximum Gross Landing Weight
MGTOW	Maximum Gross Take-Off Weight
MLW	Maximum Landing Weight
MTOM	Maximum Take-Off Mass
MTOW	Maximum Take-Off Weight
NTOW	Normal Take-Off Weight

SCHEDULE B

DEFINITION OF AERONAUTICAL SERVICES

There are currently different definitions of "aeronautical services" that are used by the ACCC in its price monitoring role (see definitions in Direction 27) and its financial reporting role (see *Airports Regulations 1997* (**Airport Regulations**) reg 7.03).

The differences in definition appear to be an historical anomaly.

The provision of "aeronautical services" by SACL was made subject to "prices notification" under the *Prices Surveillance Act 1983* (Cth) through a declaration made under s 21 of the *Prices Surveillance Act* on 30 June 2000.[105] By virtue of this declaration the "aeronautical services" comprising "aircraft movement facilities and activities" and "passenger processing facilities and activities" were made "notified services" for the purposes of that Act and SACL was declared to be a notified persons in relation to the provision of those services at Sydney airport.

The consequence of that declaration was that SACL was required to notify the ACCC under s 22 of the *Prices Surveillance Act* before increasing the price, or substantially varying the terms and conditions, for the provision of those "aeronautical services" and the ACCC was empowered to investigate and report on any increase or variation notified to it. By a further direction of the same date,[106] the ACCC was required in exercising its powers and performing its functions under the *Prices Surveillance Act* in relation to the pricing of "aeronautical services" at Sydney airport to give special consideration to factors which included "overall efficiency of the Airport's operations". Similar declarations and directions in relation to price notification were made with respect to Melbourne, Brisbane and Perth airports.[107] However, unlike airports in Melbourne, Brisbane and Perth, Sydney Airport was not subjected to a price cap.

Following the acceptance by the Commonwealth Government of the recommendations contained in the 2002 Report:

(a) the declaration under s 21 of the *Prices Surveillance Act* requiring "prices notification" in relation to Sydney, Melbourne, Brisbane and Perth airports was revoked; and

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105 Declaration 89, *Prices Surveillance Act 1983* (Cth), made by Joe Hockey, Minister for Financial Services and Regulation on 30 June 2000.

106 Direction 18, *Prices Surveillance Act 1983* (Cth), made by Joe Hockey, Minister for Financial Services and Regulation on 30 June 2000.

107 Declaration 87, *Prices Surveillance Act 1983* (Cth), made by Joe Hockey, Minister for Financial Services and Regulation on 30 June 2000; Direction 21, *Prices Surveillance Act 1983* (Cth), made by Joe Hockey, Minister for Financial Services and Regulation on October 2000.

(b) a direction was given under s 27A of the *Prices Surveillance Act* that the ACCC "undertake formal monitoring of aeronautical services", including both "aircraft movement facilities and activities" and "passenger processing facilities and activities" by the operators of Australia's 7 largest airports.[108]

The provision by SACL of "aeronautical services to regional air services" was made and remains subject to price notification[109] and to a price cap.[110]

The definition of "aeronautical services" in the Airports Regulations was inserted when the Regulations were first made on 5 February 1997.

Virgin Blue considers that there should be consistency between the definitions of "aeronautical services" under the TPA and under the Airports Regulations. This would simplify reporting requirements on airport operators to the ACCC.

In determining an appropriate definition of "aeronautical services", the Government should ensure that clear guidance is given to airport operators about the scope of aeronautical services and, in particular, the scope of aeronautical assets.

Currently, there is too much flexibility provided to airport operators to determine what assets are aeronautical assets and what assets are non-aeronautical assets. This issue is particularly important given the opportunity to shift reported revenues from aeronautical and aeronautical related services to non-aeronautical activities and to over allocate costs to aeronautical activities, hence under-reporting revenue and profit increases attributable to aeronautical and related activities.

The ACCC should be in a position to assess the allocation of revenues and costs by airports between aeronautical and non-aeronautical services. The current Airports Reporting Guideline requires airports to complete schedules which distinguish between aeronautical assets and non-aeronautical assets.[111] However, the ACCC should be able to assess whether these allocations have been appropriately made. This may require an additional degree of precision in the definition of aeronautical services.

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108 Direction 27, *Prices Surveillance Act 1983* (Cth), made by Ian Campbell, Parliamentary Secretary to the Treasurer on 26 June 2002.

109 Declaration 90, *Prices Surveillance Act 1983* (Cth), made by Ian Campbell, Parliamentary Secretary to the Treasurer on 26 June 2002.

110 Direction 28, *Prices Surveillance Act 1983* (Cth), made by Ian Campbell, Parliamentary Secretary to the Treasurer on 26 June 2002.

111 ACCC, *"Airports Reporting Guideline: Information Requirements under Part 7 of the Airports Act 1996 and Section 95ZF of the Trade Practices Act 1974"*, revised March 2004. See in particular Schedules 1.2 and 1.3.

As noted above, the ACCC should monitor charges for particular aeronautical and related services. Currently, the ACCC only considers overall aeronautical charges, so that comparisons can be made between airports on a charge per passenger basis. However, many activities undertaken at airports are not passenger based, for example, take off and landing and refuelling.

Reporting overall charges on a per passenger basis has the potential to underestimate the real level of revenue increases for airports and the real impact of cost increases on airlines. This is because passenger numbers are likely to increase faster than overall costs and other activity levels.

More fundamentally, Virgin Blue considers that the definition of "aeronautical services" should encompass all services in which airports have market power. Virgin Blue considers that these services are the services required by airlines in order to provide civil aviation services at the airport. These are the services that should be subject to regulation. As discussed above, if the definition is not broad enough to capture all of these services, then airports will seek to recover monopoly returns through introducing new charges for the unregulated services. If it is a service that an airline needs to supply civil aviation services at the airport, then the airline will have little choice but to pay the new charges. The effect of the regulation would then simply be that airports would shift monopoly charges from regulated services to unregulated services.

Virgin Blue does not consider that the current approach to defining "aeronautical charges" is appropriate to capture all of the relevant services provided by airports and other monopoly providers such as Airservices Australia. This is because the current approach to defining "aeronautical services" seeks to exhaustively list all relevant services. In the event that a service needed by airlines is not included in the list, then it will not be classified as an "aeronautical service" and airports would be free to introduce unregulated charges.

Instead of this approach of listing all relevant services, Virgin Blue considers that a better approach would be to define "aeronautical services" in a purposive manner, and list individual services as non-exhaustive examples of relevant services.

Virgin Blue sets out below a suggested definition of aeronautical services using this purposive approach:

> **aeronautical services** means those services provided at airports that are necessary for the purposes of operating and/or maintaining civil aviation services at the airport, including, but not limited to, the following:
>
> a) airside grounds, runways, taxiways and aprons;
> b) airfield lighting, airside roads and airside lighting;
> c) airside safety, including rescue and fire-fighting services and perimeter fencing;

d) nose-in guidance;
e) aircraft parking;
f) visual navigation aids and facilities and airfield navigation services;
g) aircraft refuelling services and facilities (including pipelines);
h) maintenance and repair services in relation to runways, taxiways and parking aprons;
i) environmental-hazard-control services;
j) services and facilities to ensure compliance with environmental laws;
k) ground handling services;
l) forward airline support area services;
m) aerobridges and airside buses;
n) departure lounges and holding lounges (but excluding commercially important persons lounges);
o) immigration, customs and quarantine areas and facilities;
p) security systems and services (including closed circuit surveillance systems);
q) baggage make-up, handling and reclaim;
r) public areas in terminals, public amenities, public lifts, escalators and moving walkways;
s) flight information display and public address systems and facilities; and
t) check-in counters and related facilities.
u) landside terminal access roads and facilities (including lighting and covered walkways);
v) landside vehicle services and facilities, including:
   (i) public and staff car parking (but not valet parking); and
   (ii) taxi holding and feeder rank services on airport;

w) aircraft light and emergency maintenance sites and buildings; and
x) office space in terminals for airline staff who are essential to the airlines' operations at airports.

Virgin Blue understands that DOTARS is, in general terms, content with this approach.

SCHEDULE C

EXTRACT FROM RE VIRGIN BLUE AIRLINES

Extract from *Re Virgin Blue Airlines* setting out the process employed by SACL to introduce per passenger charges in accordance with its obligation to consult with users of the airport in relation to changes to charges.

Paragraphs [180] to [199]

180. In August 2002, SACL reconsidered its position in relation to the manner in which it levied aeronautical charges. SACL's reconsideration of the Domestic PSC was documented in a number of papers.

181. First, Mr Dominic Schuster, who was at the time the Manager of Economics at SACL, prepared an internal memorandum dated 27 August 2002 for Mr Gregory Timar, then SACL's General Manager of Corporate Planning and Strategy. Mr Schuster's responsibilities included making recommendations to SACL's Board Strategy Committee in respect of the appropriate level of charges for aeronautical services. Mr Timar's position required him to address the maximisation of SACL's revenue. In particular, Mr Timar was responsible for recommending to SACL's Board that it change its pricing for domestic aeronautical charges from an MTOW-based charge to a passenger-based charge. This involved consideration of the ways in which aeronautical charges could be raised. The issue of the introduction of a Domestic PSC "for runway use" was raised in this memorandum as follows:

> "Introducing the charge at the level proposed last year would generate revenues of some $4.5m annually against the existing MTOW regime, because of the higher load factors being achieved since Ansett's collapse. Qantas continues to support a move to the domestic PSC, explicitly recognising that there would be upside for SACL. Virgin Blue is now subject to passenger-based runway charges at Melbourne and Perth Airport, but there is no suggestion that it has relaxed its philosophical stance against this form of charge. Moreover, SACL's current relationship with the carrier may make introduction more difficult. Qantas has advised that it would not support the passenger-based charge unless it also applied to Virgin Blue."

182. Secondly, in SACL's 'Traffic & Aeronautical Revenue Task Force Report', dated 16 October 2002, it was noted:

> "The domestic PSC for runway use which was rejected by the ACCC in August 2001 can now be re-instated provided all stakeholders are in agreement. The move to passenger-based landing charges domestically could yield up to $5m a year over the weight-based

regime, because of the assumptions adopted for passengers excluded from the charge, and high aircraft load factors.

...

Qantas actively supports moving to a domestic PSC. While theoretically, different carriers could be charged on a different basis, Qantas would only support the PSC on the basis that it is charged to all domestic carriers.

Virgin Blue opposes the introduction of the passenger-based charge as its single class 737 aircraft carry more passengers per landed tonne than Qantas. Virgin Blue also has a much lower rate of transfer and transit passengers, which are to be exempt from the domestic PSC, than Qantas."

183. Thirdly, Mr Schuster co-sponsored the SACL 'Board Strategy Committee (Information) Paper 7/6' that was prepared for a meeting of that Committee on 16 December 2002 ("Strategy Committee Paper of December 2002"). This Paper was co-sponsored with Mr Timar and Mr Greg Russell, Director of Aviation at SACL. Appendix 3 of the Paper stated:

"Qantas continues to be extremely keen that a domestic PSC be introduced. It has recognised informally that the potential exists for SACL to derive more revenue from a PSC than the weight-based equivalent, but has no difficulties with this. The main reasons for Qantas' enthusiasm for the PSC are that it can be passed directly to passengers, becoming a variable cost while Qantas would be unlikely to adjust airfares, and because it could strengthen their commercial position relative to Virgin Blue.

...

A further consideration is SACL's relationship with Virgin Blue which remains somewhat difficult, and whether we can successfully implement a domestic PSC at the previously struck rate with that airline. While Qantas has indicated a willingness to adopt charge struck in August 2001, one would assume that Virgin Blue management will see the potential for passenger loads to drop and argue that a charge struck prior to Ansett's collapse is no longer appropriate. They may also query the transfer and transit rate as very much higher than its experience. This may lead to as [sic] charge being calculated that comes much closer to SACL's publicly stated goal of a revenue-neutral restructuring of charges. A successful declaration of airside facilities under the Trade Practices Act access regime, as sought by Virgin Blue, would also hamper any attempt to restructure domestic charges."

A table annexed to the Strategy Committee Paper of December 2002 showed the clear economic advantage to SACL in charging a Domestic PSC.

184. There followed a number of discussions with Virgin Blue regarding the introduction of a Domestic PSC. On 10 February 2003 the newly appointed Executive Chairman and Chief Executive Officer of SACL, Mr Max Moore-Wilton, attended Virgin Blue's offices in Brisbane for a "meet and greet" and informed Virgin Blue that SACL was considering a move to a passenger-based charge.

185. In a facsimile dated 13 February 2003 Mr Brett Godfrey, Chief Executive Officer of Virgin Blue, wrote to Mr Moore-Wilton stating that Virgin Blue would not like to see an increase in landing fees given that the aeronautical charge was doubled less than two years prior.

186. In a presentation given at the Price Deregulation and Airline Commercial Agreement Workshop held by the Strategy Committee on 26 February 2003 ("Strategy Committee Presentation of February 2003"), SACL considered the optimal approach to pricing. The Presentation acknowledged a "material disadvantage" to Virgin Blue upon the imposition of a Domestic PSC. This disadvantage was based on Virgin Blue's higher load factors and use of Boeing 737 aircraft. It was noted that Virgin Blue carried around 2 passengers per tonne, whereas Qantas carried approximately 1.1 passengers per tonne. The Presentation showed that "[r]ebalancing to reflect pax [passengers]: MTOW, QF would pay around $4.00, Virgin $2.00 per pax." The Strategy Committee Presentation of February 2003 also noted "Qantas strongly supports the PSC, as it can be fully passed on to customers and aids its competitive advantage."

187. On 4 March 2003 Virgin Blue wrote to SACL stating its opposition to the change in the airside charges and seeking that SACL consult with the airlines and enter into a long-term agreement in relation to airport use. Mr Godfrey wrote to Mr Moore-Wilton:

> "If SACL is changing methodologies to push through a pricing regime that will discriminate against Virgin Blue, relative to its major competitor Qantas, and against the findings of the ACCC, we would consider this bordering on bad faith. ... I must reiterate an uncapped per pax charge levied compared with the existing MTOW would most likely directly benefit Qantas at our expense."

188. On 10 March 2003 SACL informed the airlines of its intention to implement a Domestic PSC at Sydney Airport from 1 July 2003. In a letter to Virgin Blue on that date, Mr Moore-Wilton stated SACL's opinion that the ACCC's reasons given in August 2001 did not signal a complete opposition to the Domestic PSC, but rather that the ACCC had not had enough time to consider fully and analyse the effects of the proposed passenger charge. Mr Moore-Wilton's letter also stated, *inter alia*:

> "You have expressed concern about your competitive position relative to Qantas under the domestic PSC. Sydney Airport is open to public scrutiny and must be able to demonstrate a transparent approach to charging that ensures airlines pay the same for equivalent levels of service. As such, we do not see any case for a differential charging regime. This is consistent with the approach to runway charges that I understand Virgin Blue has accepted at other airports.
>
> Passenger based charges provide a better measure of airport utilisation than traditional weight based charges, and also provide for a sharing of risk between airports and airlines, as landing charges are based on passenger loads rather than simply the scheduled weight of the aircraft which will vary over time."

189. Virgin Blue continued to oppose the introduction of a Domestic PSC on the basis that it would dramatically increase Virgin Blue's costs of operating from Sydney Airport and would place it at a significant competitive disadvantage with respect to Qantas. In a letter dated 14 March 2003 from Mr Diederik Pen, Head of Ground Services for Virgin Blue, to Mr Russell, Mr Pen stated:

> "We are very disappointed by your proposal to introduce a passenger service charge for domestic runway use. The effect of this charge, if introduced, will be to dramatically increase Virgin Blue's costs of operating from Sydney Airport as well as to place Virgin Blue at a significant competitive disadvantage with respect to Qantas.

This proposal retards the constructive relationship we had hoped we were building following our difficulties last year.

The introduction of passenger-based charges for the use of the runway at Sydney Airport will have significant anti-competitive effects on competition in domestic aviation and will penalise Virgin Blue as the more efficient operator. Virgin Blue disagrees with your statement that passenger-based charges are a better measure of airport utilisation. Weight-based charges are a better measure of the impact of use on the relevant physical assets - the run-way and associated facilities. It is impossible to believe that a 737 with only 1 passenger has only 1/150th of the impact of a 737 with 150 passengers on board. Passenger-based charges are not efficient and do not reflect the cost of the service provided.

The ACCC accepted the potential for passenger-based charges to have substantial impacts on competition in the domestic aviation market. The ACCC noted that SACL's then-proposed restructure may disadvantage new entrants who carry more passengers per aircraft. On the basis of these concerns, the ACCC objected to the charge in 2001. SACL had the opportunity to come back to the ACCC and address this issue, however SACL instead chose not to proceed with the

passenger-based charge for domestic users. I think that it is telling that SACL didn't think that it could respond to the concerns raised by the ACCC in 2001.

In the context of the current regulatory regime for airports, Virgin Blue has reluctantly accepted passenger-based charges at other airports, but these charges were part of wider deals with these airports that on balance allowed Virgin Blue to maintain its competitive position. As part of that process Virgin Blue also obtained long term commitments from them as to price and service levels. Neither of these seems to be the case with SACL.

Virgin Blue has always had a position where it will enter into long term commitments on pricing and service levels for landing charges. We have always been willing to enter such discussions with SACL on the proviso that SACL does not erode Virgin Blue's competitive position. ..."

190. A meeting of representatives from SACL and Virgin Blue took place on 21 March 2003 to discuss the move to a Domestic PSC. At the meeting Mr Russell of SACL accepted that SACL's proposal meant an increase in landing charges to Virgin Blue of 50-53% and an increase to Qantas of only 4% or even less. However, he observed that it was SACL's policy to introduce a Domestic PSC because "we feel it is more efficient to charge that way". The reason why it was efficient was not stated. We return to this issue later in these reasons.

191. A sequence of correspondence followed the meeting and on 8 April 2003 Mr Moore-Wilton wrote to Mr Godfrey in the following terms:

> "...the following outlines the situation from SACL's perspective.
>
> Virgin Blue has been aware since mid-2001 of SACL management's intention to move to passenger-based charges for domestic services. While SACL chose not to proceed with this initiative during what was a time of upheaval in the domestic aviation sector, the time has now come to bring domestic charges in line with the framework that applies to the majority of other major Australian airports and to the rest of Sydney Airport's customers.
>
> In our view, this hiatus provided Virgin Blue with a relative advantage during its start-up phase. As a matter of principle, however, SACL considers that passengers using the same Sydney Airport facilities should pay the same in airport charges regardless of which airline they fly with or the type of aeroplane on which they fly. Consistent with our aim of treating passengers consistently across carriers and recognising that all passengers use the airport's runway facilities, we have decided to levy the charge on all arriving and departing passengers, including transferring and transit passengers.
>
> The proposed passenger charge, of $2.86 per arriving and departing passenger for runway use, excluding security and GST, compares favourably with the PSC levied at other major

Australian airports. Moreover, I understand that a number of airports that have not adopted passenger-based charges would have done so, but for the opposition of Virgin Blue.

...

You observe in your letter that Virgin Blue would like long-term certainty on aeronautical costs. SACL is currently in the process of developing its Master Plan, in consultation with airlines, and it would be illogical for SACL to make long-term pricing commitments in advance of this. However I stand by my earlier proposal to negotiate long-term commercial agreements with airlines once the Master Plan has been accepted by Government, expected early next year.

In the short term, however, I am prepared to commit to Virgin Blue that, once implemented, the runway component of the domestic PSC will not change for two years. This will provide Virgin Blue with a high degree of certainty as to its costs of operating from Sydney Airport. This commitment is conditional on Virgin Blue withdrawing its application to the National Competition Council for a declaration of airport facilities for an equivalent period of two years."

192. Virgin Blue responded in a letter dated 7 May 2003. Virgin Blue told SACL that, amongst other things, the proposed Domestic PSC would increase Virgin Blue's costs by 53% whilst increasing Qantas' costs by only 4%, and constituting an overall price increase of 20% to SACL. Of particular note is Mr Godfrey's observation:

"Without trying to be flippant, let me state something that all of us can agree on, passengers don't land on runways ... aircraft do. The asset is depreciated by the rubber hitting the runway, whether the aircraft is full or empty. We expect to and are happy to pay for that privilege regardless of whether we succeed or fail in getting passengers on board - that is a business risk we assume and we are not about to pass on the cost of that risk to your shareholders.

The general principal [sic] of virtually all transport is the opposite - that is it should reward efficiency and optimum utilisation that we strive for...

...

While we are well aware of the excellent and valued relationship you have with Qantas, tilting the playing field in its favour is upsetting a long established egalitarian principle of airport facility use. We sweat the asset and SACL gets the benefit in your retail/terminal activities without incurring any additional costs.

> We also consider that your proposed charges represent unjustifiable price increases in contravention of the pricing principles articulated by the Commonwealth Government in its response to the Productivity Commission Report. Far from encouraging the efficient use of airport facilities, your proposed charges would achieve the exact opposite.
>
> ...
>
> Your $2.86 per arriving and departing passenger increases our cost by 53%, Qantas's by an estimated 4% and therefore at our detriment, grants SYD airport an overall further price increase of 20%. This follows less than two years after raising them by 97%. SACL has ignored the fact that we squeeze more passengers into the aircraft by way of a trade off in lowering our yields - SACL seems to prefer to incentivise us to fail (just think of the money we could save if our planes flew empty!). This is why, as you correctly stated, we oppose these charges.
>
> Not only has SACL chosen to change the methodology to the detriment of Virgin Blue, you are also using stealth to cover an additional $5-6 million per annum price increase on the travelling public so soon after privatisation. ..."

193. In response to SACL's comments in Mr Moore-Wilton's letter in relation to the application for declaration of Sydney Airport, Virgin Blue went on to say:

> "In light of SACL's track record on price increases, including the more recent change in methodology, further compounded by an unwillingness to commit long term due to your incomplete master plan, we are left with no choice but to assume that the airport is likely to seek further price rises in relation to this aeronautical charge. Therefore Virgin Blue believes that it is in its best interests to reject your proposal, and pursue our National Competition Council application to have the Airside Service declared, even though Virgin Blue understands that declaration under Part IIIA of the Trade Practices Act can be a lengthy process. We however certainly believe we have little to lose in light of your consultation process and consequent 'proposal.'"

194. On 26 May 2003 Mr Moore-Wilton wrote to Mr Godfrey, attaching a notification of variation of aeronautical charges that informed all customers that from 1 July 2003 SACL would start charging aeronautical fees on a per-passenger basis. In the letter Mr Moore-Wilton said:

> "I have heard the concerns of Virgin Blue, however, Sydney Airport remains of the view that passengers at the airport should pay the same price for use of the same facilities. It is particularly disappointing that Virgin Blue spokesmen have reverted to inflammatory media comments in seeking to force your view."

195. In a letter dated 28 May 2003 one of Virgin Blue's major shareholders, Sir Richard Branson, sought to intervene in the situation, expressing concerns that the proposed change in pricing would "penalise Virgin Blue, subsidise Qantas and secure a significant price rise and consequent revenue raising for SACL."

196. On 30 May 2003 SACL's Board approved the variation in aeronautical charges to a per-passenger basis, effective from 1 July 2003.

197. Mr Moore-Wilton responded to Sir Richard Branson in a letter dated 6 June 2003, expressing the view that Virgin Blue's objections were to a rise in price and not based on any "point of principle". He said that SACL would consider any further proposal from Virgin Blue. Although Mr Moore-Wilton said that Virgin Blue's objections were not based on any point of principle he did not respond, and had not previously responded, to Mr Godfrey's observation in his letter dated 7 May 2003 (see [192] above) that:

> "passengers don't land on runways ... aircraft do. The asset is depreciated by the rubber hitting the runway, whether the aircraft is full or empty... The general principal [sic] of virtually of all transport is the opposite - that is it should reward efficiency and optimum utilisation that we strive for ..."

198. Mr Moore-Wilton's principle, as stated in his earlier letter of 8 April 2003 (see [191] above), had been that:

> "passengers using the same Sydney Airport facilities should pay the same in airport charges regardless of which airline they fly with or the type of aeroplane on which they fly. Consistent with our aim of treating passengers consistently across carriers and recognising that all passengers use the airport's runway facilities, we have decided to levy the charge on all arriving and departing passengers, including transferring and transit passengers."

199. From 1 July 2003 SACL commenced imposing a Domestic PSC on aircraft using Sydney Airport rather than the previously applied MTOW-based charge.